World Islamic Banking Competitiveness Report 2013-14
The transition begins
Conte
Foreword

Rapid-growth markets or RGMs – already a significant part of the global economy – are set to become even more important. A group of 25 RGMs will constitute 50% of the world GDP, 38% of global consumer spending and 55% of fixed capital investment, by 2020. Their share of global contribution to GDP has doubled over the last decade and continues to outgrow developed markets. Further, 10 of these 25 RGMs have a large Muslim population.

Our clients have identified Bahrain and six of the RGMs to be the driving factors behind the next big wave in Islamic finance – Qatar, Indonesia, Saudi Arabia, Malaysia, UAE and Turkey (QISMUT).

On a promising note, by 2018, these RGMs will represent GDP of US$4.8t, a mostly young population of around 419m, trade flows of US$3.6t and banking assets of US$6t.

QISMUT commanded 78% of the international Islamic banking assets1 in 2012, growing at a 5-year CAGR of 16.4%. With expanding economies and a fast-growing customer base for financial services, QISMUT is an attractive prospect for any bank looking to grow its revenues. They also provide solutions to the challenges faced by some of the developed markets.

However, the financial prospects and needs of emerging-market customers tend to be much more volatile than those in developed markets. This challenge has a growing global dimension for Islamic banks: entering new markets, optimizing operations across borders, finding the right differentiation and seeking skills and funding from the global pools of talent and capital.

Hence, there continues to be a huge demand on the key reference centers – Bahrain and Malaysia in particular – to provide leadership for the next phase of industry’s progress. The notion of halal economy, inclusive growth and differentiating through responsible banking could be the game-changers that Islamic banking has been looking for. Hence, the rise of Dubai, London and Istanbul at this hour is definitely a positive development that will help to raise the performance bar for all.

EY has facilitated many of the innovations the Islamic banking industry has seen over the past decade. We hope the insights in this year’s report will provide more food for thought as you plan to operationalize your 2014 strategies.

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1 International Islamic banking assets exclude Iran

Sources:
Central Banks, Company Financial Reports,
EY Universe, EY analysis
Islamic banking assets with commercial banks globally are set to cross US$1.7t in 2013, suggesting an annual growth of 17.6% over last four years. There is a noticeable slowdown caused by two major developments. First, the continuing economic and political setbacks in some of the frontier Islamic finance markets; and second, the large scale operational transformation that many of the leading Islamic banks initiated about 18 months ago, which continues to consume focus and investment.

Sources: Central Banks, BMI, EY analysis
QISMUT – Qatar, Indonesia, Saudi Arabia, Malaysia, UAE and Turkey – are six RGMs that, together with Bahrain, are important to the future internationalization of the Islamic banking industry. They hold a large pool of financial and intellectual capital of the industry that will drive the next wave of development across existing and new markets. Islamic banks are already serving c. 38 million customers globally, two-thirds of whom reside in QISMUT.

We expect Islamic banking assets with commercial banks to grow at a CAGR of 19.7% over 2013-18 across the QISMUT countries to reach US$1.6t by 2018 (2012: US$567b). Internationalization will be an important growth driver, bringing in new challenges to these Islamic banks. Trade patterns are shifting decisively in favor of RGMs, and QISMUT will be the major beneficiaries. Banks with strong connectivity across key markets and sectors are set to gain. A key thing to note is that Islamic finance markets are far from being homogenous – customer attitudes, regulations and profitability vary significantly across markets. A major challenge for Islamic banks is to adjust the propositions, operating models, systems, tools and processes to understand and fully capitalize on the international opportunities provided.

Our analysis demonstrates that for 2012, the average ROE of the 20 leading Islamic banks was 12.6% compared to 15% for comparable conventional peers. We believe that the future success of Islamic banks will be measured less by growth of assets and more by quality of growth. The impact made through responsible banking, inclusive growth and alignment with the broader halal asset class will be important features.

We believe that the continued success in growing scale and operational transformation programs have the long-term potential to close the profitability gap with conventional banks. Many Islamic banks are already in the process of replacing or upgrading their core banking system, and should benefit from improved operations in the future. Capital planning in view of Basel III and IFSB guidelines will influence the preferred business mix toward better profitability. And, most Islamic banks believe that digital and mobile banking adoption will grow beyond payments to more complex savings and financing products.

Driving such a broad transformation program that combines cost improvement with revenue growth requires exceptional leadership capabilities and ample management capacity. We trust you will derive useful insights from this report as you assess your business structures and strategies. EY for its part remains committed to helping build a better working world for our Shari’a sensitive clients and businesses.

Ashar Nazim  
Global Islamic Finance Leader

Jan Bellens  
Global Emerging Markets Leader, Banking and Capital Markets
Key findings
Key findings

Growth

US$1.54t in Shari’a compliant assets with commercial banks globally, in 2012 (2013e: US$1.7t)

QISMUT growing at 5-year CAGR of 16.4% (2008-2012)

Profitability

Average ROE of 12.6% for top 20 Islamic banks, compared to comparable conventional average of 15%

Customers

c. 38 million customers globally with Islamic banks

Average product holding of 2.1, significantly lower than class leading average of 4.9 and indicative of potential upside in future

Sources:
Central Banks, BMI, Company Financial Reports, EY analysis
Connectivity: key to sustainable growth

- Bahrain and six RGMs (Qatar, Indonesia, Saudi Arabia, Malaysia, UAE and Turkey) are vital to the future internationalization of the Islamic banking industry.
- QISMUT represented 78% of the international Islamic banking assets (excluding Iran) in 2012. It is expected to grow at CAGR of 19.7% over 2013-18, significantly faster than rest of the Islamic finance world.
- Shifts in world trade and capital flows represents an important business opportunity for Islamic banks that have credible international presence.

Customers: with growth comes added complexity

- Islamic banks serving c. 38 million customers globally, two-thirds residing in QISMUT
- Several leading Islamic banks are doubling in size every 4 years, and are currently facing capability constraints. The shareholder returns are lower by 19% compared to conventional, for top 20 Islamic banks.
- “I want to know my Customers better,” shared the CEO of a leading Malaysian Islamic bank, summarizing a dominant theme on Islamic banks’ transformation agenda.

Operational transformation: long-term value to Islamic banks

- Momentum picked up in 2013 since its inception in 2011-12. Acceleration expected in 2014, even as year-on-year growth moderates.
- Basel III and IFSB guidelines to influence capital planning. Bahrain and Malaysia continue to lead on regulatory clarity
- Go digital – a major shift happening from technology-to-comply, to deploying mobile banking for revenue generation. This is specifically relevant for populous markets and younger customers.

