

1st East and Central Africa Islamic Banking Conference

Introduction to Islamic Finance

28 April 2009

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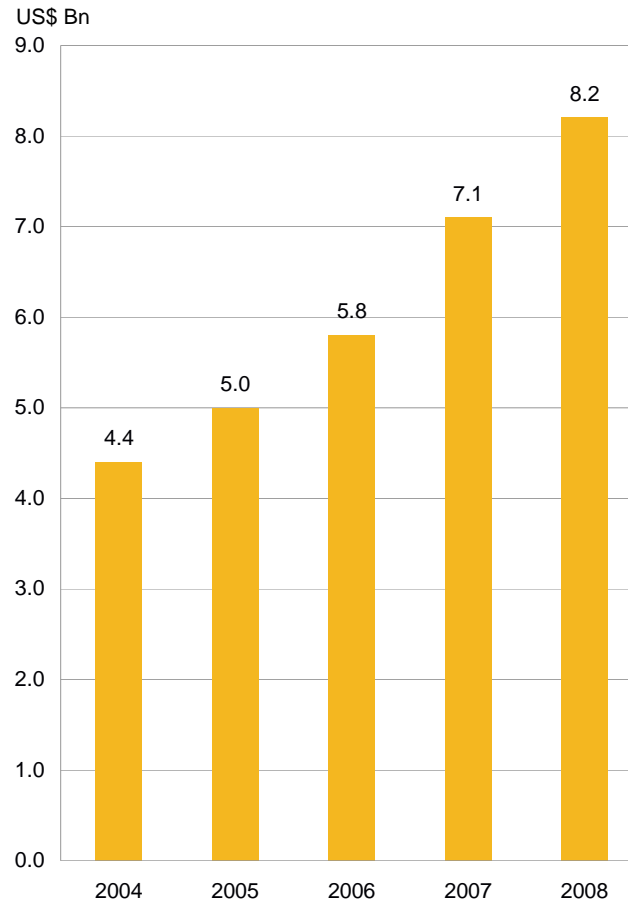
Section 1

Context of Islamic Banking in Kenya

Overview of the Banking System in Kenya

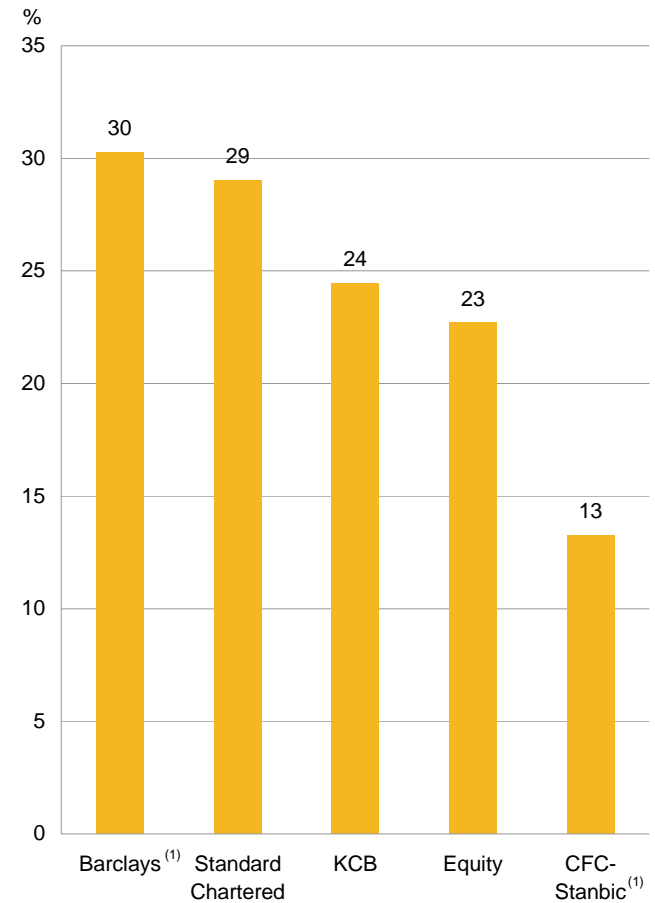
- Kenya's banking sector is fairly large and profitable ... \$47 Bn in deposits

