

## Box 1

### Islamic finance in Africa

African countries need to invest heavily to finance their development, in particular in the area of infrastructure. Islamic finance could constitute a new financing channel, making it possible to capture some of the investment flows from the oil economies of the Gulf and the Middle East.

#### 1/ Definition and principles of Islamic finance

The term Islamic finance covers all transactions and financial products complying with the principles of Sharia law: prohibition of usury, uncertainty, speculation, investment in sectors considered illicit such as alcohol, tobacco, gambling, etc., and requires profits and losses to be shared.

Prohibition	Obligation
<b>Interest-bearing loans</b> <b>Hoarding</b> because it penalises liquidity-generating activities <b>Uncertainty</b> in contract clauses (speculation, etc.) <b>Sale of assets not in the possession</b> of the seller Investment in <b>illicit</b> economic activities (such as gambling, alcohol, tobacco, arms, etc.) or contravening the fundamental Sharia principles.	All financing operations must be backed by <b>real assets</b> <b>Sharing</b> of profits and losses.

#### Main financing techniques

Islamic finance includes a vast range of financial products and structures, including notably:

**Mourabaha:** the creditor (generally a bank) purchases a given asset on behalf of a client (the debtor) and then, sells it to the debtor through one or more payments over a given period and at a price agreed in advance by both parties. The bank earns a pre-established fee (increase in the price of the good).

**Mudarabah:** this contract brings together an investor that provides the capital (financial or other) and an entrepreneur that brings its expertise. In this financial structure, the management responsibility falls on the entrepreneur. The profits are shared on the basis of a pre-defined ratio after the investor has recovered its capital and paid management fees to the entrepreneur. In the event of losses, they accrue entirely to the investor, while the entrepreneur only loses its fees.

**Musharakah:** the institution and the client jointly finance the project and take on the risk proportionately to the capital provided by each party. The profits or losses are shared between the client and the institution in accordance with the conditions decided upon in advance by both parties.

The Mourabaha contract represents overall around 60% of Islamic financing activities, while the two profit-sharing instruments together (Mudarabah and Musharakah) account for less than 20%.

**Istisna'a:** this financial contract allows a buyer to obtain goods with deferred delivery at a pre-defined price and pay in instalments throughout the manufacturing process. This financial structure is mainly used for real estate deals.

**Sukuk** (Islamic bonds): they must be backed by a tangible asset or its usufruct. Subscribers receive a share of the profits that depends on the performance of the underlying asset but is not related to time.

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## 2/ The Islamic finance market worldwide

The main players in the Islamic finance market are Islamic banks (that hold around 75% of the assets), insurance companies (Takaful), Islamic investment funds and issuers of sukuk. At end-2012, there were over 300 Islamic financial institutions in over 75 countries throughout the world.

Date and place of the first appearance of Islamic finance	Early 1960s in Egypt and Malaysia
Establishment of the first universal Islamic bank	1975
Size of the market at end-2012	USD 1,350 billion <sup>a)</sup>
Annual growth rate	Between 10% and 30% depending on asset classes
Sukuk issuance in 2012	USD 115 billion <sup>b)</sup>
Geographical breakdown of outstanding issuance (end-2012)	68.4% in Malaysia and 25.1% in the Middle East <sup>a)</sup>
Sukuk issuance in 2011	USD 84.5 billion <sup>b)</sup>

Sources: a) Islamic Finance Development report 2013; b) Standard & Poor's.

### Analysis by geographical areas

The total outstanding amount of Islamic finance is estimated to have stood at USD 1,350 billion at end-2012, with ten countries accounting for 94% of the total, of which Malaysia (411.5 billion), Saudi Arabia (269.7 billion) and Iran (185.3 billion). The countries of the Middle East accounted for 43.5% of total outstandings. At the global level, the weight of Islamic finance should nevertheless be put into perspective, with Sharia-compliant assets under management only accounting for 1.0% of traditional finance, even though, according to some estimates, total outstandings could reach USD 4,500 billion by 2020.

### Situation of Islamic banks

The Islamic banking sector (249 banks) is the most developed in Islamic finance and accounts for around 73% of total assets. It should be noted that Islamic bank loans are always **backed by real underlying assets**.