Growth to remain moderate going into 2014, as several leading Islamic banks pause for large-scale operational transformation. Customer and technology are among the top transformation themes.
Performance review
### GCC*

- First batch of Islamic banks and windows commence business in Oman
- Dubai unveils Islamic Economy vision
- Bahrain sees consolidation in Islamic banking sector

### Conventional Markets

- Hong Kong, the Philippines, Singapore and the UK initiate regulatory reforms to build Islamic banking and capital markets

### Malaysia

- The Islamic Financial Services Act 2013 introduced, providing for greater regulatory clarity. Shari’a scholars are now legally accountable for financial products approved. The act also distinguishes deposits made for savings and those made for investment, causing significant adjustment to retail portfolios
- Malaysia also to focus on Shari’a compliant socially responsible investment

### India

- S&P and Bombay Stock Exchange launch S&P BSE 500 Shari’a Index. The index represents 93% of total market capitalization on the exchange comprising 500 largest, liquid compliant securities
- The Reserve Bank of India allows Cheraman Financial Services to operate as a Shari’a compliant non-bank financial institution

### Africa

- Nigeria, Kenya, Uganda, Tanzania, Zimbabwe, Malawi accelerate efforts to introduce Islamic banking
- Morocco, Algeria, Tunisia accelerate efforts to introduce Islamic banking
- Seven new institutions acquire membership of IFSB
- Revised standard on capital adequacy for Shari’a compliant institutions issued
- Industry Stability Report 2013 launched

**IIRA**

- Comeback in the making – IIRA issued 16 ratings over the past 12 months. These include corporate governance (3), credit (3), sovereign (2), Shari’a quality (1) and fiduciary (7) ratings

**IIFM**

- Launches 3rd global sukuk market report
- Issues concept paper on inter-bank Master Wakala Agreement
- Introduces template for Islamic inter-bank transactions

**AAOIFI**

- AAOIFI to focus on developing new standards as well as refreshing some of the accounting, regulatory, corporate governance and Shari’a standards

*AAOIFI = Accounting and Auditing Organization for Islamic Financial Institutions
IIFM = International Islamic Financial Market
IIRA = International Islamic Rating Agency
GCC = Gulf Co-operation Council
IFSB = Islamic Financial Services Board

Sources:
Islamic Financial News, EY analysis
Global Islamic banking assets

Islamic banking assets with commercial banks globally reached US$1.54t in 2012. This includes both pure-play Islamic banks and windows.

Islamic banking continues to be an exciting growth story characterized by robust macro outlook of core Islamic finance markets and increasing share of system assets.

It is increasingly gaining acceptance, specially in high-growth emerging markets, as an effective means to build an inclusive financial system and replace the shadow economy.

Key themes impacting Islamic banking business in emerging markets

- Ongoing rebalancing of the world economy and eastward shift of trade and GDP growth
- Fundamental review of financial regulations
- Reform and regime changes in several developing markets
- Internet and mobile technology for banking solutions

Global distribution of Islamic banking assets

Sources:
Central Banks, BMI, EY analysis
QISMUT: The next big thing

Six RGMs together constitute 78% of the international Islamic banking assets, growing at 5-year CAGR of 16.4% (2008-12).

<table>
<thead>
<tr>
<th>Country</th>
<th>Five-year CAGR</th>
<th>Islamic assets</th>
<th>Market share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Qatar</td>
<td>31% or 1.8x</td>
<td>US$54b</td>
<td>24%</td>
</tr>
<tr>
<td>Indonesia</td>
<td>42% or 3.1x</td>
<td>US$20b</td>
<td>4.6%</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>11% or 3.6x</td>
<td>US$245b</td>
<td>53%</td>
</tr>
<tr>
<td>Malaysia</td>
<td>20% or 2.1x</td>
<td>US$125b</td>
<td>20%</td>
</tr>
<tr>
<td>UAE</td>
<td>14% or 3x</td>
<td>US$83b</td>
<td>17%</td>
</tr>
<tr>
<td>Turkey</td>
<td>29% or 1.6x</td>
<td>US$39b</td>
<td>5.6%</td>
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Our six Islamic rapid-growth markets look highly promising. The combined Islamic banking assets with commercial banks reached US$567b in 2012.

Islamic banking assets with rapid-growth markets

- Qatar: 9%
- Indonesia: 4%
- Saudi Arabia: 43%
- Malaysia: 22%
- UAE: 15%
- Turkey: 7%

Sources:
Central Banks, BMI, EY analysis

Note:
Assets share within QISMUT only
International Islamic banking assets exclude Iran which has a rather domestic industry
A strong beginning

More Islamic banks are expanding into high potential markets to build regional brands.

QISMUT

Islamic banks are bullish on future prospects, but a vast majority believe that the success of the large-scale operational transformation (in progress) is a pre requisite.

New Islamic finance markets: a tale of tempered optimism

The substantial pent-up demand promises a bright future. However, the volatile nature of some of the newly emerging Islamic finance markets imply that growth gets adversely affected by politics and social upheaval.

Banking penetration and Islamic market share

Countries with the largest Muslim population

Sources: Central Banks, BMI, Pew Research Centre, EY analysis

Note: Analysis includes domestic banking assets where data was available
Markets are far from homogenous. Each of them are in a different stage of maturity, and hence presenting a different opportunity. Growth in retail banking is a major contributor to the overall growth.

One-fifth of the banking system assets across QISMUT have now transitioned to Islamic. In Saudi Arabia, supply push has seen share of Islamic banking cross 50% of system assets.

Consistently gaining market share

Sources:
Central Banks, BMI, EY analysis
Growth in financing: driven by a strong retail push

Enabled by a much improved distribution capability, although significant gaps remain in customer operations and cross-selling.

Our estimates suggest that the majority of c. 38 million customers with Islamic banks have a single deposit account. However, retail banking is changing fast and over 20% of customers may have already transitioned from conventional to mostly Islamic banking relationship.

Sources:
Company Financial Reports, EY Universe, EY analysis

Note:
Based on data for selective Islamic banks under our coverage
Not just numbers

Islamic banking reforms to be driven by investment in talent, regulatory clarity and responsible innovation.

The ongoing global financial meltdown is an open challenge to Islamic finance policymakers and bankers to provide new outlooks and fresh and more effective solutions to economic problems. The fundamental issue with the incumbent system is its failure to efficiently intermediate between savers and borrowers.

According to economists the basic failures of the conventional system include expensive and complex financial products, distorted regulatory and tax incentives, failure to pass on meaningful returns to savers, and the disconnect with the real economy. For example, in any given economy, the household sector tends to be the net contributor of capital, given its long-term saving requirements; while the corporate sector is a net consumer of capital. They also broadly match each other in terms of quantity and tenor of capital required and supplied in a given market. Hence, logically, in a well functioning financial system, the balance sheet of a financial intermediary should broadly mirror the aggregate needs of the population.

Research however shows that the conventional financial system has failed in efficiently intermediating the savers and borrowers. The interest-based business model of financial firms meant that they were the biggest beneficiary at the cost of disgruntled retail savers who felt that they did not get reasonable and reliable returns on their investment. As a result, analysis suggests that consumers today generally do not trust banks to manage their savings.

Now the next several years will see the world's financial markets trying to cope with the fallout of the global financial meltdown. Message for the Islamic finance industry is then, quite simple: there is no merit in following a system that has malfunctioned!

Realign. Now.

The business model of Islamic banks need to provide for more efficient intermediation of funds demanded and supplied by the key segments of the market – the households, businesses and governments. Stronger linkages between financial and real economic sectors will be the differentiator.

A natural outcome will be a more direct "match-making" equation between (long-term) savers and borrowers thus providing meaningful and reliable returns to account holders. Any resulting higher cost of funds in the short term will get offset against proportionate lower regulatory cost relating to capital and liquidity over the medium term.

To achieve this goal, the top three priorities have to be knowledge, regulatory clarity and responsible innovation.

