

# IFN CIS & RUSSIA FORUM 2016

## Feasibility Study Report Presentation

# Towards the Implementation of Islamic Banking and Finance in the Republic of Tatarstan

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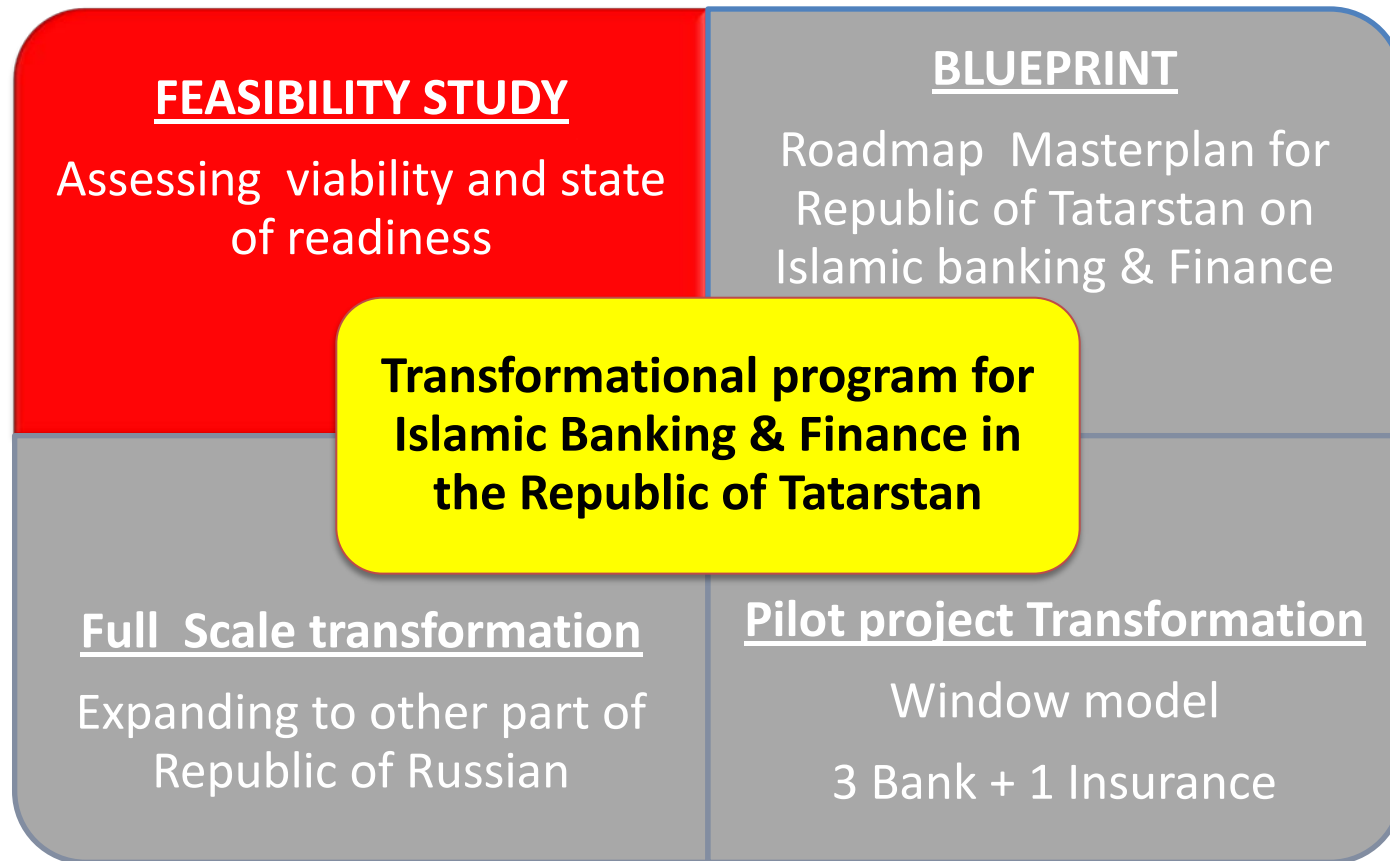
# Feasibility Study on Islamic Finance in the Republic of Tatarstan

**Section 1** – The option, potential and opportunities in Islamic banking and finance

**Section 2** – The Market Study and the Marketing strategies to implement Islamic Banking and Finance

**Section 3** - The step by step preparation in Implementing Islamic banking in the form of window services in the existing conventional banks.

# Programme Approach



## Feasibility Study Report Presentation - Section 1

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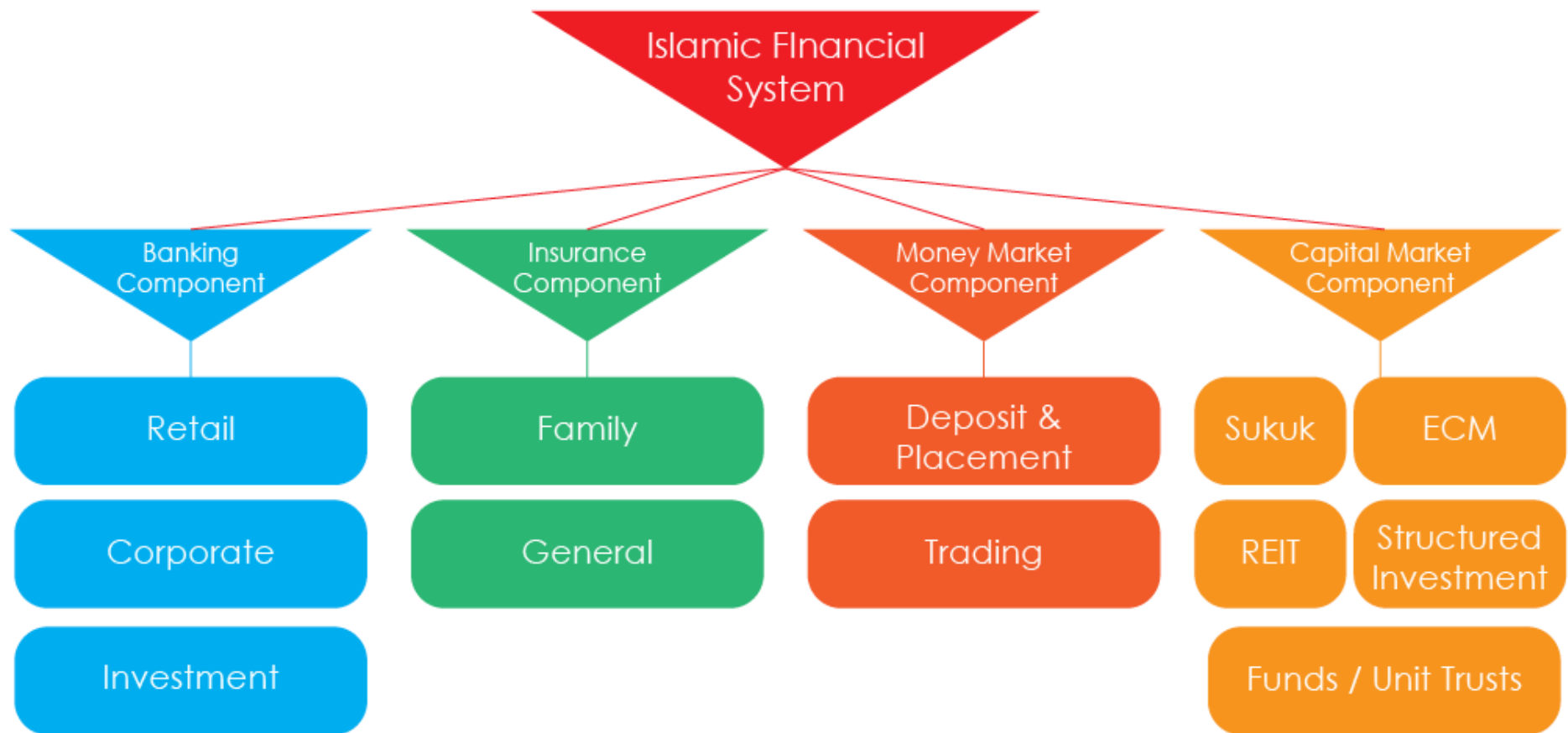
# The option, prospect and potential of Islamic banking and finance

October 7, 2015

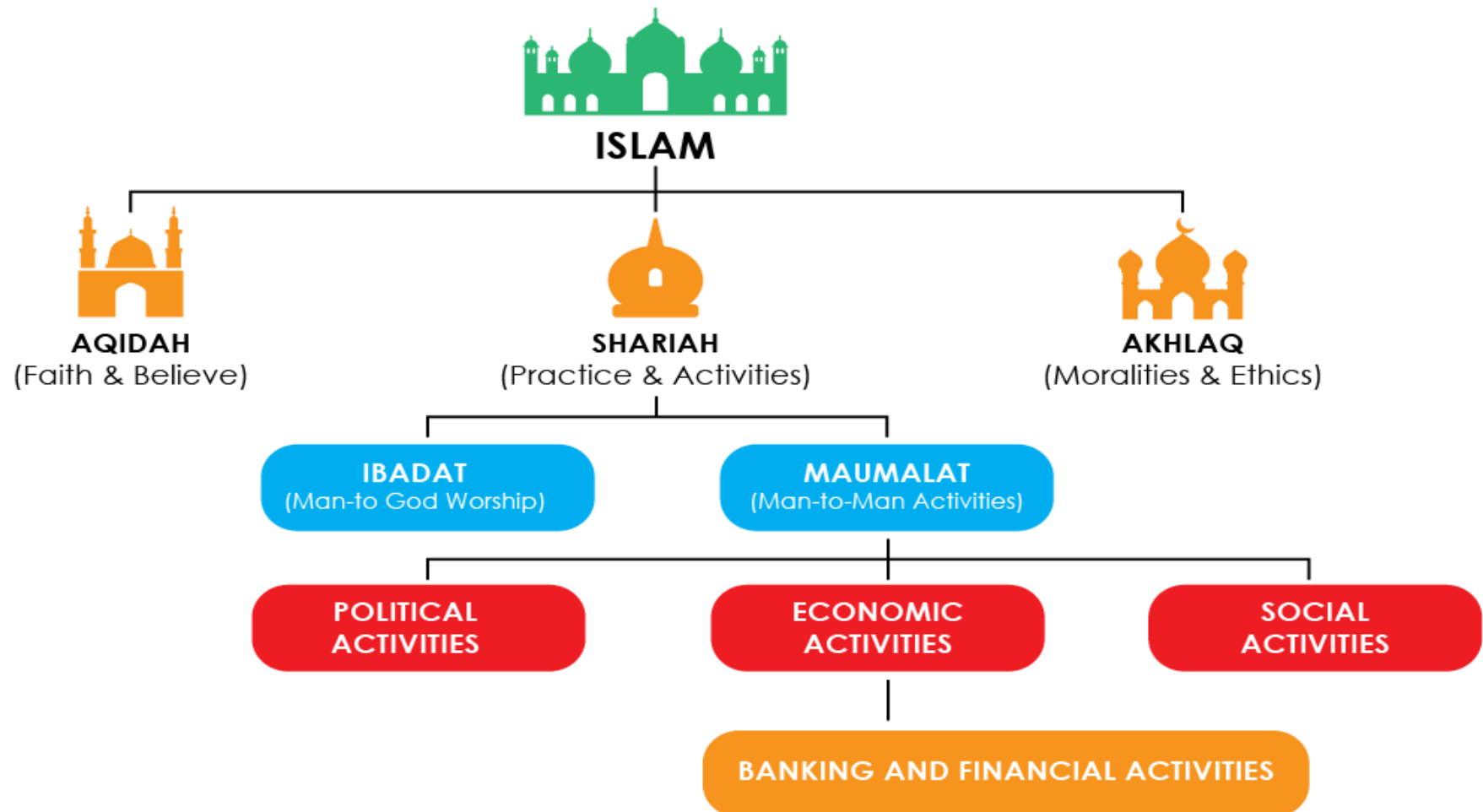
# Prospect and development of Islamic Banking

- From a humble beginning in the early sixties as a Pilgrim Saving Program in Malaysia and a social bank in Egypt, Islamic Finance has grown rapidly managing over USD1.6 trillion of assets in 2012 and is **expected to reach USD6.1 trillion by the year 2020** (Gewal, 2013).
- The range of Islamic banking and financial services has **spread beyond commercial banks – into investment banks, insurance, investment, leasing, pawn business and bonds issuance**, with multi products and services being offered to the economy.
- Islamic banking and finance is **exerting its present as a strong and viable alternative to the conventional financial system**.
- At the same time it also **affords to exist side by side with the conventional banks and financial institutions**, making the customers and clients feeling comfortable in dealing with them for their daily transactions.

