The Six Key Countries Driving Global Islamic Finance Growth[1]

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I. Islamic rapid-growth markets: QISMUT

Ernst and Young has designated 25 countries as rapid-growth markets (RGMs) within the global economy, based on three indicators: (1) their economic growth to date and future outlook, (2) the size of their economy and population, and (3) their strategic importance for global business. The RGMs include six countries, denoted by the acronym QISMUT, that are considered the most important to the international development of Islamic finance: Qatar, Indonesia, Saudi Arabia, Malaysia, the United Arab Emirates and Turkey (Figures 1 and 2). These countries, with both expertise and potential for growth in Islamic finance, account for 78% of the world's Islamic financial assets[2].

Islamic finance is a type of finance that complies with sharia, the Islamic religious doctrine (Islamic law). Islamic financial assets are sharia-compliant assets held by Islamic financial institutions[3]. Global Islamic financial assets totaled US$1.54 trillion in 2012 and over US$1.72 trillion in 2013[4]. Of that total, 78% are held as Islamic bank assets, 16% in sukuk, 4% in Islamic funds, and 1.1% each in takaful (Islamic insurance) and Islamic micro-finance[5] (Figure 3).

1 The Japanese original of this report was published in July 2014. All quoted data and figures are from publications previous to that.

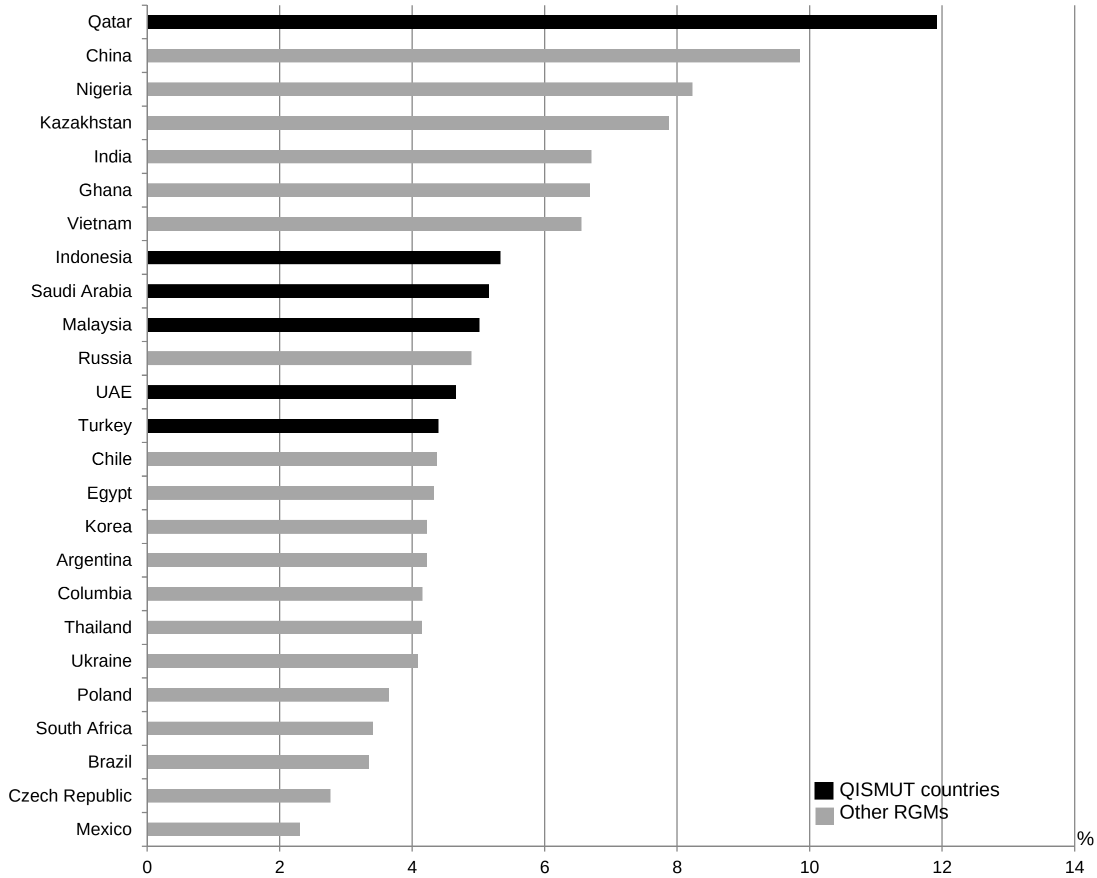
2 Excludes financial assets in Iran. According to data from Kuwait Finance House Research, Iran accounts for approximately 37% of Islamic financial assets worldwide, but because its market is the most domestic oriented, we do not include it in international comparisons.

3 A well-known impact that sharia has on Islamic financial transactions is through its prohibition of interest (riba). Besides that, trades that are considered to have excessive risk due to uncertainty (gharar) and speculative transactions (maysir) are also prohibited. Consequently, Islamic financial schemes can be broadly divided into two categories: 1) transactions via trade in actual goods and 2) transactions via investment in a business.

4 "World Islamic Banking Competitiveness Report 2013-14," Ernst & Young.

5 "Katılım Bankalarının Türkiye' de Pazar Payı Artıyor" (Participation Banks Gain Market Share in Turkey), Deloitte Turkey, 7 February 2014, and Zubair Mughal, "2014 will be promising for Islamic Finance Industry," *Zawya/Thomson Reuters*, 31 December 2013.

Figure 1: Average GDP growth rates in RGMs (2000–2013, local currency basis)



Source: Nomura Institute of Capital Markets Research, based on the IMF World Economic Outlook (WEO) Update (July 2013), the European Commission report, and World Bank data

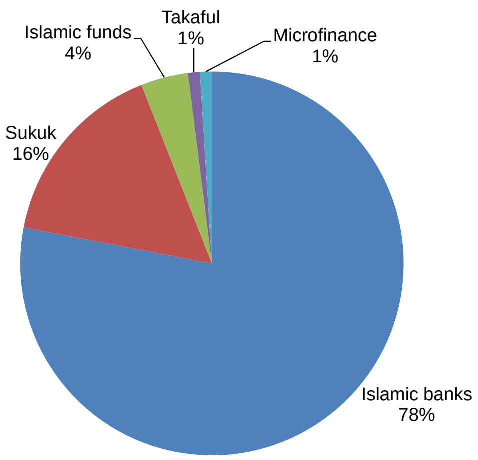
Figure 2: QISMUT countries' populations and per capita nominal GDP (PPP) [6]

	Population	GDP per capita (PPP)
Qatar	2.2million	US$102,211
Indonesia	248.5million	US$4,977
Saudi Arabia	31million	US$31,275
Malaysia	29.8million	US$16,922
UAE	9.3million	US$49,012
Turkey	76.1million	US$15,001

Source: Nomura Institute of Capital Markets Research, based on data from the Population Reference Bureau's 2013 World Population Data Sheet and the Heritage Foundation's 2014 Index of Economic Freedom

6 Purchasing power parity (PPP) is based on the relative purchasing power theory which compares inflation rates between two countries and uses an exchange rate that equalizes inflation differences. By correcting for price differences, it allows for comparisons in real terms.

Figure 3: Shares of global Islamic financial assets (2013)



Source: Nomura Institute of Capital Markets Research, based on data from Zawya / Thomson Reuters

Thanks to their abundant natural resources and strong social infrastructure, the QISMUT countries enjoyed continued growth in population and average income, thereby attracting interest from Islamic and non-Islamic companies alike, including Japanese companies. The QISMUT countries are Muslim-majority nations with large numbers of people seeking Islamic finance. At least 67% of the 38 million customers of the world's Islamic banks live in a QISMUT country[7], making these countries important drivers of growth in Islamic finance. Important elements within the national strategies of these governments include introduction of legislation, measures, and tax reforms that are compatible with, and encourage growth of Islamic finance, including the reduction of costs of issuing and managing Islamic financial products, particularly sukuk.

Islamic financial assets in the QISMUT countries totaled US$560 billion in 2012 (about 37% of the global total[8]) and are projected to grow at an average annual rate of 19.7% from 2013 to 2018. At that rate of growth, Islamic financial assets in the QISMUT countries would exceed US$1.6 trillion, about 50% of the expected global total, by 2018[9].

In light of the important role that the six QISMUT countries can play in the future global development of Islamic finance, this paper looks at the current status of each country's domestic market and the various measures that their governments have implemented to encourage growth in Islamic finance.

7 "World Islamic Banking Competitiveness Report 2013-14," Ernst & Young.

8 Including Iran.

9 "Rapid-growth markets 2013" and "World Islamic Banking Competitiveness Report 2013-14," Ernst & Young.

II. QISMUT country overview: Qatar

Overview of Islamic finance in Qatar

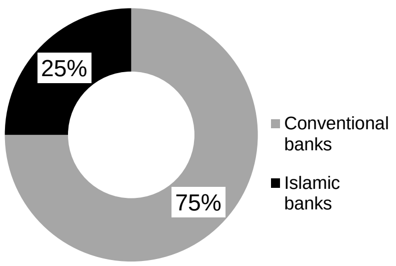
Islamic financial assets: US$54.4 billion (Ranked fourth among the six QISMUT countries)

Average growth rate for Islamic bank assets in 2008–12: 31% (1.8X that of conventional banks)

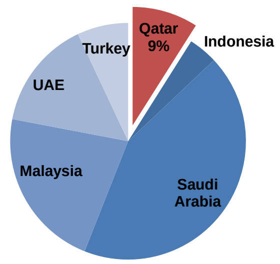
Characteristics of Islamic finance:

- Qatar's central bank has prohibited the operation of Islamic windows[10] at conventional banks since 2011, and further legislative revisions made in 2013 established a clear legal distinction between Islamic finance and conventional finance.
- Qatar issued sukuk totaling over US$5.4 billion in 2012 and over US$4.3 billion in 2013, when it ranked sixth among QISMUT countries.
- More issuance is of sovereign sukuk than of corporate sukuk.
- The government is currently focused on growth in the domestic capital market, and does not plan any global sovereign sukuk issuance in 2014.
- Several upcoming large-scale infrastructure and construction projects, including the 2022 FIFA World Cup, the Doha Metro, and the Hamad International Airport, provide an opportunity for further growth of Qatar's domestic Islamic finance.

Domestic market share:



Share among QISMUT countries:



Source: Nomura Institute of Capital Markets Research, based on data from Zawya, Ernst & Young, and Islamic Finance News (IFN)

1. Macroeconomic overview

Qatar's GDP grew at about 6% in 2013 and growth is expected to be at least 6% going forward (Figure 4). Agriculture accounts for 0.1% of GDP, industry 72.2%, and services 27.7%[11]. The non-oil sector is growing particularly fast, with estimated growth of at least 10% in 2013 and 2014[12]. The Qatar government, anticipating that the discovery of shale gas in the US and natural gas in other countries will affect the competitiveness of its oil sector, is determined to raise the non-oil sector's share of GDP to at least 50% by 2015[13]. Its main drivers of economic growth will be increased domestic consumption brought by population growth and large-scale infrastructure projects related to the Doha Metro, Hamad International Airport, and the FIFA World Cup scheduled to be held in Qatar in 2022 (Figure 5).