Lack of coherent knowledge and a comprehensive perspective on the financial aspect of the Islamic economic system is a primary limitation today. Governments, regulators and industry leaders in influential position need to promote the emerging class of professionals who understand and possess substantive knowledge of Shari'a and modern economics and banking system. Simply put, the industry needs to invest in developing 12,000 exceptional future leaders which equates to 5% of its expected core workforce.
Leading 20 Islamic banks by capitalization

Risk profile has improved considerably post global financial crisis aided by strong capital support from the government and existing shareholders in many instances.

17 Islamic banks have US$1bn or more in equity and sufficient regulatory capital. This provides for a good platform for organic and acquisitive growth.

14 of these banks are headquartered at QISMUT.

Sources:
Company Financial Reports, EY Universe, EY analysis

Note:
Excludes Iran
Country flags represent the home market of the Islamic bank
Managing capital

Sustainable profitability in the face of eroding margins will require rigorous assessment of the optimal use of each unit of capital especially in light of the increased capital requirement with the implementation of Basel III.

With the onset of Basel III, the capital requirement for Islamic banks is expected to further increase by 25-40% and the pressure for enough liquid assets and stable funding will be significant. Efficient utilization of capital will become even more critical for sustainable growth. The industry has perhaps, never faced such intense pressure on profitability before. It is more challenging for conventional banks because of limited Shari'a compliant liquidity management solutions.

So what should the industry’s response be?

Islamic banks need to focus on maximizing returns on each unit of capital invested. A cultural change has to happen through introduction of risk-based performance measurement. This demands setting up a structured fund transfer pricing framework, measuring risks in a more rigorous manner and adopting a structured cost allocation mechanism. The outcome will be increased transparency in performance assessment by business lines and portfolios, enabling better decision-making on new financing proposals and exits.

Islamic banks that have recently updated their capital optimization plan have come across many unforeseen activities. This has led to difficult and much-needed decisions on curtailing seemingly profitable portfolios as well as redirecting resources to sustainable business lines.

Dr. Sandeep Srivastava
Profitability continues to lag

The leading Islamic banks are not necessarily the most profitable. Overall, leading Islamic banks posted 19% lower ROE than comparable conventional peers.

To achieve profitable growth, Islamic banks need to balance their desire to expand rapidly with the need to do so efficiently. As a result of the pressures of mainstreaming in home markets, international growth, and regulatory changes in capital and liquidity requirements, efficiency is quickly becoming the buzzword of Islamic banks.

Lessons from the market: what can help

- Collaboration with financial and telecommunication companies to grow across markets and segments
- Investing in customer analytics
- Better capital planning through realigned risk processes and capital products

### Top 20 Islamic banks

<table>
<thead>
<tr>
<th>Country</th>
<th>Average ROE</th>
<th>Average assets</th>
<th>Average growth 2008-12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leading Islamic average</td>
<td>12.6%</td>
<td>USD21b</td>
<td>15.8%</td>
</tr>
<tr>
<td>Comparable conventional average</td>
<td>15.0%</td>
<td>USD75b</td>
<td>13.8%</td>
</tr>
</tbody>
</table>

Sources:
Company Financial Reports, EY Universe, EY analysis

Note:
Excludes Iran
Country flags represent the home market of respective Islamic banks
Regulatory clarity key to Islamic banking growth

Regulatory clarity has a direct positive impact on the development of Islamic finance

Why is it that Bahrain and Malaysia have successfully established themselves as Islamic banking reference centers with over 20% market share while others, languish at 5% or below despite having had a head start?

Regulatory clarity is the answer.

Experience shows that in countries where the regulator recognizes the uniqueness of Islamic vs. conventional banking and creates a separate regulatory framework for Islamic banks, the industry responds with accelerated growth and market share gains. The path to success in Islamic banking is, therefore, quite clear for African and Asian countries that are now opening up: ensure regulatory clarity at the outset through a distinct Islamic banking regulatory framework.

For a highly regulated industry like banking, the link between regulatory clarity and industry performance should not come as a surprise. There are many benefits of having a customised regulatory framework. The industry loves the certainty that comes with setting clear rules of the game. The regulator can adopt global best practices in a systematic way while preparing the regulatory framework. Also, it can do so in a proactive manner (rather than reactively and in response to crisis).

A separate regulatory framework also makes it easier for bankers’ who have to implement the rules. Interestingly, and contrary to general perception, this also makes it easier for the regulators after the initial hard work of creating a separate framework.

So what is the process of putting together a separate Islamic banking framework? One of the most recent examples is that of Oman. The only GCC country that had not allowed Islamic banking until early last year, Oman decided at the highest level to permit Islamic banking in 2012. The Central Bank of Oman developed a comprehensive 600-page regulations in six months’ time. The regulations drew inputs from the following:

- Existing conventional banking framework based on Omani Banking Law and Basel II guidelines (where they do not contradict Shari’a)
- Shari’a, governance and accounting standards of the AAOIFI
- IFSB guidelines on capital adequacy and risk management
- Leading practices on Shari’a governance from around the world

Libya, Iraq, Tunisia, Kenya and Nigeria are among the countries showing keen interest in opening up to Islamic banking. Kazakhstan, Tajikistan and Azerbaijan are also moving in that direction. The governments and regulators in these countries would do well to create a distinct regulatory framework at the outset. This is the most likely route for accelerated, yet sustainable, growth of the Islamic banking industry.
Sukuk innovation

From US$5b new issues in 2003 to US$130b in 2012 – Malaysia is the leading market.

Q3 2012 saw the debut of the first Islamic Basel III compliant Tier I structure, closely followed in Q1 2013 by another Islamic bank, both from the UAE, successfully raising US$1b each. The structure was based on the old Mudaraba structure with a slight variation where the Mudarib indemnifies the investors if it so chooses – allowing full return of original capital at the option of the Mudarib. This structure has since been revised to adapt to corporates with the option of a cumulative coupon.

Sources:
Zawya, Thomson Reuters, Bloomberg and EY analysis
Challenging the structure

Devil is in the details – legally enforceable “optionality” can mimic capital protection-like behaviour for Mudaraba and Musharaka structures.

Recent activity has seen issuance of several hybrid sukukas that qualify as Tier I Capital per Basel III guidelines. In EY’s discussions with clients and scholars, an interesting question has been raised as to the validity of the security from a liquidation standpoint.

Scholars in 2008 disallowed the re-purchase/purchase undertaking of the assets under Mudaraba and Musharaka structures for its original nominal value and instead stipulated that assets be liquidated at market value. This made the transaction unsustainable for fixed income products like sukuk since the holders of the sukuk were subject to equity risk on the basis of the market value of the Musharaka/Mudaraba asset at the time of maturity.

Innovation since then has meant that the Mudarib has the option to indemnify the sukuk holders if the liquidated Mudaraba Assets are lower than the original Mudaraba Capital, and pay the shortfall under certain circumstances. In the courts, this type of indemnity provision is legally enforceable. Hence it may be argued that, going forward, Musharaka and Mudaraba may be used as a fixed income instruments.

If the Shari’a scholars are satisfied that an indemnity is not the same as a purchase undertaking to buy at nominal value, then this allows for those issuers who are unable to issue Ijara sukuk (because they may not have sufficient tangible assets for structuring) to utilize this “indemnity” concept to allow Musharaka and Mudaraba contracts as viable fixed income Shari’a compliant instruments once again. Jury is yet to give a verdict.