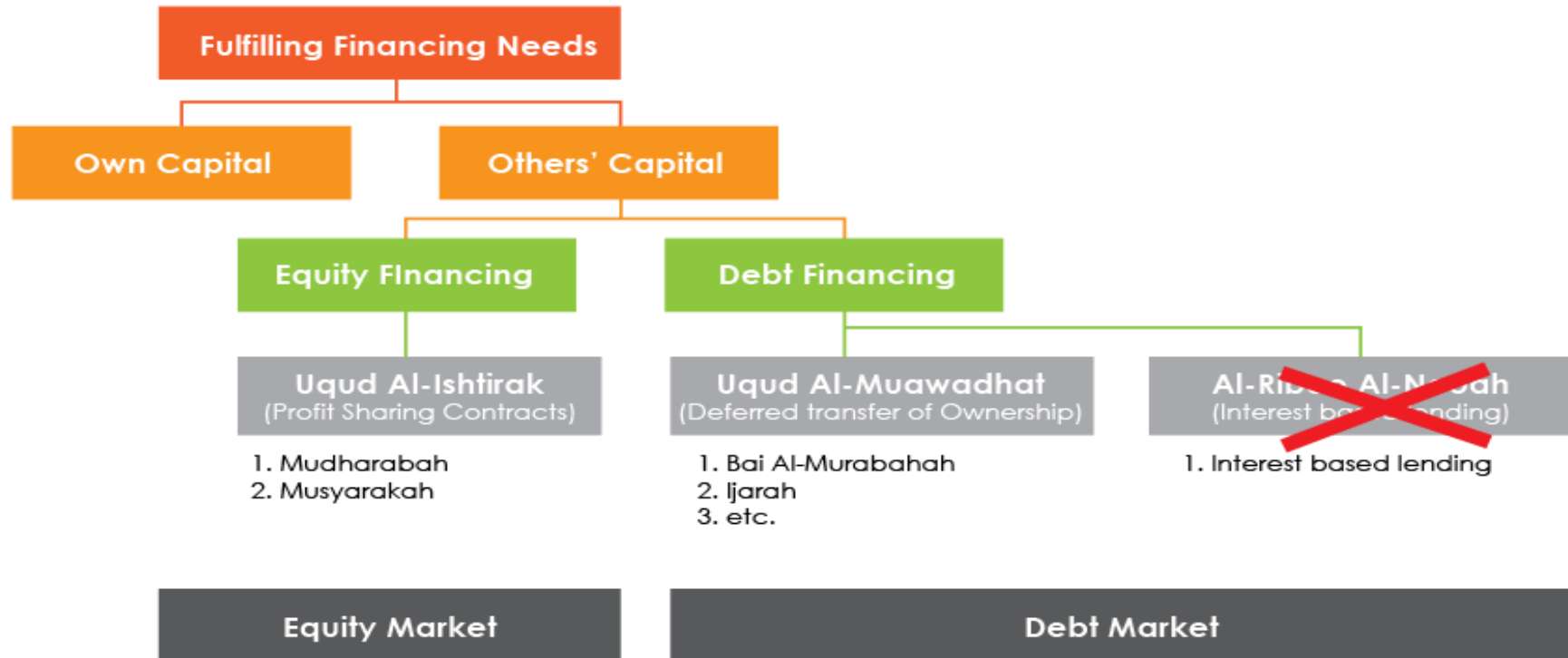
# Islamic finance and its value proposition



# Principle of Islamic bankings



# DIFFERENCES BETWEEN ISLAMIC AND CONVENTIONAL BANKING AND FINANCE



*Islam forbids the practice of interest-based lending. This prohibition is contained in the following verse from the Qur'an:*

*"...and Allah has permitted trading and prohibited riba (interest)...."*



# The market study and the marketing strategies to implement Islamic banking in the Republic of Tatarstan

# Republic of Tatarstan as the launching pad

- The Republic of Tatarstan is an ideal launching pad for the development of Islamic Banking and Finance industry in the Russian Republic.
- The region with ample natural resources and productive human resources, is one of the most developed in Russian Federation.
- The 4,000,000 population provide a convenient size to work on.
- The region is relatively rich with a per-capital income of over USD13,500. The region will be a high income economy even before 2020.
- The banks inclusion rate is rather high exceeding 85% due to the traditional practice of crediting salaries and pension into banks accounts.
- The Banks density is wide but not exhaustive making it rather convenient to achieve a wide spread impact in a short time of introduction.
- The religious composition of the population with almost 50% Muslim, especially the Tatars made it convenient to introduce Islamic financial products and services.

# PEST ANALYSIS

Political	Economic
<ul style="list-style-type: none"> <li>• Stability, safety</li> <li>• Tightening of legislation in the sphere of financial services</li> <li>• The instability of the political situation in Russia is not reflected in the situation in Tatarstan</li> </ul>	<ul style="list-style-type: none"> <li>• One of most economically developed regions of Russia</li> <li>• Most attractive region in Russia for investment</li> <li>• 2,050,876 economically active population</li> <li>• The Republic of Tatarstan possesses rich natural resources, the powerful and diversified industry, high intellectual potential and the qualified labor</li> <li>• Inflation rising</li> <li>• Lowering of the key rate of the Central Bank</li> <li>• The decline in SME lending in the past six months</li> </ul>
Social	Technological
<ul style="list-style-type: none"> <li>• Growing population, although with high rate of ageing</li> <li>• 28 institutions of higher education</li> <li>• Low unemployment rate (4.1%)</li> <li>• On 3rd place in Russia by average salary size and per capita consumer spending</li> <li>• Lack of knowledge of the population in financial services</li> <li>• One of the regions with the lowest delay</li> </ul>	<ul style="list-style-type: none"> <li>• One of most economically developed regions of Russia</li> <li>• Most attractive region in Russia for investment</li> <li>• 2,050,876 economically active population</li> <li>• The Republic of Tatarstan possesses rich natural resources, the powerful and diversified industry, high intellectual potential and the qualified labor</li> <li>• Inflation rising</li> <li>• Lowering of the key rate of the Central Bank</li> <li>• The decline in SME lending in the past six months</li> </ul>

# SWOT ANALYSIS

Strengths	Weaknesses
<ul style="list-style-type: none"> <li>• New Islamic bank with the new value proposition – socio-economic benefits for customers and the country</li> <li>• Clean balance sheet, lack of problematic assets that have hugely affected large banks in the market</li> <li>• Ethical and moral values inevitably ingrained to Sharia principles will differentiate the bank from majority of the market players</li> <li>• The ability to use banking services people who didn't use it because of religious principles</li> </ul>	<ul style="list-style-type: none"> <li>• Human capital deficit, comprehensive training required</li> <li>• Shariah scholars deficit</li> <li>• Misunderstanding Islamic finance principles by clients - wrong customer expectations</li> <li>• Legislation adaptation: Tax issues, Banking law definitions</li> <li>• Administrative barriers for new credit market participants</li> </ul>
Threats	Opportunities
<ul style="list-style-type: none"> <li>• Reputation risk if conventional products are imitated</li> <li>• Political stereotype risks 'associated' with Islam</li> <li>• Lack of demand risk</li> <li>• Liquidity risk</li> <li>• Regulatory risk because of flawed legal system</li> <li>• Low product demand</li> </ul>	<ul style="list-style-type: none"> <li>• Investment attraction</li> <li>• Solving problem of debt load and rising delay</li> <li>• The influx of capital that has not been used</li> <li>• Encouraging various sectors of the economy by attracting part of the population that previously was not involved in the financial sector (because of religious principles)</li> <li>• Entering new markets</li> </ul>

# PORTER FIVE FORCES MODEL ANALYSIS



# INTERNAL ANALYSIS

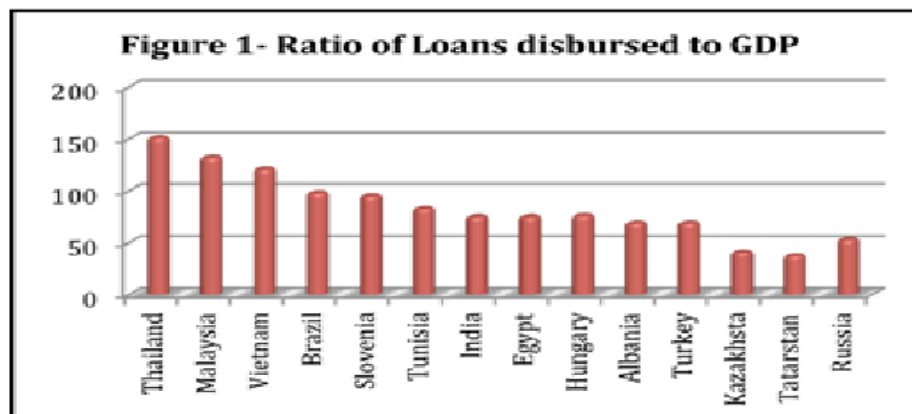
Analysis:	A new Islamic bank needs to focus on effective social benefits it delivers without compromising on its financial sustainability. This will be in accordance with Sharia rules and values and also will position the bank at its unique place in the market.
Proposition:	To be the country's number one supplier of most dependable and most socially effective banking services. To be the bank that while doing banking business is committed to society.
Analysis:	To be truly an Islamic bank and avoid a reputational risk the bank must see its mission in helping businesses and individuals to support their financial needs and thereby stimulate an economic activity for the benefit of society. A fruitful long- term relationship with customers will be achieved through a sense of partnership.
Proposition:	The bank stands to help Russian businesses and people build a greater and brighter future for themselves and their country by providing highly professional, modern and Sharia-based banking services for all. As a truly Islamic bank it sees itself as a partner of private businesses, individuals and the Tatarstan and Russian community as a whole.
Analysis:	The bank needs to be closer to the society as a real partner. Quality of service is a success factor for any bank. Sharia fundament will provide the bank with exceptional ethics and moral standard, which will be valued by customers over time. The same level of commitment to staff, customers and future generations will provide a sustainable growth of the bank.
Proposition:	<p>Honesty and Respect – the bank makes it a responsibility to treat each and every customer with honesty and respect. Trust and Partnership – the bank is a partner that customers can always trust. Quality of Service – the bank intends to provide the most reliable banking services and find solutions to every banking need.</p> <p>Contribution – the bank aims to make a positive contribution to Tatarstan through a beneficial Islamic banking mechanism. Sustainability and Growth – the bank thinks about the future of the bank, the Tatarstan people and the country.</p> <p>Ethics and Morals – the bank is based on highest ethical and moral standards of Sharia that makes the bank socially responsible in every relationship - with the customers and communities as well as the staff.</p>



