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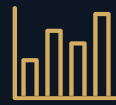
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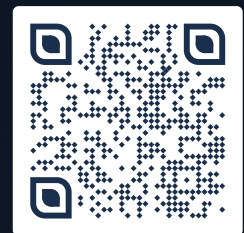


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Saudi Arabia: Potential to lead the way

Since opening its doors to foreign investments over two decades ago and doubling down on its diversification ambitions through its bold Vision 2030, Saudi Arabia has made its mark in the world, building itself to become the Middle East's largest economy and the world's top 20. But has the bastion of Islam managed to live up to international expectations when it comes to Islamic finance? VINEETA TAN finds out.

Big potential

"This may not be a popular opinion: compared to the UAE and Malaysia, Saudi Arabia is a little behind as far as Islamic finance is concerned," said one panelist at the high-level Chatham House style IFN KSA Dialogues in Riyadh.

Others agreed, but everyone at the table also believes that the Kingdom's potential far exceeds any other jurisdiction, and that it is on the right path toward realizing it.

"Saudi Arabia may have been late to start but given the sheer size of the economy and the type of activities it is undertaking, but it will surpass most of the other developed Islamic markets quite soon," remarked a speaker, echoing the general sentiment of the dialogue.

"We need to find proper solutions that would make securitization Shariah compliant"

The Kingdom has been indeed diligent in harnessing its unique position as a champion of Islam to anchor itself as a global center for Islamic finance.

Most consequential of them all, according to market practitioners, is the Kingdom's responsiveness toward developing an efficient regulatory environment that is both welcoming to foreign investors as well as protective of the public.

"We have seen recent developments of revising the local regulatory landscape to provide more confidence to foreign investors to allow this region to take off. This has been a real gamechanger on the ground," said one expert.

From establishing a ministry of investment, to setting up special economic zones and introducing a raft of regulatory reforms including a new foreign investment law and robust insolvency regime, Saudi Arabia has catapulted itself to

become one of the most powerful economies in the world, with foreign direct investments (FDI) flowing in at double-digit growth rates year-on-year. Analysts believe the Kingdom could attract US\$100 billion in annual FDI by 2030 based on its current impressive track record.

"If the Kingdom is able to execute Vision 2030, especially in opening up new structures for financial services, not only for asset managers, bonds or Sukuk but also for retail transactions, I think this will not only change Saudi, but will also change the world," opined one practitioner.

Hurdles persist

There is no doubt that Islamic finance will play a prominent part in realizing Vision 2030, but there are still kinks to iron out.

"In terms of structuring and processes, there are questions that need to be addressed. For example, we need to find proper solutions that would make securitization Shariah compliant," highlighted one expert.

Even issuing Sukuk is not as easy as it could be, despite Saudi Arabia being one of the most prolific Sukuk issuers globally.

"I am flying the colors of the Kingdom - why should I comply with AAOIFI when some elements of AAOIFI are actually creating constraints for Shariah compliant borrowers and originators in the Kingdom? If I go to another country, I will have to accommodate different rules to be recognized as Shariah compliant which may contradict the benefits for citizens," lamented one practitioner.

AAOIFI rules are not mandatory in Saudi Arabia but are made a regulatory requirement in a handful of jurisdictions including the UAE, Bahrain, Oman, Sudan and Syria.

One of the thorniest AAOIFI requirement which has caused consternation in the industry in recent years is the implementation of its Shariah Standard 59 regarding the sale of debt, which impacted Murabahah-based transactions.

Market players call for more harmonized rules at a regional and global level.

Tech promise

Capital markets aside, practitioners believe that fintech could up the ante for the Kingdom.

"Governments in this region are very responsive - they're quick to look into new avenues of technology and start thinking about regulations and their role in developing the ecosystem," observed one panelist.

