

# PricewaterhouseCoopers Islamic Finance Briefing\* Jakarta, Indonesia

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\*connectedthinking

PRICEWATERHOUSECOOPERS 

## Agenda

- Introduction
- Indonesian developments:  
Jusuf Wibisana
- Presentation: Mohammad Faiz  
Azmi – PwC Global Islamic  
Leader, supported by Margie  
Margaret, PwC Indonesia Tax  
Director
- Conclusion



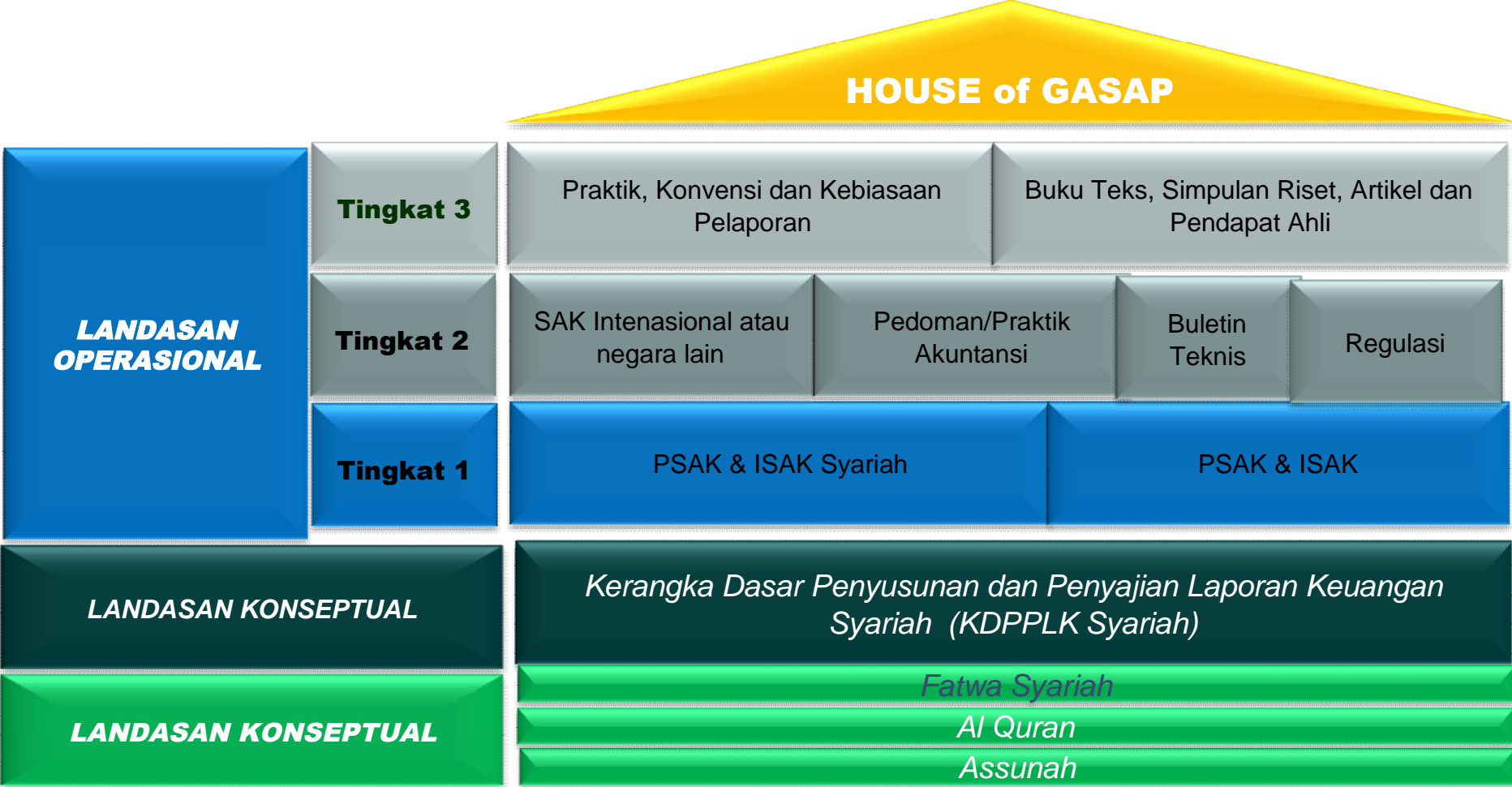
## Bank Indonesia's Initiative

- Bank Indonesia (BI)'s objective to grow syari'ah segment from 2 % to 5 % at the end of 2008 through:
  - Strengthening syariah bank institution
  - Developing syariah products
  - Public education and building alliances
  - Enhancing government roles and strengthening law framework
  - Strengthening human capital
  - Effective supervision