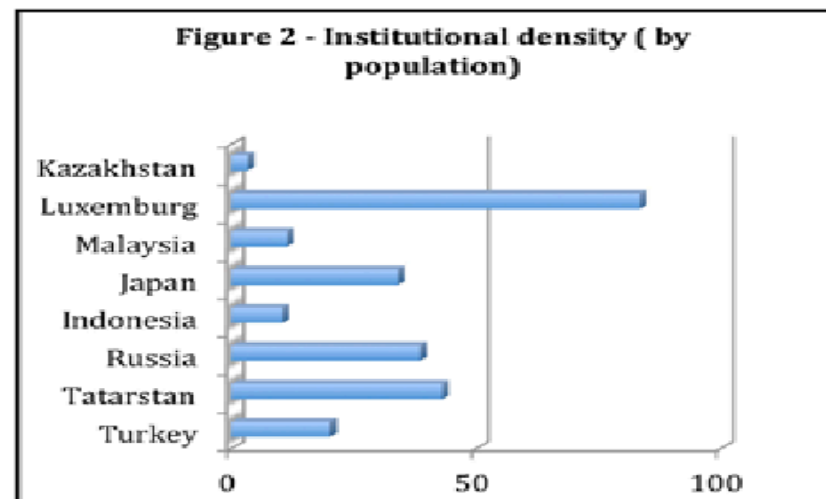
# Broad category of contracts in Islamic finance

Broad Category of Contracts	Highlights
Sale based	<ul style="list-style-type: none"> <li>• Sale and purchase transaction in the form of contracts such as Murabahah, Salam and Istisna'.</li> <li>• Under Murabahah, the Bank earns revenue in the form of margin. For the customer, it is an alternative of procurement of certain goods using the Bank financing facility.</li> <li>• Under Salam, the Bank provide financing in accordance with the need of the last customer and it has an opportunity to earn profit if at the time of submission to the bank, the market price of goods is higher than the amount of financing. For the customer, fund is procured in advance as working capital in production of goods.</li> <li>• Under Istisna', the Bank earns revenue in the form of margin while the customer procure funds to order production of goods with agreed specified criteria and with payments on agreed terms.</li> </ul>
Lease based	<ul style="list-style-type: none"> <li>• Leasing transaction in the form of contracts such as Ijarah and Ijarah Muntahiya Bittamleek which gives opportunity for the bank to earn fee/Ujrah while allowing the customer to have the rights of use and/or the opportunity to the rights of ownership.</li> </ul>
Profit and equity based partnership	<ul style="list-style-type: none"> <li>• Profit sharing transaction in the form of Mudharabah and Musharakah contracts.</li> <li>• For the Islamic bank, Mudharabah financing is one of the forms of financing to customers. The Bank earns revenue in the form of profit sharing from the business managed by customer.</li> <li>• For the customer, the need for capital is fulfilled via a partnership with the Bank</li> <li>• Under Musharakah financing, the Bank earns revenue from the business managed by both the Bank and customers. The customer's need for capital is also fulfilled via a partnership with the bank.</li> </ul>
Islamic Loan	<ul style="list-style-type: none"> <li>• Lending and borrowing of funds without any remuneration with the obligation to pay back the loan principal.</li> <li>• For the Bank, this contract is applied for its social function and opportunity to earn fee from other services that are provided together with the Qard facility.</li> <li>• For the customer this is a non-commercial credit source and his mandatory obligation is only up to the principal amount which gives him the flexibility when to remunerate the Bank.</li> </ul>

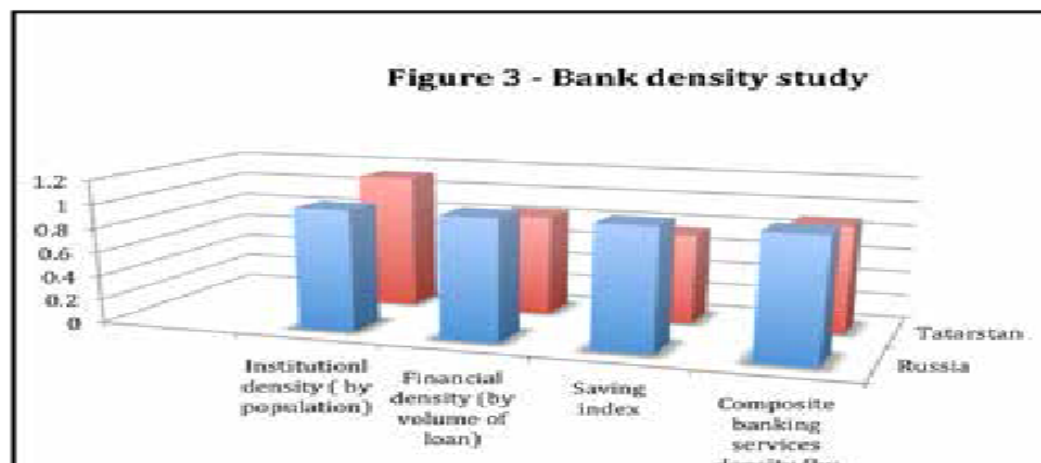
# Bank density analysis



Source: The World Bank's database (The World Bank, 2012)



Source : Constructed based on the available statistics



Source : The overall density analysis constructed based on data available.



# Conclusion (cont'd)

- The average income of the population is rather low compared to the monthly cost of living making **saving rather low to support the supply of fund** into the banking system. Currently the government sector and the private sectors – oil and gas and manufacturing are supporting the banking sectors supply of fund.
- Based on the **Density study of the banking and financial system** – in terms of bank per land size, bank per population, bank per loan disbursed and bank per deposit – the banking sector in the Republic of Tatarstan is **quite densed and very competitive but still leave some room for further development.**

# Conclusion (cont'd)

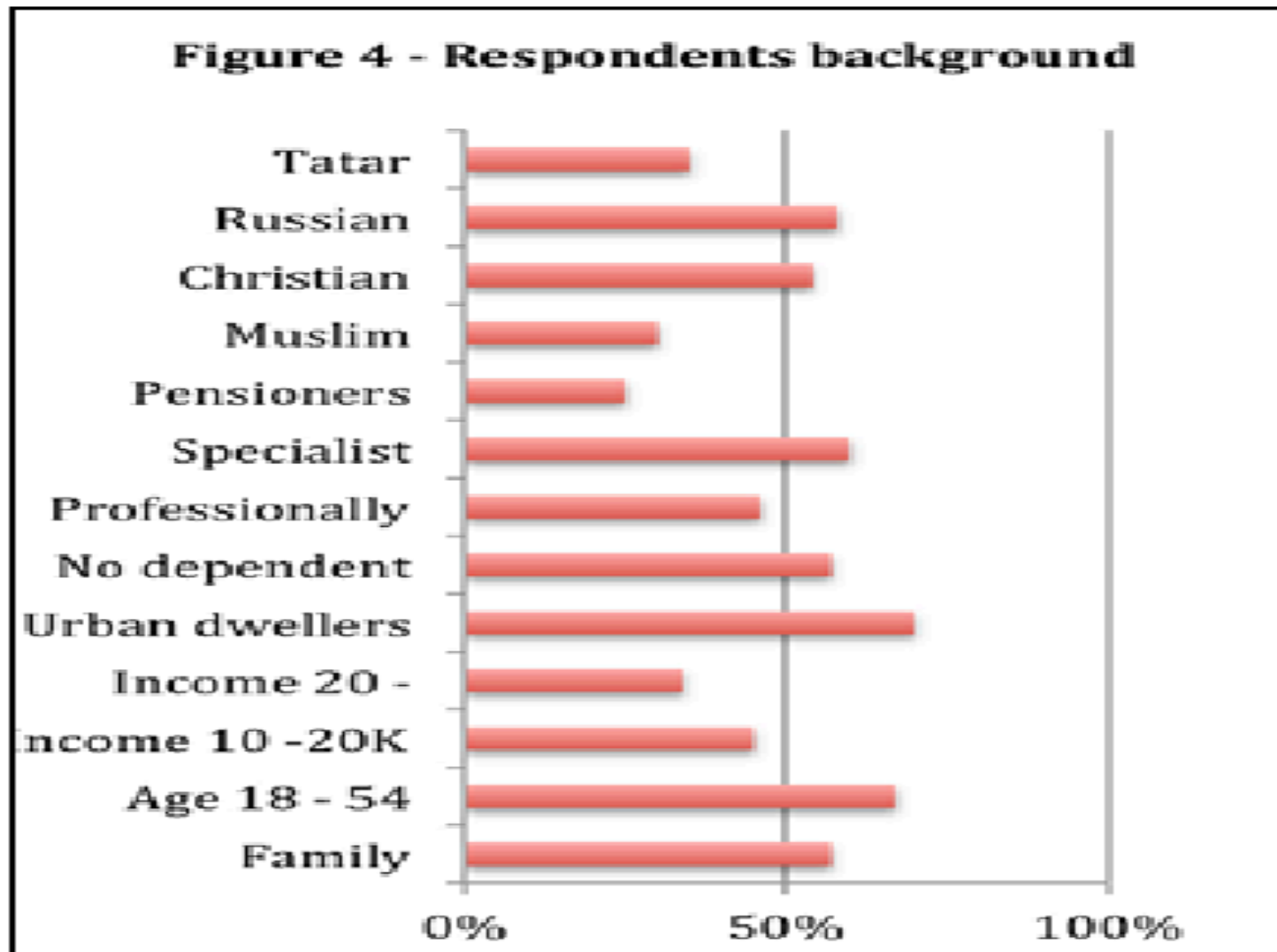
- **Opportunity** to introduce Islamic banking and financial sector is **still ample and attractive**.
- The **consumers behaviour study** indicates **strong and positive prospect** as the **consumers are looking forward** and are **ever willing to explore and support** the establishment of the Islamic banking and services and the introduction of new products and services in banking.
- A success introduction of Islamic banking and finance industry in Kazan will be seen as **a pilot project success case** that will prompt similar introduction in the whole Russian Federation.

# Conclusion (cont'd)

- **Real opportunity** existed - For example, where the **demand for housing loans is very high but the supply of fund is limited**. The **issuance of Sukuk** from a more developed market like the Middle east, Turkey, Iran, Malaysia and Singapore will attract new fund and support the success of the industry .
- The country rating need to be workout though in order to reduce the cost of fund.