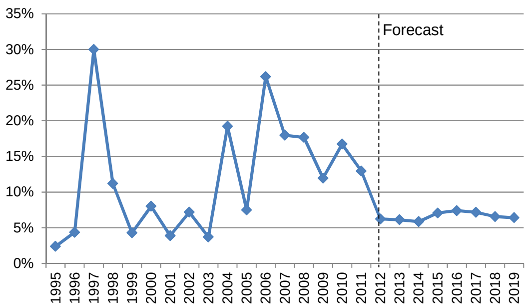
[10] An Islamic window is a department set up within a conventional bank to provide Islamic financial services and handle Islamic financial transactions.

[11] CIA World Factbook (2013 data).

[12] "Qatar's non-oil sector to grow at the rate of 10 percent," *bq Magazine*, 9 April 2013 and "Rapid-Growth Markets Forecast," Ernst & Young, February 2014.

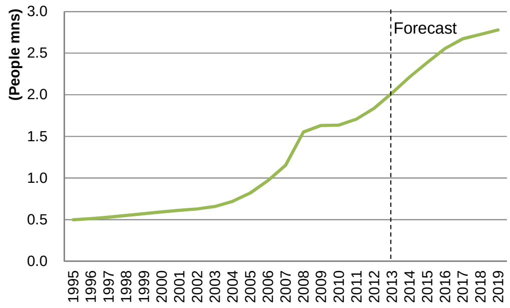
[13] IFN 2014 Guide, February 2014.

Figure 4: Qatar's economic growth rate



Note: Figures from 2012 are forecasts.
Source: Nomura Institute of Capital Markets Research, based on IMF data

Figure 5: Qatar's population growth

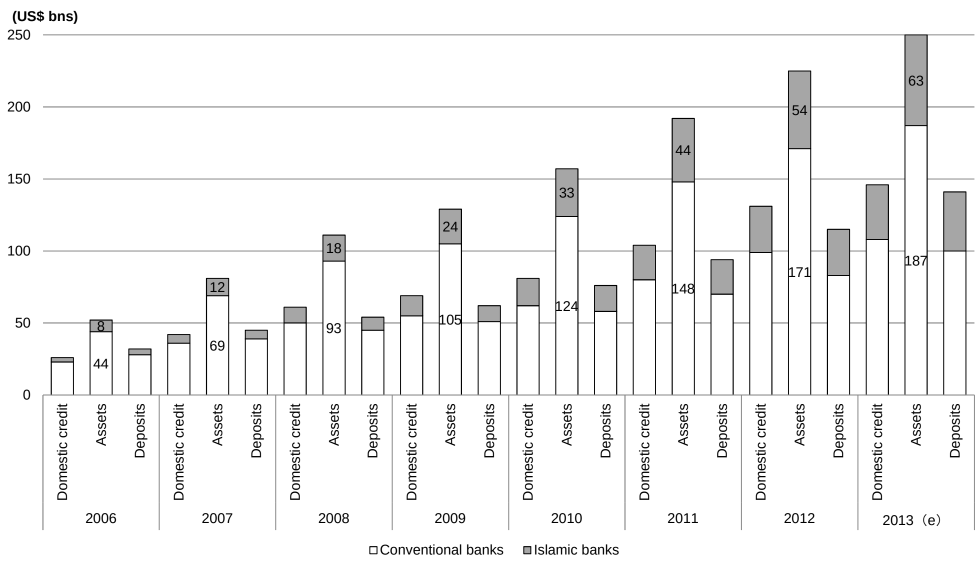


Note: Figures from 2013 are forecasts.
Source: Nomura Institute of Capital Markets Research, based on IMF data

2. Islamic finance market

As Qatar's population and consumption have grown[14], the need for financial products has diversified. Its domestic Islamic banks are adapting to changing needs by focusing on developing Islamic financial products for retail and SME customers, thereby creating a new customer base. Qatar's Islamic bank assets grew at an annual rate of about 31% over the 5-year period ending at the end of 2012, when they stood at US$54.4 billion (Figure 6). Even assuming that growth rate averages only about half of that (15%) for the five-year period from 2012, those assets will exceed US$100 billion in 2017[15].

Figure 6: Growth of Qatar's banking industry (2006–2013e)



Source: Nomura Institute of Capital Markets Research, based on data from the Qatar Central Bank, S&P, and IFN

14 According to a 5 March 2014 article by John Pratap, "Qatar's forecast 10.5% average population growth will be one of world's highest: QNB", *Reuters (Zawya)*, including immigrants, Qatar's population grew about 10% in 2013.

15 "Qatar's Islamic banks are on a fast track to growth," S&P, 16 September 2013.

A number of upcoming large-scale construction projects will present significant opportunities for developing Islamic finance in Qatar. Sukuk issuance from both the government and private-sector corporations is expected to grow in order to finance new infrastructure projects, including the stadiums and hotels needed for the 2022 FIFA World Cup. Qatar's Islamic banks will also be issuing sukuk to raise funds in preparation for implementation of Basel III regulations and tighter oversight by the regulators and the central bank[16].

Sukuk are also being issued by companies in sectors outside of banking and construction. For example, the telecom company Ooderoo Qatar (formerly Qatar Telecom) issued a US$1.25 billion sukuk in H2 2013. The co-lead managers for that sukuk issuance included not only Islamic financial institutions, but also conventional banks such as Singapore's DBS Bank, Deutsche Bank, HSBC, and QNB Capital. We think participation in Islamic financial transactions by conventional banks and nonbanks, in addition to the government and Islamic banks, bodes well for the future of Qatar's financial markets.

Of Qatar's four Islamic banks, the one growing the fastest is Barwa Bank, which was established in 2010. We attribute Barwa Bank's rapid growth to investments in Qatar's several billion US dollar infrastructure projects, as well as to its development and provision of Islamic financial services in such businesses as investment banking and asset management. The bank is also pouring resources into fixed income, sukuk issuance services, and forex services, and it has made headway developing products and services to meet a range of market needs. Its efforts have paid off in the form of (1) 227% growth in customer deposits from 2011 to 2013[17], (2) 85% growth in net income in H1 2013, and (3) its involvement as co-arranger with the Islamic Development Bank (IDB) in a US$1 billion sukuk issuance.

3. Government and regulations

Qatar's government, aiming to be the region's Islamic financial center, has devised a variety of strategies and policies to encourage development of Islamic finance within the country. In 2011, it implemented legislation prohibiting the operation of Islamic windows at conventional banks. This handed a big advantage to Islamic banks, because the new law resulted in all customers seeking sharia-compliant financial services to switch from conventional banks to Islamic banks.

Its introduction in 2013 of a new Central Bank Law (Law No. 13 of 2012, the QCB Law) created a legal distinction between Islamic banks and conventional banks. The QCB Law defined Islamic banks as those that (1) operate interest-free financial businesses aimed at producing profit, (2) develop new sharia-compliant savings and investment products, (3) offer financial services with the aim of benefiting society at

[16] For more on the impact that Basel III will have on the sukuk market, see Bedi G. Lackmann, "Basel III creates new opportunities for sukuk (Islamic bond) issuance," *Nomura Journal of Capital Markets,* Summer 2014 Vol.6 No.1.

[17] Total customer deposits as of end-December 2013 stood at QAR21.2 billion (US$5.8 billion, using an exchange rate of QAR3.67/USD1).

large and based on the concept of common benefit, and (4) deepening the bank's understanding of sharia-compliant finance and contributing to the existing body of knowledge in the field of Islamic finance.

In addition, the government and government-affiliated holding companies have become the primary sponsors of domestic Islamic banks. The Qatar Investment Authority (QIA)[18] is a key shareholder[19] of the Islamic banks Masraf Al-Rayan[20], Qatar Islamic Bank (QIB)[21], and Qatar International Islamic Bank (QIIB)[22], while the government-operated Qatar Holding and Barwa Real estate are the principal shareholders of Barwa Bank. Furthermore, to help Islamic banks manage their liquidity, the government's bond issuance program includes both regular government bonds and sovereign sukuk.

As Islamic capital markets grow, Qatar has the potential to become the region's third-largest Islamic financial market behind Saudi Arabia and the UAE. Whether it uses that potential to become an Islamic financial center will depend on the future efforts of the government and market participants.

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[18] QIA is Qatar's sovereign wealth fund (SWF).

[19] "Qatar's Islamic banks are on a fast track to growth," S&P, 16 September 2013.

[20] Masraf Al-Rayan is Qatar's second-largest Islamic bank. Established in 2006, its favorable relationship with the government enabled it to average annual growth of 55% from 2007 until 2012. As of end-2012, it had provided roughly 63% of its investment to the government and public institutions, and the bank's total assets were US$18.1 billion as of end-September 2013.

[21] QIB was established in 1982, making it Qatar's longest standing Islamic bank, and with total assets of about US$21 billion as of end-2013, it is also Qatar's largest Islamic bank. It is particularly active in the real estate industry, into which its investments accounted for about 36% of the bank's entire investment portfolio as of end-2012. Its primary shareholders include QIA and Qatar's royal family.

[22] QIIB was established in 1991, and its approximately US$9 billion in total assets ranks it as Qatar's third largest Islamic bank. In addition to the real estate industry it is also active in the services industry, with the former accounting for about 26% of its total investments and the latter about 27% as of end-2012.

III. QISMUT country overview: Indonesia (I)

Overview of Indonesia's Islamic financial assets

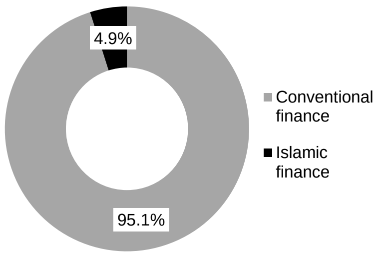
Islamic financial assets: US$21.4 billion (Ranked sixth among the six QISMUT countries)

Average growth rate for Islamic bank assets in 2008–2012: 42% (3.1X that of conventional banks)

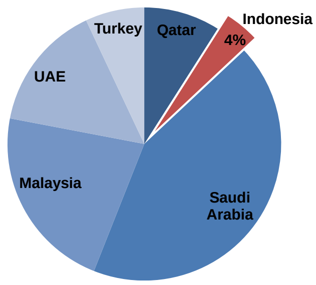
Characteristics of Islamic finance:

- Conventional banks are legally allowed to operate Islamic windows.
- Indonesia issued sukuk totaling about US$5 billion in 2013, ranking it fifth among QISMUT countries.
- The majority of the sukuk issued were sovereign sukuk.
- Since January 2014, all financial institutions, including Islamic banks, are being administered by the OJK, Indonesia's Financial Services Authority.
- Indonesia's central bank announced plans to increase the number of Islamic banks, currently 11, to 25 banks by 2023.
- The OJK became a full member of the Islamic Financial Services Board (IFSB)[23] in 2013.

