

A CLOSER LOOK AT ISLAMIC FINANCE IN SRI LANKA

About The Author

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The buzzphrase in today's business world is 'Islamic banking and finance (IB&F)'.

BACKGROUND

Islamic finance takes its principles and rules mainly from primary and secondary sources. The primary sources include the Quran (text of god) and Sunnah (Words or Acts of the Prophet [SAW]).

Secondary sources include Ijma - consensus, Qiyas - Analogy and Ijthihad – interpretation of learned jurists and scholars. Other authorities of interpretation such as Shari'ah supervisory boards (SSB) and 'The Islamic Fiqh Academy' KSA are also important elements in Shari'ah.

Sharia'h has been translated as 'Islamic Law' but comprises not only that, but also moralities, ethics and guidelines for a complete way of human life. In the field of Islamic Banking and Finance, Sharia'h plays a vital role.

ISLAMIC FINANCE IN SRI LANKA

Sri Lanka is not well known for this niche market, but the country's recent resolution of its civil armed conflict has given new hope and positive views about the future of Sri Lankans. Sri Lankan Shari'ah conscious investors and other interested groups were pleased to see the country's first fully fledged Islamic commercial bank inaugurated by the central bank governor in August 2011.

This was a remarkable event in the history of Islamic banking and finance in Sri Lanka. It took more than a decade to achieve, due to issues like double taxation, separate banking rules and regulations, corporate governance and other issues that needed to be addressed to cater to this new market.

The Sri Lankan financial market consists of a number of Islamic financial service providers in the form of investment and leasing companies and subsidiaries of finance companies.

Additionally, the government owned Bank of Ceylon has started its own Islamic windows model operating under the brand name of Al-Noor more than a year ago.

These market needs were witnessed by the current retail banking market leader in conventional banking - Commercial Bank, which kick started its operation as a specialized branch and a delivery channel for Islamic banking customers under the name of Al-Fadhla.

As per the estimates and research studies, there is an Islamic banking asset base within the country of more than approximately \$1,000 million in 2010.

Global Islamic fund assets under management grew by 7.6% to \$58 billion in 2010, up from \$53.9 billion in 2009, according to Ernst & Young Islamic funds and investments report (2011).

According to the figures released by research firm - Cerulli Associates (2011), global Islamic finance assets will reach \$5 trillion by 2015.

CREATING AN INFRASTRUCTURE

To create the infrastructure for the Islamic banking and finance market, another component plays a major part the insurance industry.

The Islamic insurance (Takaful) industry was started in Sri Lanka with very few players catering to Shari'ah conscious insurance holders. The current players are winning the trust of the entire Sri Lankan community in terms of Islamic insurance by highlighting its unique features of rewarding the policy holders, where Takaful scheme payments will be pooled and invested in acceptable Islamic investment opportunities and the return shared with customers.

The Shari'ah conscious investors have more options in terms of Islamic Finance in Sri Lanka. They have a golden opportunity to invest in Colombo Stock Exchange (CSE), by way of participating

in the Islamic funds (Eg: Amana-Namal Equity Funds) and unit trust ('Crescent I fund' is an open ended Shari'ah compliant fund). The myth that Islamic finance caters only to the high end market and does not consider the needs of lower income earners is not entirely accurate. In fact, there are institutions in Sri Lanka striving to alleviate Sri Lankans by providing Islamic Micro Finance facilities throughout the island in order to make a difference in their lives.

CHANGE AND LOCAL IMPLICATIONS

Although Islamic Finance has proved groundbreaking, with far reaching impacts worldwide while flourishing as a young market, there are issues and critical challenges to be addressed locally.

The Islamic banking and finance industry is facing challenges around the globe a lack of Shari'ah scholars with in depth knowledge of finance products (in a recent press release for The Star news media, Dr Zambry said statistics by the International Islamic University of Malaysia (IIUM) showed that two million Islamic finance professionals were required to fill positions in IFIs worldwide by the year 2020), modern technology (the current software systems and other technologies have been developed based on interest bearing tools and products which Islamic banks cannot use without customization). This has been addressed by some Islamic finance education institutes in Sri Lanka through classroom education, public awareness and events enhancing knowledge in the field. This has helped Sri Lanka shine globally with well educated, qualified and experienced industry professionals who work outside Sri Lanka as top executives in Islamic banks.

ISLAMIC FINANCE AS A SOLUTION

It can be argued that Islamic finance is a solution provider for many current local and global economic ills, since Islamic finance functions without interest/usury

(Riba), uncertainty (Gharar), gambling (Qimar) and speculation (Mysir).