# Important Findings of the Market Study

## BACKGROUND OF THE RESPONDENTS



*Source : Constructed based on the available statistics*

# The Market study report

- The market study was conducted on **1,044 respondents** from among the banking customers and population of Kazan city and the Republic of Tatarstan at large.
- It was based on a set of questionnaires set up the researchers in English – translated into Russian language and re-translated back into English by an expert groups before used in the field work.
- The **field work run for about three months** involving **over 30 enumerators** being employed through a **Data Collection company in Kazan City**.
- The **field work were preceded by a Focus groups session and the personal interviews** with the objective of getting feedback on the questions and to dig deeper into the questions to be asked to the general respondents.
- The **market study report run to about 118 pages** – from page 28 to page 135 in the final report
- The report include **192 Statistical tables** that detailed out the findings
  - Respondents background
  - Descriptive statistics
  - Cross tabulation
  - Statistical analysis – Spearman Rho
  - Regression analysis

SOME OF THE INTERESTING FINDINGS OF THE MARKET RESEARCH ARE  
PRESENTED HEREWITH

# **THE CANDID REPORT**

## Criterion for selecting bank



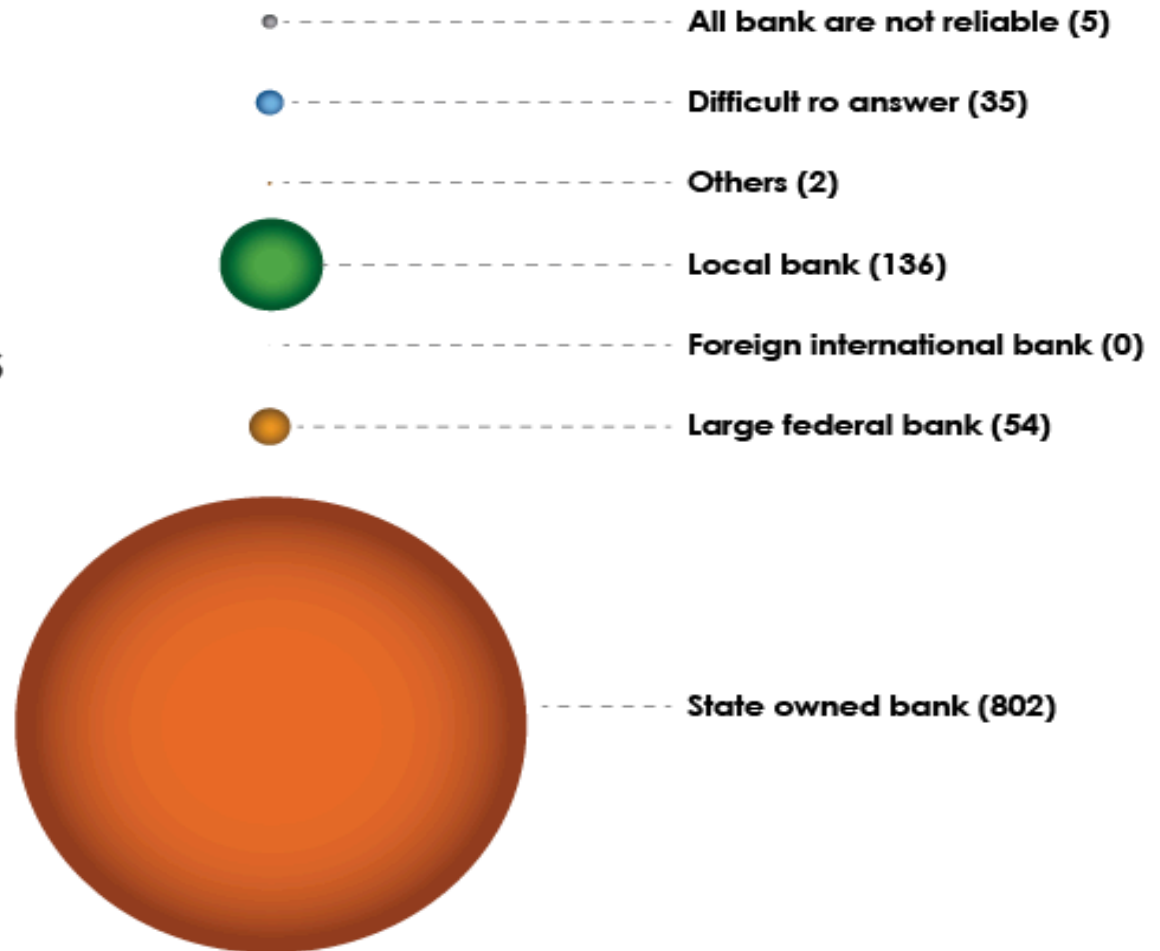
Source : Constructed from data collected



# The choices of banks

- Customers choose banks based on :
  - The strength of the banks
  - The convenient location
  - The number of ATM
  - Convenient on-line banking services
- To introduce Islamic banks services, we need to work with the existing established and big banks to capitalise the criterion above that they readily qualify

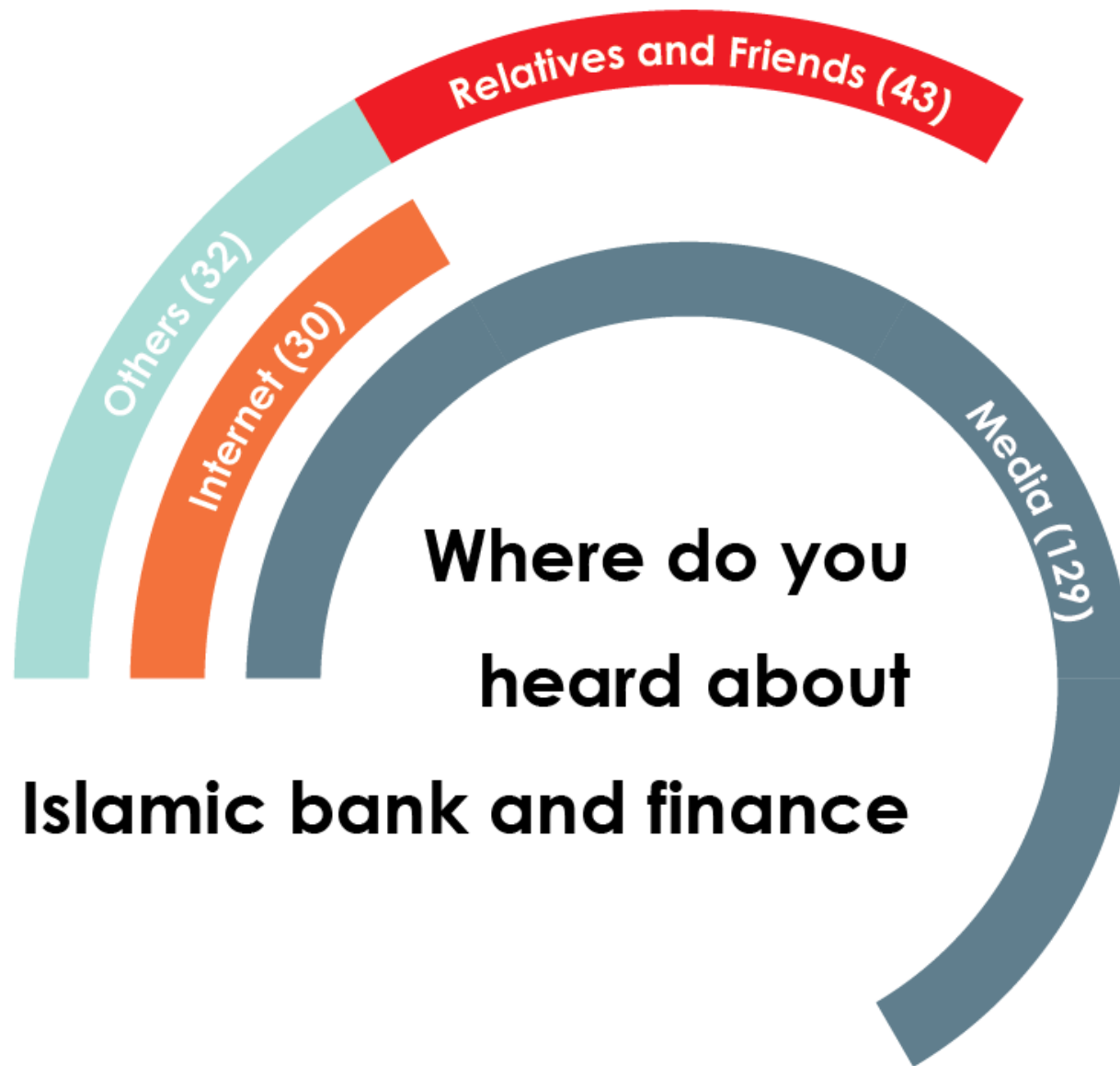
## The choice of banks



Source : Constructed from data collected

# The choice of banks

- The two main choices of banks are :
  - The states bank – particularly Sber Bank
  - The local state bank – particularly Akbar bank
- The launching of Islamic banking and services should start with the above two banks
- It then should be expanded into the foreign established Islamic banks



Source : Constructed from data collected

# The media for promotion

- Most banking customers learn about banks and their services from :
  - Media
  - Relative and friends and
  - Internet
- The promotional program should start with the most convenient and cost effective ways namely :
  - The internet – Social media and web pages
  - Families and friends as the pillar

# What is your opinion about Islamic bank

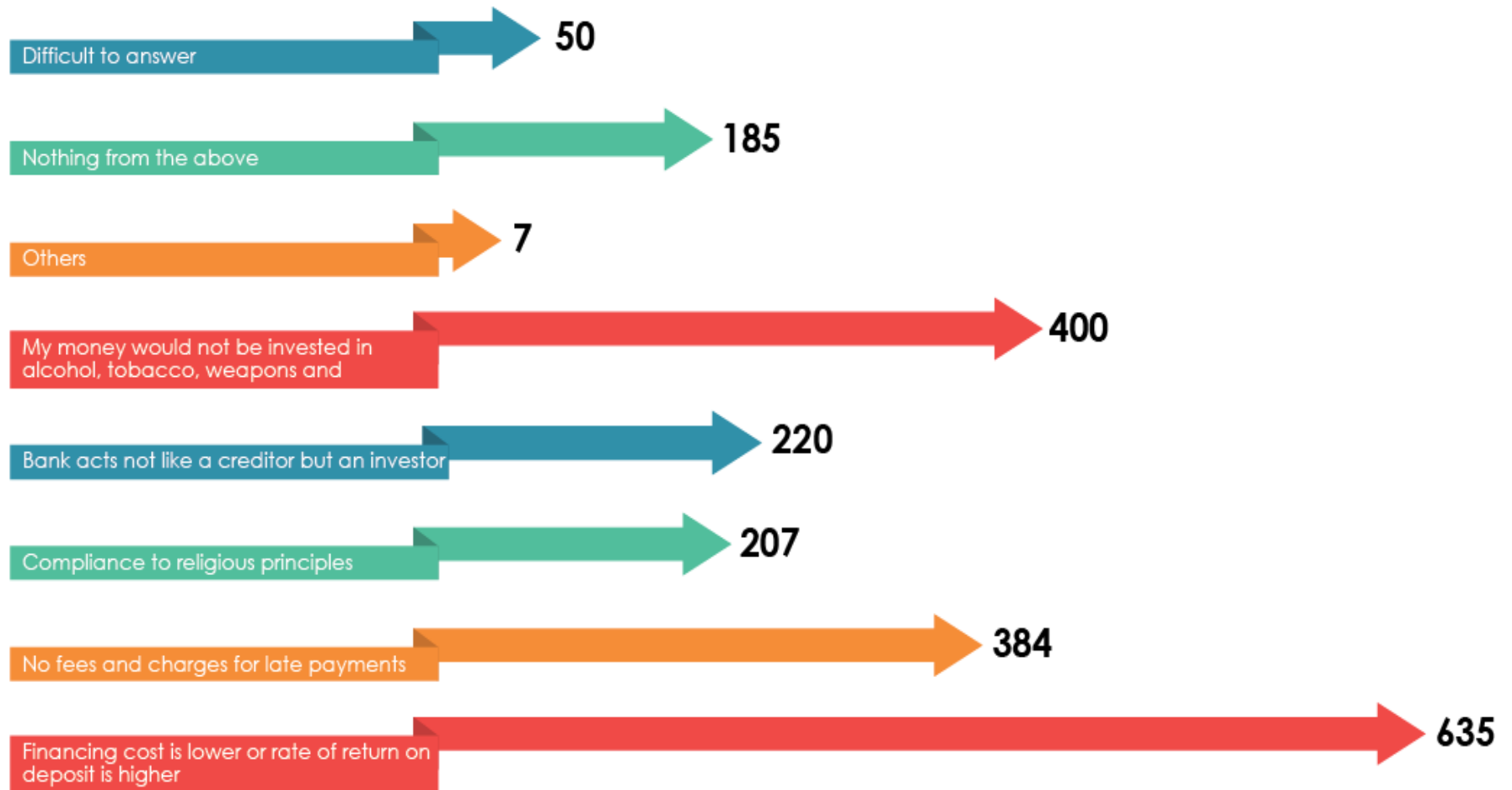


Source : Constructed from data collected

# Expectation of Islamic banks

- Over 75% of the banking customers do not have any expectation of Islamic banks.
- Only less than 10% think that Islamic bank will comply with the Islamic principles.
- The facts above provide us with all the opportunities to create a new and correct impression about Islamic banking and finance.
- This require some crucial strategic thinking to form the marketing strategies

