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DIALOGUES

2022

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The inaugural World Islamic Finance Dialogues

REDmoney has been covering the Middle East since 2004 and organizing industry-leading events in the region since 2008. On the 5th December 2022, IFN brought to Bahrain the inaugural World Islamic Finance Dialogues. A series of extended discussions among leading regulators and the industry's elite, the World Islamic Finance Dialogues gathered 20 market leaders for three roundtable engagements to discuss the industry's most pressing issues: capital markets, Islamic sustainable finance and investments and digital assets.

The dialogues followed the hugely successful IFN Thought Leadership Dialogues in Dubai and IFN KSA Dialogues in Riyadh earlier in June, both of which received overwhelmingly positive feedback from speakers and delegates.

We are pleased to present the key findings and discussion highlights from the three dialogues in this report.

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DIALOGUE ONE: GLOBAL ISLAMIC CAPITAL MARKETS, INFRASTRUCTURE FINANCE & PRIVATE EQUITY

- Inflation, a rising interest rate environment and the implications for potential issuers of Islamic capital market products and Islamic facilities.
- How do Islamic facilities present viable funding options for asset-heavy industries such as transport and oil and gas?
- How are Islamic finance structures funding projects and infrastructure?
- The role of private capital in the Islamic finance markets.
- Beyond listed Sukuk: what are the opportunities presented by the private placement market?
- What options do hybrid or combination Sukuk offer issuers?
- How do Tier 1 and Tier 2 Sukuk offer financial institutions a flexible, efficient and user-friendly way of satisfying regulatory capital requirements, and what do perpetual Sukuk structures offer such issuers?
- Developing the global Sukuk and Islamic financing market: regulation, hedging, risk and liquidity management instruments.
- With the demise of LIBOR, is SOFR a good alternative for the Islamic finance market?
- The evolution of Shariah compliant fund and collective investment schemes: ETFs, Sukuk, leasing and trade finance funds.
- The outlook for Shariah compliant direct real estate investment and private equity.
- The role of technology and marketplace financing in Islamic finance.



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KEY HIGHLIGHTS

DIALOGUE ONE: GLOBAL ISLAMIC CAPITAL MARKETS, INFRASTRUCTURE FINANCE & PRIVATE EQUITY

GCC continues to be a bright spot for Islamic banking

- Despite global headwinds such as high interest rates and skyrocketing inflation, the GCC has benefited from the tailwind of favorable energy prices
- Islamic banks in general have adopted strong fiscal discipline and experts expect this to continue

“COVID-19 had impacted banks quite significantly as profit dipped. But now with higher interest rates, we’ve seen margins improving and we’ve seen profitability in some cases even exceeding pre-COVID levels.”

- While global macroeconomic uncertainties remain, such as the ongoing war in Ukraine and with China opening up its borders again, market participants are cautiously optimistic that banks in the GCC region would largely maintain its positive momentum

“The GCC is an outlier – we are in our own bubble, if you like, and that’s buoyed by the commodity prices and the fiscal discipline of governments.”

Interest rate environment sparks Sukuk hesitancy

- It has been a relatively muted year for the Sukuk market as global Sukuk volumes continue to suffer in 2022 following a steep decline in 2021
- Analysts project Sukuk issuance in 2022 to be between US\$160 billion and US\$170 billion from US\$181 billion the year before
- The drop has been attributed to the rise in interest rates which has made it more expensive for issuers, particularly corporates, to tap

the Islamic capital market, with funding costs in the upward region of between 7% and 10%

- High funding costs coupled with a relatively short market window to market the paper and structure the facility using the right mechanism and tenor to support the investment agenda make it challenging for issuers

“On the supply side, the main cause of people holding back is the interest rate environment more than anything else. As soon as we start seeing downward movements and some cuts in the US, we will see people jumping in.”

Sukuk demand remains strong but supply mismatch persists

- Potentially more downside than upside in 2023 for the Sukuk market depending on interest rate movement and funding needs; however, industry experts are largely bullish on the long-term market trajectory, with some even expecting positive revenues from their Islamic deal-making business in 2023

“What we have seen in the market with regards to issuers, especially on the Sukuk side, is that they have kept their programs ready and are just waiting for the right time (favorable rates) to jump in — be it in the first quarter of 2023 or second quarter.”