## Development of the Syariah Accounting Standards

- Setting up the Syariah Accounting Committee within the Indonesia ASB; members are representatives from accounting profession, practitioners, regulators.
- Introducing new numbering
- Transaction/product based standards, instead of institution
- Work closely with the Central Banks to enhance transparency
- Will be published in English and Arabic as well
- Have dedicated conceptual framework and House of GASAP

# House of Generally Accepted Syariah Accounting Principles



## Current Pronouncements

- Framework for Preparation and Presentation Syariah Financial Statements
- PSAK 101: Presentation of Syariah FS
- PSAK 102: Murabahah
- PSAK 103: Salam
- PSAK 104: Istishna'
- PSAK 105: Mudharabah
- PSAK 106: Musyarakah

# Agenda

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- Opportunities
- Challenges
- Conclusion



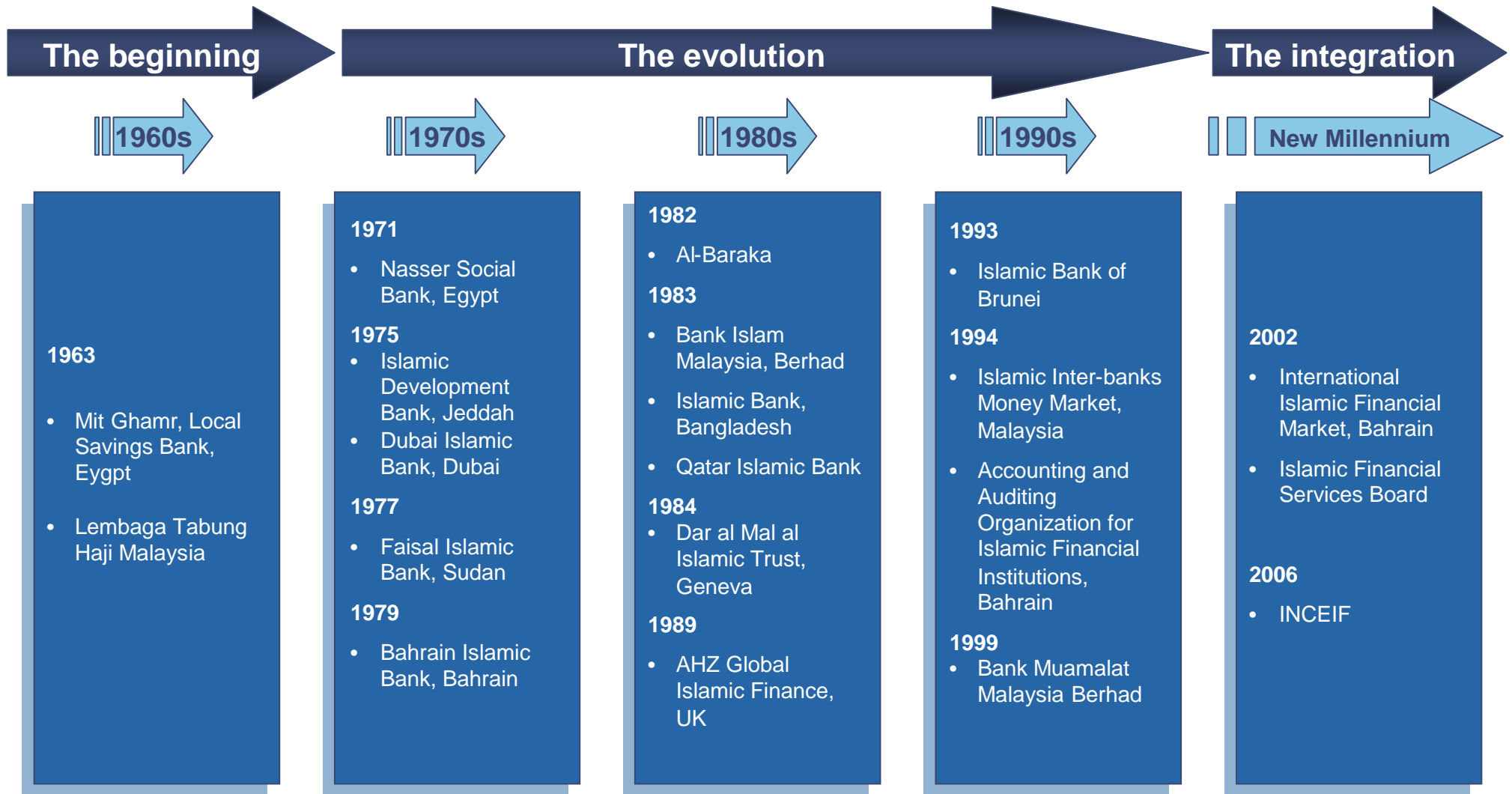
Three interlocking puzzle pieces are arranged on a light gray surface. Two pieces are white, and one piece is blue. The pieces are positioned in a cluster, with the blue piece at the bottom right of the group.