# Perception about Islamic bank



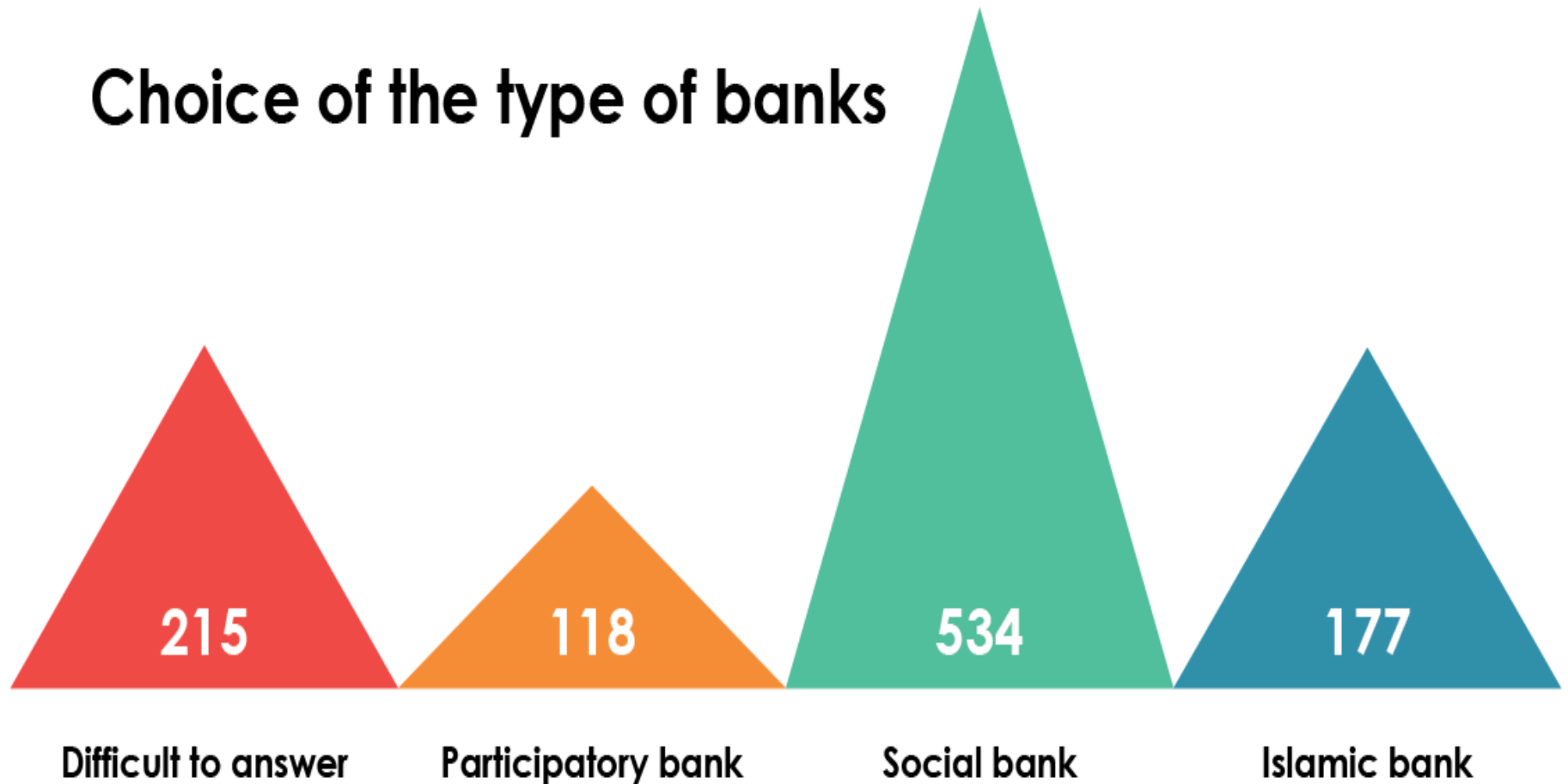
Source : Constructed from data collected



# Perception about Islamic banking services

- More than 63% of the banking customers expect that Islamic banks to offer lower financing costs and provide higher return than the conventional banks.
- Another 40% expect that their money will not be invested in the non-halal business and transactions
- Another 38% expect that Islamic banks will be sympathetic with customers difficulties in loans repayment.
- The marketing strategies will have to project and highlight the attractive services provided

## Choice of the type of banks



Source : Constructed from data collected

# Type of Islamic banks

- More than 53% of the banking customers expect the Islamic banks to be a social banks type – providing friendly and communities banking services.
- Another 12% associate it with the participatory bank that is being planned in the Russian Federation.
- The strategies is to start by provide banking services that are communities and social based and focus. This require a strategic focus in the launching program.

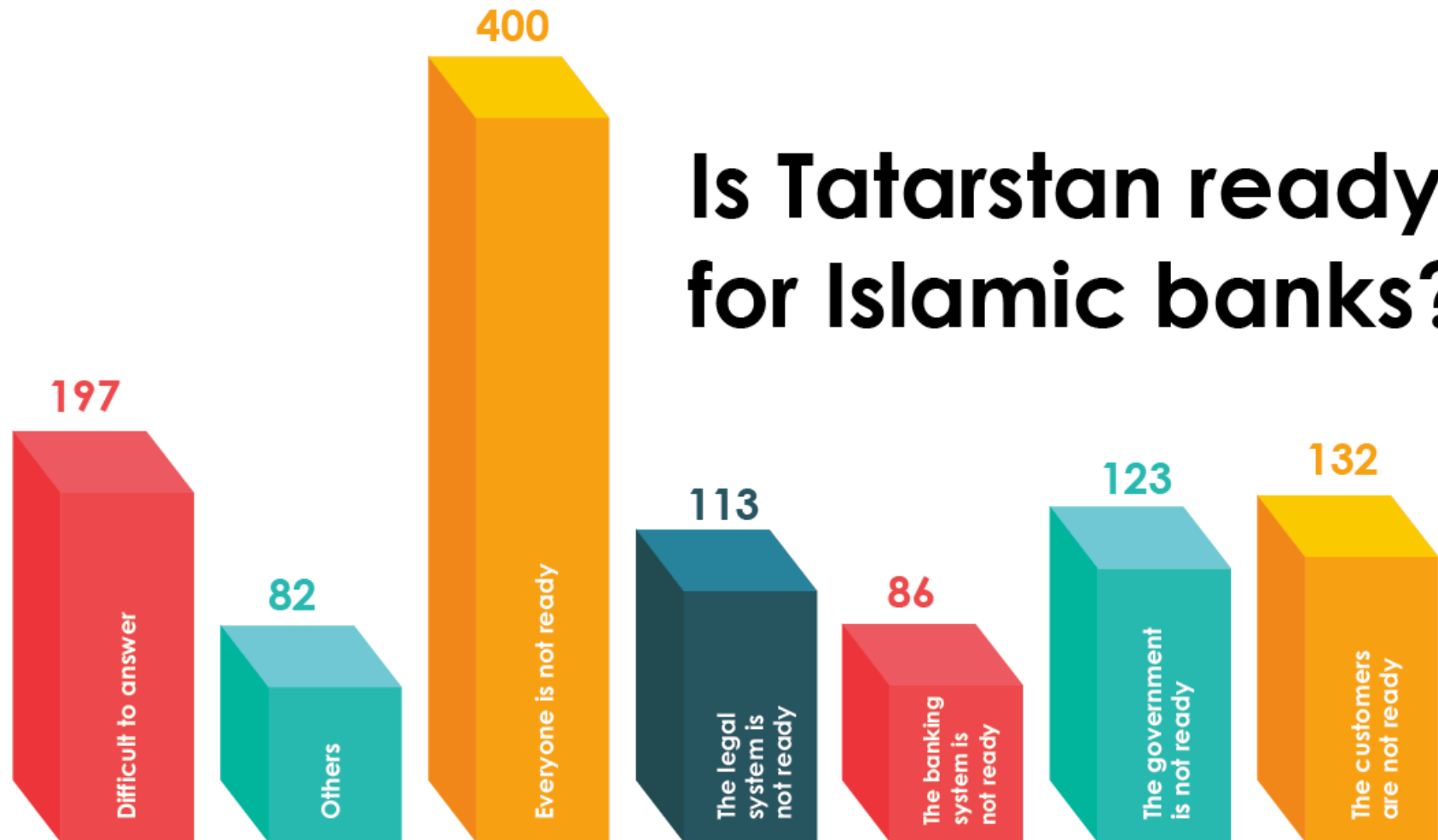
**Are you curious about  
Islamic bank**



# Curiosity about Islamic banking and finance

- Only 35% of the banking customers are curious to know more about Islamic banking and finance
- The other 75% do not really care about it.
- The marketing strategies need to be very attractive and focus to target a specific high potential segment of the market.

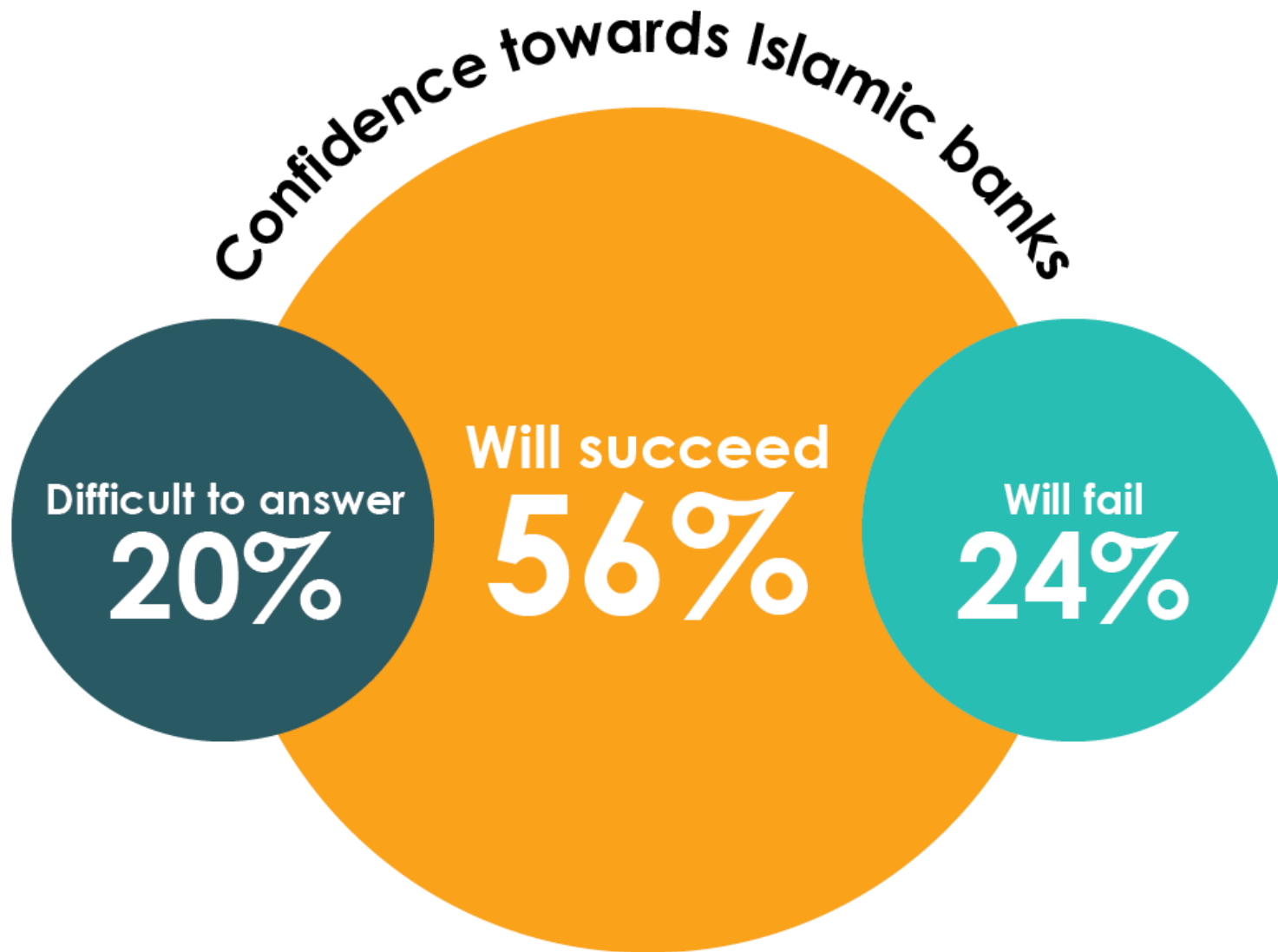
# Is Tatarstan ready for Islamic banks?