- Institutional investors globally, particularly from the EU and the US, who have been relatively more selective with their source of liquidity, have relaxed their preference since the last quarter of 2021, opening up opportunities for Sukuk in the GCC

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DIALOGUE ONE: GLOBAL ISLAMIC CAPITAL MARKETS, INFRASTRUCTURE FINANCE & PRIVATE EQUITY

- Domestic banks generally make up the majority (60–70%) of investors of five-year Sukuk offerings; however, as Sukuk tenors increase, participation from the EU, the US and Asia also increases, according to investment bankers, underscoring demand

“If you look at the analysis of 2021, you will realize that there is a gap of almost US\$180 billion between the demand and supply of Sukuk, meaning there’s active demand. The average oversubscription rate for Sukuk in 2021 is almost four times. So, there’s still a lot of demand but the supply side is not where it needs to be.”

AAOIFI Standard 59 created confusion but dust has settled (largely)

- Market experts agreed that Islamic finance documentation has greatly improved in terms of clarity and structure with the help of global standards; however, there is still room for improvement
- The panel noted that they have encountered investors who are not comfortable investing in Islamic instruments due to ambiguity over what is considered as Shariah compliant
- Some suggested setting up a more structured program or establishing a law such as the Islamic Financial Services Act in Malaysia
- The implementation of AAOIFI Standard 59, and subsequent adoption of the standard by the Central Bank of the UAE, created confusion and unease among those involved in commodity Murabahah transactions
- Some of the main hurdles which emerged included issues surrounding tangibility ratios of Sukuk which increased to 51% from about one-third and certain changes to indemnities which created legal uncertainty
- Market participants had to scramble and work alongside Shariah scholars and legal experts to ‘restore’ some degree of standardization on how to structure Murabahah deals in compliance with AAOIFI Standard 59
- The lack of clarity and ensuing confusion deterred some issuers, and the new requirements pose a challenge for asset-light corporates to tap the market
- However, the panel is generally of the opinion that the dust has settled, and that the industry has figured out alternatives, albeit with some efficiencies (having to have separate documentation for investors in the UAE and Saudi Arabia for example)

“The Sukuk market, from a Shariah perspective, is now on a much stronger footing. But from a credit-risk perspective, we did not see a material shift in terms of investor risk profile.”



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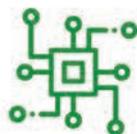
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DIALOGUE TWO: ISLAMIC SUSTAINABLE FINANCE AND INVESTMENT

- Opportunity knocks: the exciting prospects for Islamic sustainable finance and investment.
- Important considerations in the development of efficacious Islamic sustainable investment products.
- Understanding the structure and benefits of transition, sustainable and sustainability-linked investment products.
- Islamic sustainable funding options available to asset-heavy industries.
- Managing important sustainable investment regulatory, reporting and disclosure requirements for issuers and investors.
- Fit for purpose: measuring the long-term benefit of green and sustainable financial investments and avoiding the issue of greenwashing.
- Stress-testing credit and investment portfolios for climate risk, and the role of regulators.
- With ESG and sustainability continuing to grow in Islamic capital markets issuance, when will we see the measurement of impact?
- Are sufficient issuers engaging with independent, third parties to measure green, sustainable and social credentials?
- Are tax environments in the GCC less conducive toward green issuances?
- Where does technology play a role in Islamic sustainable finance and investment?



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KEY HIGHLIGHTS

DIALOGUE TWO: ISLAMIC SUSTAINABLE FINANCE AND INVESTMENT

Islamic finance industry making good ESG progress

- The Islamic finance industry is well positioned and has the advantage in driving the sustainable finance agenda as ESG values are already embedded in the roots of Islamic finance

“The concepts of ESG, particularly on the social and governance sides, are extremely well developed in Islamic finance, and the industry is, I believe, even ahead in this respect as compared with conventional finance.”

- Islamic finance institutions and key Muslim markets are making relatively good progress, with governments putting in place plans to be carbon-neutral
- There are remarkable opportunities for Islamic finance to be part of this progress as sustainability funding requirements are deep

“We should not undermine what has been done by Islamic banks. Of course, there is always room for improvement, but we should recognize what they are doing now.”