Another echoed the sentiment: "I see a lot of willingness from the Saudi government to understand technology and

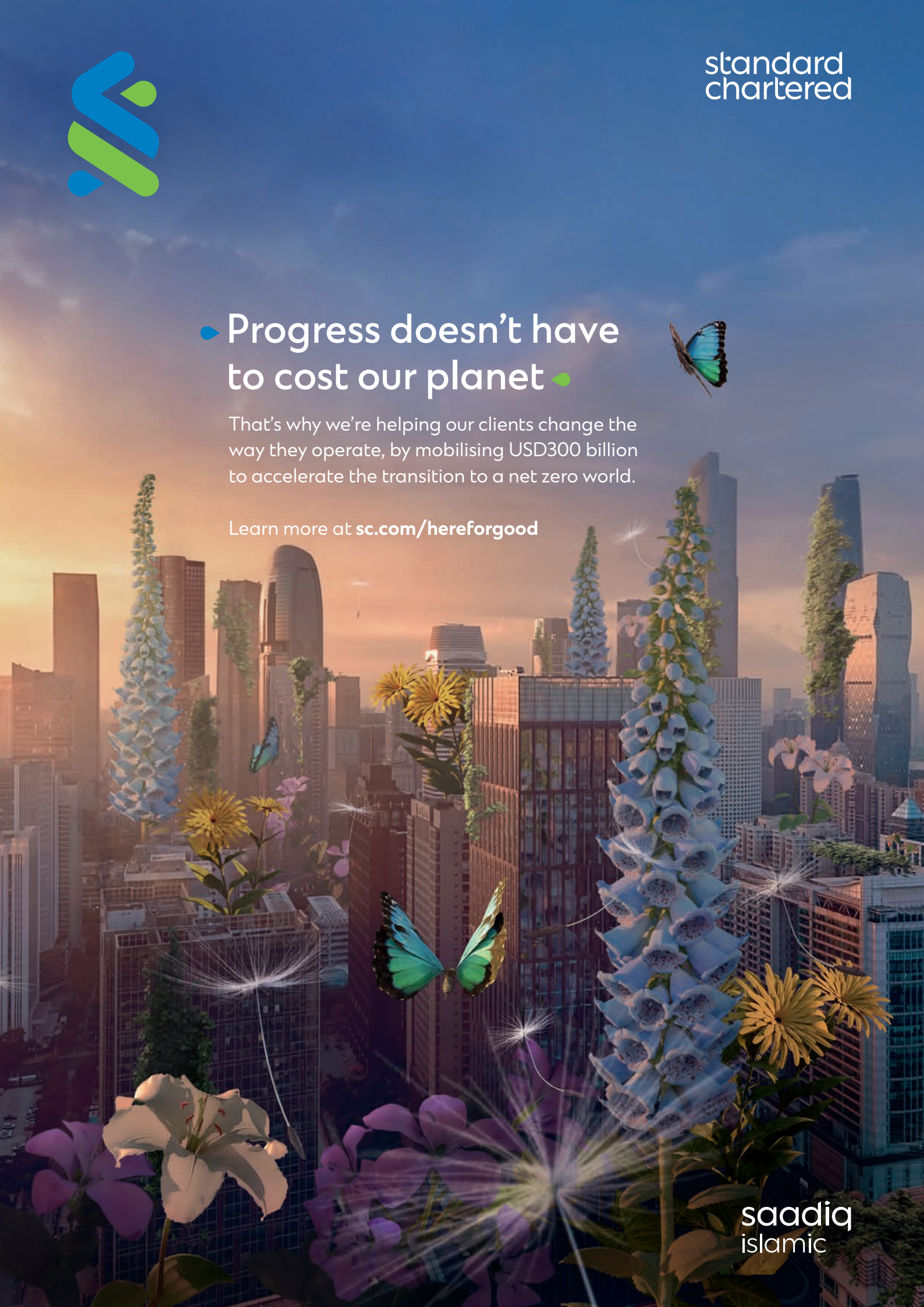


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to be at the forefront of developing new products that will revolutionize [financial services] not only for Saudi but also for the world.”

Indeed, the Kingdom has proactively engaged the industry to understand evolving fintech trends to put in place effective regulations and implement international best practices across multiple verticals including digital banking, blockchain and digital assets, P2P and Buy Now Pay Later (BNPL).

However, more can be done, particularly for Islamic fintech.

“We need global institutions or governments like the Saudi government, to incubate and provide capital to start-ups in a way that does not hinder their growth - provide capital but let them still be innovative and nimble,” said one practitioner.