Banking Deposits



Source Central Bank of Kenya, ICP

Return on Equity of Top Banks in Kenya for 2008



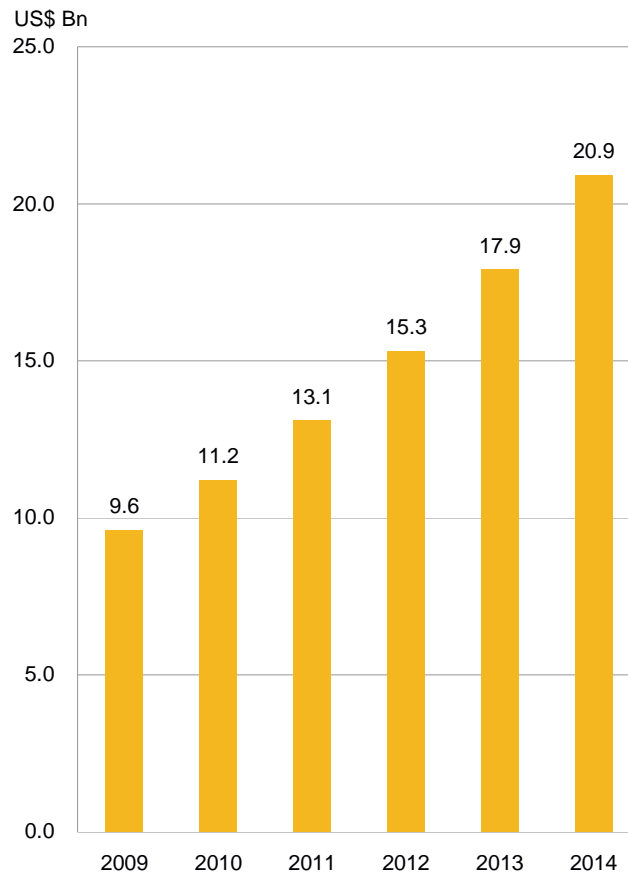
Source Bankelele- Nairobi Banker, ICP

Notes
1. For 2007

Projected Islamic Banking Potential

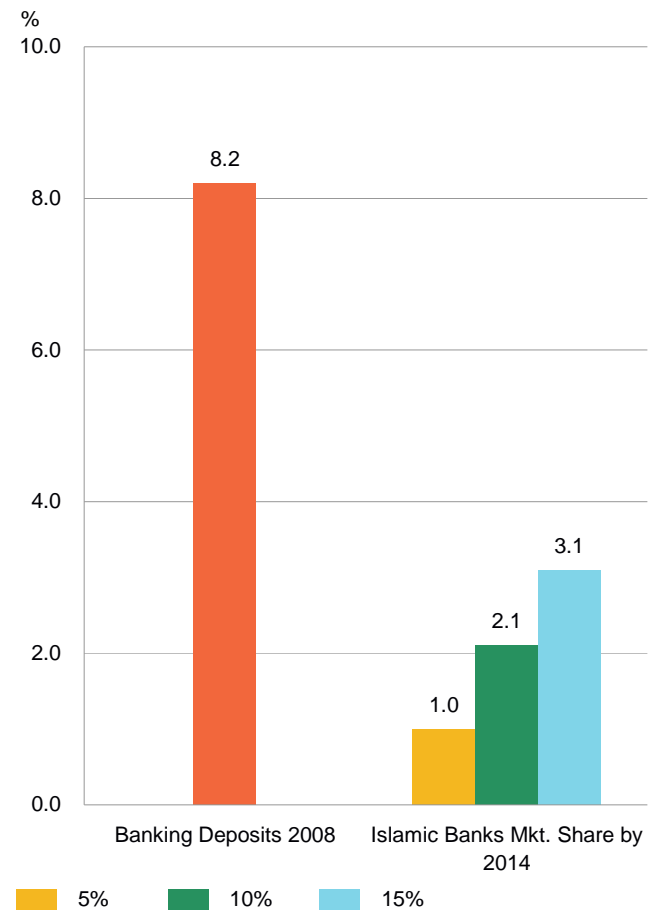
- With a market share of 10% Islamic banking deposits are projected to increase to \$2 Bn by 2014

Projected Banking Deposits



Source ICP

Projected Share of Islamic Deposits



Source ICP

Section 2

Background and History of Islamic Banking

Global Islamic Finance at a Glance

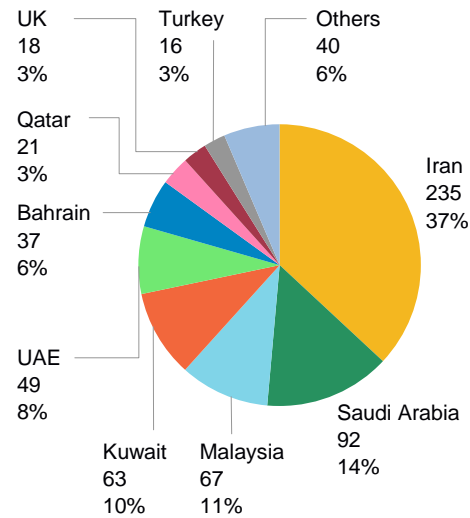
- Estimated to be a **\$750 Bn–\$800 Bn** industry
- Over **300** financial institutions worldwide and **growing ...**
- Spread across more than 75 countries, both Muslim and non-Muslim
- Concentrated in **Middle East** and **Southeast Asia**
- Expanding into Europe and US
- Asset growth of 20pc–30pc over the last decade
 - Set to almost **triple** by 2015 to \$2.8 Tn
- International banks with Islamic offering include; Morgan Stanley, Citigroup, HSBC, UBS, Standard Chartered, Deutsche Bank, Goldman Sachs, Lloyds and Barclays amongst others

Islamic Finance Today

- Islamic banking leading the way ... comprising 74% of the Islamic finance assets