Domestic market share:



Share among QISMUT countries:



Source: Nomura Institute of Capital Markets Research, based on data from Zawya, Ernst & Young, and Islamic Finance News (IFN)

1. Macroeconomic overview

Indonesia's annual GDP growth averaged over 6% in 2010–2013, and that level of growth is expected to continue (Figure 7). Agriculture accounts for 14.3% of GDP, industry 46.6%, and services 39.1%[24]. Economic growth has been driven by increasing private-sector consumption as well as inflow of investments, pushing GDP on a PPP basis to US$1.28 trillion in 2013[25]. Consumption growth can be attributed to growth in average income, while the strong inflow of investment can be attributed to the upgrading of its sovereign bonds to investment grade by Fitch in December 2011 and by Moody's in January 2012[26].

Indonesia's population was estimated to be 253 million as of 2014 (Figure 8), of which 87% (over 220 million) are Muslims[27]. This makes Indonesia the world's largest Islamic country, and gives it huge potential in Islamic finance.

[23] The IFSB is a standard-setting organization that cooperates with financial supervisory and regulatory authorities supporting the sound development of Islamic finance and proposes regulations and reforms in a broad range of financial sectors, including banking, capital markets, and takaful (Islamic insurance). For details, see IFSB Objectives on the IFSB website (http://www.ifsb.org/objectif.php).

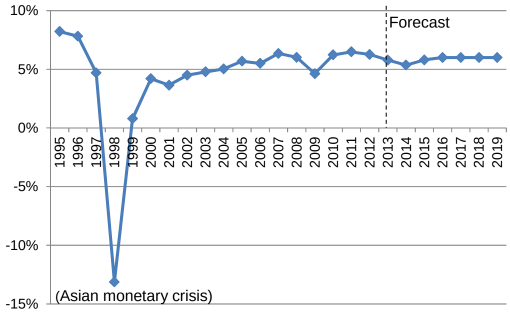
[24] CIA World Factbook (2013 data).

[25] CIA World Factbook (2013 data).

[26] "Global Trade and Investment Report", JETRO, 2013.

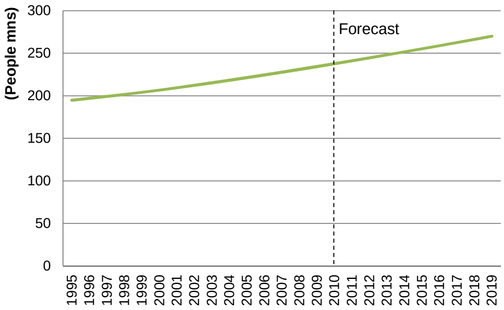
[27] CIA World Factbook.

Figure 7: Indonesia's economic growth rate



Note: Figures from 2013 are forecasts.
Source: Nomura Institute of Capital Markets Research, based on IMF data

Figure 8: Indonesia's population growth



Note: Figures from 2010 are forecasts.
Source: Nomura Institute of Capital Markets Research, based on IMF data

2. Islamic finance market

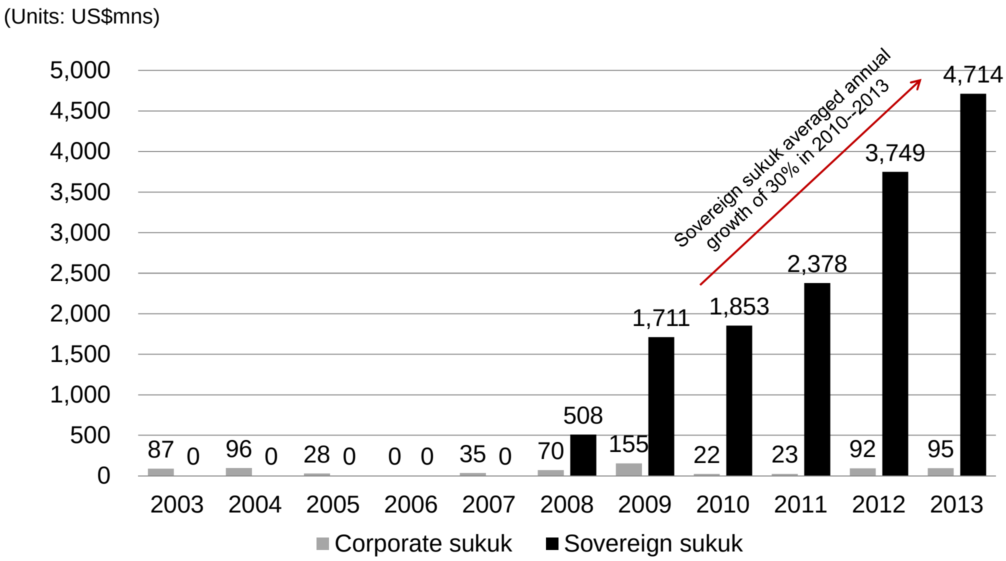
Indonesia's Islamic financial market primarily comprises Islamic banks, Islamic capital markets (including sukuk and sharia-compliant equity), and takaful. Islamic rural banks and Islamic micro-finance organizations also provide Islamic financial services, which although still on a small scale are expected to grow.

In addition to its 11 domestic Islamic banks, Indonesia has 23 conventional banks that provide Islamic financial services through their Islamic windows. Islamic banking assets grew at a rate of 24.2% in 2013, rising to over US$21.4 billion in 2014[28]. On the other hand, Indonesia's Islamic financial market only accounts for about 4.9% of the domestic financial market, and is in many respects undeveloped compared with its neighbor Malaysia.

The government's slowness in drafting legislation and reforming taxes has clearly affected the sukuk market. There have been 50 sovereign sukuk issues totaling over US$14.9 billion since 2008, but only 46 corporate sukuk issues totaling US$700 million since 2003 (Figure 9). Indonesia's sukuk market is dominated by sovereign sukuk, and we think this suggests a need for some incentives, including changes in the way sukuk and other Islamic financial products are taxed as well as tax breaks that encourage the issuance of corporate sukuk.

[28] "Islamic banking growth in Indonesia," *IFN*, Volume 11, Issue 14, 3 April 2014.

Figure 9: Indonesia's sukuk (2004–2013)



Source: Nomura Institute of Capital Markets Research, based on the IFIS database

3. Government and regulations

Indonesia's first Islamic bank was established in 1991, and Islamic banks have been legally recognized since 1992. Profit distributions were first recognized as a source of revenue in addition to interest and commissions & fees with the implementation of the Banking Act in 1992, which also required the establishment of a sharia board within Islamic banks. Additionally, it requires that each Islamic bank's sharia board obtains an opinion from the Indonesian Council of Ulama (MUI[29]), Indonesia's main organization for sharia scholars, when it verifies the sharia compliance of financial products and services[30]. The government further specified regulations for Islamic banks with the passage of comprehensive legislation aimed at Islamic banks in 2008: Act No. 21 Concerning Sharia (Islamic) Banking.

Indonesia's regulators have also recently begun implementing a range of policies aimed at fostering the growth of Islamic finance within the country. One important step was the OJK joining the IFSB. The government plans to introduce regulations for the Islamic financial sector and takaful based on regulations from the IFSB. It also plans to expand the list of Islamic finance methods that are officially approved, and has proposed diversifying the types of sukuk[31] that can be issued, and initiating Islamic repo transactions[32].

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29 Majelis Ulama Indonesia.

30 Tim Lindsey, "Between Piety and Prudence: State Syariah and the Regulation of Islamic Banking in Indonesia," The University of Melbourne.

31 Asia Development Bank's "ASEAN+3 Bond Market Guide" Volume 1, Part 2, Section 3: Indonesia Bond Market Guide.

32 Bernardo Vizcaino, "Indonesia's Islamic finance sector broadens," *Reuters*, 2 April 2014.

Indonesia's central bank (Bank Indonesia) plans to cooperate with the International Islamic Liquidity Management Corp. (IILM)[33], a Malaysia-based organization in which it is a shareholder, to increase the amount of domestic high-quality Islamic liquid assets and to create a short-term sukuk market. It also plans on sponsoring study sessions aimed at raising awareness of Islamic finance among consumers.

Additionally, the Ministry of Finance announced that it plans to quadruple the amount of sovereign sukuk issued to fund infrastructure projects from 2015 as a way to expand the domestic Islamic finance market and, as already noted, the central bank announced plans to increase the number of domestic Islamic banks from 11 currently to 25 by 2023[34].

There is also a possibility that future government policies will further accelerate growth in the Islamic finance market. For example, the government is considering authorizing the Islamic bank subsidiaries of conventional banks to provide Islamic financial services through their parent banks' branch network, and we think this would provide an important engine for growth if implemented[35]. This is because it would allow conventional banks' Islamic bank subsidiaries to expand their own network at minimal cost by using their parent banks' branches, thereby giving them the ability to attract a greater number of retail customers. That would rapidly increase the market share of Islamic banks and expand access to low-cost funds, reducing their funding costs and raising the competitiveness of the domestic Islamic banking sector overall.

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33 IILM is an organization that promotes the issuance and growth of high-quality liquid assets, such as investment grade sukuk, in Islamic financial markets.

34 "Indonesia's BTPN to buy Bank Sahabat for Islamic Unit," *IFIS*, 21 January 2014 and "Indonesia boosts sukuk issuance fourfold to fund infrastructure projects," *IFN*, 24 March 2014.

35 Farouk Abdullah Alwyni, "The Development of the Indonesian Islamic Finance Industry: Restraining growth and reinforcing business foundation," *IFN*, February 2014.

IV. QISMUT country overview: Saudi Arabia (S)

Overview of Saudi Arabia's Islamic finance

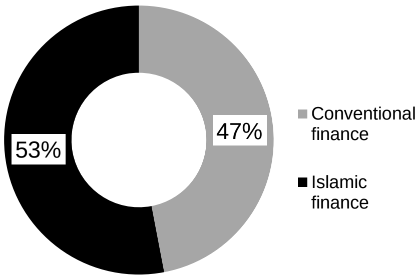
Islamic financial assets: US$245 billion (Ranked first among the six QISMUT countries)

Average growth rate for Islamic bank assets in 2008–2012: 11% (3.6X that of conventional banks)

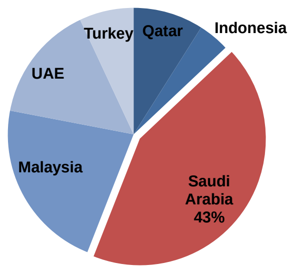
Characteristics of Islamic finance:

- Conventional banks are allowed to operate Islamic windows.
- Saudi Arabia issued sukuk totaling about US$14.6 billion in 2013, ranking it second among QISMUT countries.
- Although the number of corporate sukuk issues has exceeded that of sovereign sukuk in recent years, the cumulative issuance amount of sovereign sukuk is greater than that of corporate sukuk.
- The world's largest Islamic Bank based on assets, Al-Rajhi, and the Islamic Development Bank (IDB) are both based in Saudi Arabia.
- Islamic finance accounts for more than 50% of the domestic financial market, and the majority of that is accounted for by Islamic bank assets.
- The sharia compliance of Islamic financial products is verified by each bank's internal sharia board.
- Seven universities and 22 educational institutions in Saudi Arabia offer a specialized education in Islamic finance, making the country a leader in Islamic finance education.