The allure of Saudi Arabian start-ups is growing rapidly: local start-ups are attracting big money, outshining the rest of the MENA region. In 2023, venture funding in the Kingdom broke the US\$1 billion threshold for the first time, increasing 33% year-on-year (y-o-y) to reach US\$1.38 billion, according to data provider MAGNiTT. Saudi Arabia commanded the lion share (52%; up from 30% in 2022) of venture capital (VC) funding in MENA last year.

The star of this phenomenal VC rise is the fintech sector: VC funding into this vertical surged 181% y-o-y to US\$704 million. In fact, the funding secured by two Saudi fintech start-ups (Tabby and Tamara) last year - both Shariah compliant - had elevated them to unicorn status as they hit US\$1 billion valuation, becoming the first Islamic fintech start-ups to win that title.

These successes prove that Saudi is on the right track.

“What we need to do is to lobby for more technology development - it is not only about technology, but also about

technology enabling. If we help our government understand the technology landscape such as blockchain and smart contracts, that will help us start building,” remarked a practitioner.

“Saudi Arabia has the potential and ability to change the face of Islamic finance globally”

Strategic focus

There is no denying the force Saudi can become in the global Islamic finance arena. It has the political will, it has the vision, it has the talent.

It has done well so far: it has one of the largest concentrations of Islamic banking assets worldwide, its Shariah compliant cooperative insurance sector is one of the fastest growing globally, it produces more Sukuk than most.

There are still ways to go in terms of product diversity as well as market depth and breadth. But Saudi Arabia is on a jet fueled by its multitrillion dollar Vision 2030, increasingly affluent young and productive population and affinity with Islam.

“Saudi Arabia has the potential and ability to change the face of Islamic finance globally - what Saudi does has a ripple effect around the world.”

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Funding Saudi Arabia's skyscrapers — how?

Saudi Arabia has a vision — a big and expensive vision — to move away from the oil economy. To that end, the Kingdom announced a US\$1 trillion pipeline of infrastructure projects. The towering question is: how can we fund them Islamically? VINEETA TAN finds out using the insights shared at a high-level Chatham House style dialogue at the IFN KSA Dialogues in Riyadh with market and regional leaders.

Six priorities

The two-hour no-holds-barred discussion identified six priority areas the Kingdom should take on to successfully fund its massive infrastructure needs.

Firstly, it needs to have consistent government policies and initiatives. Secondly, identify and replicate its private-public partnership (PPP) successes in the water and power sectors to other industries.

"I think the key is to expand that PPP framework to other sectors such as infrastructure and into more nascent sectors like data storage," opined one practitioner.

"Greenfield assets are a bit more difficult for DCMs to fund as they are a non-existing tangible asset at financial close, making it a negative carry"

Projects must also, of course, demonstrate bankability, ie feasible, financially viable and profitable to ensure long-term sustainability. The Kingdom would also benefit from attracting and capitalizing on international know-how.

The establishment of infrastructure institutions is also crucial. The government has been doing so by setting up entities and vehicles such as the National Development Fund and National Infrastructure Fund.

Diversifying funding sources, from the traditional banking sector, is a driving theme. Experts believe the Kingdom needs to look beyond its domestic banks, and toward more international bank capital as well as different sources of

fund — particularly from the capital markets — to ensure a more stable flow of funds to finance its ambitious economic diversification national agenda.

"We know there is not enough money in Saudi Arabia to pay for Vision 2030 — you must import global capital ... and Saudi Arabia has done this extraordinary job of preparing the country for foreign investment," remarked one investor.

Old and new economies

Saudi Arabia's flow of infrastructure projects can be viewed from the perspectives of old economy and new economy, suggested one expert.

Old economy assets are essentially existing brownfield assets, and the new economy is the Kingdom's pipeline of greenfield assets.

"DCMs [debt capital markets] are very interesting when it comes to monetizing the old economy assets because those assets exist and generate cash flows and they are free from construction risks," he explained, adding: "Greenfield assets are a bit more difficult for DCMs to fund as they are a non-existing tangible asset at financial close, making it a negative carry."

Greenfield assets also take several years to build and hence fund disbursements are gradual, rather than immediate, making the banking market a more suitable source of funding.

Brownfield challenges

To capitalize on brownfield investments, ratings are vital.

"We need to create a pool of existing brownfield assets that are rated investment grade, so they open the way for DCM capital to come into the country."