Geographic Breakdown of Islamic Finance End 2007

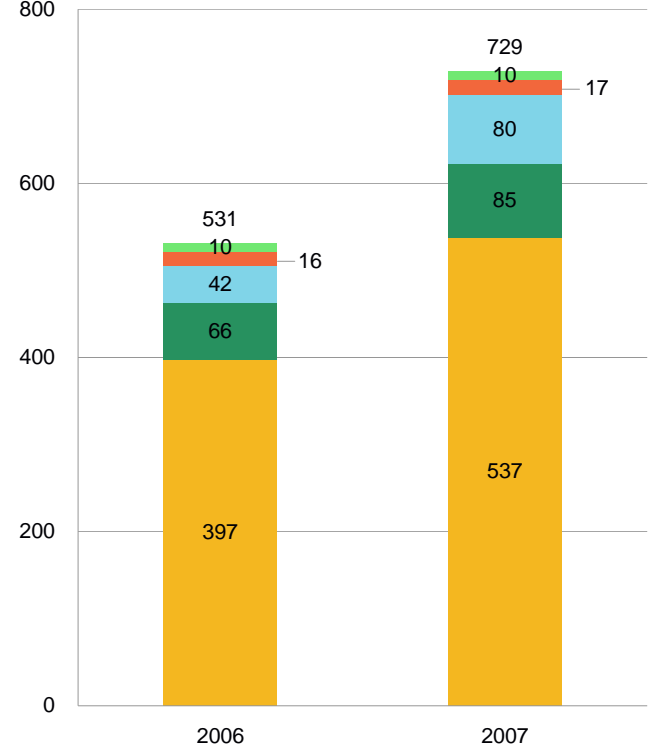
\$ Bn



Source The Banker; IFSL Research, Islamic Finance 2009, ICP

Global Islamic Finance Assets

\$ Bn



Source IFSL Research, Islamic Finance 2009 estimates based on The Banker, Ernst & Young, World Islamic Funds & Capital Markets Conference, ICP

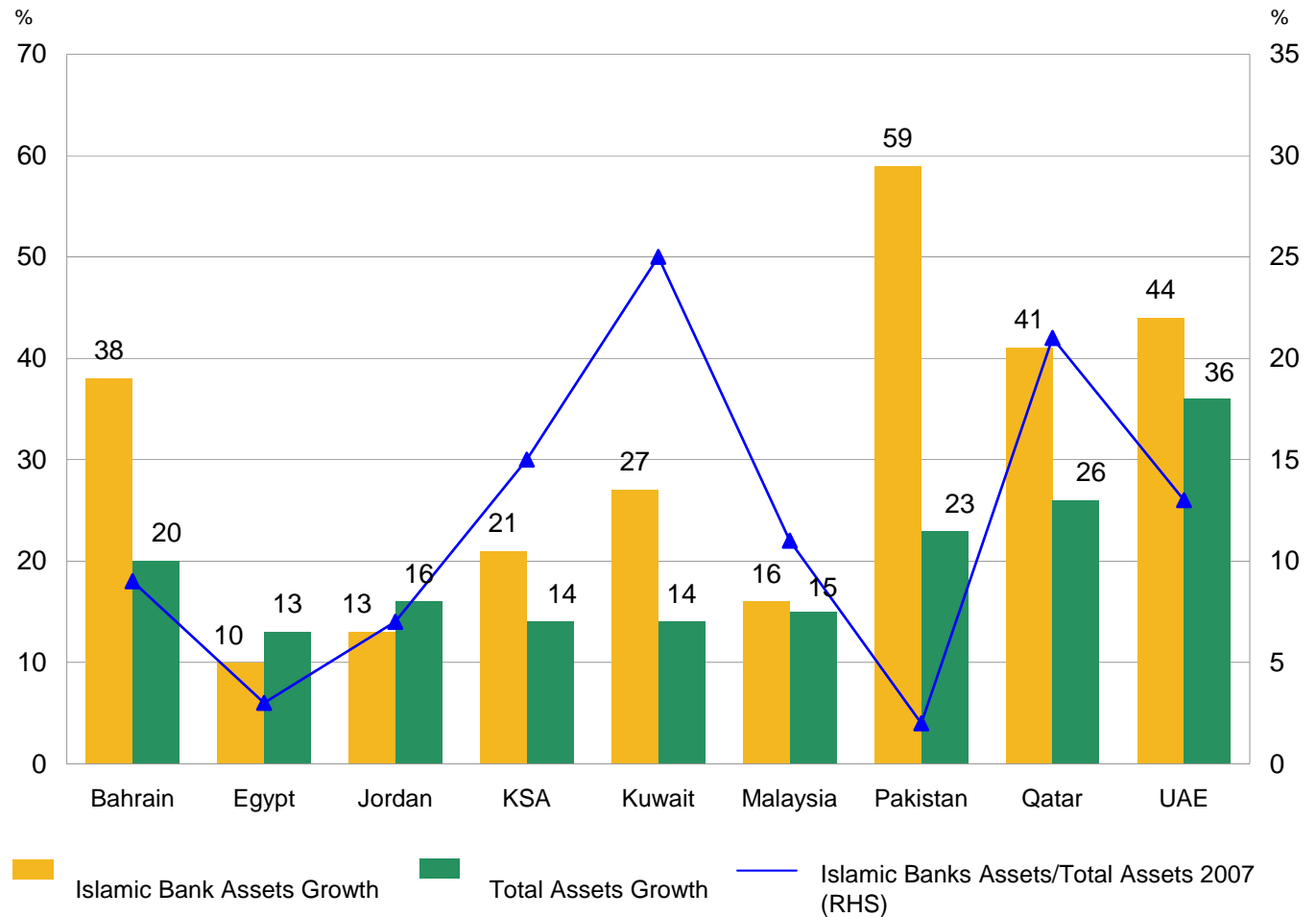
Islamic Banking Today

Asian Banker 2008. “World’s 100 largest Islamic banks showed growth of 26.7% in comparison to conventional growth of 19.3%”