Domestic market share:



Share among QISMUT countries:



Source: Nomura Institute of Capital Markets Research, based on data from Zawya, Ernst & Young, and Islamic Finance News (IFN)

1. Macroeconomic overview

Saudi Arabia averaged annual GDP growth of 6.25% in 2010–2012[36], and with approximately US$270 billion of Islamic financial assets it is the world's second-largest Islamic financial market[37].

Saudi Arabia's international balance of payments and fiscal balance are both now significantly in the black as a result of rapid growth in profits from petroleum refining in recent years, and this has reduced government debt as a share of GDP to 3.6%[38]. Agriculture accounts for 2% of GDP, industry 62.5%, and services 35.5%[39], but the economy is heavily dependent on the oil sector[40], and the North American shale boom along with the resurgence of oil refining in Libya and Iraq may lead to slower growth in the future[41]. Saudi Arabia's non-oil sector is also growing, however, and whereas

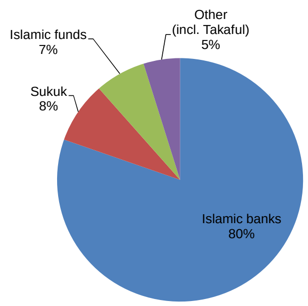
36 IMF Country Report No. 13/229, July 2013.
37 "Saudi Arabia is identified as one of the most developed Islamic finance countries," *Zawya*, 18 November 2013.
38 From The Heritage Foundation, "Index of Economic Freedom 2014" and Hylmun Izhar, "Saudi Arabia: Potential in the non-oil sector, Zakat and Waqf," *IFN*, February 2014.
39 CIA World Factbook (2013 data).
40 Arab Petroleum Investments Corporation, "APICORP's Economic Commentary," December 2013.
41 From the Ernst & Young Emerging Markets Center.

the mining sector, which includes oil and natural gas and accounts for roughly half of nominal GDP, grew 5.9% in 2012, a number of non-oil sectors grew by double digits, including the construction industry at 16.5%, transportation and communications at 12.2%, finance, insurance and real estate at 11.1%, and manufacturing at 10.9%[42]. We think growth in the non-oil sector is important for maintaining the future growth of Saudi Arabia's economy and Islamic finance market.

2. Islamic finance market

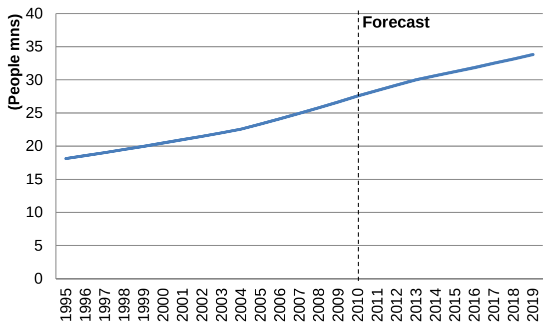
Islamic finance accounts for more than 50% of the domestic financial market, the majority of which is held as Islamic bank assets. The primary drivers of domestic Islamic finance are the oil sector and its nearly 100% Muslim population of over 29 million[43] (Figure 11).

Figure 10: Categories in Saudi Arabia's Islamic finance market



Note: Based on 2012 data.
Source: Nomura Institute of Capital Markets Research, based on data from Zawya (Reuters)

Figure 11: Saudi Arabia's population growth

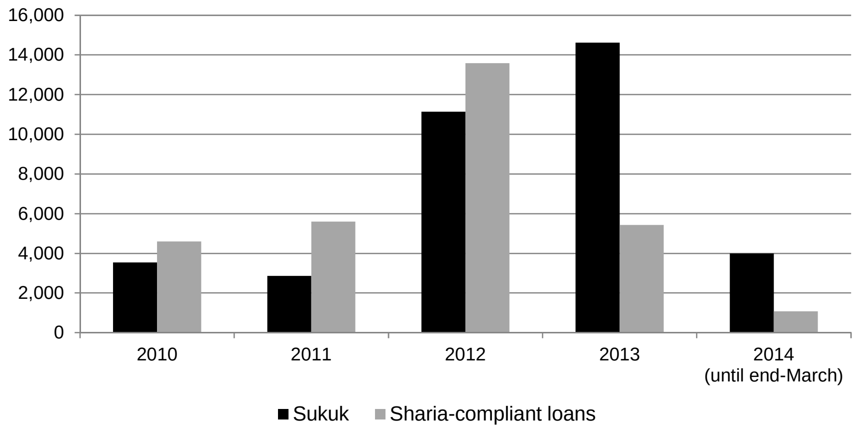


Note: Figures from 2010 are forecasts.
Source: Nomura Institute of Capital Markets Research, based on IMF data

To assure future growth of the Islamic finance market, Saudi Arabia is focusing on three main areas in addition to activity by Islamic banks: project finance, Islamic asset management, and Islamic socially responsible investing (SRI). Major recent examples of project finance include a US$2 billion sukuk issuance to finance a renewable energy project by the Polysilicon Technology Company. Various other domestic infrastructure projects are also expected to foster future growth, particularly in the sukuk market (Figure 12). Saudi Arabia has the world's second largest market for Islamic asset management behind Malaysia, with approximately US$12 billion of sharia-compliant assets under management[44]. Saudi Arabia is also a leader in Islamic financial education, with seven universities and 22 educational institutions offering credentials in Islamic finance.

[42] From the Japan External Trade Organization's (JETRO) 2013 JETRO Global Trade and Investment Report.
[43] From the "2014 World Population Review" database.
[44] Hylmun Izhar, "Saudi Arabia: Potential in the non-oil sector, zakat and waqf," *IFN 2014 Guide*, Feb. 2014.

Figure 12: Growing volume of sukuk issuance relative to sharia-compliant loans



Source: Nomura Institute of Capital Markets Research, based on the IFIS sukuk and loan database

3. Government and regulations

Governance reform is critical to the future growth of Islamic finance in Saudi Arabia. Islamic finance has a modern history of about 40 years in the country, starting with establishment of the Islamic Development Bank (IDB) in 1975. Its development since then has primarily been driven by the introduction of Islamic financial services by conventional banks, however, and no regulatory regime designed specifically for Islamic finance has been put together. Financial regulations have been introduced by two government bodies, the Saudi Arabian Monetary Agency (SAMA) and the Capital Market Authority (CMA). Both agencies have the authority to implement the Islamic financial regulations proposed by the IFSB, but their responsibilities do not include monitoring the sharia compliance of Islamic financial services and products offered by domestic banks. All Islamic banks have sharia boards, the members of which are chosen by the banks' Board of Directors. The majority (about 90%) of sharia board members are said to be specialists in Islamic law, and relatively few have expertise in financial law or economics. Neither the ability to speak a foreign language nor experience in the banking industry are conditions for selection[45]. This has blocked the standardization of Islamic finance, and because each bank offers Islamic financial products based on decisions made by its own sharia board, in some cases an Islamic financial product approved by one bank is not approved by other banks or customers[46].

Saudi Arabia is an important market for global Islamic finance. Given the future potential of Islamic finance in Saudi Arabia, we think involvement by Islamic financial institutions in non-oil sectors (including retail and project finance) and the standardization and/or compliance monitoring of Islamic financial products and services are critical conditions for sound growth.

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[45] Reem M. Assad, "The Regulatory Framework of Islamic banking in Saudi Arabia," Saudi Economic Association.

[46] British Embassy Jeddah, "Saudi Arabia: Islamic Finance Market February 2013," *UK Trade & Investment*, February 2013.

V. QISMUT country overview: Malaysia (M)

Overview of Malaysia's Islamic finance

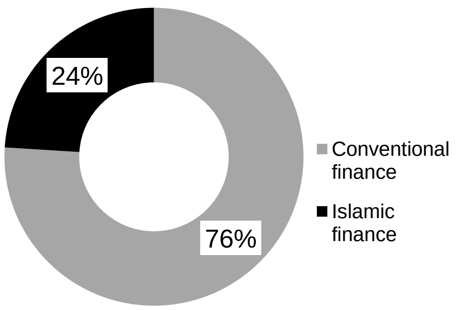
Islamic financial assets: US$140 billion (Ranked second among the six QISMUT countries)

Average growth rate for Islamic bank assets in 2008–2012: 20% (2.1X that of conventional banks)

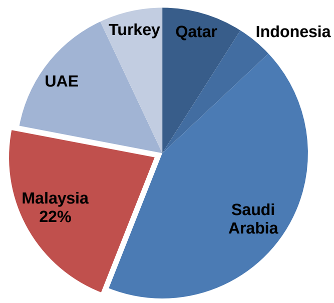
Characteristics of Islamic finance:

- Conventional banks are legally allowed to operate Islamic windows.
- Malaysia has the world's largest sukuk market, with issuance totaling US$86.7 billion in 2013, equal to about 70% of global sukuk issuance that year. ）
- The majority of sukuk issued are sovereign sukuk.
- Malaysia further clarified its legal framework in 2013 with passage of the Islamic Financial Services Act (IFSA) and the introduction of an Islamic insurance framework.
- Since 1997, the sharia-compliance of domestic Islamic financial products and services has been verified by the Shariah Advisory Council (SAC) of Bank Negara Malaysia, the country's central bank.
- Japan's three megabanks (Sumitomo Mitsui Banking Corp., Bank of Tokyo-Mitsubishi UFJ, and Mizuho Bank) and the Nomura Group's Nomura Islamic Asset Management provide Islamic financial services in Malaysia.

Domestic market share:



Share among QISMUT countries:



Source: Nomura Institute of Capital Markets Research, based on data from Zawya, Ernst & Young, and Islamic Finance News (IFN)

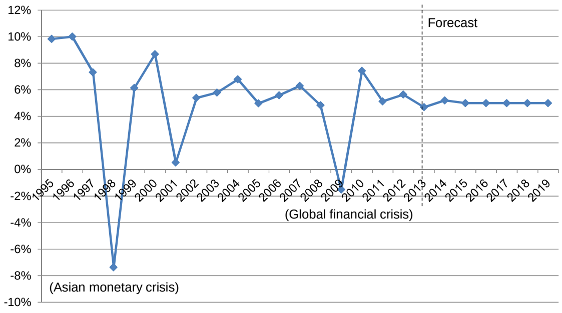
1. Macroeconomic overview

Malaysia's economy, driven by the construction, manufacturing, and services industry, recorded average GDP growth of 4.3% from 2008 to 2012, and 4.8% in 2013. Growth is expected to average 5% going forward (Figure 13).