Industry must recognize oil dependency problem; transition finance potential huge

- Major Islamic finance powerhouses may be criticized over their net-zero ambitions due to their dependence on oil; however, there lies the opportunity for meaningful change

“The first step is to recognize the problem and to take responsibility and say that we are contributing to climate change and also to recognize that there is a risk from climate change on financial stability — physical risk and losses as a consequence of climate disasters were estimated at US\$350 billion in 2021.”

- Muslim nations play a vital role in global climate action as high-emitting countries and companies possess the best know-how regarding emissions reduction

- The UAE has demonstrated how transitioning to clean energy is possible despite being one of the world’s largest oil producers. Dubai’s clean energy mix hit 21% at the end of 2021, exceeding its 16% target, while Abu Dhabi is on track to achieve 65% by 2035
- It is unrealistic to expect oil-dependent countries to give up on hydrocarbons in totality without considering the economic implications and pragmatism of such an endeavor
- We need to accept and understand that investments in fossil fuels may be justified as transitioning from high-carbon emissions to zero emissions may require passing through lower-carbon, not zero, energy sources

“All the crises that we have, whether it is inflation, interest rates, the expectation of a recession, or energy prices — we have the tools to mitigate and control them. But when it comes to climate change, there is only one tool, and that is action.”

- This transition to a nature-positive economy is an immense opportunity for transition and blended finance

COP benefited MENA; Islamic finance stands to gain

- Two MENA countries — Egypt and the UAE — hosting the UN Climate Change Conference [or Conference of the Parties (COP) of the UNFCCC] for two consecutive years (COP27 in 2022 and COP28 in 2023) sends an important message to the world: climate change is a priority for MENA
- The MENA region has been a beneficiary of COP as it has mobilized regional cooperation and coordination at a level never seen before
- While cognizant of the flaws and gaps of COP with its commitments and execution, market participants are nonetheless hopeful that the upcoming COP28 would spur Islamic finance activities in the region as heavyweights such as Saudi Arabia and the UAE double down on their decarbonization efforts while bolstering their Shariah finance industry

“The UAE and Saudi are interested in developing Islamic finance, so we can expect a lot of the financing for these [sustainable] projects to very likely be Shariah compliant.”



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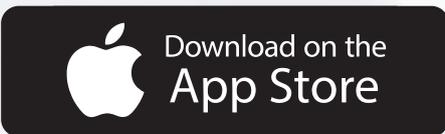
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DIALOGUE TWO: ISLAMIC SUSTAINABLE FINANCE AND INVESTMENT

Measurement is crucial first step, but hindered by lack of data

- One of the biggest challenges the industry faces is the lack of quality data to understand the full ESG picture
- Without reliable data, or methods to collect relevant data, such as our carbon footprint or the impact of initiatives, it is difficult to identify real issues and to properly ascertain the success — or failure — of any measures

“How can we solve what we cannot measure?”

- The industry should leverage on big data technology to narrow this information gap
- Monitoring, reporting and communication are essential in one’s sustainable journey

“We need first to know our contribution to climate change, and this can be done through measurement, reporting which would help us in setting targets. Only after aligning those targets with national and international strategies can we identify objectives and actions that we can take as financial institutions.”

Green is gold, but we should also focus on the ‘S’ and ‘G’ of ESG

- Pundits often pit the green Sukuk/financing market against its conventional counterpart as there is a tendency to heavily focus on the more commercially lucrative environmental theme of the ESG spectrum
- The Islamic finance industry may be disadvantaged in the green sphere; however, experts think it is stronger on the social and governance dimensions due to the industry’s community-driven finance proposition and its long-standing use of Zakat, Sadaqah and Waqf
- We need to avoid describing the industry’s ESG progress solely from a green perspective

“We have to make a distinction between ESG and green — we shouldn’t use the word ESG and green as synonymous.”

Regulators must play proactive role

- Regulatory impetus or push is needed to prepare the market to embrace ESG finance
- The role of the regulator in this respect has to be more defined; the lack of clarity in some emerging markets has held the industry back
- Regulators need to be proactive in implementing requirements for disclosure, transparency and reporting
- Nonetheless, market practitioners have to be prepared to venture into unregulated territories or in areas where the legal treatment is vague as regulators are still at an early stage of establishing a robust environment

“In some instances, you cannot wait for the regulations to come in as it will take time. You have to act; you have to make the first move”

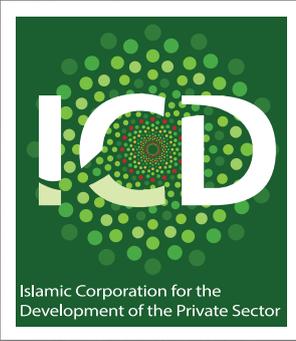
- In creating a conducive environment, the industry also still lacks human capital with deep ESG knowledge and thus it should focus on capacity-building

“We need to empower practitioners — capacity-building should cover board of directors, senior management and Shariah scholars.”