Nida Raza

World Islamic Banking Competitiveness Report 2013–14
Primary Sukuk issuance 2013

Sources:
Zawya, Thomson Reuters and Bloomberg
Ready for transition
Strong fundamentals
Eastward shift in the economic “center of gravity” to drive a stronger Islamic banking sector

Economy
$4.8t
Combined GDP is set to cross US$4.8t by 2018 for QISMUT, growing at 6.7% per annum. Average per capita income range between US$5,500 and US$103,000.

Banking population
252m
QISMUT will have total population in excess of 419 million with 286 million between the age of 15 and 64 years, by 2018. Bankable population is estimated to be in excess of 252 million.

Banking penetration
90%
Banking assets to GDP across QISMUT still much lower than developed markets. Islamic finance is gaining market share at the expense of conventional practices and is also helping replace the shadow economy.

Trade
$3.6t
Volume of trade for the six markets will increase by 49% during the current decade. Unprecedented shift in global trade balance is in favor of high-growth emerging markets. Transport, machinery and equipment are to emerge as the single biggest trade opportunity.

New markets
13
In addition to QISMUT and other existing Islamic finance markets, 13 new jurisdictions are in the process of introducing legislative or regulatory enhancement to enable Islamic banking.

Connectivity across markets and collaborations to create synergy of expertise, to expeditiously address pent-up demand across new segments and markets.

Hammad Younas

Sources:
Global Insight, EY analysis
... but not without challenges

Any meaningful and incremental growth will require exceptional operational framework and localized banking model.

**Socio political stability**
The so-called Arab Spring and situation in parts of Middle East and Africa could be unnerving for Shari’a sensitive investors and businesses. It is also important to de-politicize the enablement of Islamic finance.

**Regulatory clarity**
Progress could be much slower in the absence of Islamic financial regulatory framework. Key areas to address are supply mechanism (window vs. pure-play) demand management (product cost, consumer protection, Shari’a governance) and infrastructure (liquidity management, awareness, talent pool).

**Scale**
Most Islamic banks are relatively small and their business books are primarily concentrated in 1-2 markets. There is no easy answer either, given the dearth of acquisition targets in key markets.

**Technology to grow**
Mobile banking is among the five most disruptive megatrends identified by senior executives interviewed by EY. Substantial progress is still needed to translate this into a distinct business advantage.

**Quality of operations**
High growth has a cost. Leading Islamic banks have reached a point where step-change is required to sustain performance and internationalize further – specially with regards to customer orientation, governance and technology.

Disruptive innovation can bring about the required reforms in the Islamic banking industry. In a bold step forward, the Islamic banking regulations in Oman have disallowed commodity murabaha contracts. For a long time now, the (mis)use of commodity murabaha and tawwaruq has disillusioned proponents of Islamic banking. Banks, multilaterals and Islamic infrastructure institutions should grab this (small) window of opportunity to help drive and sustain product development efforts.
Influencing factors

Impact of macro and micro environmental shifts:
- Emergence of rapid-growth markets
- Significant regulatory reforms
- Opening up of new markets
- Digital technology and mobile banking

Opportunities:
- Connecting RGMs
- Responsible banking
- Demographics

Challenges ahead:
- Enabling job creation
- Transforming banks’ operations
One scenario for sustainable and responsible growth

<table>
<thead>
<tr>
<th>Influencer</th>
<th>What does it mean?</th>
<th>Why is it important?</th>
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</table>
| **Socially useful** | Socially useful and compliant business book; including both negative screens (alcohol, tobacco, riba) and positive (renewable energy, community housing); incorporate into credit analysis and decisioning process; channelize Zakat, Waqf and government subsidies to economically targeted investments | • Shift away from competing on price only  
• Develop a sellable, unique offering to avoid head-on competition with larger, more established traditional banks  
• Be mainstream, look beyond the core Shari’a customers |

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</thead>
</table>
| **Customer focus** | Diversify (to be inclusive and accessible) and be analytical when serving each segment; change to be a responsive operating model for medium and small businesses | • Translate market share growth into profitability  
• Job creation (stay relevant to real issues confronting QISIMUT and other Islamic finance markets) |

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</table>
| **Connectivity** | Across important Islamic finance markets – population centers and business centers; also link into world’s growth engines including China and India; be the drivers of digital banking economy | • Global trade power decisively moving to rapid growth markets  
• Mobile banking revolutionizing the way emerging markets bank |
Dubai

Transition anchored by a growing number of credible reference centers

Aiming to build closer linkages between financial sector and the real economy

Seven pillars that will prop up Dubai as the capital of Islamic economy

A hub for Sukuk or Islamic bonds and all Islamic financial services

A solution provider to the $4t global halal industry

A legal framework with regulatory bodies for the Islamic market

A favourite tourism center for families from around the world

Islamic digital economy providing a platform for Islamic e-Biz

A global capital for Islamic fashion, design, architecture and arts

A world class hub for Islamic economy standards and certification

Clearly, Dubai has set an exciting and challenging mandate for itself. Success for Dubai will raise the performance bar across the Islamic finance markets internationally. Primary risk is the quality of execution.
A series of sovereign sukuk issuances has firmly put Turkey on the world map of Islamic finance – many institutions are first-time investors in Turkey.

World Bank and Turkish Treasury are to set up Global Islamic Finance Development Center; Istanbul stock exchange is also going to set up Islamic finance research facility.

Turkish participation banks continue to outperform global industry on profitability.

Transition anchored by a growing number of credible reference centers

With only four participation banks serving the nation, the supply-side bottleneck is holding back the industry. Actualizing the full potential of participation banking requires increased regulatory clarity and new financial institutions (banking, takaful and fund management).
Consistent, determined progress to transform Islamic banking into mainstream play by 2020

Strong, visible support from the Government on legislative and regulatory aspects: Islamic Financial Services Act 2013 enacted

World leader in Islamic sukuk market

Major talent initiatives launched: INCEIF, ISRA, IBFIM; financial sector requires c. 33% (or 56,000) additional workforce during the current decade

Actively supporting new jurisdictions that are opening for Islamic finance

Going forward, sustaining this strong performance requires structural transformation of the domestic institutions. Islamic outfits of conventional banks need to re-evaluate their brand standing, capital plan and ability to influence the strategic direction of conventional parent. Our view is, strategic and financial independence of Islamic subsidiaries will help.
UK established the first ever ministerial-led Islamic Finance Task Force, jointly chaired by Baroness Warsi and the Financial Secretary to the Treasury.

Aligning tax and regulatory framework is among top priority, according to stated goals.

More than a dozen banks in London are delivering Islamic finance solutions. London’s skyline has been transformed by Shari’a compliant deals – including the Shard, Chelsea Barracks, Harrods and Olympic Village.

Ground-breaking initiative has been taken to issue sovereign sukuk and introduce Shari’a index on London Stock Exchange.

Islamic finance is deemed to become increasingly relevant as British businesses seek to connect with high-growth emerging markets. Level playing field for Islamic financial solutions and institutions remain a challenge for now.
Transition anchored by a growing number of credible reference centers

Home to four global standard setting institutions: AAOIFI, IIFM, IIRA and GCIBAFI

Strong regulatory track record in guiding Islamic banking industry through boom and meltdowns

Waqf Fund: promoting research and development effort through industry roundtables chaired by central bank

Talent hub for financial services with more than 400 Islamic and conventional financial institutions

The transitory nature of the global Islamic finance industry is an open challenge to policymakers and Islamic bankers to provide new outlooks and more effective solutions.
Performance outlook
Industry in 2018 ... a potential scenario

An estimated US$1.6t in assets and with a 48% share of banking system profit pool across QISMUT

Across QISMUT, Islamic banking assets are set to cross US$662b in 2013.