Agriculture accounts for 11.2% of GDP, industry 40.6%, and services 48.1%. According to data from Malaysia's Department of Statistics, the country has maintained a trade surplus and growth in both imports and exports since the global financial crisis (Figure 14). Electrical and electronics products account for approximately one third of exports, while three specific products, palm oil, LNG, and crude oil, account for one fourth of exports, and including petrochemical products as a fourth product segment, brings that share of exports to about 30%. Its export diversity and lack of dependence on primary industries are strengths of the Malaysian economy relative to Saudi Arabia and the UAE[47].

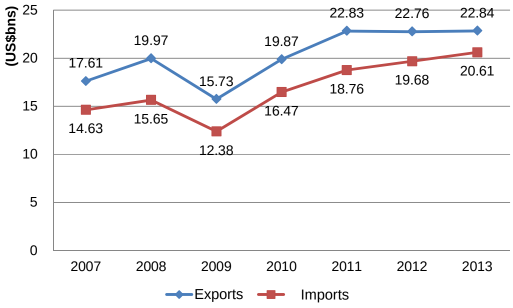
47 From the JETRO Global Trade and Investment Report: Malaysia 2013 edition.

Figure 13: Malaysia's GDP growth



Source: Nomura Institute of Capital Markets Research, based on IMF data

Figure 14: Malaysia's import/export trend



Source: Nomura Institute of Capital Markets Research, based on JETRO's statistical data

2. Islamic finance market

Malaysia, East Asia's Islamic financial center, has 10 domestic Islamic banks and six foreign Islamic banks providing Islamic financial services, and provides solid support for the growth of Islamic finance through its stable government and economy, high level of knowledge and expertise in Islamic finance, and regulatory regime geared toward Islamic finance.

Malaysia has introduced a clear set of regulations specifically for Islamic finance and has made considerable progress in achieving growth in the sukuk and takaful markets and developing Islamic financial products. Malaysia has the world's largest sukuk market and accounts for more than half of all sukuk issuance. Domestic sukuk issuance averaged 29% annual growth from 2008 until 2013, and totaled a record high US$110.3 billion in 2012. Malaysia also issues a significant amount of sovereign sukuk, and accounted for about 70% of worldwide issuance in 2013 (Figures 15 and 16).

Figure 15: Malaysia's sukuk issuance

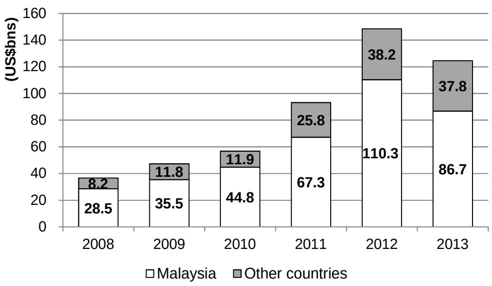
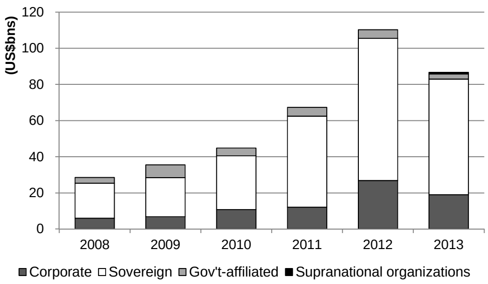


Figure 16: Malaysia's sukuk issuance by type



Note: Affected by the Fed's tapering, sukuk issuance fell 16% in 2013 to only US$86.7 billion, with corporate issuances being the main driver at -36.6% y-o-y.
Source: Nomura Institute of Capital Markets Research, based on the IFIS database

Malaysia contributes to the growth of global Islamic finance not only through growth in its domestic market but also by cooperating with other Islamic countries and promoting the global standardization of sharia regulations. For example, Bursa Malaysia (formerly the Kuala Lumpur Stock Exchange) and Tadawul (Saudi Arabia's stock exchange) signed a memorandum of understanding in 2014 to promote bilateral cross-border transactions, primarily aiming to (1) develop Islamic capital markets, (2) exchange expertise on Islamic finance, (3) improve personnel development and knowledge of markets, and (4) strengthen bilateral financial and economic relations. This strengthening of the relationship between Malaysia and Saudi Arabia, two major players in the global Islamic financial market, is an important step toward the standardization and globalization of the Islamic financial industry[48].

As a result of these efforts, many foreign-capitalized financial institutions, including Japan's three megabanks and the Nomura Group, have established Islamic financial business bases in Malaysia and support further strengthening of the country position as an Islamic financial center.

3. Government and regulations

Malaysia's Islamic financial sector continued developing at a fast pace in 2013. An important step toward sound market growth came with its passage in June 2013 of the Islamic Financial Services Act 2013 (IFSA) legislating the governance of sharia-compliant Islamic financial transactions. This resulted in the standardization of sharia rules related to Islamic finance, simplified sharia compliance, strengthened risk management, and provided a clear legal distinction between Islamic financial products and conventional financial products.

To ensure the smooth implementation of IFSA regulations, in 2013–14 Malaysia's central bank, Bank Negara Malaysia, applied new sharia standards to Islamic financial transactions and agreements and adopted a policy of promoting the global standardization of its domestic Islamic financial sector. These included issuing guidelines for murabaha transactions[49], publishing templates for wakala[50] and tawarruq[51] contracts, and publishing concept papers for mudaraba[52] and musharaka[53].

Malaysia has also adopted policies favoring growth in Islamic asset management by improving the sharia compliance screening methods used by the Securities Commission Malaysia for securities traded on Bursa Malaysia. As a result of its standardization of sharia-compliant securities transactions, sharia-compliant assets under management, which account for about 16% of domestic Islamic financial assets,

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48 "Bursa Malaysia and Tadawul sign MoU to foster closer financial and economic ties," *IFN*, 21 February 2014.

49 This is a transaction whereby an Islamic bank purchases a product on behalf of the customer (such as an automobile or industrial machinery), then sells that product to the customer, usually based on a schedule of installment plan payments, which build in fees and a profit.

50 Wakala is basically the same as asset management and other fee businesses that are part of conventional finance. The investor provides funds to the Wakil (agent, i.e., bank) and the bank invests the funds on behalf of the investor.

51 Tawarruq is a mechanism to create profit equating to interest using a product transaction.

52 Mudaraba is a partnership to which the investor contributes funds and the business operator contributes expertise.

53 Musharaka is a partnership-based form of Islamic finance allowing the investor and business operator to jointly invest in and manage a single project.

totaled over US$24 billion in 2013 and are expected to grow at a double-digit pace over the next 10 years[54].

Malaysia's takaful market is also growing rapidly as a result of diversifying consumer needs. It grew by 21% in 2012, and currently accounts for about 71% of the takaful market in ASEAN countries. Takaful premiums paid in Malaysia accounted for 11% of the roughly US$20 billion paid worldwide in 2013[55]. To support further growth, Malaysia issued its Takaful Operating Framework in 2013, through which it provided comprehensive guidelines for takaful investment companies. In addition, with its Risk-Based Capital Framework for Takaful Operators, Malaysia introduced equity capital ratios, suitable capital buffers for risk exposures, and other regulatory standards to ensure sound growth in the overall market.

VI. QISMUT country overview: UAE (U)

Overview of Islamic finance in UAE

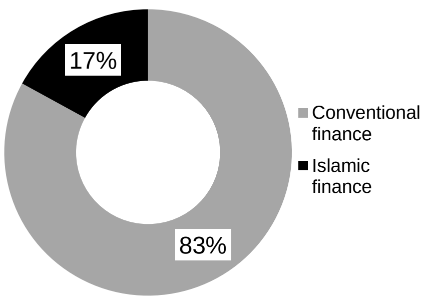
Islamic financial assets: US$83 billion (Ranked third among the six QISMUT countries)

Average growth rate for Islamic bank assets in 2008–2012: 14% (3X that of conventional banks)

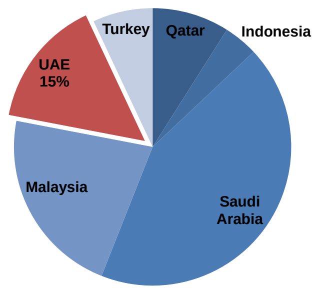
Characteristics of Islamic finance:

- Conventional banks are legally allowed to operate Islamic windows.
- The UAE issued sukuk totaling US$7.1 billion in 2013, ranking it third among QISMUT countries.
- Although in Dubai more sovereign sukuk (including issuance by government affiliated agencies) are issued than corporate sukuk, in Abu Dhabi corporate sukuk account for more issuance than sovereign sukuk.
- The Dubai Islamic Economy Development Centre was established in 2013.
- To distinguish between Islamic banks and conventional financial institutions, the UAE passed Islamic finance legislation (UAE Law No. 6 of 1985) in 1985.
- To strengthen the governance of Islamic financial institutions, the UAE's central bank established the Islamic Banking Committee (IBC).
- The Dubai government plans on establishing a Central Sharia Board to coordinate the verification of sharia compliance and standardize financial product structures and rules within the UAE.

Domestic market share:



Share among QISMUT countries:



Source: Nomura Institute of Capital Markets Research, based on data from Zawya, Ernst & Young, and Islamic Finance News (IFN)

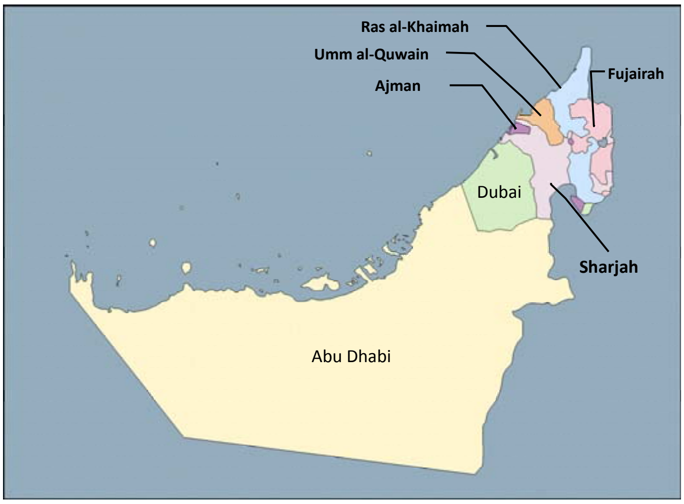
[54] Raja Teh Maimunah, "Malaysia: A Continuous Evolution," *IFN*, February 2014.

[55] Liau Y-Sing, "AIG Lured to Malaysia by Growing Takaful Market: Islamic Finance," *Insurance Journal*, 18 February 2014.