Islamic banks cannot do it all — collaboration imperative

- Fostering inclusive and sustainable growth is a collective responsibility
- The Islamic finance industry is a diverse group with different players with different capabilities suited for a variety of projects and initiatives
- We need to identify what ESG issues can be tackled best by which particular institutions, whether investment or wholesale banks, retail banks, financing companies, fintech companies, insurers or private equity and venture capital funds

“No single type of Islamic bank or investment house could cover all the issues of ESG. We need the whole ecosystem to do that ... we need to look at the whole picture and the whole ecosystem instead of just relying on big banks.”



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DIALOGUE THREE: DIGITAL ASSETS, DIGITALIZATION AND THE EVOLUTION OF ISLAMIC FINANCIAL SERVICES

- The digitalization of Islamic financial services: what is working, what is viable and what is not? What do the answers to these questions mean for the evolution of Islamic financial services?
- Does digitalization allow us to better address issues such as product authenticity and the minimization of uncertainty?
- Is the success of neobanks inevitable, and how will they change the market?
- How will the development, provision and distribution of digital Islamic financial services evolve in the near term?
- The importance of recent initiatives by regulators in creating an environment for the enhancement of the domestic financial services sector's digital infrastructure.
- The likely effects of bank mergers on the digitization of Islamic financial services.
- Evaluating regulator-fostered sandboxes: what is on offer, what is beneficial and how successful are initiatives?
- Beyond retail: developing and distributing effective and attractive Shariah compliant digital wealth management, investment and insurance products.
- The development of systems and software for Islamic banks: driving scale, integrity and efficiency.
- The tangible benefits of peer-to-peer lending and equity crowdfunding: how these key technologies can be further applied to today's banking and financial markets.
- How are stablecoins, non-fungible tokens, utility tokens, equity tokens and other digital assets being applied to financial markets?
- What is the potential for new and structured products based on cryptocurrencies for the domestic market: ETFs and complex leverage mechanisms such as DeFi?



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KEY HIGHLIGHTS

DIALOGUE THREE: DIGITAL ASSETS, DIGITALIZATION AND THE EVOLUTION OF ISLAMIC FINANCIAL SERVICES

What is the current Islamic financial landscape like?

- Islamic financial institutions are operating in a drastically different environment that is constantly changing amid technological advances
- The demographic is becoming more digital-savvy, leading to changing consumer behavior and demands
- There is an opportunity to rethink the industry's processes and approach to better serve a wider market and in line with the teachings of Shariah

“Practices should not continue the same way they have been going for the last 40 years within the Islamic finance space. Fintech offers us an opportunity to enhance those practices — to enhance transparency, give confidence and conduct transactions in line with the true spirit of Shariah.”

- Regulations remain a hurdle to Islamic fintech in most markets, with regulators caught in a tricky position balancing between innovation and protection of consumers and the financial system
- GCC regulators are doing a fair job by mobilizing measures such as regulatory sandboxes and relevant policies such as an open banking framework
- 2022 was a challenging year for (Islamic) fintech start-ups, with a notable number of businesses shuttering; however, this is hardly a testament to the potential of fintech, rather it is an indictment of weak business models and poor management

“It was a bad year for bad companies.”

- Middle- and lower-income segments, of which Muslims form a large part, have lack of access to technology, which worsens the wealth divide globally

- There are immense opportunities in technology which can lower the cost of asset acquisition such as the tokenization of liquid assets which facilitates the fractionalizing Sukuk and real estate investments, making them more accessible to the middle- and lower-income retail investors

What should Islamic financial institutions take note of when preparing their strategy to become digital-ready?

- Before any institution can undertake any digital transformation, they need to have a clear vision of what they would like to achieve
- Important dimensions to consider include the social impact of the transformation as well as operational and execution aspects such as efficiency, accountability and security

“It is very important for any digital transformation initiative to be underpinned by a vision and monitored by proper regulations.”