McKinsey 2008. “Islamic banks are growing at phenomenal levels, faster than the average banking sector in most geographies”

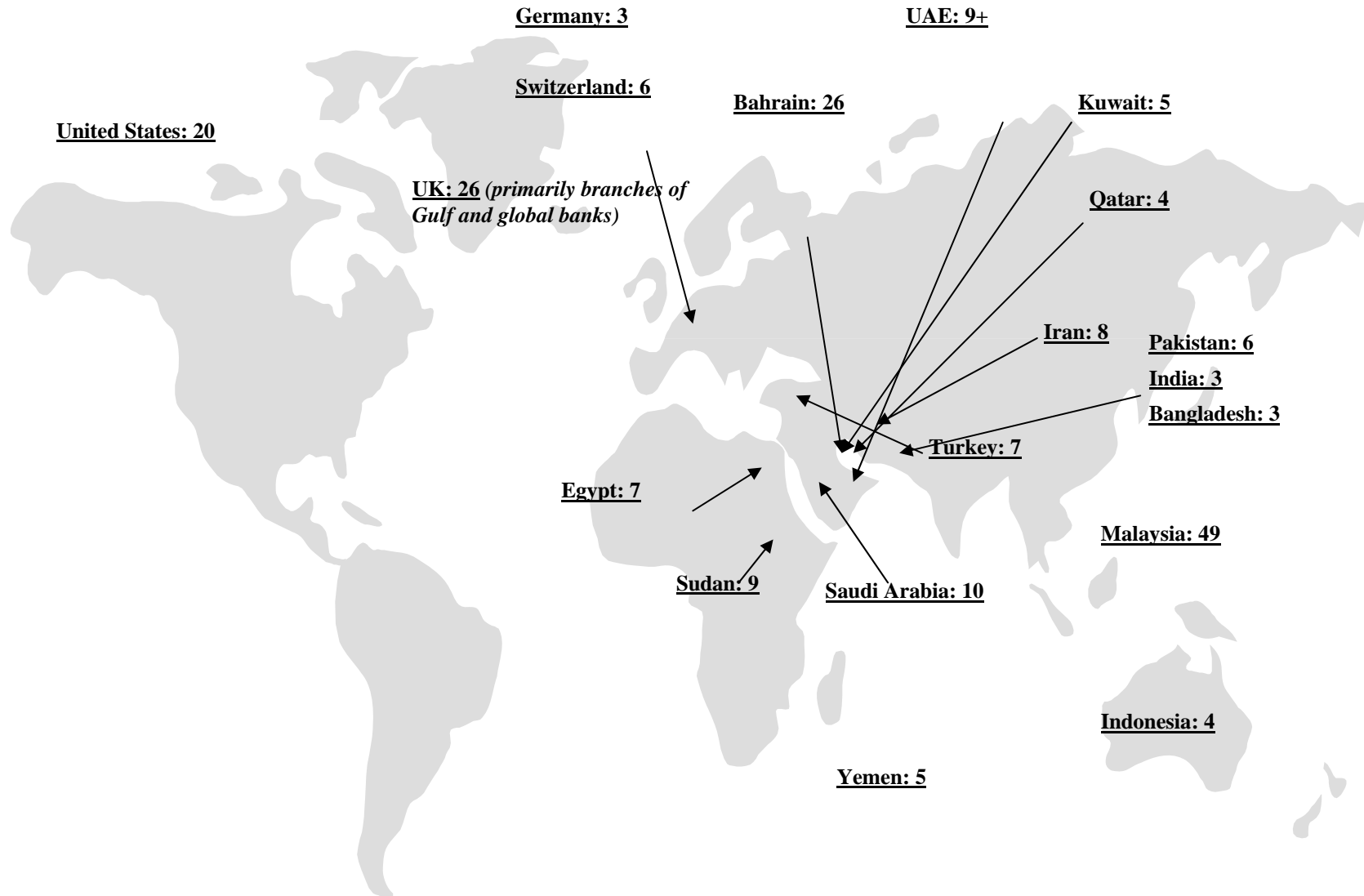
Global Investment House 2008. “Islamic banking, a powerful alternative and a promising tool to change the entire landscape of banking”

Growth Comparison of Islamic Banking Assets with Total Assets (CAGR 2003–2007)