1. Macroeconomic overview

The United Arab Emirates (UAE) is a federation of seven emirates: Abu Dhabi, Dubai, Sharjah, Ajman, Umm al-Quwain, Fujairah, and Ras al-Khaimah (Figure 17). Oil and natural gas account for about 80% of the government's revenues, and like Saudi Arabia, the UAE is highly dependent on the oil sector. Abu Dhabi, which accounts for about 90% of the UAE's oil production, is the center of the UAE's oil sector, while Dubai is its hub for finance, trade, transportation, fashion, and tourism. Following the Arab Spring in 2013, the UAE government introduced policies aimed at infrastructure development and growth for the emirates in the north, where incomes are relatively low[56]. Agriculture accounts for 0.6% of GDP, industry 61.1%, and services 38.2%[57].

Figure 17: Map of United Arab Emirates



Source: Nomura Institute of Capital Markets Research, based on data from D-Maps

According to the Dubai Chamber of Commerce and Industry, Dubai has plans to grow the core sectors of the Islamic economy, including Islamic finance, Islamic tourism, halal food and halal cosmetics. It expects the worldwide market for Islamic tourism, now worth US$137 billion, to more than double in size over the next five years to US$284 billion, and looks for the global halal food market to grow from US$1.1 trillion currently to US$2.5 trillion. It expects the market for Halal cosmetics and daily necessities in the Asia-Pacific region to average 11% annual growth from 2013 until 2018[58]. Dubai is trying to capture global market share in these sectors, including Islamic finance, by generating growth in its domestic Islam-related markets[59].

An increase in construction and infrastructure projects (such as hotels, roads, and parks) is expected to result from the decision to hold the 2020 World Expo in Dubai, and we think this could become an engine for further economic growth.

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56 From the Heritage Foundation's 2014 Index of Economic Freedom.

57 CIA World Factbook (2013 data).

58 Infiniti Research Ltd., "Halal Cosmetics and Personal Care Market in the APAC Region 2014-2018," April 2014.

59 "Dubai to focus on Islamic economy and Expo 2020 in 2014," *Gulf News*, 9 February 2014.

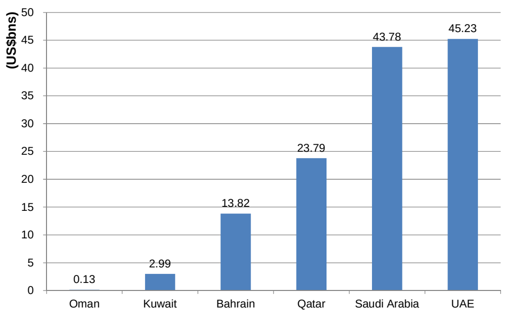
2. Islamic finance market

According to IFIS data on sukuk, the UAE's cumulative sukuk issuance to date is about US$45.23 billion, making it the largest sukuk market in the GCC (Figure 18).

Like the other QISMUT countries, the UAE is engaged in various activities aimed at making itself an Islamic financial hub, and within the GCC[60] competes with Saudi Arabia, Qatar, and Bahrain. The UAE not only competes with other countries, but also fosters competition among the emirates, of which Dubai and Abu Dhabi have the most competitive Islamic financial markets.

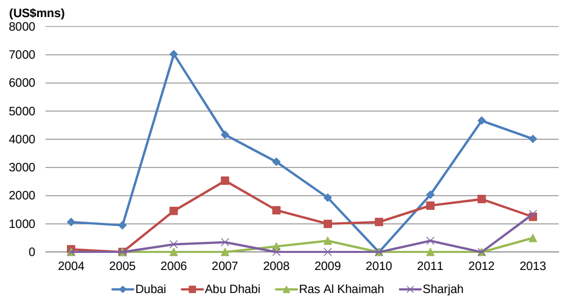
Dubai accounts for 67% of the UAE's sukuk issuance, and attracted international attention in 2004 when it issued the first international sovereign sukuk to fund the expansion of Dubai's international airport. Non-Islamic investors filled 70% of the orders book, strengthening Dubai's global reputation as an Islamic financial hub. Sukuk issuance has grown rapidly since 2005 as a result of several different infrastructure projects in Dubai being financed with sukuk. The Dubai financial crisis (Dubai World)[61] occurred in 2009, however, and although an emergency loan of US$20 billion from Abu Dhabi helped to avoid a default, Dubai suffered a major setback to its image, and did not issue any sukuk in 2010. Starting in 2011, it was able to repair its image with the successful restructuring of the debt in question, and because rising crude oil prices were fueling growth in the financial assets and investor base of oil-producing countries, it resumed sukuk issuance (Figure 19).

Figure 18: GCC members up to the present



Source: Nomura Institute of Capital Markets Research, based on the IFIS database

Figure 19: Sukuk issuance by the emirates Sukuk issuance (2004–2013)



Notes: 1. Including corporate, sovereign, and government-affiliated issuance.
2. There is no record of any sukuk from Ajman, Umm al-Quwain, or Fujairah.

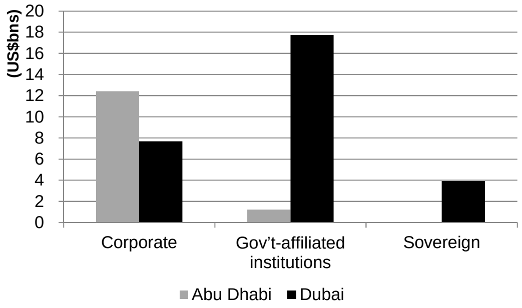
Source: Nomura Institute of Capital Markets Research, based on the IFIS database

60 The Gulf Cooperation Council (GCC) has six members: the UAE, Bahrain, Kuwait, Oman, Qatar, and Saudi Arabia.

61 The Dubai crisis, triggered when the government-affiliated holding company Dubai World asked its creditors for an extension of its debt repayment deadlines, sparked concerns over the debt of government affiliated companies and created turmoil throughout global financial markets. For reference see:Saima Arai, "Kaifuku ni mukau Wangan Shokoku no Sukuuku Shijou to Isuramu Ginkou (The sukuk market and Islamic banks in the recovering Gulf states)", Summer 2012 issue of Nomura Capital Markets Quarterly (in Japanese).

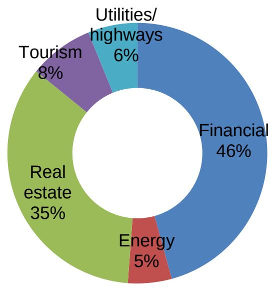
Abu Dhabi issued its first sukuk in 2004[62], but has only issued 20 since then[63]. One possible reason is that the emirates are awash in liquidity from resource revenue. Abu Dhabi has roughly 94% of the UAE's oil reserves, and the Abu Dhabi Investment Authority (ADIA) is one of the world's largest sovereign wealth funds with US$627 billion of assets in its portfolio. Accordingly, Abu Dhabi does not need to issue sukuk or bonds for funding infrastructure projects to the same extent as Dubai does. On the other hand, Abu Dhabi's corporate sukuk issuance is greater than that of Dubai, and we expect Islamic financial institutions and real estate-related companies to continue issuing sukuk (Figures 20 & 21).

Figure 20: Sukuk in Abu Dhabi and Dubai



Source: Nomura Institute of Capital Markets Research, based on IFIS database

Figure 21: Types of corporate sukuk in Abu Dhabi



Source: Nomura Institute of Capital Markets Research, based on IFIS database

3. Government and regulations

The UAE aims to be the center of the world's Islamic economy and has implemented a variety of policies to promote the growth of Islamic finance. Examples of this include its establishment of the Dubai Islamic Economy Development Centre in December 2013 to support the creation of an Islamic economic hub in Dubai and throughout the UAE, as well as the central bank's establishment in April 2014 of an Interim Marginal Lending Facility (IMLF). The IMLF is a scheme to strengthen liquidity management at domestic Islamic banks by recognizing as collateral a borrower's holdings of sovereign sukuk or sukuk issued by authorities in any of the emirates. The IMLF represents critical progress for Islamic finance because it is set up as a backstop to Islamic financial markets and to provide sharia-compliant, interest-free loans[64] to Islamic financial institutions that do not have access to interest-bearing funding from conventional financial institutions or the central bank during times of market stress.

The UAE Central Bank set up its Islamic Banking Committee (IBC) to regulate Islamic finance, provide oversight of financial products, and strengthen the governance of Islamic financial institutions throughout the UAE while pushing for the

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62 A US$100 million sukuk issuance from the National Central Cooling Company (Tabreed). Source: IFIS database.

63 This is less than half the number of sukuk deals that Dubai has issued.

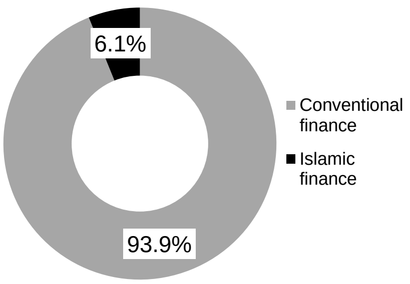
64 David French, "UPDATE 1-UAE c.bank to launch overnight lending facility April 15," *Reuters*, April 2014.

standardization of the individual emirates' Islamic financial markets[65]. Furthermore, the Dubai government[66] announced in 2013 that it would establish a Central Sharia Board to standardize the sharia compliance of domestic Islamic financial products as well as the structure and regulation of those products, and policies to increase by way of product standardization the number of investment products listed on the Dubai Financial Market[67]. Efforts by both of these regulatory bodies show the importance of standardized regulations to the sound growth of Islamic finance.

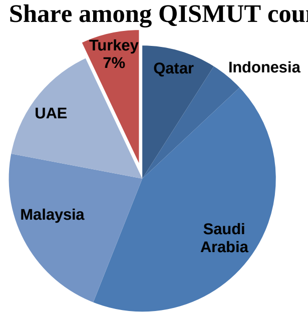
VII. QISMUT country overview: Turkey (T)

Overview of Islamic finance in Turkey
Islamic financial assets: US$50 billion (Ranked fifth among the six QISMUT countries)
Average growth rate for Islamic bank assets in 2008–2012: 29% (about 2X that of conventional banks)
Characteristics of Islamic finance: ● Conventional banks are prohibited from operating Islamic windows. ● Turkey issued sukuk totaling US$4 billion in 2013, ranking it fourth among QISMUT countries. ● Its issuance of sovereign sukuk attracted the attention of the Islamic financial sector, motivating many overseas investors to invest in Turkey for the first time. ● To ensure the state's secularism, Turkey's Islamic banks are legally called "participating banks," and governed by the same banking laws and administered by the same authorities (Banking Regulation and Supervision Agency and Savings Deposit Insurance Fund) as conventional banks. ● The World Bank and Turkey's Ministry of Finance worked together to establish the Global Center for Islamic Finance in Istanbul. ● The Istanbul Stock Exchange (ISE) plans to establish an Islamic finance research center. ● Turkey's sovereign debt is rated investment grade by Fitch and Moody's.