Expect a CAGR of 19.7% through 2013-18, with total assets reaching US$1.6t across these six important markets.

Globally, Islamic banking assets are expected to grow to US$3.4t by 2018.

Main dependencies for this growth are: economic stability in certain Islamic finance markets; capacity and capability building at larger Islamic banks to transition to the next phase of development; and connectivity across high-growth markets and sectors.

**QISMUT could grow from US$662b in 2013e to US$1.6t in 2018**

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<tr>
<th></th>
<th>2013e Assets (US$b)</th>
<th>2018f Assets (US$b)</th>
</tr>
</thead>
<tbody>
<tr>
<td>KSA</td>
<td>285</td>
<td>632</td>
</tr>
<tr>
<td>Malaysia</td>
<td>140</td>
<td>392</td>
</tr>
<tr>
<td>UAE</td>
<td>95</td>
<td>205</td>
</tr>
<tr>
<td>Qatar</td>
<td>113</td>
<td>166</td>
</tr>
<tr>
<td>Turkey</td>
<td>48</td>
<td>121</td>
</tr>
<tr>
<td>Indonesia</td>
<td>68</td>
<td></td>
</tr>
</tbody>
</table>

Sources: Central Banks, BMI, EY analysis
Islamic banking profit pool across QISMUT estimated at US$9.4b in 2012

By 2018, Islamic banking profit pool could reach US$26.4b or 48% of the banking system profits across QISMUT.

Internationalization and operational transformation programs – currently under way at several leading Islamic banks – could enhance their profitability by up to 15%, helping close the gap with leading financial institutions.

Globally, Islamic banking profit pool is projected to reach US$30.5b by 2018, driven by higher retail focus.

Sources:
Company Financial Reports, EY analysis
The transition to socially useful banking

Invest responsibly

- Socially responsible investment (SRI) estimated at more than US$26t in assets under management globally, by 2015
- Incorporates social, environmental and ethical considerations
- Islamic banks confirm to some of the attributes of SRI

Comply and promote

- Guidelines and reporting framework from regulators
- Reporting and disclosure by Islamic banks (voluntary basis)
- Reporting and disclosures from corporate clients
- Assessment and comparison for compliance

Economically targeted

- Leverage low-cost, long-term zakat, waqf and government funds to diversify to mass market and small businesses
- Asset strategy to pass on funding cost advantage to promote inclusive growth (unlike traditional microfinance models that invest in underdeveloped segments to benefit from higher marginal returns)

Malaysia formalizes SRI

- Introduces ESG Index (environment, social and governance)
- Supports framework for SRI Sukus
- Establishes a government venture capital fund to invest in SRI businesses

Rauf Rashid
Pausing to grow again

Operational transformation that started in 2011–12 and will take at least 2–3 years to complete, to drive a stronger Islamic banking sector

Asset growth

<table>
<thead>
<tr>
<th>Year</th>
<th>Growth Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013e</td>
<td>16.9%</td>
</tr>
<tr>
<td>2018f</td>
<td>21%</td>
</tr>
</tbody>
</table>

Noticeable slowdown in growth as focus continues to be on op's improvement. Revival driven by improved efficiency, retail and trade finance, and new markets.

Profits

<table>
<thead>
<tr>
<th>Year</th>
<th>ROA (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013e</td>
<td>1.6%</td>
</tr>
<tr>
<td>2018f</td>
<td>1.9%</td>
</tr>
</tbody>
</table>

Lower ROA – partly due to capex with long term value, and efficiency issues. Successful transformation could see ROA improve by up to 15%.

Customers

<table>
<thead>
<tr>
<th>Year</th>
<th>Customers</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013e</td>
<td>38m</td>
</tr>
<tr>
<td>2018f</td>
<td>70m+</td>
</tr>
</tbody>
</table>

Value not fully captured with average product holding of 2.1. Segmentation and cross-selling high on agenda in key Islamic finance markets.

Sources:
Central Banks, BMI, Company Financial Reports, EY analysis of selective banks and markets.
Entrepreneurial finance to support middle market and small businesses could be a key differentiator

A once-in-a-decade market opportunity has recently been created as a result of the increased hurdles for SMEs in equity financing. The concept of equity crowdfunding is targeted at start-up businesses and SMEs.

Crowdfunding is a way of financing projects and businesses through small contributions from a large number of sources, rather than large amounts from a few. Given the employment and economic growth-related benefits associated with SMEs, policy makers worldwide have begun taking a variety of steps to encourage the development of equity crowdfunding. These steps include: revamping their regulatory environment, giving tax breaks and setting up co-investment funds to invest side-by-side with the private sector investors as part of the equity crowdfunding process.

Access to finance for SMEs is more constrained in the GCC than other emerging regions. The average rate of SME financing as a proportion of total financing is only 2% in the GCC region, in comparison to 8% for the MENA region. This rate of credit extension is disproportionately lower in comparison with SMEs contributions to GDP ranging from 30% in

The Global Venture Capital and Private Equity Country Attractiveness Index

Sources:
The Index, covering 116 countries, was developed by IESE Business School, University of Navarra, Spain, and sponsored by EY
Entrepreneurial finance to support middle market and small businesses could be a key differentiator, drives job creation, innovation and strong economic activity.

No Islamic finance market among the top 10 countries in the world on venture capital attractiveness.

Malaysia (#25), Saudi Arabia (#28) and Turkey (#35) appear relatively better placed.

Saudi Arabia, UAE and Jordan to 70% in Egypt, and to employment ranging from 30% in UAE, 40% in Saudi Arabia and Egypt to 50% in Jordan. Further, at this stage the GCC HNW’s access to professionally intermediated small/ mid-cap (international or regional) transactions is exceptionally limited, almost bordering on being non-existent. The opportunity is to establish small-ticket equity platforms to penetrate medium-sized businesses.
CEO agenda
Transformation for Islamic retail banks

Many Islamic retail banks suffer from lower profitability than the conventional banks. We estimate that their profitability is, on average, about 19% lower than conventional banks, mostly driven by higher expenses.

Compared with conventional banks, Islamic banks have more complex products, more process steps and more interfaces. Often they lack scale economies, operate basic technologies and find offshoring difficult. Throughout the credit cycle, risk costs tend to be higher due to weaker credit processes and a portfolio concentration – often in real estate.

At the same time, our consumer surveys highlight that Islamic retail banks need to improve dramatically on their quality of customer service, their distribution reach and capabilities, and their product range to attract and retain the most loyal customers.

Hence, Islamic retail banks often find themselves between a rock and a hard place in their need to improve profitability and the need to strengthen their service offering. In response, many Islamic banks have launched cost and risk transformation programs to improve their cost position and provisions. We believe that these will not be sufficient and that Islamic banks will additionally have to bring about a dramatic change in the following three domains if they are to succeed in driving profitable growth – a tough challenge.

Cross-selling

Islamic banks have typically not tapped into the customer cross-selling opportunities provided. Average product holding of 2.1 is well below class leading 4.9 products per customer of established conventional institutions. A targeted cross-sell program supported by a productivity toolkit for the frontline bankers and by customer analytics can bring a dramatic uplift in product holdings per customer.