Source: Morgan Stanley, ICP

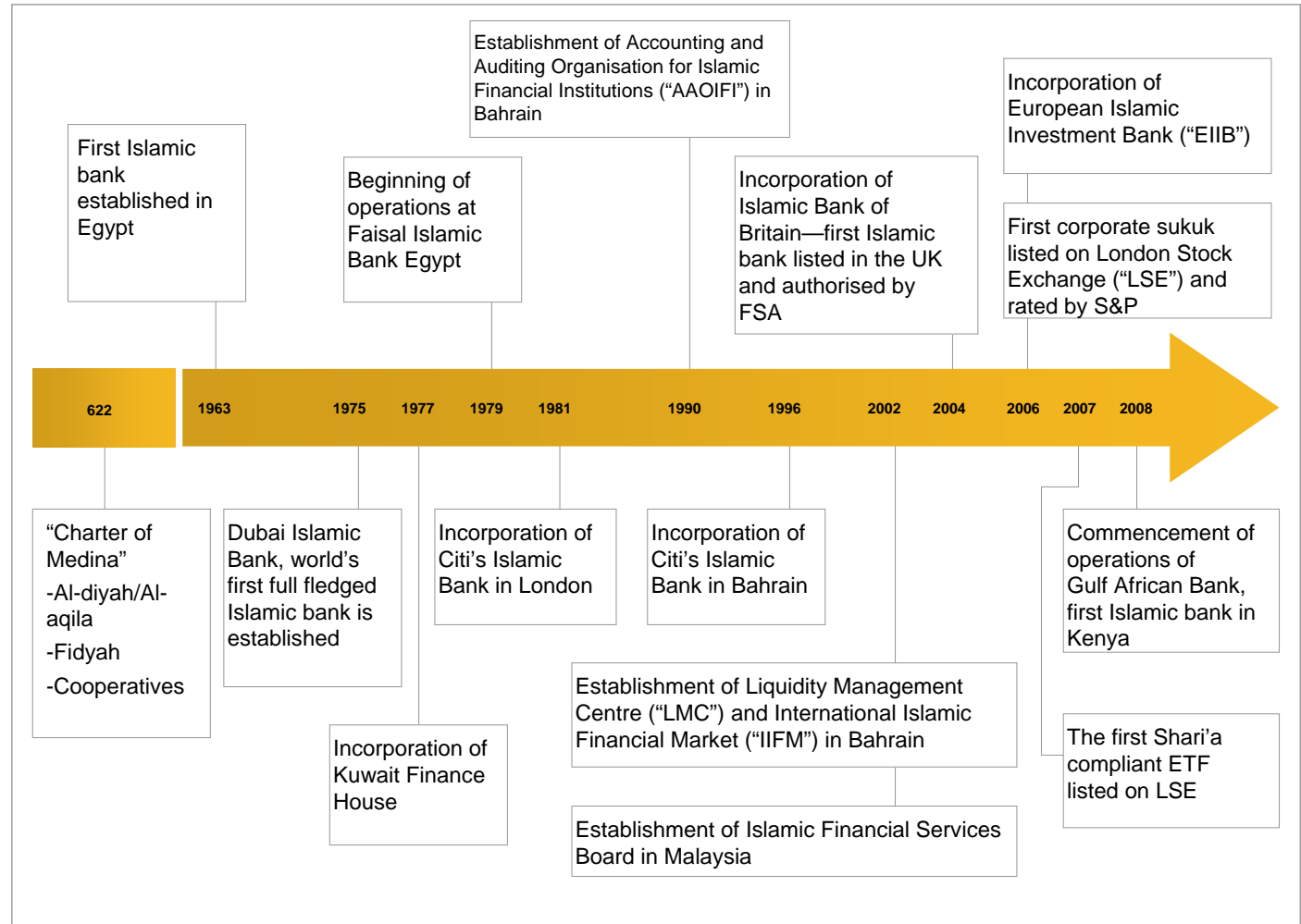
>300 Institutions in 50+ Countries ...



BACKGROUND AND HISTORY OF ISLAMIC BANKING

Key Milestones in the Development of Islamic Banking

- Contemporary execution of Islamic Banking has existed for less than four decades



Source Morgan Stanley, Islamic Banking, September 2008

Current Popularity of Islamic Banking

- Why is Islamic finance currently in vogue?
 - Failure of existing structure re-focusses attention to finding an alternate system
 - Islamic finance—a credible alternative source of funds
 - Islamic finance needs tangible assets
 - Pressures on margins in traditional markets lead banks to investigate new opportunities
 - Islamic economic theory fully supports financing in many industrial sectors where they add value and benefit to society
 - Right deal, right place, right time ...