Source : Constructed from data collected

# Is Tatarstan ready for Islamic bank ?

- More than 40% of the banking customers think that the republic is not ready for Islamic banks
- About 11% each of the customers felt that The Republic of Tatarstan is not ready for Islamic banks because the customers, the government and the legal frameworks are not ready.
- The strategies of introducing Islamic banks must be done precisely and most transparently to project the well preparedness of the environment.



Source : Constructed from data collected



# Potential success of Islamic banks

- More than 56% of the banking customers are very confident that Islamic banks will be successful if introduced in the Republic of Tatarstan.
- The spirit is important and should be capitalise in the marketing strategies

# Summary of the result

- **Most banking customers in the Republic of Tatarstan** have not heard much about Islamic banking and finance making it rather difficult to research initially.
- They have heard of the name but understand it **just as a product label**.
- **The Muslim** customers are however able to **relate it with their religion and their obligation as a Muslim**.
- Most banking customers including the non-Muslim are **very curious about Islamic banking** ( Note that only about 33% of the respondents are Muslim and out of that less than 10% are practising Muslim).
- Bank customers **do not look at advertisement, bill board or commercial**. They just **'follow the flow' – listen to their friend and relatives**.
- There is a **need for a serious consumers education program through a proper exposure on the principles and practices of Islamic banking and finance**.
- The **Muslim groups are very committed on Islamic banking** and are **willing to try and spread the news to their family and friend**.

## Summary of the result (cont'd)

- This committed group – about 30% of the respondents ( which also include the non Muslim) are **willing to try even at a slightly less favourable terms offered by the Islamic banks.**
- A **nationwide and appropriate Exposure** in Islamic bank and finance is seen **as the starting point** to the proper introduction of Islamic banks in the Republic of Tatarstan.
- **Customers may still compare** the banks services with the conventional banks in terms of financing costs and investment return which require some appropriate strategies being introduced.
- Banking customers in the Republic of Tartarstan are **keen to explore the social Islamic banking principles** in the newly introduced Islamic banking and finance industry in the republic.
- More than 56% of the respondents are **confident that Islamic banking and Finance will be successful** when introduced in the Republic of Tatarstan.
- On the strategy to introduce the banks, **two important strategy were proposed :**
  1. **Use the existing banks to promote and start with window services**
  2. **Use the employers as the catalyst to credit salaries and pension into Islamic banks accounts.**

# SPEARMAN'S RHO ANALYSIS

- Spearman's rho analysis attempt to relate one question to another to investigate some in-depth relationship in the responses. The higher the factor, the more substantial the relationship is and the more relevant the variable.
- The variable '**bank's location near the place of living** is a very relevant variable in choosing the bank
- **Attractive interest rate** and **the bank's location near living and working place**, have been associated closely.
- **Promotion in banks, advertisement in the internet, TV and radio advertisement and bill board** all are closely related to the **formation of positive perception** that may lead to the customers recommending the bank to the family members.

## Spearman's Rho tests (cont'd)

- The responses '**I don't**' pay attention to advertisement is negatively related to the **idea of considering and recommending Islamic banks to others especially family members**. This is indicating the uphill task to reach the consumers through the normal means of promotion. This highlight **the need for a proper consumers education program** on Islamic banking and Finance.
- The spearman's rho analysis also indicate that the banking consumers in the Republic also closely associated themselves with **foreign banks** especially the established foreign bank. This can be a winning strategy in the development of Islamic banking and financial industry in the republic.
- Of course **low financing costs and higher investment return** will be a very good attraction to the consumers. Consumers tolerance is another factor.
- **Compliance to the Shariah principles** will be the basic criterion expected. Customers also expect Islamic banks to focus on the **Mudharabah principle (Partnership )** in bank financing and investment indicating the higher level of expectation of the Islamic banking and financial industry.
- What is also interesting is the different perspective of Islamic banking and finance adopted by the banking consumers group. They would like to see a **social Islamic banking practices** being implemented in the republic. This is a drastic shift in the thinking about Islamic bank which are more towards 'profit optimisation' modelling to the Capitalistic economic paradigm. The old Soviet Union economic paradigm based on the Socialistic perspective may still be strong. This is indeed refreshing and may spark a new development in the Islamic banking practices worldwide.

## Spearman's Rho tests (cont'd)

- The banking customers in the Republic of Tatarstan are **rather cautious** about the prospect of Islamic bank development in the republic. There is a **balance perspective** on the success feasibility of the industry. Not so much because the government, or the legislation or the peoples are not ready, but we figured out it is because **they do not have an in- depth knowledge of the Islamic banking system**.
- Banking consumers are also **uncertain of the acceptability** of the Islamic banking system in Russian simply because they felt the **consumers do not know enough about the system**. This is confirmed by the table below that indicate the interest to learn more about Islamic banking and finance to determine its potential acceptability.

# Feasible Acceptance of Islamic Banking and Financial Services

- All the variables examined in the study were related to the feasible acceptance of Islamic banking and finance products and services.
- What is interesting is that of all the variable, the **'promotion in bank'** is the only relevant variable.
- It indicate that to be acceptable, Islamic banking and finance industry **must be promoted through the existing bank in the conventional bank.**
- The ideas is that banking customers would like to hear **endorsement by their existing bank** on the positive value and advantage of Islamic banking products and services.
- It means, Islamic banks should be introduced **as part of the conventional banking product ranges under the 'Islamic window' principle** to attract the customers.

# Willingness to Try Islamic Banking Service

- A regression analysis was conducted to determine the willingness of the banking customers in opening a bank account with Islamic banks.
- The  $r$  and  $r$ -square were low indicating that the model does not fit well, basically because there are some important variable that are missing. We figured out that missing variable are **the familiarity with Islamic banking principles and its product and services** as reflected from the earlier analysis.
- This was also indicated in the result of the regression analysis indirectly when the respondents answer of '**would like to know more about Islamic finance**' was shown to be very significant.
- However, '**attractive interest rate**' is also shown to have a significant effect in the decision to start banking with Islamic banking. This reflect the perspective of conventional banking that are deep entrusted in their understanding of the banking system and could only be changed some serious consumer education program.
- Another important influence and role could be played by the **employers**. This include the **government bodies as employers**. If they **recommend or instruct employees to open account with Islamic bank because they want to deposit their employees salaries into the bank**, then employees will be willingly follow the step.



# Conclusion

The overall observation are :

- **More than 56%** of the respondents are **confident that Islamic banks and finance will be successful** when developed in the Republic.
  - **Only 24% of the respondents** felt that it may not be successful.
- 
- **Male are more confident** than the female counter part.
  - **Bachelor having higher confident**
  - The higher income groups earning **20k – 30k group have the highest confident at over 65%**
  - The **more religious groups having higher confident**. This include both the Muslim and the Christian who account for 30% and 53% respondents
  - **The younger income groups less than 24 yrs old showing higher confident.**
  - The **higher educated groups showing the higher confident.**
  - **The Tatars showing much higher support at 64%** ( though the Tatars were only 35% of the respondents )

## Conclusion

- **More than 20% of the respondents are willing to bank with Islamic bank even if the bank offer less return, charge higher rates, cumbersome and staff are not dressed in the Muslim ways.**
  - The **Male** groups will be more tolerable
  - The **bachelors** groups will be more tolerable
  - The **higher income groups** will be more tolerable
  - The **more religious groups** will be more tolerable
  - The **younger groups** in the society age less than 34 years will be more tolerable
  - The **higher educated** groups in the society will be more tolerable
  - **The Tatar** will be the more tolerable groups

# A Case Study Presentation

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## Towards Implementation of Islamic Finance in the Republic of Tatarstan

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December, 2015

# The technical study report

- The technical team explored the feasibility of introducing Islamic banking and financial services including Banking, insurance and capital market services.
- Their conclusion was Islamic banking products and services can be implemented in the Republic of Tatarstan and the whole Russian Republic immediately without having to change the laws or introducing new laws.
- All that is needed is some changes in the banks regulations that could be done internally to accommodate the Islamic banking services to co-exist with the conventional banks.
- The teams recommended that 'ISLAMIC WINDOW' services be offered by the existing banks especially the state owned banks.
- Important products for 'Micro finance' – such as ar-Rahnu (pawn shop) and 'House financing' will be the preferred products in the market.
- Raising capital through the SUKUK should be sought by the states banks to finance the introduction of Islamic banking services.
- The states banks will paly an important roles in making Islamic banking services a success in the Russian republic.

## *Steps Towards Implementation of Islamic Finance in the Republic of Tatarstan-A Case Study*

Section 1 – **Our Understanding of the Market, Competitive Landscape and Regulatory Environment**

Section 2 – **Implementation Steps : Overall Perspective**

Section 3 – **Implementation Steps : Pre-Operational Prerequisites**

Section 4 – **Implementation Steps : Pre-Launch**

Section 5 – **Implementation Steps : Post Launch**

Section 6 – **Lessons Learnt**



# 1. Our Understanding of the Market, Competitive Landscape and Regulatory Environment

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# The Republic and Kazan City is an ideal launching pad for Islamic finance

### Key Take-aways

- Economically advance region, large number of Muslim population.
- Consumers behavioural study indicates strong and positive prospect of Islamic finance.
- Nonetheless, there is a serious need for consumers education program on the principles and practices of Islamic banking and finance.
- While the committed group – about 30% of the respondents of the survey conducted ( which also include the non Muslim) are willing to try even at a slightly less favourable terms offered by the Islamic banks.

Market



# The Republic and Kazan City is an ideal launching pad for Islamic finance

### Key Take-aways

- Banking sector almost saturated and very competitive.
- Real opportunity exists - demand for housing loans is high, the supply of fund is limited- opportunity of issuance of Sukuk
- Customers may still compare financing costs and investment return with conventional banks requiring appropriate strategies to be introduced.
- two important strategy were proposed from the survey :
  - ✓ Use existing banks to promote and start with window services
  - ✓ Use employers as champions to credit salaries and pension into Islamic banks accounts.