Affluent proposition

Islamic banks can further enhance their revenue growth by targeting the affluent customers with a segmented value proposition, with a stronger focus on wealth management. To deliver a segmented offering Islamic banks need to decide on the segment proposition (and its branding), the relationship model, the service model and efficient infrastructure.

Service quality and productivity

Many Islamic banks have launched efficiency programs to address their disadvantaged cost base. We believe that the focus must be on efficiency combined with service quality, lead-time improvement and better risk management. This can be achieved by a tailored "lean banking" program for end-to-end process improvement, leveraging digital technologies that interface smoothly with legacy systems or avoid their constraints.

Driving such a broad change program combining cost improvement with revenue growth requires exceptional leadership capabilities and ample management capacity.
A renewed focus on understanding the customers

From our discussions with leading Islamic bankers, it is clear that the CEO Agenda this year is a continuation of the priorities set out in 2011/12: banks need to get to know their customers better and their clients’ businesses better. Know Your Customers (KYC) and Know Your Client’s Business (KYB) are not just compliance requirements, but they are also helping CEO’s link behavioral information with banking services. Historically, banks have kept plenty of information on customers but have done little to leverage it.

Increasing average product holding from an industry average of 2.1 to a class-leading 4.9 can increase profitability by 40% from such customers. For some Islamic banks, the impact on ROE could be as high as 5%.

Abid Shakeel
Why segmentation and why now?

What Islamic banks need
- Mature customer insights from data analytics
- Identifying customer needs
- Develop a product suite for different segments
- Increase in customer advocacy and recommendation to family and friends

Capability from segmentation
- Needs-based selling
- Profitable product suite
- Marketing mix across channels
- Increased customer satisfaction

Impact on profitability
- Increased sales per meeting for sales advisers
- Increase in average product holdings and profitability of customers
- Increase in marketing ROI
- Increase in customer acquisition at lower costs

Segmentation can not only provide opportunities to increase sales but also allow banks to optimize their marketing spend and sales incentives spend for staff. Used to its optimum, it’s a tool that can increase revenue and optimize costs at the same time.

Mohammed Khan
Banks have long grouped customers into segments, the most common method of segmentation being income bands. So while segmentation for customers is not a new concept, the advancement in data gathering and analysis through introduction of data warehouses, customer profiling and propensity modeling has given Islamic banks the opportunity to get really closer to their own customers as well as attract new ones.

However, in our survey, 62% of respondents indicated they do not segment by profiling and 10% said they did not know how they segment their customers.

Directly linked to segmentation is the development of profitable and relevant product suites, and a significant 69% of respondents indicated their bank could not measure product profitability and hence customer profitability.
Ambitions need to be backed by actions

Launching new products can be a minefield and the safest option is to look at the market leader and take a copycat approach. However, the greatest prize lies with new product innovation. Using real customer insights, data mining, profiling and propensity models, product development can produce some real winning propositions. Combining product development with other milestones in the roadmap could not only increase the APH, but also increase the sales conversion ratio of frontline staff.

44% of our survey respondents confirmed their preferred activity to increase profitability is to increase their customer base. Yet, more than half of our respondents indicated they do not have the right mix of products to acquire their existing customer or their target customers. To compound the matter,

30% of respondents confirmed they were yet to develop new products for 2014 and a further

12% yet to identify which products they would go to market with in 2014.

Note:
APH = Average Product Holding
Evaluating your segmentation capabilities

**Basic**
- No data warehouse for customer information
- Marketing department undertaking product campaigns aimed at the entire market
- No measure of APH
- No measure of product or customer profitability

**Intermediate**
- Customer information held in a data warehouse
- Customer analytics team that can provide APH info and profitability
- Customer information being used by marketing and product teams to identify customers with propensity to buy
- Branch teams left to develop contact programmes to engage with suitable customers

**Advanced**
- Customer information in a bespoke data warehouse, which has an analytics engine for insight reports
- Sophisticated data analytics used to develop propensity models matching customers with products
- Product and marketing teams that develop mature customer profiles and regularly review product range and penetration with target customers
- Marketing teams that develop treatment strategies matching products, touchpoints and target customers
- Customer insight team generating leads reports for cross-sales opportunities

In the future, the ability to use customer insights to innovate will differentiate successful Islamic banking from others.
Breaking down silos and implementing a collaborative management model across business and support function remains a key challenge for Islamic banks. The existing management matrix needs a serious rethink as Islamic banks grow across borders and complexity.

Shoaib Qureshi
Serving newly opened Islamic finance markets offers an exceptional opportunity for Islamic banks to build regional brands.

Selim Elhadef

Expansion into any new market can be fraught with complexity. Getting it wrong can erode profitability and damage an institution’s reputation. More than one-third of CFOs underestimate the costs involved in entering emerging markets, and 40% underestimate the time. As many of these markets are already quite sophisticated in their retail and commercial offerings, new entrants need to determine which subsectors offer the greatest potential and how they can differentiate themselves from local competition. For example through technology and innovation to bring down the cost of serving customers in these markets, or through enhanced product or service capabilities.

Developing the right underlying operating model is also essential for new entrants. There are, in essence, three models that new banks tend to pursue:

- The first model is the local operating model, where all the systems and infrastructure supporting a country’s operations are located in that country. This model is likely to be used in markets where local regulations require back-office functions to be located in the same country. However, it can make it difficult to serve smaller or lower-margin markets effectively.

- The second one is the regional hub whereby countries in a region may share systems and operations hosted in a single country. This model can be more cost-effective, but the markets it supports require a degree of harmonization and therefore may only work across a smaller number of relatively homogenous markets rather than an entire continent.

- The third model is a centralized model, where the infrastructure and systems for all countries, either globally or in a particular region, are located (as much as possible) in a single country. This model is more efficient than the regional operating model but may not be able to cope with the inconsistent demands of the local markets it serves.

Regulators do not necessarily allow all these models – for example, companies may be required to locate their backoffice in the country of operation. New entrants must therefore consider the impact of such regulations on their ability to function profitably in these markets.

The quality and reliability of local infrastructure will also influence a variety of issues, from the requirement for a branch structure to the cost of cash management. And the availability of a sufficiently skilled and experienced workforce will be a factor if banks are to avoid big recruitment and retention challenges.

Finally, banks must consider their mode of entry. Here again options may be limited by local regulations. Joint ventures can offer foreign banks access to local market knowledge and offer local banks access to greater technical know-how and a broader range of products. However, if institutions have different objectives, in addition to the challenge of different cultures, joint ventures may prove unsuccessful.

Entry by acquisition can give investors greater control than a joint venture and provide quick access to market share, skills and existing distribution channels. However, valuations of targets in emerging markets can be difficult; disclosure requirements may not be as rigorous as in the acquirer’s home market, and corporate governance not as robust. Again, ensuring cultural alignment will also be crucial, particularly if resource challenges force banks to bring in staff from offices in other markets.

Acquisition is not always possible, as local regulations in many markets limit foreign ownership of companies. As an alternative, banks might consider establishing a branch or a subsidiary. Of these, a branch can be less costly and more efficient than establishing an independent, separately capitalized subsidiary – a situation that will be exacerbated by moves to Basel III. However, as a branch can be more difficult to resolve in the event of the failure of a banking group, regulators are increasingly requiring new entrants to establish subsidiaries. In deciding the right mode of entry to a new market, banks must consider not only what is most efficient now, but what will be most efficient in the future, in light of an evolving regulatory landscape.
Connecting RGMs

Trade and capital flow connectivity will become increasingly important to support domestic corporates’ expansion into new markets.