Islamic Banks Less Affected than Conventional Banks

- Islamic financial institutions (“IFI”s) have displayed strong resilience amid the current global financial debacle
- Greater growth of Islamic assets in comparison to total assets, despite the industry’s small size
- Global Islamic banking assets grew around 27% in 2007
- The Islamic banks benefit from these buffers
 - Its core principles of prohibition of speculation and interest rates
 - Domestic credit portfolios
 - Strong retail platform
 - Conservative approach to business
 - Focus on basics of banking

Infrastructure Institutions Providing Macro Level Support

- Set consistent standards in terms of regulatory, accounting and auditing frameworks
- Monitor, inspect and supervise Islamic financial institutions
- Provide intra industry comparability



- IFSB formulates international regulatory and prudential Shari'a standards in line with international regulations



- AAOIFI develops, prepares and issues financial accounting standards, Shari'a standards and their relevant exposure drafts



- IIFM takes part in the establishment, development and promotion of Islamic capital and money markets



- IIRA, sole Islamic rating agency, provides a rating spectrum to capital markets and banking sector in predominantly Islamic countries



- IDB fosters economic development and social progress in accordance with Shari'a principles

**General Council for
Islamic Banks and
Financial Institutions**

- GCIBFI enhances awareness and visibility of Islamic financial industry in major international financial markets

Section 3

Key Principles of Islamic Banking

Principles of Islamic Finance

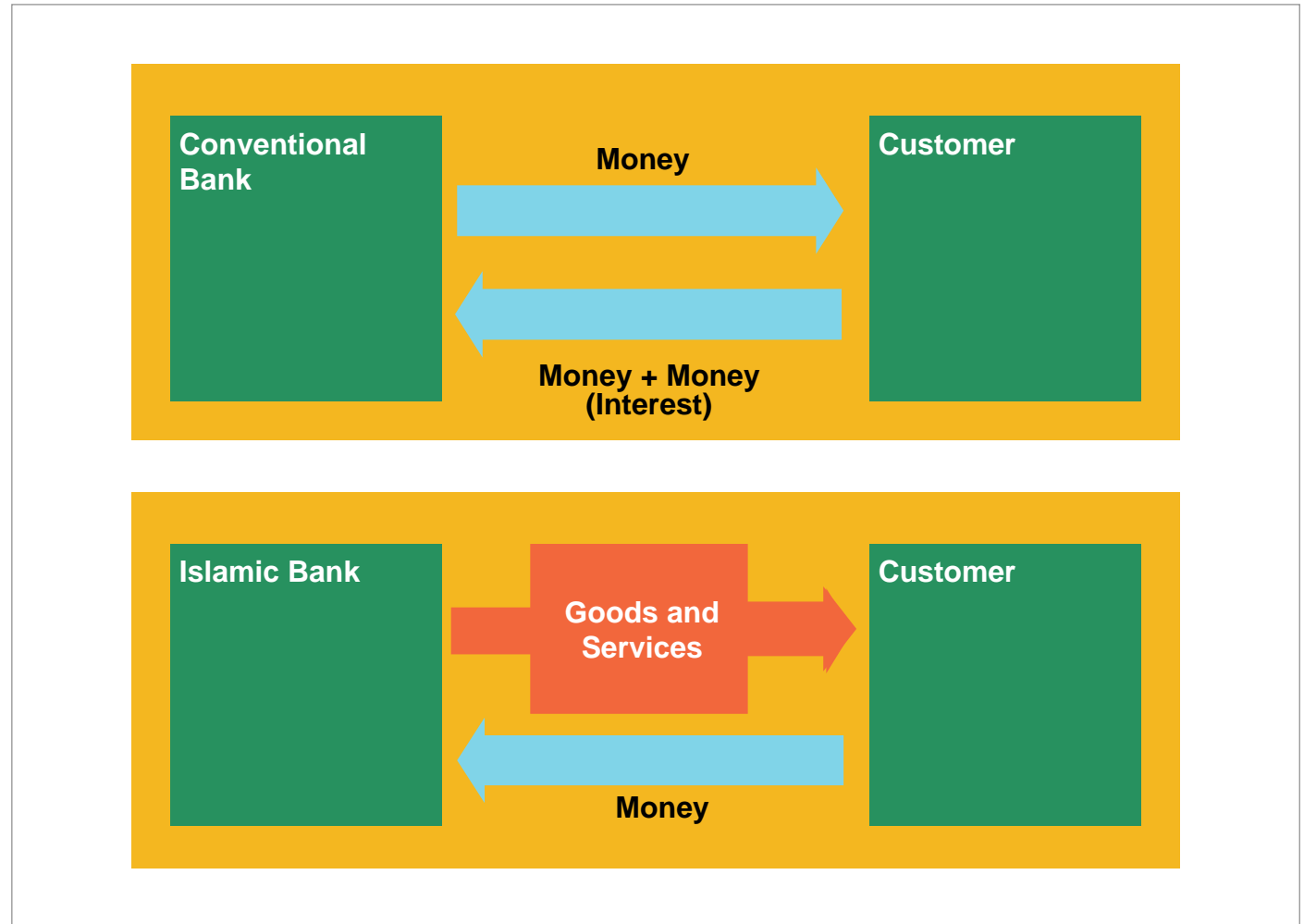
Shari'a Requirements

- The fundamentals of Islamic finance and banking are taken from Shari'a (Islamic Law)
- The rules governing Islamic finance and banking are based on five main principles:
 - **Prohibition on Interest (riba):** Cannot receive a specified payment based on the capital provided. All transactions must be asset backed and returns received will then be based on the income generated from the asset
 - **Restriction on activities/commodities:** e.g., alcohol and gambling are prohibited activities
 - **Profit and loss sharing mechanism:** The risks and rewards of a financing should be equally shared between the provider and user of capital . No one is entitled to any addition to the principal sum if they do not share the risks involved
 - **Prohibition on Uncertainty or Speculation (gharar)**
 - **Prohibition on Speculation or Gambling (maisir)**
- Other key principles include:
 - More equitable distribution of income and wealth
 - Increase equity participation in the economy
 - Owner of capital can legitimately share the profits made by the entrepreneur
 - Owners of capital are allowed a share in surplus which is uncertain, meaning investors have no right to demand a fixed rate of return
- Islamic Banks by default must conform to all other Islamic principles as well