- Apart from securing management buy-in, governance and monitoring of the strategy execution are important, and equally important is to have a dedicated team to spearhead the transformation

How should technology such as decentralized finance and cryptocurrency be regulated?

- The collapse of FTX, one in a string of crypto failures, has shaken investor confidence and cast a great uncertainty over the future of the asset class
- But these failures involve centralized institutions run by either corrupt or incompetent individuals left free to operate in the absence of regulations
- This demonstrates that centralized organizations need centralized regulations

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DIALOGUE THREE: DIGITAL ASSETS, DIGITALIZATION AND THE EVOLUTION OF ISLAMIC FINANCIAL SERVICES

- The lesson for the Islamic finance community is that regulators need to be proactive and act swiftly

“[Regulators and standard-setting bodies] tend to come in after it’s safe and after FTX and everybody’s blown up. If [regulators] really want to add value, they’ve got to go beyond and further and take a risk ... take a position. Don’t always hedge their bets because you don’t add value if you’re late to the game — just jump ahead and get people to follow you.”

- Formulating standards is a time-consuming endeavor, which has to be done with the participation of the market; unfortunately, fintech, such as decentralized finance, is rapidly evolving, making it challenging for standards to keep up
- Standard-setting bodies also have the challenge of issuing a standard that is relatively universally acceptable to a wide audience
- While issuing immediate standards is unrealistic, policymakers can and should support the industry by publishing principles-based

statements or thought leadership papers to point the industry in the right direction

“Standards take time and with such a fast-moving environment, you set a standard, it might be out of date. You maybe need to start publishing some principles-based papers to say that as a concept, crowdfunding is beneficial for communities, etc, and is Islamic because of X, Y and Z; and then leave the implementation and the execution and the standards for when you’re ready.”

- Industry practitioners believe AAOIFI can take a more active role in providing guidance to the industry due to its trusted reputation as an independent standard-setting body
- AAOIFI is engaging the industry on the best way forward with regards to digital assets; and working on a standard on smart contracts, with blockchain and digital banking standards in the pipeline