# Introduction

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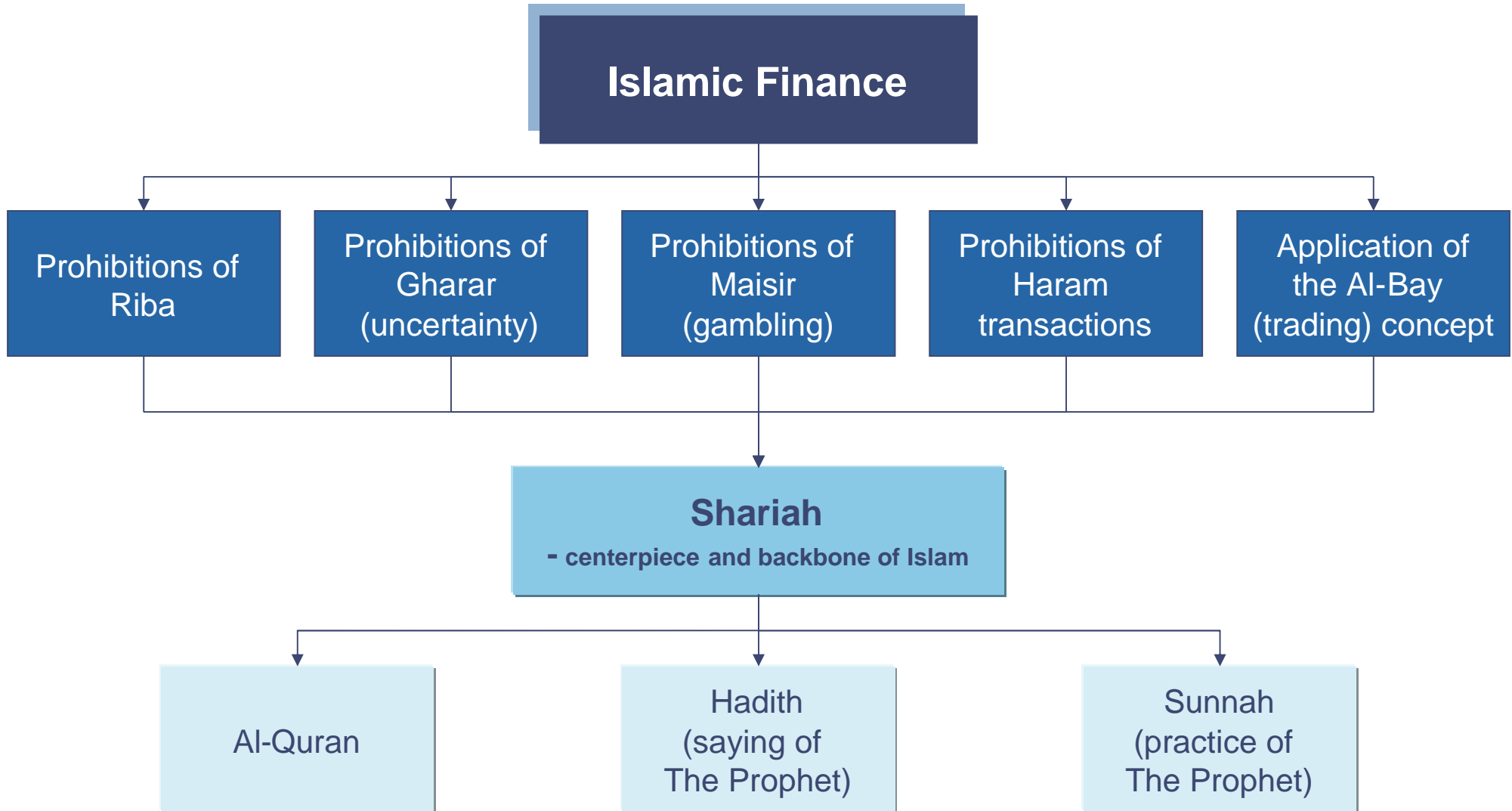