- GDP growth of 5.4% a year for RGMs, or three times faster than advanced economies (2000–10).
- Over 2011–20, RGMs growth will continue to outpace advanced economies by nearly 3.5% a year.
- RGMs will account for 38% of world consumer spending and 55% of fixed capital investment.

- Exports from RGMs constitute 10% of the world GDP, having doubled in the last decade. By 2030, their share will approach 20% or double that of advanced economies.
- Machinery and transport equipment will make the largest sector contribution to trade over the next 10 years.

Our current share of trade finance business is one-third of our due share. Scale and infrastructure both are needed. We expect 2014 will be about strengthening the platform.

GCC Islamic banker

Sources:
- EY analysis
Correspondent banking relationships are the driving force behind any successful trade finance business. Regulatory compliance is now the primary consideration alongside financial and operational agility of correspondent banking relationships.

Ideally, a customer would want to execute bulk of the documents in one go, instead of signing various Islamic contracts at different stages of the transaction.

Product innovation is required to develop products based upon many different Islamic contracts, which is easy for customers to understand and execute, specially for export finance and letter of credit discounting.

Treasury and trade finance solutions are a strong fit for cross-selling purposes. Currency hedge and availability of foreign currencies is a key factor in repeat sales for trade finance business.

Sources:
EY analysis

*LG — Letter of Guarantee
LC — Letter of Credit
FX — Foreign exchange

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Houssam Itani

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Growth rate of trade flows (indexed at 2011)
Basel III and impact on capital planning

Impact of Basel III on capital ratios is reduction of c. 3% for Islamic banks under our coverage. Part of this can be addressed through efficient capital planning.

Key sources of change

- Limited recognition of minority interest, AT1* and T2** capital
- Stringent restrictions on AT1 and T2 eligibility
- Additional deductions from capital:
  - Increase in capital charge from CCR*** and market risk (Basel 2.5)

Capital impact (sample of GCC Islamic banks)

<table>
<thead>
<tr>
<th>Capital (Basel II)</th>
<th>Capital (Basel III)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tier2</td>
<td>Tier1</td>
</tr>
<tr>
<td>2.7%</td>
<td>1.2%</td>
</tr>
<tr>
<td>15.9%</td>
<td>14.3%</td>
</tr>
</tbody>
</table>

Existing Tier 2 instruments, including sukuk, are in most cases non-eligible under Basel III

Maged Fanous

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*AT1 — Additional tier 1
**T2 — Tier 2
***CCR — Counterparty credit risk

Sources:
EY analysis
Many Islamic banks need to review and strengthen their capital position, once revised capital regulation is issued by national authorities in near future.

Islamic banks’ focus should be on capital optimization through the review of their internal processes and through the optimal capital structure.

We are seeing increased demand for eligible Tier2 Islamic capital instruments.

National Liquidity Guidelines are still under development in many of the key Islamic finance markets.

Among others, major challenges for Islamic banks are:

- Limited availability of ‘high-quality’ compliant assets
- Limited trading volumes and quantities of required compliant instruments

Sources:
Global Insight, EY analysis

National regulators to implement Basel III liquidity requirements for Islamic banks in a way that recognizes industry limitations.
Mobile banking

Mobile banking is one of the five most disruptive megatrends, going into 2014 – EY survey.

Mobile money purchases, transfers, financing payments and other financial services – are here to stay. Millions, if not billions, of customers will have it no other way.

In the emerging world, people without bank accounts want to use their phones to “do finance” via text messages or browser software. They cannot afford to wait for bank branches and ATMs to appear where mobile phones and local merchants are already in place and ready to serve banks’ traditional functions.

In more mature markets, meanwhile, millions of smartphone owners are getting accustomed to using browsers, dedicated apps and near field communication technology to buy and sell, and to send money. Evermore accustomed to using their smartphones for everything, they see no reason that finance should be an exception.

In emerging markets, EY believes that mobile money offers opportunity for the expansion of participation within the payment systems, the ability to facilitate payments in which barriers had existed, and to eventually evolve to allow the “banking” of individuals who have not been able to enter the financial services sector in the past. For Islamic finance providers, the mobile revolution is a chance to reach new customers and bring them to other banking services, a new market with hundreds of millions of potential clients.

Hence, the battle for the electronic wallet is on, and it is not at all clear whether banks will win it.

They have some key advantages: experience with the regulations and security necessary to handle accounts, plus the trust of consumers who are accustomed, after all, to banking with banks. But, they also have some handicaps, in the form of legacy systems and a lack of familiarity with the hardware and software of the digital world.

Some Islamic banks have responded by holding back. It is a reaction made easier by the fact that mobile money is not yet a switching issue for most customers.

Others have decided that they need to be ready but do not have the resources or business plan to justify striking out on their own. They may choose to spread the risk while cranking up the potential and increasing speed-to-market by partnering with complementary service providers. These are the institutions that, in joining with other companies, are creating new hybrids: combinations of telecoms and banks, or retailers and banks, or even social media sites and a bank.

The leading Islamic banks are rolling out dedicated apps and seeking partners for mobile money experiments.

Amid all the uncertainty, one thing is clear – after decades of speculation, the era of mobile-money has finally arrived. If not now, then soon, every Islamic bank will have to decide how it will participate.
Few disruptive innovations have the same potential for widespread positive socio-economic impact as mobile money. Lower cost of transaction and customer acquisition, increased flexibility, greater accessibility and inclusiveness are some of the key benefits which can be realised. As with every such opportunity, this would require timely and quality solution development and deployment under-pinned by rigorous and pragmatic program and risk management.

Shabkhez Mahmoud
Country outlook
Qatar
Qatar’s banking sector has grown at a CAGR of 16% over last five years

- Islamic banks had US$54b in assets in 2012, and are expected to sustain a 20% plus growth trajectory over medium term
- Increasing investment in infrastructure projects in preparation for FIFA World Cup will keep demand for corporate credit at a high level, leaving banks reliant on external funding

Sources:
Central Banks, Company Financial Reports, EY Universe, EY analysis of selective banks
Indonesia
Indonesia’s banking sector is characterized by a growing economy, 250 million (mostly Muslim) population, increasing per capita income (c. US$3000), high-financing margins and low banking penetration (loan to GDP ratio of 33%).

- Islamic banks had US$20b in assets in 2012 or c. 4.6% of system assets, expected to grow to US$100b plus by 2018 at a six-year CAGR of 33%.
- Many foreign Islamic banks keen to invest in Indonesia, though progress has been slow due to regulatory and legal considerations.

Sources:
Central Banks, Company Financial Reports, EY Universe, EY analysis of selective banks
Saudi Arabia
Islamic banking constituted 53% of the system assets in 2012, estimated at US$245b. This includes both pure-play Islamic banks and Islamic assets with conventional banks. Mainstreaming of Islamic banking in Saudi to get a further boost with (expected) transformation of conventional banks’ business.

- With continued economic growth and abundant liquidity in the banking system, competition for corporate credit is expected to increase, and margins will be under pressure.
- Entry into the well-regulated banking sector is possible through a non-banking financial institution (leasing, mortgage, capital markets, etc.).