Section 4

Comparison Between Islamic
and Conventional Banking

Basic Difference Between Conventional and Islamic Modes of Finance



Major Similarities Between Islamic and Conventional Banks

Commercial Institutions

- Both commercial institutions licenced to offer deposit/investment schemes to customers
- Play the role of a financial intermediary

Inter-Bank Facilities

- Same temporary source of finance for liquidity management purposes

Current Account/ Demand Deposits

- Used for safekeeping and convenience in payments
- Do not offer return or profit
- Checkable
- Face value of the deposit is guaranteed by the bank

Savings Account

- Checkable
- Do not have a fixed term to maturity

Major Similarities Between Islamic and Conventional Banks (cont'd)

Investment Accounts

- Investors committed for a certain time period
- Usually not checkable
- Early withdrawal may be denied by bank, but usually allowed as per industry practice
- Usually withdrawal before a minimum period results in denial of all profits
- Weightage is reduced accordingly for withdrawals after the minimum period

Retail Services

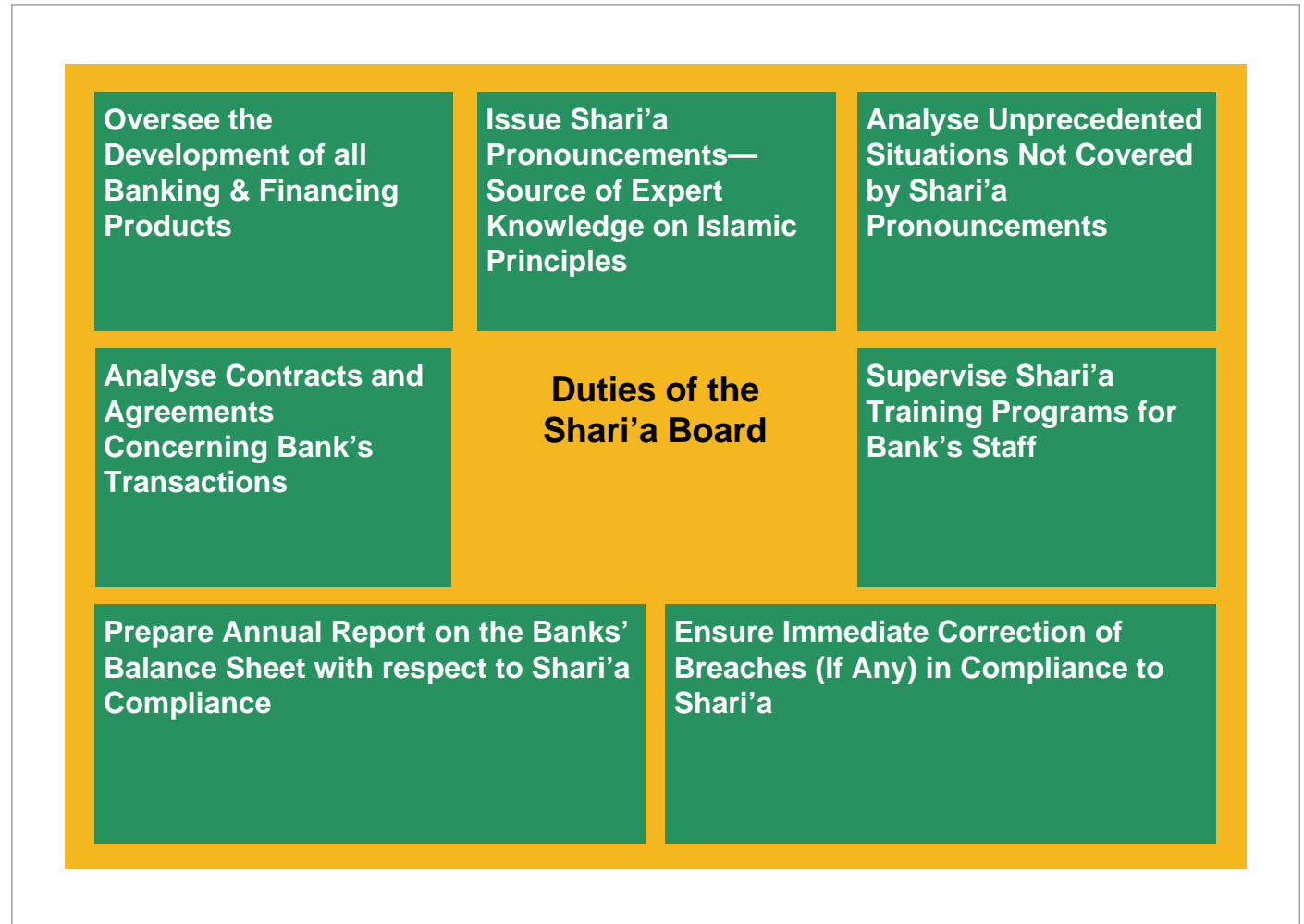
- Similar forms of retail services offered including
 - Checking accounts
 - Money transfers
 - Trade finance services
 - Lockers, online services
 - Debit cards
 - ATM service