The stamp of approval from rating agencies aside, DCM investors may still be hesitant to pour their money into infrastructure projects. For starters, the country lacks risk-sharing mechanisms, according to market practitioners.

Another glaring hurdle concerns documentation bankability, specifically a make-whole provision, a type of call provision on a bond allowing the issuer to pay off the remaining debt early, which is more favorable to investors as the payment would not only be for the capital invested or outstanding capital balance, but also the unpaid profits until the maturity of the concession. Except for one solar project closed in early 2023, this provision is generally not yet incorporated into project documentation in Saudi Arabia.

But there are ways to circumvent this issue: a credit enhancement via a guarantee would enhance the feasibility, and appeal, of a bond. This can be facilitated by a credit



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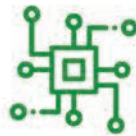
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rating. Instruments such as the European Investment Bank's funded and unfunded guarantees would also help.

"These kinds of products are entirely feasible in Saudi Arabia today because the government is not only thinking whether I should fund the project or should I bring peace? The government is getting to a level of sophistication where it is thinking about how I can make it entirely private sector-friendly through a more nuanced approach," observed one panelist.

"What that means for the Islamic finance industry is that it should seize the opportunities to diversify itself proactively, not reactively"

Beyond banking

Islamic finance practitioners would remember the days when banks were fired up about getting their skin in the infrastructure game. Unfortunately, this enthusiasm seems to have dwindled due to Basel constraints.

"Leaders in the Islamic finance industry that took a lot of interest in the infrastructure space a couple years back are slowly moving away from it because it consumes a lot of long-term capital, and that also needs to play out with their assets and liabilities mismatch," explained one speaker.

This means we need alternatives.

"Investors and developers themselves need to be a bit more creative when it comes to financing their projects," said one panelist. The private markets — both debt and equity — could be a viable avenue of funding.

Tokenization is also one such display of creativity.

"The IPO of Aramco was subscribed in the retail space as they could subscribe through ATMs. Those are soft signals that tokenization can be something big here," highlighted one speaker. "Obviously, it will not bridge the gap of the funding requirements which are in the trillions of dollars; but every little bit could help, and technology could play a big part."

Another fellow panelist agreed: "When you tokenize assets, you open up a world of opportunities for investors who are not restricted by borders and jurisdictions, and assets immediately become liquid for buying and selling in the secondary market."



Blazing a green trail?

Like many of its peers, Saudi Arabia cannot discuss building its future, or infrastructure, without a touch of green. Unfortunately, the green agenda journey may not be that straightforward.

"Most people still think ESG as a box-ticking exercise — there is no real drive or sincerity in actually driving toward ESG," lamented one practitioner. "However, we can use rating frameworks to empower businesses to be more responsible by basing ratings on their commitment to and compliance with ESG."

The fact that most, if not a certain portion, of existing assets in Saudi Arabia likely are not compliant with ESG goals or practices is also a challenge.

"We could monetize them through Sukuk, which won't be ESG-compliant, but the proceeds could go to the new economy that will have an ESG agenda," suggested a speaker.

Above everything else, another panelist reminded the table that the industry has Maqasid Shariah — a concept that predates the ESG movement, and to many, goes beyond the ESG philosophy.

"When we talk about ESG within Islamic finance, we have got a much bigger framework — the Maqasid Shariah. If you bring that into context, ESG is automatically covered."

Crossroads

To effect any real change at the ground level, the retail mindset and, perhaps more significantly, the mentality of institutions and corporates must change to be more inclined toward Shariah compliant investment and funding.

"Until the corporate mindset changes to accept ethical means of financing, Islamic finance will not grow; its full potential cannot be tapped unless and until that mindset changes."

We are at a generational crossroad, and a technological one too, according to one practitioner.

"There are a lot of products on the table, a lot of assets on the table, and what that means for the Islamic finance industry is that it should seize the opportunities to diversify itself proactively, not reactively."