### Situation of Islamic bond markets

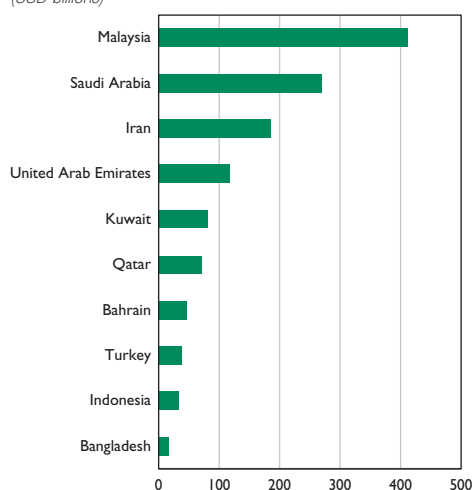
Sukuk (Islamic bonds) are similar to asset-backed securities (ABSs) and must be backed either by a tangible asset or its usufruct.

Total outstandings of Islamic bonds worldwide stood at USD 249.6 billion in 2012 (against less than USD 10 billion a decade earlier), of which Malaysia accounted for USD 170.9 billion or 68.4%. In 2012, 881 issues were recorded, of which 679 for Malaysia (77.0% of the total).

The Middle East constitutes at present the second largest area in terms of issuance and listings, accounting for 34.6% of outstandings, or USD 59.2 billion. In Africa, Sudan was the largest issuer, with sukuk issuance of USD 130 million.

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Outstandings of Islamic finance by country (USD billions)



Source: Islamic Finance Development report 2013.

### Situation of Islamic investment funds

Islamic investment funds have grown increasingly over the past decade (up 20.0%) and managed assets of almost USD 43 billion at end-2012. Despite this strong growth, the size of most of these funds remains relatively small, with over half not exceeding USD 50 million.

#### Outstandings of Islamic investment funds

(USD billions)

Country	Pakistan	Canada	Indonesia	Singapore	Luxembourg	Kuwait	South Africa	United States	Malaysia	Saudi Arabia
Assets managed	0.6	0.6	0.7	0.8	1.1	1.3	1.4	3.6	15.3	17.9

Source: Islamic Finance Development report 2013.

### 3/ The situation in Africa and the Franc Zone

#### Constraints and outlook

In Africa, the penetration rate of Islamic finance remains low, accounting for just 1.0% of the global Islamic finance outstandings. With the exception of Sudan, where the activity of the 25 banks complies with Sharia law, it is still in the early stages in many countries, including in North Africa. Many African countries are nevertheless considering issuing Islamic bonds in order to diversify funding sources and attract foreign investors. In this respect, Islamic bonds issued by African countries could attract a new investor base from countries in the Gulf Cooperation Council (GCC), with large budget surpluses, or specialised institutions, such as the Islamic Development Bank (IDB), a pioneer in project financing in areas such as infrastructure, agriculture and energy.

In **Egypt** and **Tunisia**, a new regulation was introduced at end-2013 to promote the development of Islamic finance.

The authorities of **South Africa** may issue sukuk for the first time in 2014. The Ministry of Finance announced the issuance over the next three years of almost USD 4.5 billion in Islamic bonds (USD 1.5 billion per year).

The legal and operational framework of **WAEMU** and **CEMAC** countries would have to be adapted to offer the whole range of Islamic finance operations. In this respect, the BCEAO and the IDB signed a Memorandum of Understanding in September 2012 to promote and develop the Islamic finance industry in WAEMU countries.

Senegal announced a sovereign sukuk issue for 2012, which should eventually see the light in 2014, in the amount of 100 billion CFA francs. The 2012-2014 sukuk issue was structured by the West African Development Bank (BOAD), while the Islamic Bank of Senegal, a subsidiary of the IDB, will be the central depository. This issue will be used to finance infrastructure projects.

Since 2008, the IDB and its subsidiary, the Corporation for the Development of the Private Sector (ICD), have invested in a number of West African markets. These two structures are the majority shareholders of the **Islamic banks** of **Guinea**, **Mauritania**, **Niger** and **Senegal**. The ICD pooled these investments by creating **Tamweel Africa Holding S.A.** and, at end-2012, held a loan portfolio of over EUR 400 million. The IDB is now aiming to open a bank in **Benin** and **Mali** as well as an Islamic bank and a leasing company in **Chad**.

At the current state of financial sector development in Franc Zone countries, Islamic microfinance and the **Istisna'a** contract offer good growth prospects, especially in the area of the financing of real estate and agricultural projects. Other more complex financing techniques could be used more in high value-added sectors and mainly concern large companies.