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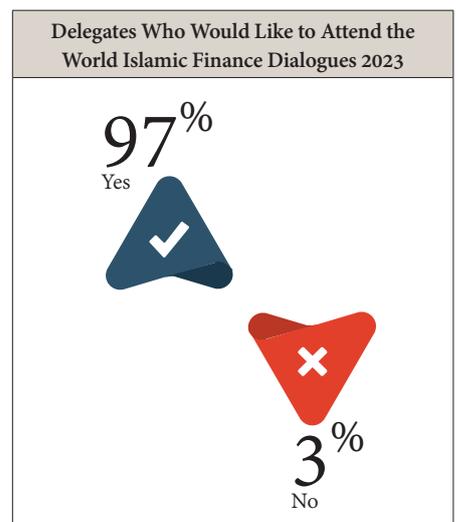
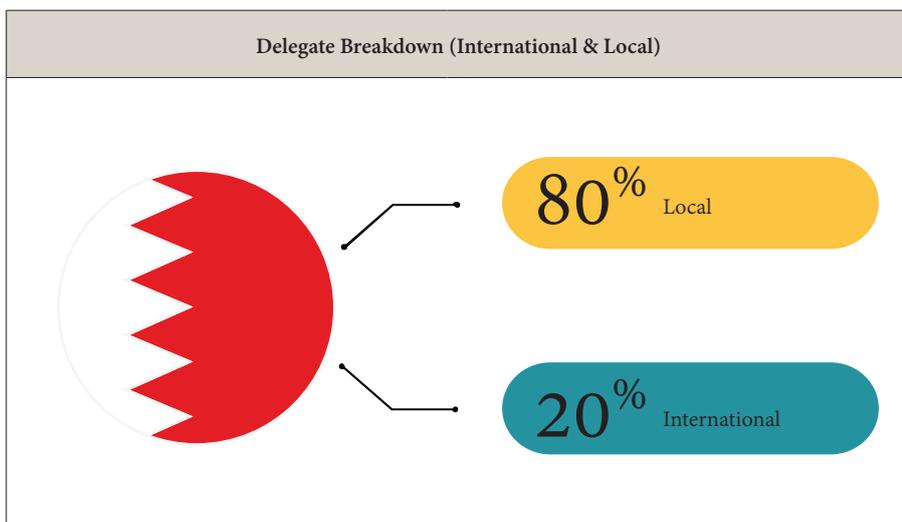
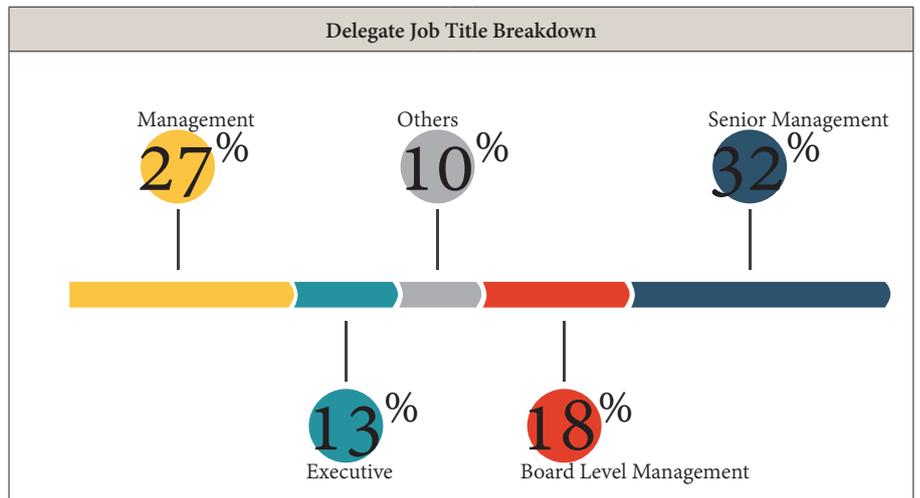
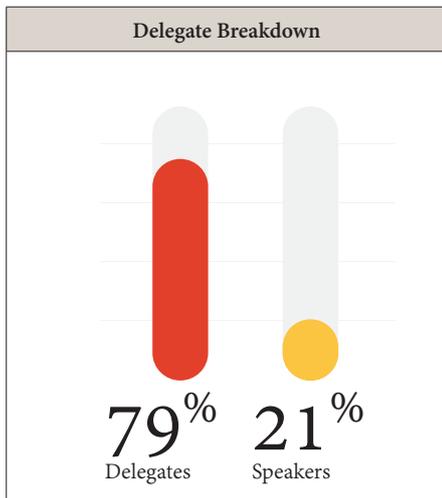
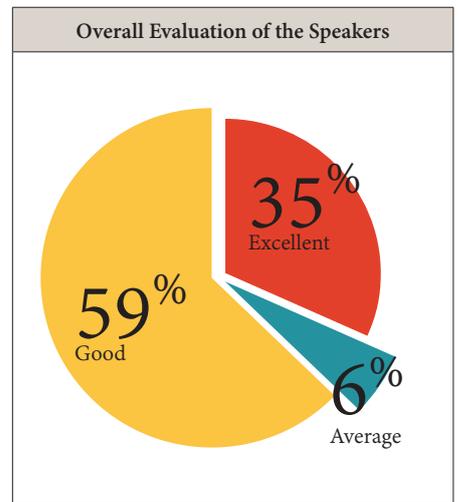
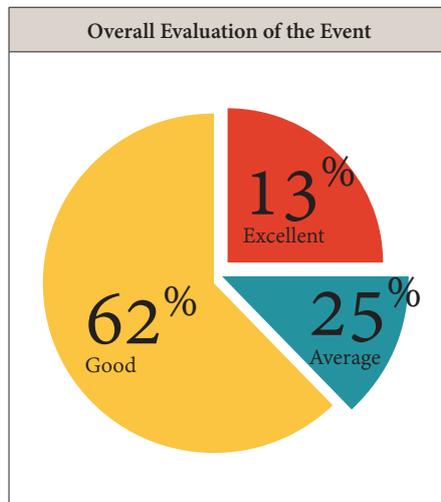
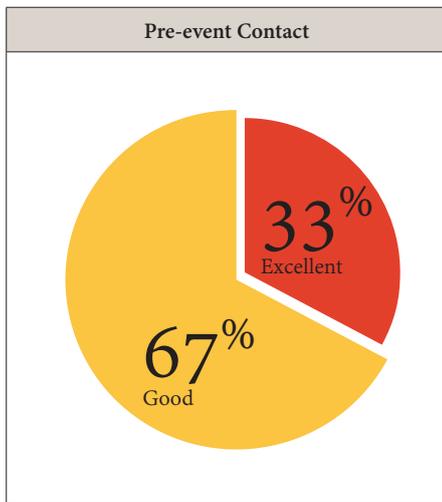
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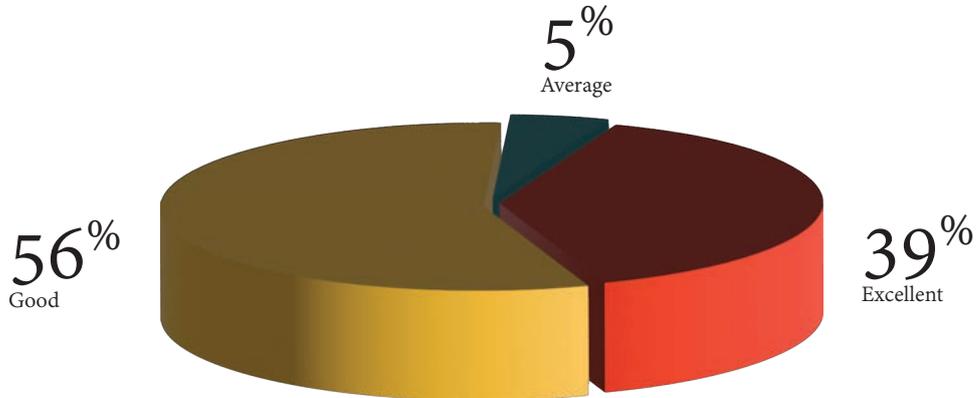