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Building a Nation — the Growing Influence of Islamic Finance and Banking in the Kingdom of Saudi Arabia

- What are the notable recent achievements and milestones of Saudi Arabian Shariah compliant markets and how do regulatory environments influence growth and development?
- Development of the Saudi Arabian Islamic finance markets: increasing market depth and liquidity, driving innovation in hybrid, perpetual, restructuring and syndicated transactions, and Islamic capital markets versus bank funding.
- Applying Shariah compliant structures to the funding of clean energy projects and infrastructure and in the shift away from hydrocarbons.
- How can Shariah compliant transition, sustainable and sustainability-linked financing products be further incorporated into the Saudi market?
- What are the notable recent milestones and key developments within Saudi Arabian Islamic banking, what is the current outlook for the sector and how do prudential regulatory environments allow for growth?
- Do Tier 1 and Tier 2 Sukuk still offer Saudi Islamic financial institutions an effective way of satisfying regulatory capital requirements, and do we feel the same about additional Tier 1 issuances as we did before?
- What other funding options are open to Saudi Arabian Islamic financial institutions, and what liquidity management tools are available?
- The digitalization of Islamic financial services: what is working, what is not and what this means for the transformation of Islamic financial services in the Kingdom.
- The growing prominence of Islamic P2P and equity crowdfunding in the Kingdom, and the opportunities these activities offer.
- Is it feasible to require Saudi Arabian Islamic banks to incorporate ESG frameworks as part of a wider Islamic banking philosophy?
- How can Islamic banking be further applied to social impact initiatives and are local banks doing enough in the development of sustainable retail, corporate and commercial products?



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Toward Saudi Vision 2030 — Developing Strategic Projects and Infrastructure through Shariah Compliant Investment

- Saudi Arabian bilateral Shariah compliant investment — latest trends, investment types, asset classes and opportunities.
- Potential targets for private equity investment in the Saudi market, and the role of privatization.
- Opportunities for Shariah compliant investment in the Kingdom through public-private partnerships, and the role of government-driven mega projects.
- The latest opportunities and demands for Shariah compliant direct investment into Saudi Arabian real estate market.
- The growth, development and performance of the Saudi Arabian REIT market.
- Other potential areas for investment of Shariah compliant capital into and out of Saudi Arabia.
- The principal structures used to facilitate Shariah compliant investment in Saudi Arabia, and other structures that could potentially be employed.
- What roles do insurance for investment and export credit and other forms of guarantees play?
- How do we effectively balance climate and investment risk and where do ESG considerations play a role in investment decisions?
- What represent Shariah compliant investment opportunities in the financing of low-carbon technologies and renewable energy in the Kingdom?
- Continuing the development of effective ESG and sustainable investment taxonomies and regulatory frameworks in Saudi Arabia.
- Assessing the increasing influence of Waqf in fund and investment management structures in the Kingdom.



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Saudi Arabia: Prioritizing Islamic finance

The Kingdom of Saudi Arabia remains the leading Islamic banking and finance jurisdiction in the world, with its Shariah banking sector holding a 74.9% share of the country's total banking assets as at the end of 2022, according to the IFSB. NESSREEN TAMANO writes an overview of the Saudi Islamic finance landscape.

Regulatory landscape

A single regulatory framework governs both the Islamic and conventional banking industries in the Kingdom, which generally follows Shariah law but has no specific regulation for Shariah banking. All banks have their own Shariah boards to ensure compliance. The Saudi Central Bank (SAMA) regulates the banking, finance and Takaful sectors and has a dedicated Islamic Finance Division, while the Capital Market Authority (CMA) oversees the Saudi capital market under the Capital Market Law.

In 2020, the Saudi Arabia-headquartered IsDB partnered with the UAE's Ministry of Finance to establish a unified, global legal and legislative framework for the Islamic finance industry, using AAOIFI standards as a reference.

Banking and finance

There are 11 local banks licensed by SAMA, four of which are fully-fledged Islamic — Al Rajhi Bank, Aljazira Bank, Alinma Bank and Bank Albilad — while the rest operate Islamic banking units.

The past few years have seen developments, including the establishment of the three major rating agencies' offices in the Kingdom as well as interest by foreign banks and financial institutions to set up offices in Saudi Arabia, which have contributed to the growth of the Shariah banking sector.

Some notable mergers have also taken place in the banking sector. Saudi British Bank and Alawwal Bank merged in 2020, and in 2023, the former rebranded to Saudi Awwal Bank as a result of the merger. In 2021, Samba Financial Group and National Commercial Bank completed their merger to become Saudi National Bank, and then announced its plan to convert all its retail branches into fully Islamic units.