### Competitive Landscape





# The Republic and Kazan City is an ideal launching pad for Islamic finance

### Key Take-aways

- For market entry - survey indicates Islamic banking and finance is best promoted through the existing bank in the conventional bank.
- Recommends **windows approach** for implementation at initial stage in view of:-
  - ✓ **ease** of implementation
  - ✓ **time and resources** required
  - ✓ **phased and controlled** approach implementation basis
  - ✓ build-up **public confidence** and positive perception



Competitive Landscape



# The Republic and Kazan City is an ideal launching pad for Islamic finance

### Key Take-aways

- Via windows approach at initial stage requires only specific areas to be addressed, covering:-
  - ✓ definition of deposits, provision of credits, and definition of banking activities
  - ✓ governance and compliance with establishment of an Advisory Council of Experts to cover Shariah governance and compliance
  - ✓ To allow for and introduce non-interest bearing money market instruments to operate in the money market
  - ✓ To allow for non-interest bearing provision mechanism/instruments with the Central Bank
  - ✓ Tax neutrality treatment for transactions based on Shariah principles or any other equivalent principles as banking credit institutions are only allowed to buy and sell of financial assets.
  - ✓ Revision of the Civil Code on lease, bank loans and credit and bank deposit

## Legal and Regulatory Environment

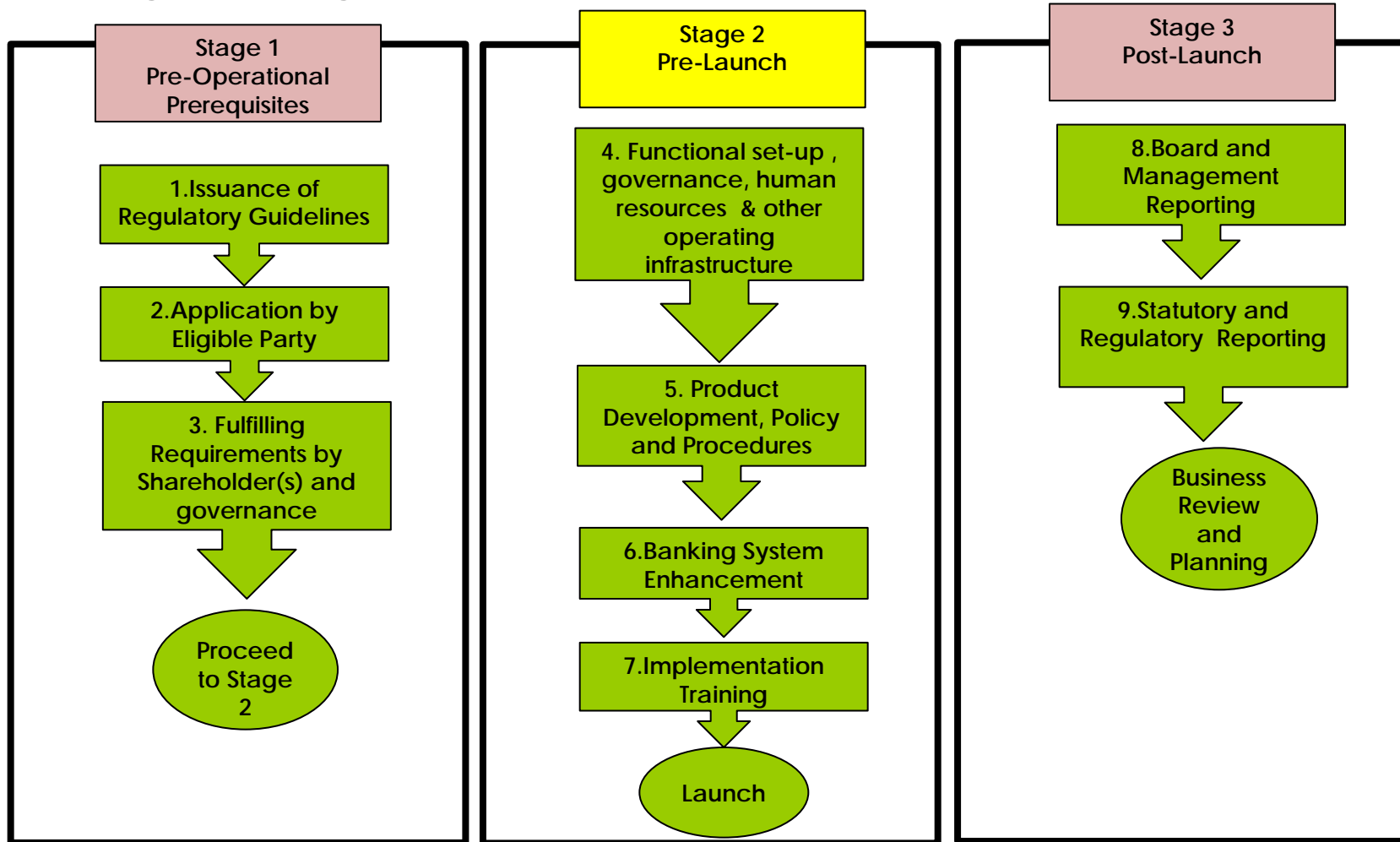


## 2. Implementation Steps: Overall Perspective

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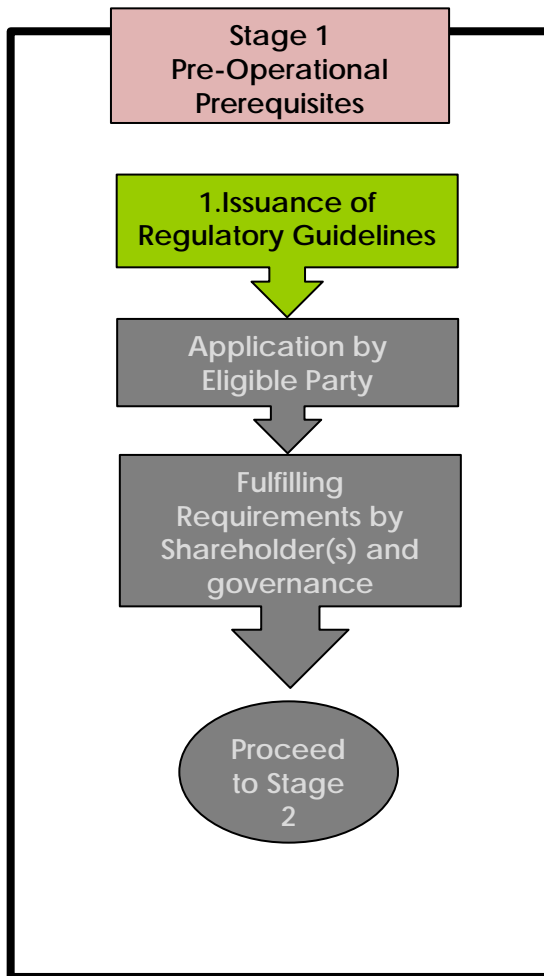
The implementation phases of Islamic banking windows as illustrated through the stages of business operations



### 3. Implementation Steps : Pre-Operational Prerequisites

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## Step1-Issuance of Regulatory Guidelines: An Example

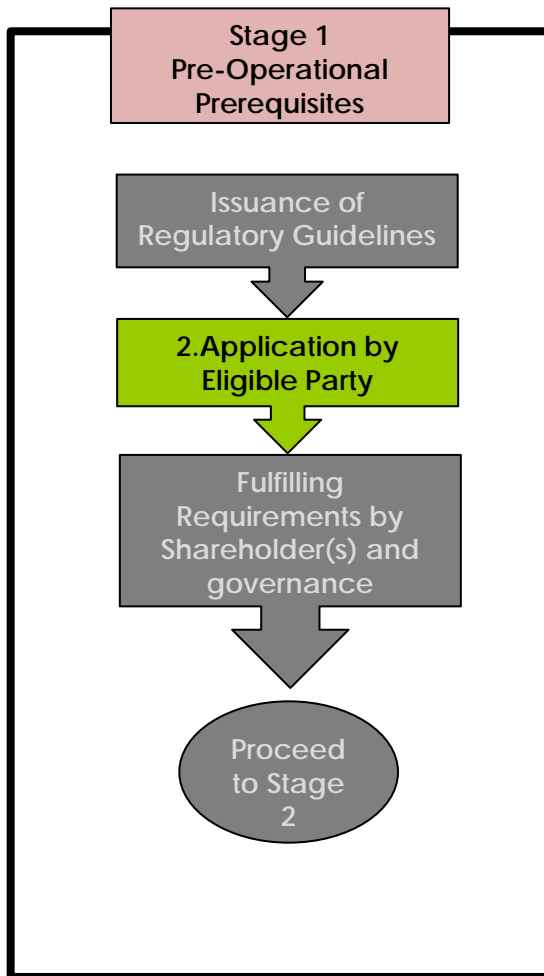


To facilitate the participation of eligible institutions in offering Islamic banking products and services via a windows operations the guidelines issued by the Central Bank include:-

- ✓ definition of the scope of activities for the Islamic banking window operations.
- ✓ Minimum requirements to participate in the Islamic windows including minimum shareholders fund allocation for the operations of the window
- ✓ Application requirements and procedures covering at least the purpose or business case, business plan, methods of segregating sources and uses of funds, methods of identification of customer points of contact, systems in particular for accounting reporting, profit distribution and transactions handling .

Reference: BNM/RH/GL 001-27 Guidelines on Skim Perbankan Islam

## Step 2-Application by Eligible Party: An Example



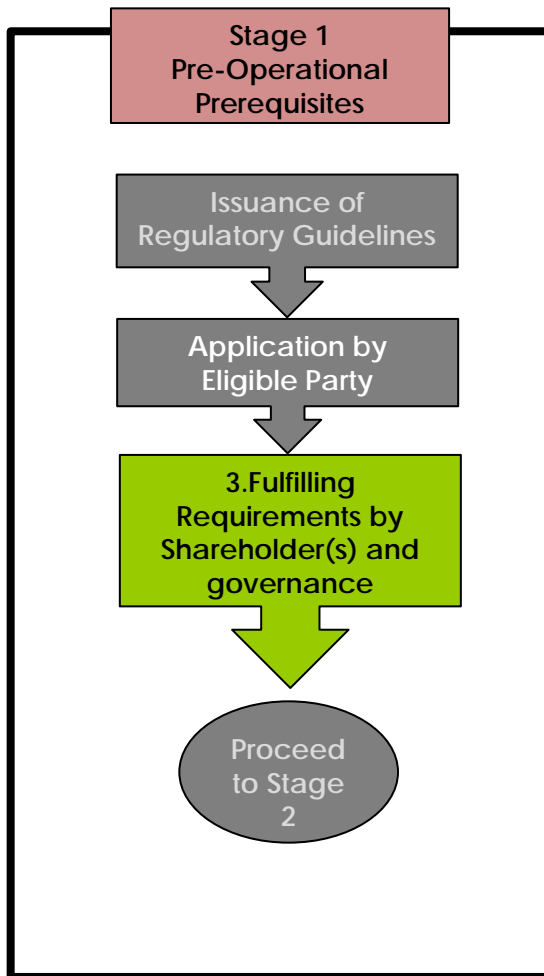
An eligible party submits its application to participate in offering of Islamic banking products and services via a windows operations including:-

- ✓ the purpose or business case,
- ✓ business plan,
- ✓ methods of segregating sources and uses of funds
- ✓ methods of identification of customer points of contact
- ✓ systems in particular for accounting reporting, profit distribution and transactions handling
- ✓ Propose functional set-up,
- ✓ Propose management team
- ✓ Propose implementation plan

Reference: BNM/RH/GL 001-27 Guidelines on Skim Perbankan Islam



## Step 3 -Fulfilling Requirements by Shareholders: An Example



Once the application is approved, the applicant will undertake the following:-

- ✓ Establish the function responsible for the windows operations
- ✓ Allocate the required shareholders fund which is to be maintained at minimum of RM20 million for commercial banks and RM6 million for investment banks
- ✓ Appoint the Head of Islamic Banking business
- ✓ Form the Shariah Committee