Section 5

Role/Mandate of the Shari'a Board

Shari'a Board

- Usually comprises of world renowned Shari'a scholars with the requisite expertise in financial matters and Islamic law
- May appoint a Chief Shari'a Officer to coordinate with management on Shari'a related matters on a day-to-day basis
- If any transaction is implemented in a Shari'a repugnant way, the Shari'a board renders the derived income as impermissible and deposits it to a charity



Section 6

Morgan Stanley Islamic Finance Window

- The Morgan Stanley Islamic Finance Window provides a full service offering
- The team has Sukuk structuring, and execution capabilities, as well as asset management and structured product structuring expertise
- Also a member of the Islamic Financial Experts Group advising the UK Government on their inaugural Sukuk issue and Islamic Finance strategy

Morgan Stanley Islamic Finance

Islamic Financing Transactions – Full Service Offering

Capital Market & Bank Financing Transactions (as Bookrunner/MLA)

- **First** international Islamic mandatory convertible for Tabreed
 - Upsized from initial AED1.1 Bn to AED1.7 Bn (AED1.5 Bn plus AED200 MM increase option)
- **First** true-sale securitization in the GCC region creating Islamic RMBS
 - Tamweel \$220 MM mortgage backed security offering
 - **First** time tranching in a Sukuk product was allowed
 - Awarded “**Best Structured Deal 2007**” by Islamic Finance News
- **First** real estate project financing in the MENA region
 - Aldar \$2.1 Bn syndicated credit facility

Fund Related Products

- Al-Futtaim MENA Real Estate Shari’a Development Fund. \$500MM first closing in May ’08. Sole Shari’a Structuring Advisor and Placement Agent
- \$300MM Pearl Qatar Real Estate Development Fund. Closed in Jan ’08 and was over subscribed. Sole Shari’a Structuring Advisor and Placement Agent
- Saudi Spanish Infrastructure Fund. \$680MM first closing in December 2007. Sole Shari’a Structuring Advisor and Placement Agent

Structured Products

- A US\$10 Bn structured notes programme has been established to issue a broad range of Islamic structured products
- Developed innovative Islamic short-medium term products for financial institutions that improve upon traditional commodity murabaha related instruments

- The Morgan Stanley Shari'a Supervisory Board consists of world renowned scholars to ensure authenticity and Shari'a compliance of Morgan Stanley's Islamic Finance business

Shari'a Supervisory Board

Sheikh Nizam Yaquby, Bahrain

Considered one of the world's leading experts in the field. He is a member of the Shari'a supervisory boards for several Islamic financial institutions, including Credit Suisse, Citi Islamic Investment Bank, Amanah Finance HSBC, Dow Jones Islamic Index, Abu Dhabi Islamic Bank, ABC Islamic Bank, Royal Bank of Canada, Shamil Bank and others.

Sheikh Yaquby was educated in the classical Shari'a sciences in his native Bahrain and in Makkah. He is a graduate in Economics and Comparative Religion from McGill University.

Dr Mohamed Elgari, Saudi Arabia

Former director of the Center for Research in Islamic Economics at King Abdulaziz University in Saudi Arabia, where he also serves as an Associate Professor of Islamic Economics. He is an expert at the Islamic Jurisprudence Academy, Jeddah. As well as a member of the Academic Committee at the Islamic Development Bank (IDB) and the Islamic Fiqh Academy in Jeddah. Dr. Elgari is a member of the Shari'a Boards of International Islamic Financial Market, Dow Jones Islamic Index, National Commercial Bank, Credit Suisse, Amanah Finance HSBC among others.

Dr Elgari holds a Ph.D. in economics from the University of California.

Dr Mohd Daud Bakar, Malaysia

Dr. Bakar is currently the President/CEO of the International Institute of Islamic Finance and Amanie Business Solutions Sdn. Bhd. He was an associate professor at the International Islamic University Malaysia. He is also Chairman of the Shari'a Advisory Council at the Central Bank of Malaysia, member of the Shari'a Advisory Council at the Securities Commission of Malaysia, Accounting and Auditing Organization for Islamic Financial Institutions and International Islamic Financial Market in Bahrain, Dow Jones Islamic Market Index as well as for various financial institutions. He is a licensed Shari'a advisor for Islamic Securities in Malaysia. In 2005 he was awarded the Islamic Banker Award by the Association of Islamic Banking Institutions Malaysia.

He received his first degree in Shari'a from University of Kuwait and PhD from the University of St. Andrews. In 2002, he completed his external Bachelor of Jurisprudence at University of Malaya.

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