Sources:
Central Banks, Company Financial Reports, EY Universe, EY analysis of selective banks
Malaysia
• Islamic banks had US$120b in assets in 2012, expected to grow to more than US$390b by 2018 at 6-year CAGR of 21%
• With 91% of Malaysians multi-banked, we expect banks to embark upon customer segmentation and investment in customer loyalty schemes to improve profitability through cross-selling
• The ongoing liberalization of the financial sector will create opportunities for partnerships between domestic and Middle Eastern banks, which may become a key driver for East-to-East linkages promoting trade and increasing the size of the global Islamic finance industry

Islamic banking market share

20%

Sources:
Central Banks, Company Financial Reports, EY Universe, EY analysis of selective banks
United Arab Emirates
• Islamic banking assets estimated at US$83b in 2012 or 17% of the system assets. This includes Islamic assets of some of the larger conventional banks.

• Greater regulatory clarity and new enabling infrastructure critical for sustainable growth. Dubai’s Islamic Economy vision should help.

• Most UAE Islamic banks are well capitalized and keenly exploring regional expansion going into 2014.

Sources:
Central Banks, Company Financial Reports, EY Universe, EY analysis of selective banks.
Turkey
Turkey will have 11 million households with income of US$30,000 or more by 2030, the same level as Canada today. Young demographic, ongoing regulatory reforms and government’s willingness to promote financial inclusion through participation banking provides for a strong playing ground for Shari’a compliant financial institutions.

• Participation banks had US$39b in assets in 2012, expected to grow to US$121b by 2018 at 6-year CAGR of 21%. SME and retail banking are the primary engines of growth.

• With only four participation banks operational, Turkey faces a major supply-side constraint, which is limiting the development of the industry.

Sources:
Central Banks, Company Financial Reports, EY Universe, EY analysis of selective banks
Sources

• Making the right moves – Global banking outlook 2012-13
• Central bank reports
• Global Insight – comparative world overview tables
• BMI reports on commercial banking
• Bank annual reports
• Banking in Emerging Markets

Our industry awards

- **World Islamic Banking Awards 2011, Bahrain**
  - Thought Leadership Award, 2011

- **3rd International Takaful Summit, London**
  - Best Takaful Advisory Firm, 2011/2009

- **CPI Financial Islamic Finance Awards, Dubai**
  - Best Islamic Research, 2011

- **CPI Financial Islamic Finance Awards**
  - Thought Leadership Award, 2011

- **World Islamic Banking Awards, Bahrain**
  - Best Takaful Advisory Firm, 2011/2009

- **World Islamic Banking Awards, Bahrain**

- **World Islamic Banking Awards, Bahrain**
  - WIBC Leading Islamic Financial Services Provider, 2008

- **Kuala Lumpur Islamic Finance Forum, Malaysia**

- **Sheikh Mohammed Bin Rashid Al Maktoum Award**
  - Best Islamic Consulting Firm, 2006

Consistently ranked the best Islamic Advisory firm since 2006
Report methodology and tools

- Global Islamic banking assets are estimated based on publicly available data from 20 Islamic banking markets
- The research and insights are primarily based on EY Islamic Banking Universe (EY Universe), which is proprietary, based on sample and is not meant to be fully exhaustive
- The EY Universe analysis covers 70 Islamic banks and 46 conventional banks across 12 Islamic banking markets, with a total asset base of $5.7t (2012)
- For the purpose of this report, the analysis excludes Iran market due to its unique characteristics (except when reporting estimated global industry assets)
- EY Universe covers approximately 80% of the estimated global Islamic banking assets (excluding Iran market)
- Insights are also based on industry survey, including interviews with executives and industry observers, to identify key trends, risks and priorities
- Limited disclosures on Islamic windows, subsidiary operation and offshore businesses was a limiting factor
- The EY Universe is categorized as follows:
  - QISMUT – Qatar, Indonesia, Saudi Arabia, Malaysia, UAE and Turkey
  - GCC – Bahrain, Kuwait, Qatar, Saudi Arabia, UAE
  - Rest of the world – Bangladesh, Egypt, Jordan, Pakistan, Turkey, South Africa, Tunisia etc.

Anonymity and quotes
- All interviewees were assured of anonymity and minutes documented during our discussions
- Quotations have been used to support arguments made in the report
EY Universe of Islamic and conventional banks

Islamic banks that contributed data to Universe:

**Bahrain**
- Al Baraka Bank Bahrain
- Ithmaar Bank
- Al Salam Bank
- Bahrain Islamic Bank
- Khaleeji Commercial Bank
- Kuwait Finance House Bahrain

**Saudi Arabia**
- Al Rajhi Bank
- Bank Al Jazira
- Alinma Bank
- Bank AlBilad

**Kuwait**
- Kuwait Finance House
- Ahli United Bank
- Boubyan Bank
- Kuwait International Bank

**Qatar**
- Qatar Islamic Bank
- Masraf Al Rayan
- Qatar International Islamic Bank

**Bangladesh**
- Al Arafah Bank
- First Security Bank
- ICB Islamic Bank
- Islami Bank Bangladesh
- Shahjalal Islami Bank

**Jordan**
- Jordan Dubai Bank
- Jordan Islamic Bank

**Egypt**
- Al Baraka Egypt
- Faisal Islamic Bank of Egypt

**Turkey**
- Al Baraka Turk
- Bank Asya
- Kuveyt Turk
- Turkiye Finans

**Indonesia**
- Bank Bri Syariah
- Bank Muamalat
- Bank Syariah Mandiri
- Bank Syariah Mega
- Bank Syariah Bukopin
- Bank Jabar Banten

**Malaysia**
- Affin Bank
- Al Rajhi Bank
- Alliance Bank
- Asian Finance
- Bank Islam
- Bank Muamalat
- CIMB Islamic Bank
- Hong Leong Islamic Bank
- Kuwait Finance House Malaysia
- Maybank Islamic Bank
- Public Islamic bank
- RHB Islamic Bank
- Bank Rakyat

**Pakistan**
- Al Baraka Pakistan
- BankIslami
- Burj Bank
- Dubai Islamic Bank Pakistan
- Meezan Bank

Noor Islamic Bank
Sharjah Islamic Bank
EY Universe of Islamic and conventional banks

Conventional banks that contributed data to our Universe:

**Bahrain**
- Arab Banking Corporation
- Ahli United Bank
- Bank of Bahrain and Kuwait
- National Bank of Bahrain

**Saudi Arabia**
- National Commercial Bank
- Samba Financial Group
- Riyad Bank
- The Saudi British Bank
- Arab National Bank

**Kuwait**
- National Bank of Kuwait
- Burgan Bank
- Commercial Bank Kuwait

**Qatar**
- Doha Bank
- Qatar National Bank
- Commercial Bank of Qatar

**Indonesia**
- Bank Central Asia
- Bank Mandiri
- Bank Negara Indonesia
- Bank Rakyat Indonesia

**Malaysia**
- CIMB Bank
- Maybank Bank
- RHB Bank
- Public Bank

**Pakistan**
- MCB Bank
- National Bank
- United Bank

**Bangladesh**
- Agrani Bank
- Rupali Bank

**Jordan**
- Arab Bank

**Egypt**
- Banque Misr
- Commercial International Bank
- Union National Bank Egypt

**Turkey**
- Turkiye Vakiflar Bankasi
- Yapi ve Kredi Bankasi
- Turk Ekonomi Bankasi
- Turkiye Garanti Bankasi
- AK Bank

World Islamic Banking Competitiveness Report 2013-14
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