# The Journey of Islamic Finance



Source : *Islamic Banking : A Practical Perspective* by Khir, Gupta and Shanmugam

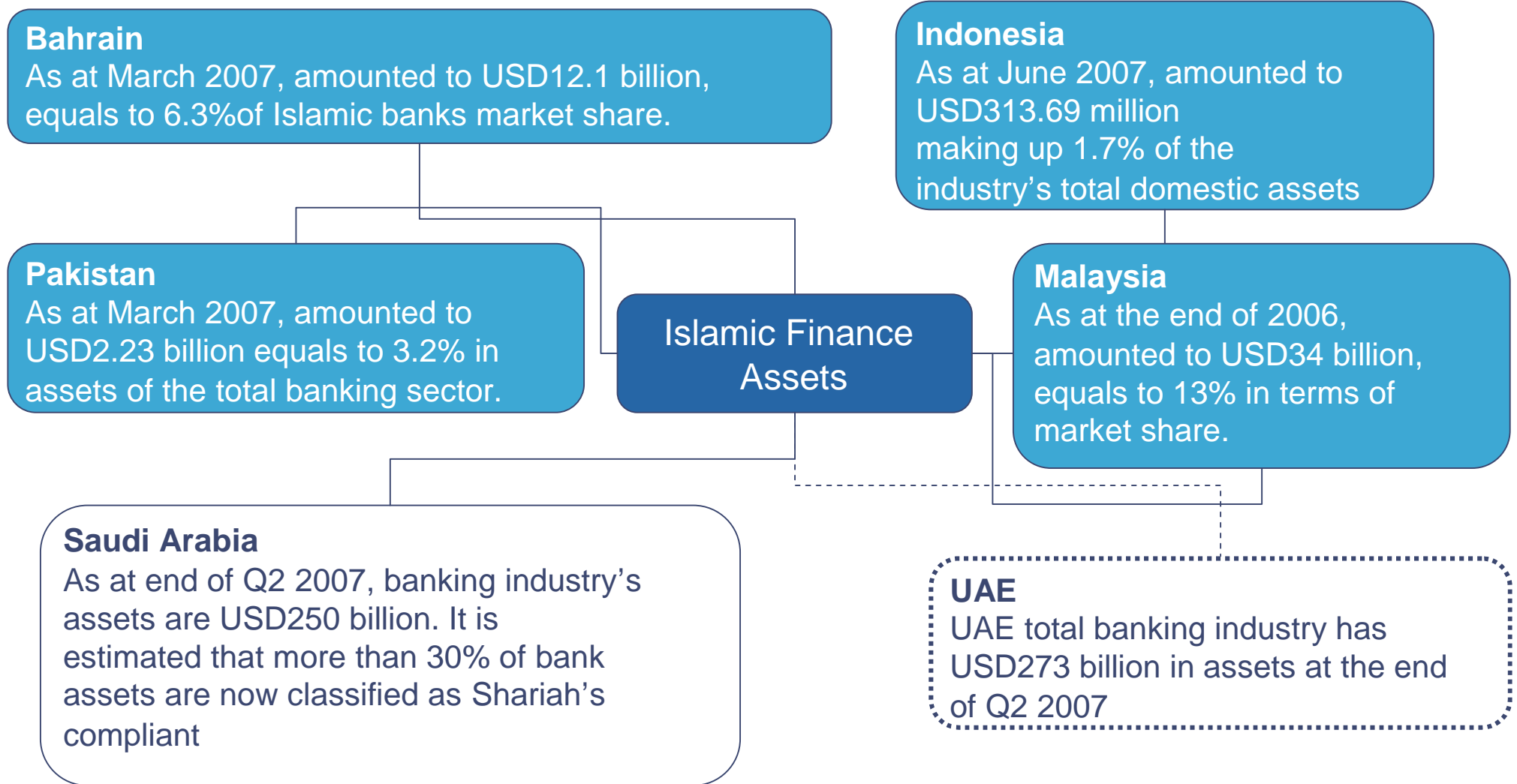
# Foundations of Islamic Finance



## Key Statistics

- Islamic banks & “windows” are now present in at least 60 countries
- Estimated assets in Islamic Banks or “Windows” exceed USD560 billion
- Islamic mutual funds exceed USD300 billion
- Islamic sukuk bonds exceed USD50 billion
- Equity capitalisation on Dow Jones Islamic Index exceeds USD10 trillion
- Islamic private capital in Middle East for High Net Worth Individuals exceed USD1.5 trillion
- Conservative estimates of USD17 billion of Islamic funds for investments

## Islamic Finance Assets of Key Countries



## Introduction

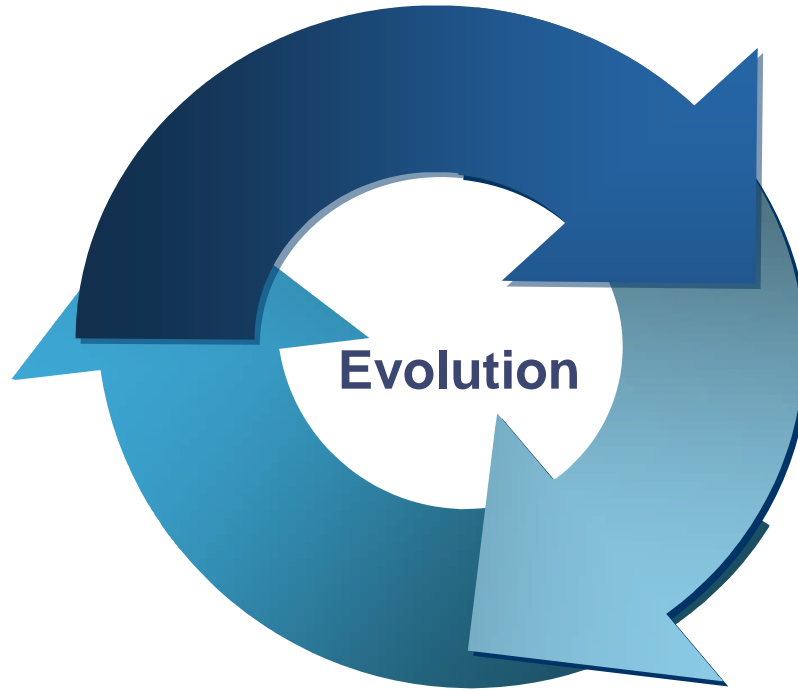
# Islamic Finance in Southeast Asia

### Malaysia

- 1963 – established Pilgrims fund.
- 1983 - Bank Islam Malaysia Berhad (first Islamic bank) was established.
- 1993 – Bank Negara Malaysia introduced Interest-free banking scheme and Islamic “windows”.
- 2001 – Central Bank issues Financial Sector Master Plan which set outs future direction of the financial system over the next 10 years
- 2005/2006 – transformation of Islamic “windows” into a full-fledged Islamic subsidiaries of banking group.

### Thailand

- 1987 – establishment of Pattani Islamic Savings Cooperative
- 1994 – idea to established full-fledged Islamic banks by Thai government
- 2002 – setting up of full-fledged Islamic branch by Krung Thai Bank and establishment of Islamic Bank of Thailand.