OVERVIEW

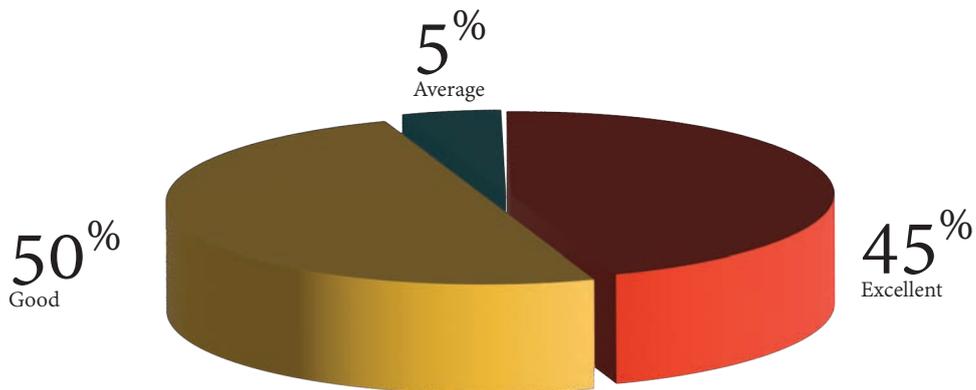


SESSIONS OVERVIEW

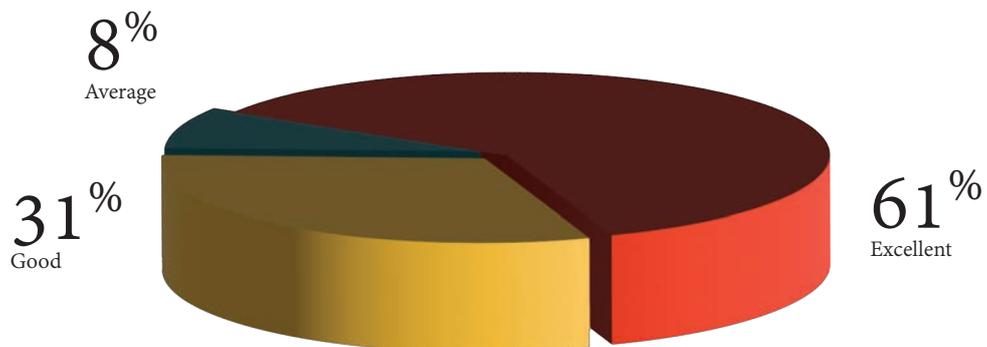
Dialogue One: Global Islamic Capital Markets, Infrastructure Finance & Private Equity



Dialogue Two: Islamic Sustainable Finance and Investment



Dialogue Three: Digital Assets, Digitalization and the Evolution of Islamic Financial Services



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