There are three digital banks with licenses from the central bank. STC Bank, or stc pay, formerly an e-wallet, and D360 Bank, which is backed by the Public Investment Fund as a key investor, are both currently in the pilot phase, while Vision Bank is yet to start its operations. The Kingdom also has a thriving Islamic fintech scene, with 15 fintech companies registered under SAMA's regulatory sandbox and 11 licensed digital payment companies, all of which provide Islamic solutions (if not fully-fledged Shariah compliant).

Capital market

The CMA has a parallel market to the main market of the Saudi Exchange, which opened up in 2019 to foreign companies

wishing to be listed on the exchange, and the Kingdom is also featured in the MSCI and FTSE Russell Indices.

Saudi Arabia debuted its sovereign Sukuk in 2017, that year's largest issue size at US\$9 billion. It also issues local Sukuk monthly under its Saudi riyal-denominated Sukuk program. In 2021, the Kingdom overtook Malaysia as the world's biggest Sukuk issuer for the first time since 2018, with over US\$32 billion issued by the GCC country, compared with Malaysia's US\$26 billion. Some notable Sukuk issuances from the Kingdom's corporate sector, which has many regular issuers, include the US\$6 billion debut deal from Saudi Aramco in 2021, and more recently, Al Rajhi Bank's US\$1 billion facility that received an orderbook of US\$3.75 billion.

The IsDB also made headlines (in 2019) when it issued its first-ever green Sukuk paper worth EUR1 billion (US\$1.07 billion), and again in February 2020 with a US\$2 billion Sukuk issuance. In 2023, the bank issued another US\$2 billion facility to fund its green and sustainable strategies.

Asset management

The Kingdom remains home to the largest number of Islamic funds worldwide, holding 34% of total Islamic fund assets under management. According to the CMA's latest annual report, as at the end of 2021, there are 751 investment funds in the country, including 17 REITs and six exchange-traded funds.

Takaful

Operating a fully Islamic insurance sector, Saudi Arabia is the largest Takaful market in the world with 30 licensed insurance operators, accounting for more than 87% of total contributions along with Malaysia and the UAE, according to the IFSB's latest data.