Domestic market share:



Share among QISMUT countries:



Source: Nomura Institute of Capital Markets Research, based on data from Zawya, Ernst & Young, and Islamic Finance News (IFN)

1. Macroeconomic overview

Turkey's high economic growth over the past 10 years now ranks it the world's 17th largest economy. GDP grew by an average of over 6% annually from 2010 until

65 Mian Muhammad Nazir, "Shariah governance at the Central Bank of UAE," *IFLR*, 30 October 2012.

66 The UAE's federal constitution provides for a separation of powers between the federal government and each emirate's government, and it is the latter that has authority over resource development, education, economic policy, and building/maintaining infrastructure. In Dubai, the various trade-related government agencies (including the Dubai Financial Services Authority (DFSA)) hold considerable sway.

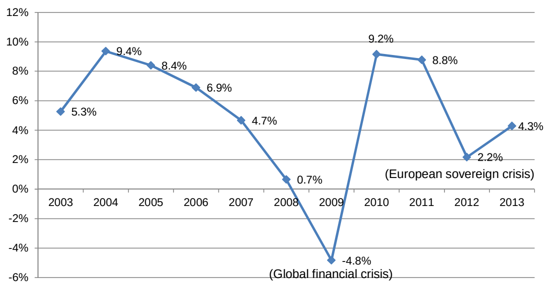
67 "Dubai plans central Islamic finance regulatory board," *Reuters*, 27 February 2013.

2013, and totaled US$1.16 trillion on a PPP basis in 2013 (Figure 22). Agriculture accounts for 8.9% of GDP, industry 27.3%, and services 63.8%[68].

Trade data from the Turkish Statistical Institute (TurkStat) show 2012 exports grew 13.0% from the year prior to US$152.4 billion, still a strong performance after the 18.5% growth in exports recorded in 2011, while imports declined 1.8% to US$236.5 billion, causing a 20.6% narrowing of the trade deficit to US$84.1 billion[69]. In 2013, however, exports declined 0.5% to US$151.8 billion and imports increased 6.4% to US$251.7 billion, causing a 19% increase in the trade deficit to about US$100 billion[70] (Figure 23).

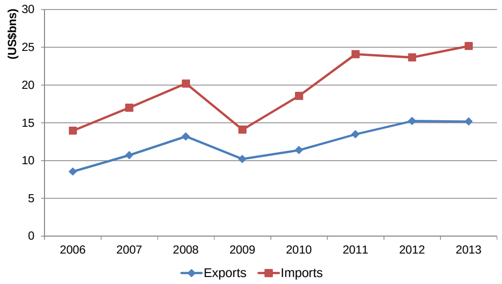
Turkey's biggest driver of economic growth is the tourism industry, which recorded the highest growth rate at 14.9%. Manufacturing grew 3.4%, trade 5%, and the construction industry 7.6%[71].

Figure 22: Turkey's GDP growth rate



Source: Nomura Institute of Capital Markets Research, based on IMF data

Figure 23: Turkey's export/import trends (2003–2013)



Source: Nomura Institute of Capital Markets Research, based on data from the Turkish Statistical Institute

2. Islamic finance market

Turkey currently has four Islamic banks[72], and Islamic finance accounts for about 6.1% of the domestic financial market[73]. The population, which is over 95% Muslim, continues to grow, and the large number of SMEs together with government assistance programs are driving the growth of Islamic finance in Turkey. Total assets held by domestic Islamic banks grew at an average annual rate of over 34% from 2003 until 2013 (Figure 24).

Important components of the growth strategies of Islamic banks are the development and diversification of products and services that meet customer needs,

68 CIA World Factbook (2013 data).
69 From data in the Turkish Statistical Institute's "Foreign Trade by Years."
70 Data for 2013 are estimates from the Turkish Statistical Institute.
71 "Turkey becomes world's third in economic growth," *The Daily Sabah*, 11 September 2013.
72 1. Bank Asya, 2. Turkiye Finans, a subsidiary of (and 66.3% owned by) National Commercial Bank (NCB), 3. Kuveyt Turk, a subsidiary of (and 62.2% owned by) Kuwait's Kuwait Finance House, and 4. Albaraka Turk, a subsidiary of (and 54.1% owned by) Bahrain's Al-Baraka Banking Group.
73 Deloitte Turkey, "Katılım Bankalarının Türkiye' de Pazar Payı Artıyor" (Participation Banks Gain Market Share in Turkey), 7 February 2014.

the spread of online banking, and rapid increase in branches[74] (Figure 25). This has increased the interest of retail customers, and 38% of the Turks who are not currently using Islamic banks have interest in doing business with Islamic banks in the future, according to a Reuters survey[75]. That same survey also found that about 80% of those not using Islamic banks and about 40% of current Islamic bank customers had either "no knowledge of" or "no detailed knowledge of" the differences in structure between Islamic and conventional financial products, making clear the need to raise the knowledge and awareness of Islamic finance within the country. We think Islamic financial institutions, educational institutions, and the government can play important roles in this regard.

Figure 24: Islamic banks' total assets in Turkey

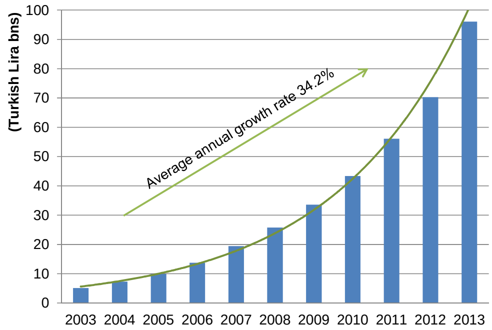
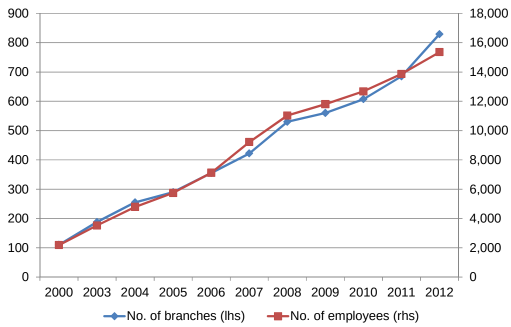


Figure 25: Number of branches and employees of Turkey's Islamic banks



Source: Nomura Institute of Capital Markets Research, based on data from the Banking Regulation and Supervision Agency (BDDK) and the Participation Banks Association of Turkey (TKKB)

The segment of Turkey's Islamic financial market of most interest to nonresident investors is sukuk. In addition to Islamic banks, private-sector corporations and the government also issue sukuk. Both US dollar-denominated and Turkish lira-denominated sukuk have been issued since 2010, and sukuk issuance totaled over US$4 billion in 2013 (Figure 26). In its Development Plan for 2007–2013, the Turkish government positioned Islamic finance as one element of the country's growth strategy, recent regulatory reforms have increased the number of different types of legally recognized Islamic financial products (including types of sukuk), and declines in issuance costs (including taxes) have made issuance easier[76]. We therefore expect Islamic financial markets to grow and sukuk issuance to increase.

74 The number of Islamic bank branches grew from 607 to 938 from 2010 until 2013.

75 From Mustafa Adil, "Turkey Participation Finance Report 2014: Fundamentals and the Promise of Growth" and documents published by Thomson Reuters.

76 Cabinet Decree 2011/1854 exempted sukuk with a maturity of at least five years from income taxes and started applying the same tariff rate applied to conventional loan assets to sukuk with shorter maturities. The Omnibus Bill No. 6111 (2011) exempts the transfer of assets between a sukuk issuer and the issuing body (SPV) from corporate tax and stamp duties.

Figure 26: Sukuk issuance in Turkey since 2010

Issuance/maturity (term)	Borrower	Issuance amount (USD)	Currency	Status	Type	Domestic/ international	Listing	Sector	Rating agencies	Ratings
Expected in June 2014 (60 months)	Kiler GYO	100mn	USD	Planned	Corporate	International	-	Real estate, construction	-	-
Jun 2014--Jun 2019 (60 months)	Albaraka Turk Participation Bank	3.5bn	USD	Planned	Corporate	International	-	Financial	-	-
Feb 2014--Feb 2016 (24 months)	Turkish Government	600mn	TRY	Issued	Sovereign	Domestic	-	Government-affiliated	Fitch, Moody's	BBB-, Baa3
Before end-2014--	Bank Asya	500mn	USD	Planned	Corporate	International	-	Financial	-	-
Nov 2013--Nov 2014 (12 months)	Kuwyet Turk Participation Bank	74.05mn	TRY	Issued	Corporate	Domestic	Unlisted	Financial	-	-
Undecided	Turk Telekom	1bn	USD	Planned	Corporate	International	-	Telecom	-	-
Oct 2013--Oct 2018 (60 months)	Turkish Government	1.25bn	USD	Issued	Sovereign	International	Unlisted	Government-affiliated	Fitch, Moody's	BBB-, Baa3
Aug 2013--Aug 2015 (24 months)	Turkish Government	970mn	TRY	Issued	Sovereign	Domestic	Unlisted	Government-affiliated	-	-
May 2013--May 2014 (12 months)	Aktif Bank	47.88mn	TRY	Issued	Corporate	Domestic	Unlisted	Financial	JCR-VIS Credit Rating	AA-
May 2013--May 2023 (120 months)	Albaraka Turk Participation Bank	200mn	USD	Issued	Corporate	International	Unlisted	Financial	-	-
May 2013--May 2018 (60 months)	Turkiye Finans Participation Bank	500mn	USD	Issued	Corporate	International	Irish Stock Exchange	Financial	Fitch	BBB
Announced in April 2013	Agaoglu Group	2bn	USD	Planned	Corporate	International	-	Energy, tourism	-	-
Mar 2013--Mar 2023 (120 months)	Bank Asya	250mn	USD	Issued	Corporate	International	Irish Stock Exchange	Financial	Fitch, Moody's	B+, Ba3
Mar 2013--Mar 2014 (12 months)	Bank Asya	69.26mn	TRY	Issued	Corporate	Domestic	Unlisted	Financial	-	-
Undecided	Turkish Airlines	500mn	USD	Planned	Corporate	International	-	Transportation	-	-
Undecided	Akbank	280mn	TRY	Planned	Corporate	Domestic	-	Financial	-	-
Oct 2012--Oct 2014 (24 months)	Turkish Government	900mn	TRY	Issued	Sovereign	Domestic	Unlisted	Government-affiliated	-	-
Sep 2012--Mar 2018 (66 months)	Turkish Government	1.5bn	USD	Issued	Sovereign	International	Irish Stock Exchange	Government-affiliated	Moody's, S&P	Ba1, BB
Oct 2011--Oct 2016 (60 months)	Kuwyet Turk Participation Bank	350mn	USD	Issued	Corporate	International	London Securities Exchange	Financial	Fitch	BBB-
Aug 2010--Aug 2013 (36 months)	Kuwyet Turk Participation Bank	100mn	USD	Redeemed	Corporate	International	London Securities Exchange	Financial	Fitch	BBB-

Note: Data as of March 2014.
Source: Nomura Institute of Capital Markets Research, based on sukuk data from IFIS

3. Government and regulations

Turkey's government promotes the growth of Islamic finance, but because of legally enshrined secularism, Islamic banks are called "participation banks" and are governed by the same laws as conventional banks. For similar reasons, Turkey's Islamic banks, unlike the Islamic banks in many Islamic countries, have not established sharia boards. Islamic banks develop Islamic financial products within the confines of banking laws, and provide customers with products and services after verifying sharia compliance with outside Islamic scholar consultants[77]. If the consultant does not approve a particular product as sharia-compliant, however, in some cases the bank will consult with and seek the approval of another consultant. Because of these differences in products and services among Islamic banks, the customer chooses the bank it believes provides services that are most in line with sharia, and does business with that bank.