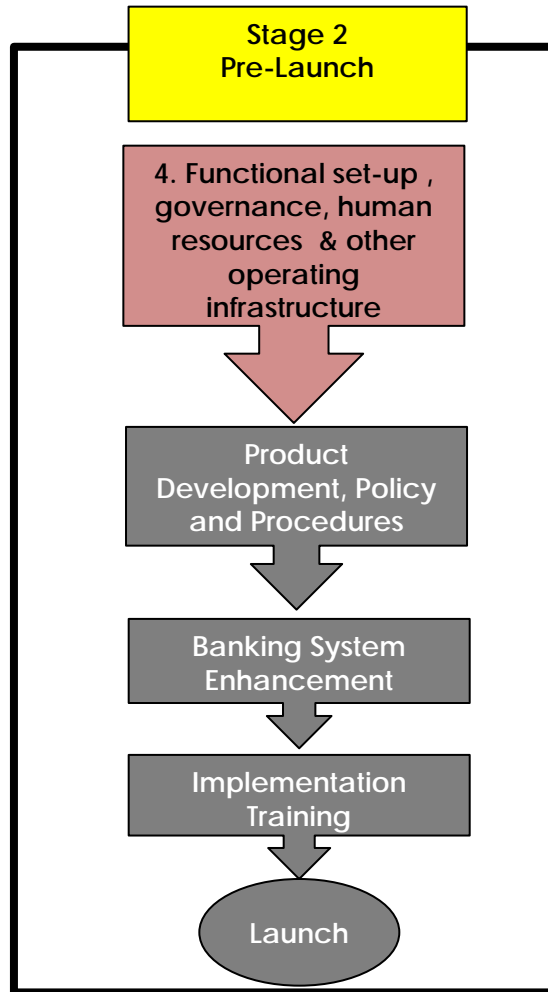
Reference: BNM/RH/GL 001-27 Guidelines on Skim Perbankan Islam



## 4. Implementation Steps : Pre-Launch

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### Step 4- Functional Set-up, Governance etc: An Example

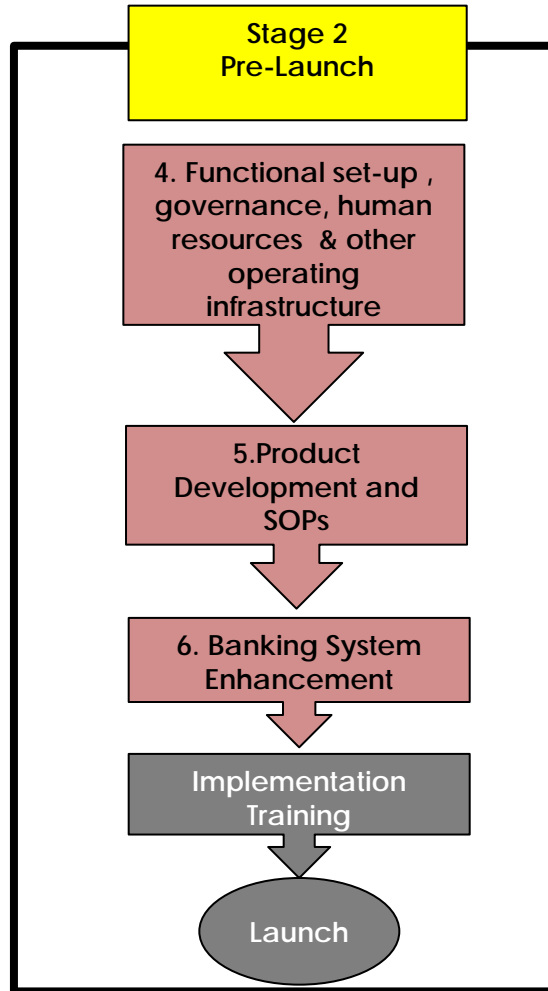


Once the division is established and the Head is appointed:-

- ✓ Appointment of Head of Internal Shariah function – a function to ensure day to day compliance and act as the liaison with the Shariah Committee members who are external parties and are independent of the operations.
- ✓ Redeployment or recruitment of adequate number and skilled resources
- ✓ Development of policies pertaining to the windows operations covering approving limits, branch supervision, business development and credit control where similar infrastructure with the conventional banking operations is shared.

Reference: BNM/RH/GL 001-27 Guidelines on Skim Perbankan Islam

### Steps 5 & 6 - Product Development and Standard Operating Procedures: An Example

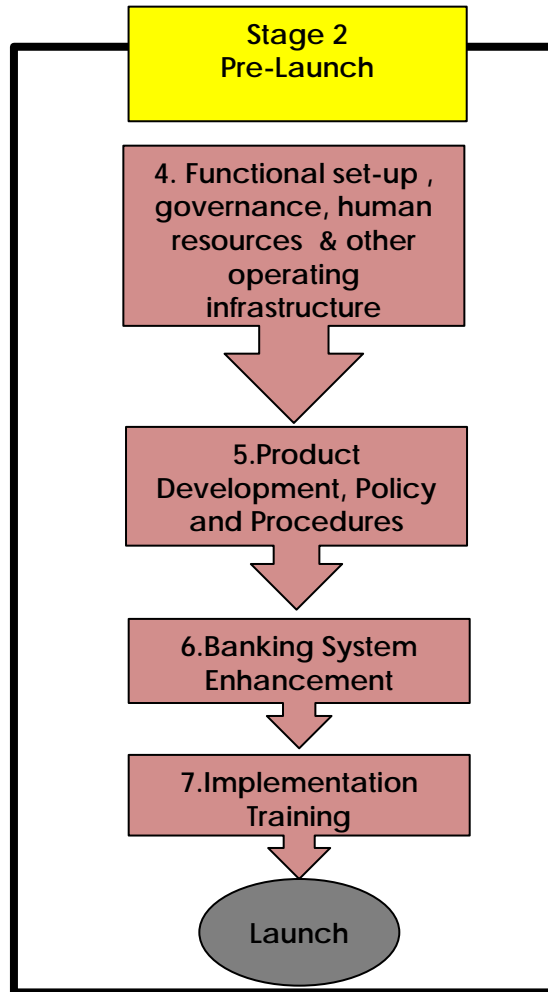


The institutions are required to observe relevant guidelines on introduction of new products among others include:-

- Shariah Committee approval is required
- Risk assessment on relevant areas is done and appropriate control measures are in place
- Standard operating procedures are developed
- IT system is properly developed and tested, if applicable
- Employees are properly briefed and trained
- Product disclosure information is available

Reference: BNM/RH/GL 001-27 Guidelines on Skim Perbankan Islam

### Step 7 – Implementation Training: An Example



- An important prerequisite is the implementation training.
- Employees are required to have the necessary knowledge on:
  - Islamic banking products and their differences with conventional banking products,
  - internal policies and procedures as well as
  - Relevant Shariah contracts.

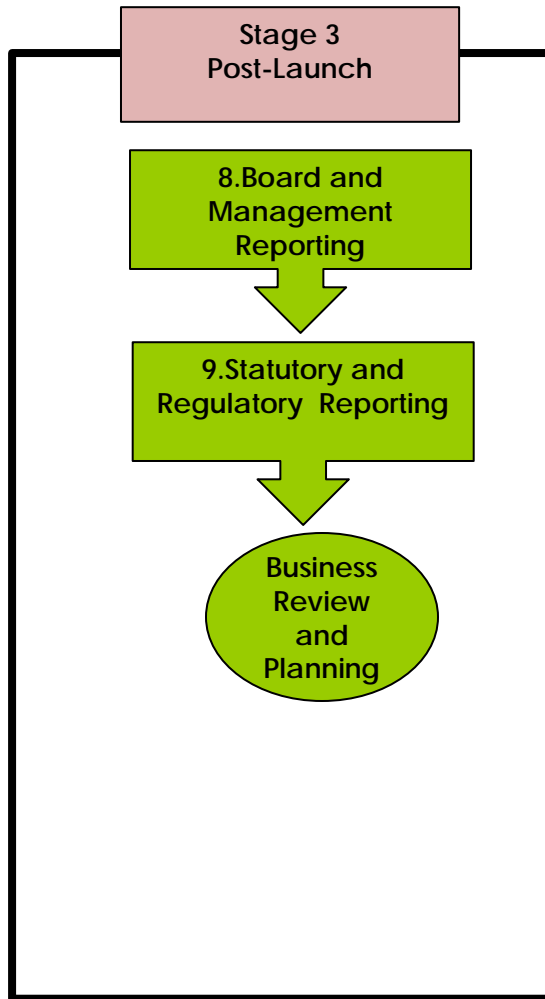
Reference: BNM/RH/GL 001-27 Guidelines on Skim Perbankan Islam



## 5. Implementation Steps : Post-Launch

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### Step 8- Board and Management Reporting : An Example

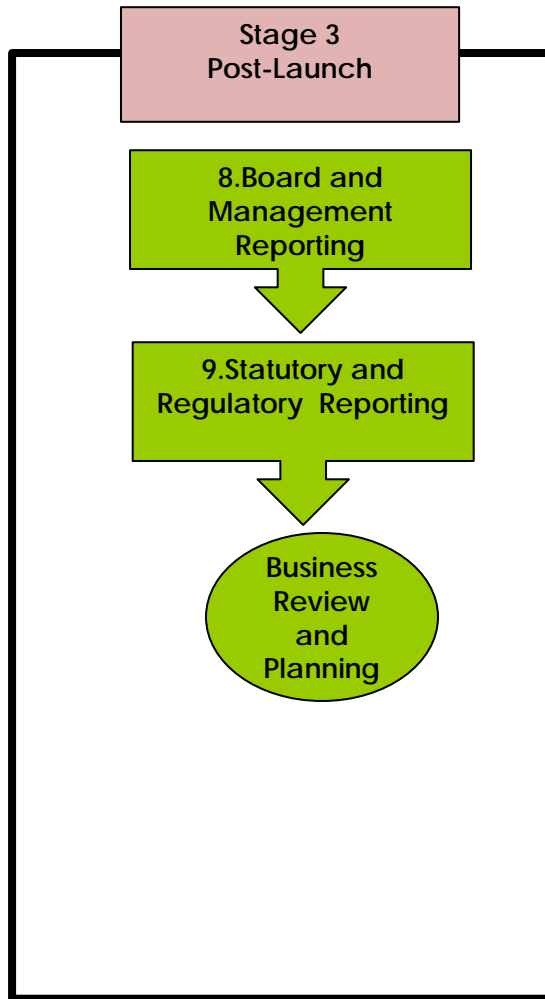


The windows operations is required to:-

- ✓ Separate records for all transactions and to prepare a separate daily trial balance of its operations.
- ✓ Know the daily balances of its assets and liabilities and hence separate account codes for all ledgers are maintained to ensure integrity of the recording.

Reference: BNM/RH/GL 001-27 Guidelines on Skim Perbankan Islam

### Step 9- 9.Statutory and Regulatory Reporting : An Example



The windows operations is required to:-

- ✓Disclose separate balance sheet and income statement, cash flow statement and statement of changes in equity in the notes of the financial statements of the principal financial statements.

Reference: BNM/RH/GL 001-27 Guidelines on Skim Perbankan Islam

# 6. Lessons Learnt

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### *Lessons Learnt*

1. Shareholders fund allocation as working capital allocation for the operations of the window must be sufficient.
2. The window operations must be accorded with appropriate status in the overall set-up of the banking credit institutions to allow for smooth execution. The windows should be viewed as an opportunity to expand business and not as a competitor of the conventional business.
3. The personnel in-charge of the window operations must be at least a senior person reporting to the Chief Executive Officer.
4. Front lines employees must be adequately trained to serve customers-to avoid miscommunication on the differences of Islamic banking and conventional banking.



# Thank You

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