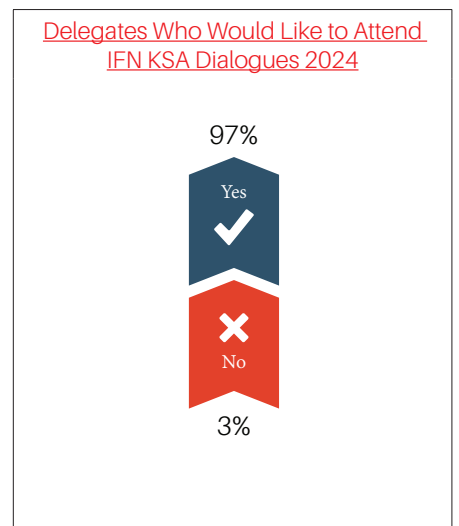
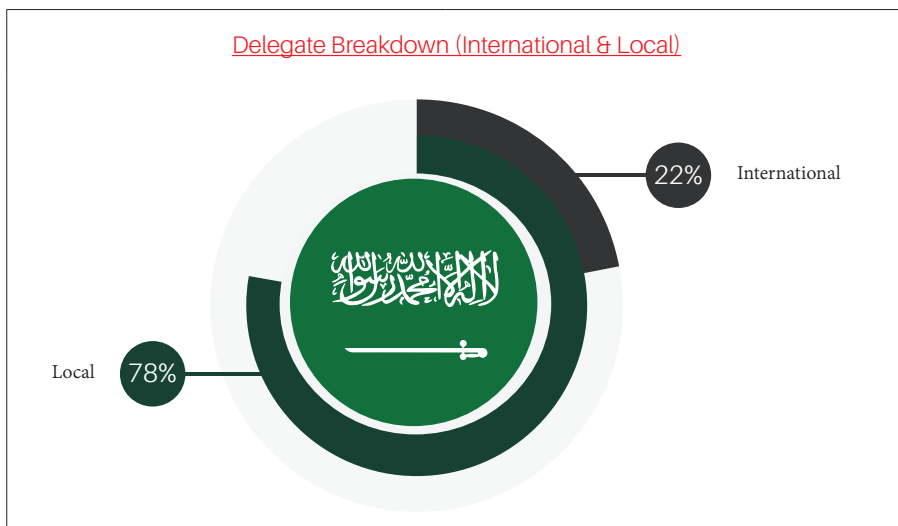
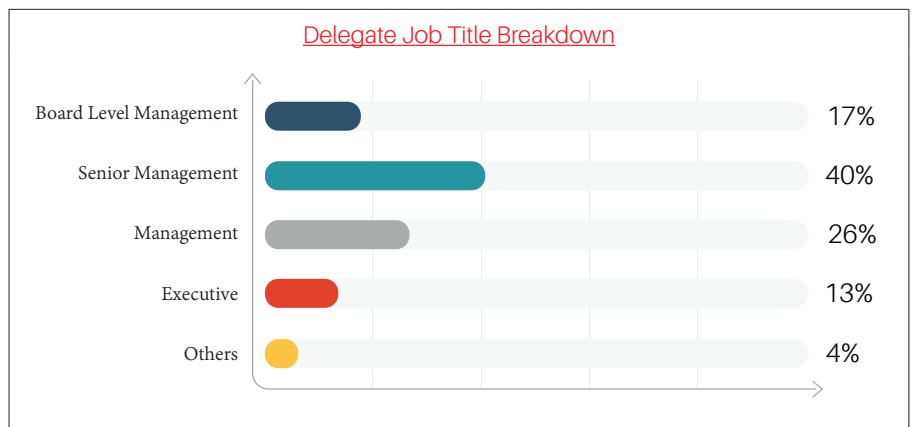
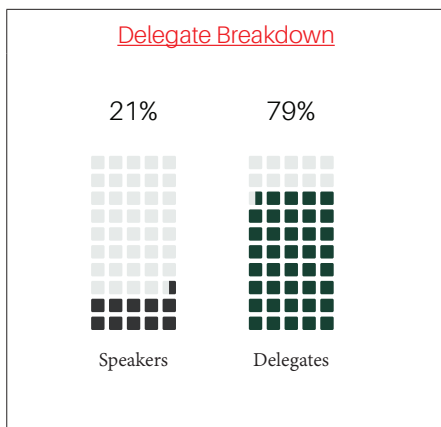
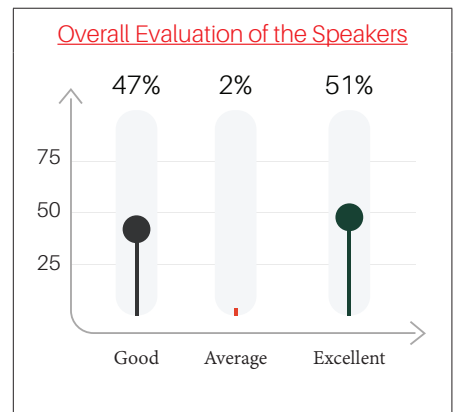
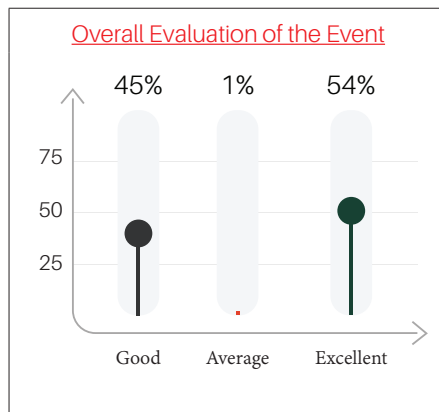
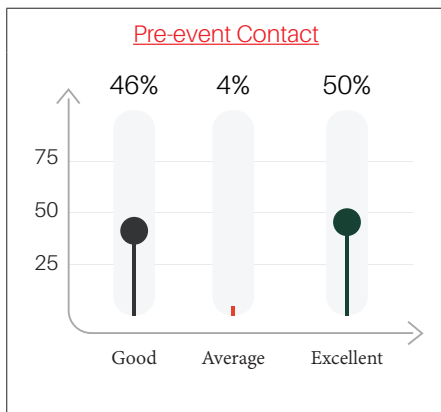
It is, however, a highly concentrated market, and insurers in the country are pressured into merging to enhance capability. In 2021, three mergers were completed: AlJazira Takaful Taawuni with Solidarity Saudi Takaful; Walaa Cooperative Insurance Company with Metlife, American International Group and the Arab National Bank for Cooperative Insurance; and Gulf Union Cooperative Insurance Company with Al-Ahli Cooperative Insurance Company. In 2023, Gulf Union entered into another merger agreement with Al Sagr Cooperative Insurance Co. AlAhli Takaful Company and Arabian Shield Cooperative Insurance Company are currently undergoing a merger process, as are Saudi Enaya Cooperative Insurance Company and United Cooperative Assurance Company.