The Turkish government has long implemented various strategies to grow Islamic finance and diversify its overseas investor base, including by strengthening business relationships with Middle East and North African (MENA) nations. It has also established a goal of becoming a regional Islamic financial center and raising Islamic

[77] There are also Islamic banks that employ Islamic scholar consultants.

finance's share of the domestic financial market from 6.1% to 15% by 2023[78]. It took several important steps toward achieving that goal in 2013.

One of those was a policy of its three state-owned (conventional) banks establishing Islamic banks and participating in the Islamic finance market in the future. The government has emphasized that "it aims for the sound expansion of domestic Islamic finance through the participation of its soon-to-be established participation (Islamic) banks in the market in addition to the four private participation banks currently operating in the country, with the goal being to expand the market rather than redistribute existing market share." It also announced plans to take various measures, including the amendment of legislation, to achieve this participation[79]. Turkey is also supporting the growth of Islamic banking by adopting the same rule as Qatar of not allowing conventional banks to operate Islamic windows.

Another important event was the World Bank's establishment, in cooperation with the Turkish government, of the Global Center for Islamic Finance in Istanbul. The center plans on carrying out a variety of activities, including global Islamic finance research, human capital development, and the development of Islamic finance in emerging markets. This alliance means Turkey has gained the World Bank's support in its drive to become a regional Islamic finance center.

Turkey's importance to the development of Islamic finance in the region can also be seen by the UK government's decision to learn from the Turkish experience with sovereign sukuk by exchanging opinions with the Turkish government prior to its inaugural sovereign sukuk issuance in June 2014[80].

This interest in Turkey's Islamic finance, efforts by Islamic banks, and assistance from the government bode well for further growth in Islamic finance.

VIII. Summary and the future of QISMUT

Islamic banks in QISMUT countries had assets totaling over US$662 billion in 2013. Based on the assumption that Islamic financial assets will grow at an average annual rate of 19.7% in 2013–18, we look for total combined assets of US$1.6 trillion by 2018 within QISMUT alone. By that same year, we expect global Islamic financial assets to have grown to US$3.4 trillion[81].

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78 Syed Siddiq Ahmed, "Participation Banks: A Turkish Delight," *IFN*, 6 August 2013. "Turkiye'nin 2023 Islami Bankacılık Hedefi 100 Milyar Dolar" (Turkey's 2023 Islamic Banking Goal is 100bn USD)," Ernst & Young, 20 March 2013. "Turkey: Investment potential pressure by political imbroglio," *IFN*, 22 January 2014.

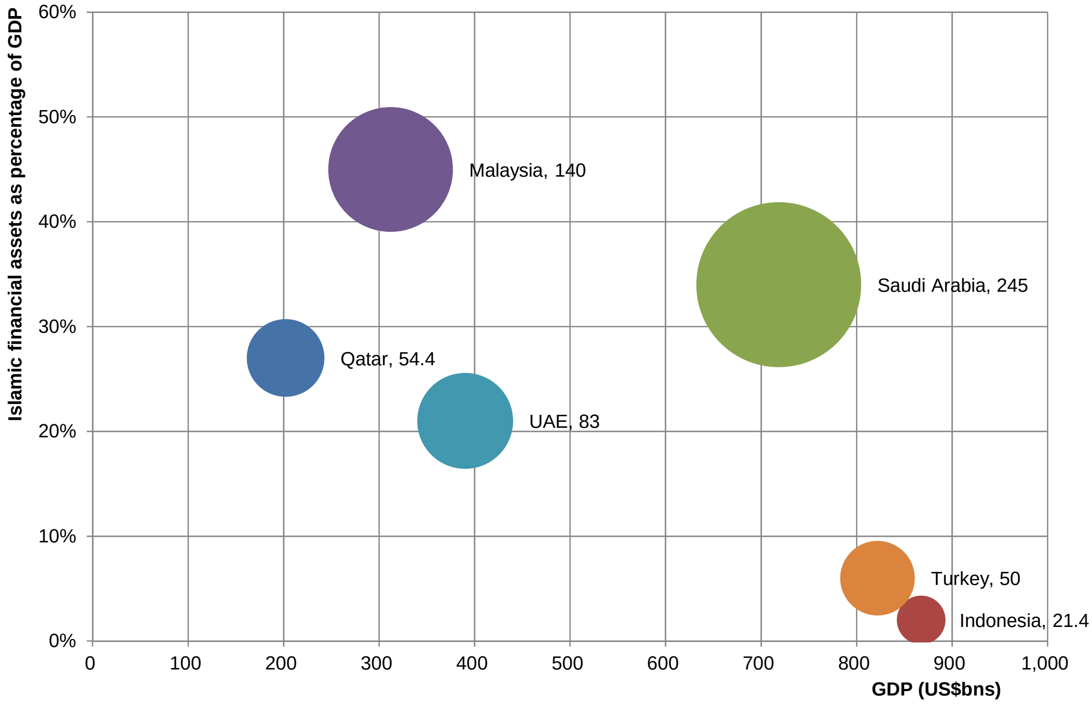
79 Halkbank ("People's Bank"), VakifBank (literally "Foundations' Bank"), and Ziraat Bank ("Agricultural Bank") Source: Erdal Saglam, "Halk'in faizsiz bankasi icin Vakifbank yasasi bekleniyor" (Halk Bank Waiting for the VakifBank Law to begin interest-free banking), *Hurriyet*, 18 November 2013 and "GB'de masaya biz de oturalım" (We also should have a seat at the table), *Bloomberg HT*, 29 March 2013.

80 "UK seeks sukuk advice from Turkey as it targets debut," *IFIS*, 10 December 2013.

81 "World Islamic Banking Competitiveness Report 2013-14," Ernst & Young.

The conditions for growth in Islamic finance currently differ across markets (Figure 27). Volume growth, level of governance, and knowledge of Islamic finance (intellectual capital) and awareness of it in the market are important indicators of development.

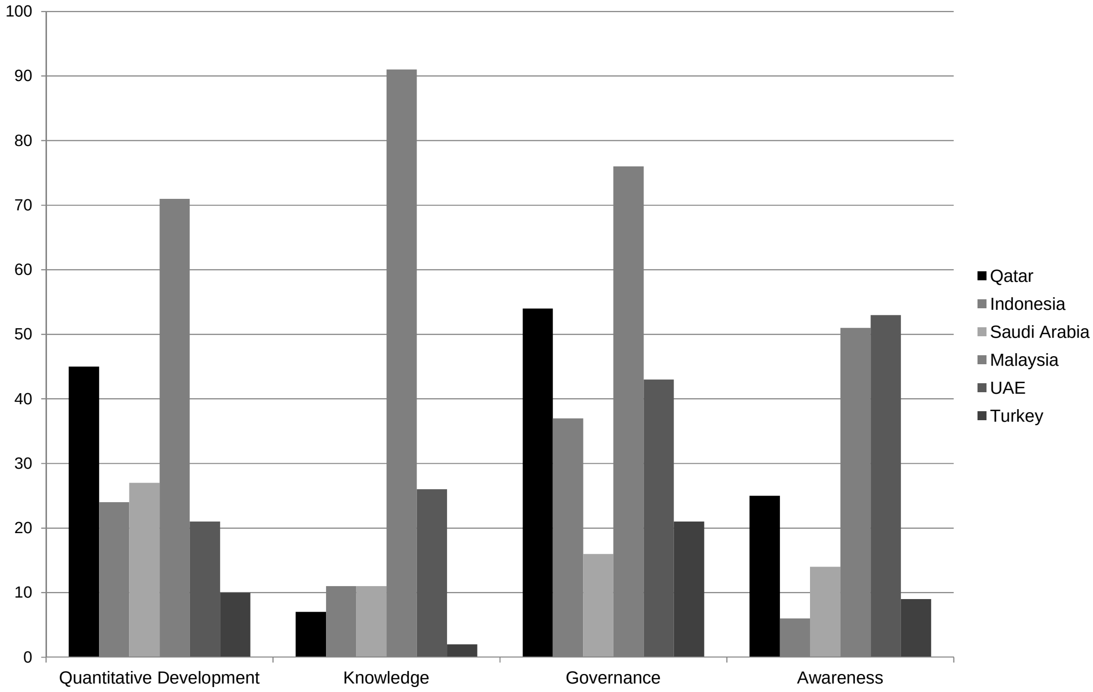
Figure 27: Islamic financial assets as a share of GDP in the QISMUT countries (2013)



Note: The figures next to each country's name show the amount of Islamic financial assets in units of US$1 bns.
Source: Nomura Institute of Capital Markets Research, based on various sources

According to Islamic Finance Development Indicator data, produced jointly by the Islamic Corporation for Development of the Private Sector (ICD) and Thomson Reuters, Malaysia is currently the leader among the QISMUT countries in developing Islamic finance. It has a particularly big lead over the others in terms of volume growth, knowledge, and governance, and ranks right behind UAE in market awareness (Figure 28).

Figure 28: Islamic finance development status in the QISMUT countries (as of May 2014)



Source: Nomura Institute of Capital Markets Research, based on the Islamic Finance Development Indicator and data from Reuters and ICD

The countries with the most developed Islamic economies behind Malaysia are Qatar and the UAE. Qatar does well with transaction volume and governance, while the UAE does well with market awareness and Islamic finance knowledge. Saudi Arabia, Indonesia, and Turkey all have significant potential in Islamic finance, and their challenge moving forward is to raise their relatively low levels of knowledge and awareness among people.

As already noted, each country's market has its own set of strengths and weaknesses, and thus the policies being pursued by each government are different. We think the most important factor for achieving the sound growth of Islamic economies in the QISMUT countries and worldwide is global cooperation within the industry in implementing legislation that accommodates Islamic finance, standardizing regulations, and developing human capital. Also critical to achieving this is cooperation among the governments and among the global Islamic institutions that will play a major role in future growth, including the IFSB, AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions), the IDB, and the World Bank Global Center for Islamic Finance.

With growth hopes pinned on the RGMs, Islamic financial markets are becoming increasingly important to global business as a result of the economic growth in Islamic countries. Given that a quarter of the world's population is Muslim, rapid growth in the Islamic economies of QISMUT countries should provide new opportunities for global financial business.