To safeguard global financial markets, Islamic finance industry experts should have a global view and take actions to develop Shari'ah, accounting, auditing, ethics and corporate governance standards for banking, insurance, leasing, capital markets and money market sectors.

As a value addition, the Bahrain based Accounting and Auditing Organization for Islamic Financial Institute (AAOIFI) and Malaysian based Islamic Financial Services Board (IFSB) is working closely with other international standard setting bodies to integrate global norms, standards and best practices of Islamic and conventional banking and finance.

ISLAMIC FINANCE AND INFORMATION TECHNOLOGY

Islamic finance's growth has been fuelled by many factors, including rapidly changing information communication technology.

Even though Shari'ah compliance is the key for Islamic banking, competitive technological advancement facilitates fully automated branches - a touch screen for banking transactions with no human resources, advanced mobile applications for smart phones, high tech security ATM machines, SMS and GPRS banking services and so on.

These drive the industry forward with rapid changes in the modern business environment. Modern world customers are smarter and more knowledgeable and can easily switch to other banks just by a click of a mouse. And information systems strategy is the heart of the banking sector and will determine the success of the business.

CUSTOMIZING SOFTWARE FOR ISLAMIC FINANCE

We need to customize conventional core banking software to be used as readymade products since there is no standalone core banking software system for Islamic banks.

The customization should be done to Islamic banking principles, accounting, cash management, credit facilities and other operational requirements as per Islamic finance regulations.

STANDALONE SOFTWARE

Because of the customization of conventional banking software for Islamic banks, the urgency or need for the stand alone Islamic banking software has been shadowed.

One of the important issues is the change in legal and tax systems for Islamic finance. The banking act of 2005 brought in some changes to accommodate a profit and loss sharing banking system and is a proactive action of the government.

There are some tax modifications such as double taxation, stamp taxes (for Islamic banking transactions) that have been proposed by Islamic Finance Focus Group (IFFG) which includes experts of the industry from Sri Lanka. These are positive signs which accommodate this niche market by making amendments to the current legal and tax system which has been developed over period of time to suit conventional banking products.

HOW OTHER COUNTRIES ARE PROGRESSING WITH ISLAMIC FINANCE

Other countries - especially the UK - are aspiring to become Islamic finance hubs by making changes in legal frameworks through their budgets.

The UK has five Islamic banks regulated under FSA.

The following list of the countries shows the global appetite for the fast growing Islamic banking industry:

Thailand	Thailand already has the Islamic Bank of Thailand, backed by the government to attract Foreign Direct Investments through Islamic finance, which is to be used for economic development.
Singapore	The first regional bank launched, which is the Asian Islamic Bank with a \$100 Million investment.
India	An emerging market for Islamic finance, deliberations going on with the Reserve Bank of India (RBI) with Islamic finance propositions.
Canada	Canada is seriously looking into regulatory issues in accommodating Islamic banking and finance institutions.
Germany	Appetite portrayed through their debut in the industry: Saxony Sukuk worth \$100 million.
Oman	Already given approval for the second full-fledged Islamic Bank.
Malawi	Very recently created an Islamic Pension Fund.
Mauritius	They have launched the first Islamic bank in the country in the middle of this year.
Kazakhstan	Banking and financial institutions are looking at different options for investments because the world sees this country as the hub for Commonwealth (CIS) countries.
Australia	Pushing through legislation to remove tax barriers on Shari'ah-compliant products that would pave the way for issuing of Islamic bonds.
Nigeria	Stanbic IBTC Bank, a unit of South Africa's Standard Bank Group, has been issued with a preliminary license to offer Islamic banking services in Nigeria.
Gabon	Changing its financial laws to accommodate Islamic Finance and attract FDI as a part of their economic reform.
Hungary	Magyar Iszam bank will be the first Islamic bank to be launched very soon.
Afghanistan	Expects to enact an Islamic Banking law before end of 2011.

A NEW FUTURE

Sri Lanka is a conflict affected middle income country with high national achievements in social indicators like literacy rates, doctors per patient, medical expenditure per patient and more.

The country's economic performance improved vastly in 2010, reflecting the post war era optimism and reduced negative impact of the global financial crisis.

GDP growth is estimated at around 8% for this year based on the positive expectations of healthy growth in investments and business opportunities. Islamic finance can contribute to the development of infrastructure of the Sri Lankan economy, especially by attracting foreign direct investments from oil rich nations for upcoming development projects in the country.

The global banking and finance system market is shifting from conventional systems to Islamic finance systems by understanding the benefits from it.

Well articulated and effective government policies, an appropriate Shari'ah compliance framework, efficient, effective and market based regulations and tax and legal frameworks accelerate institutional infrastructure. Comprehensive Islamic finance market products and service offerings will drive this local niche and young market segment to the next level.