Outlook

The Saudi government and the regulators continue to drive the development of the Islamic banking and finance industry, both locally and regionally, with new initiatives for market players and stakeholders. This strong backing only reaffirms the Kingdom's goal of becoming a global Islamic finance hub, supported by its Vision 2030 Financial Sector Development Program.



EVENT OVERVIEW



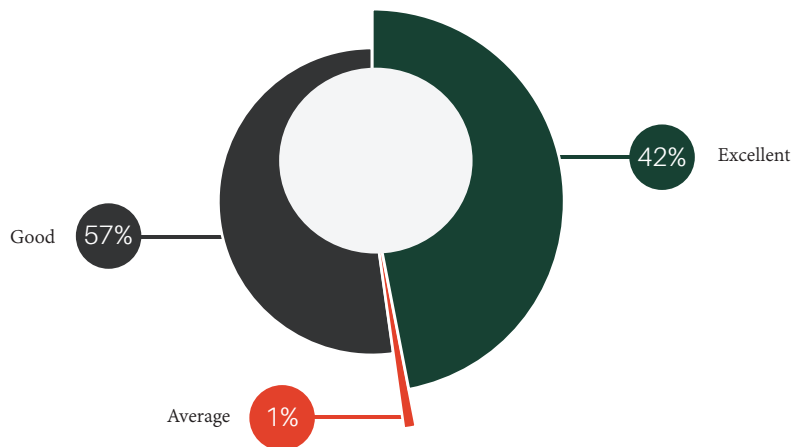
Omar Khaliel, CEO, Riba Free Foundation

“ IFN KSA was a quality event with lots of positive discussion and engagement on a host of relevant and pertinent matters. There was a mix of representatives from the IF industry, and I very much look forward to next year’s event. As always, IFN events create a professional and warm environment for the industry to come together. ”

Dialogue One: Building a Nation — the Growing Influence of Islamic Finance and Banking in the Kingdom of Saudi Arabia



Presentation: Bank Syariah Aladin



Dialogue Two: Toward Saudi Vision 2030 — Developing Strategic Projects and Infrastructure through Shariah Compliant Investment



ATTENDING COMPANIES' LIST

ACWA Power	General Authority for Awqaf
ADP Law Firm	Gowling WLG
AIK Group	Hejaz Financial Services
Al-Iman Muhammad ibn Saud Islamic University	Ideofuzion
Arab National Bank	Invesense Asset Management
ArabWeeks	Jadwa Investment
ARCOM	Jazra Investments
Australian Mortgage Managers	King Saud University
Aventicum Capital Management	Logofeel
Aventura Air Center	Meysan Partners
Azimuth Global Partners	Mohammed Alhedaithy Auditing Office
Bait Al-Maal Al Khaleeji	Moody's Investors Service
Bank Aladin Syariah	MRHB Network
Bank Muscat	Norton Rose Fulbright
BAWASIG	Rafd Business Services
Bin Zafrah	Riba Free Foundation
BlackRock	SABB
Charles Sturt University	Safa Investment Services
Cykube	SAMA
Dar Al Taqreer	Saudi Awwal Bank
DDCAP	Saudi Real Estate Refinance Company (SRC)
Dentons	Standard Chartered Saadiq
Dr Mohammed Al-Hashem Law Firm	Tejoury
Faidh International	Tenami Capital
Family Homes Funds	The Law Office of Looaye Al-Akkas
Finpal	Wixeman Management Consulting
Freedom Asset Management	Www.ssc-arabia.co