### Singapore

- 2005 – Ministry of Finance announced a number of changes to taxation such as waiver of double stamp duty on Islamic real estate financing and for Islamic Bonds to enjoy same concessionary tax treatment as conventional bonds.
- 2005 – Banking regulations allow banks in Singapore to offer financing based on the Murabahah concept, without a need to seek MAS' approval
- 2006 – Launch of FTSE-SGX Asia Shariah 100 Index
- 2006 – Singapore expressed their intention to establish an Islamic financial hub.

### Indonesia

- Prior to 1992 – several non financial institutions offering Islamic financing to rural areas.
- 1992 – to meet demand for interest-free banking, the government allowed Shariah banking operations in Act no. 7 of 1992 (legal foundation for Shariah banking operations). Several amendments made in 1998 and in 1999, the New Act no. 23 gives the central bank authority to conduct its task according to Shariah principles.
- 2002 – Bank Indonesia issued blueprint for Islamic banking.
- 2006 – Bank Indonesia allowed conventional banks with Shariah banking units to offer Shariah's products and services.

Three interlocking puzzle pieces are arranged on a light gray surface. Two pieces are white, and one piece is blue. The blue piece is positioned at the bottom right of the group, and the two white pieces are positioned above and to the left of it. The pieces are slightly offset from each other, creating a sense of depth and movement.

Opportunities

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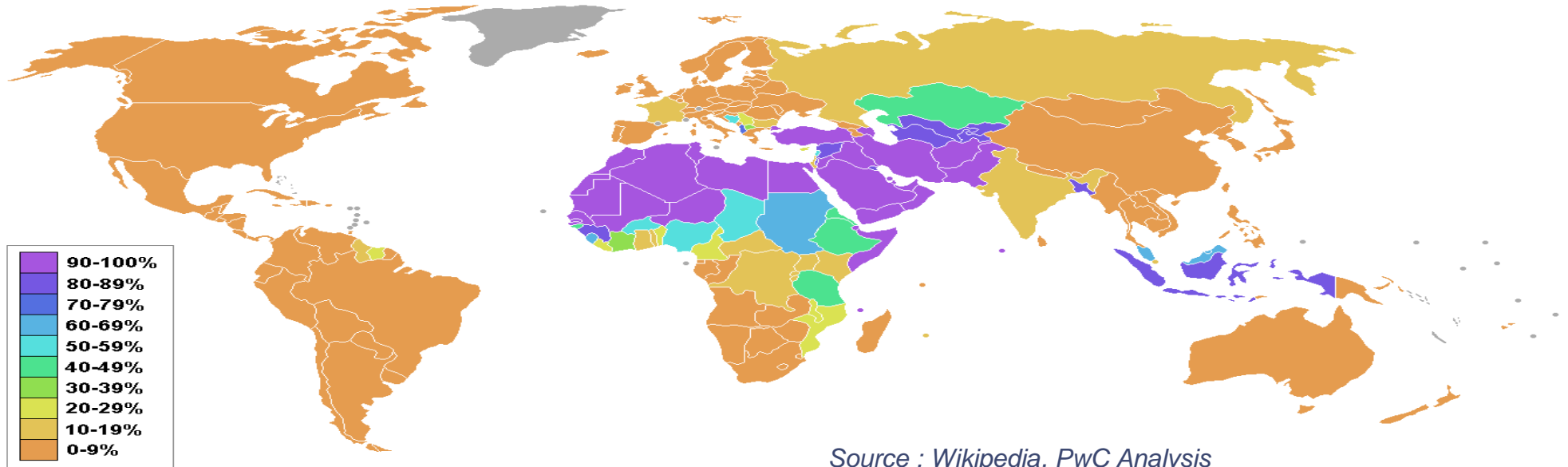
Opportunities

## Opportunities in Islamic Finance

- Not part of global economy
- Population demographics
- Investment opportunities
- Growing middle class in Islamic countries



# Population Demographics



Source : Wikipedia, PwC Analysis

Top 25 Countries of Muslims by Population			
Rank	Country	Muslim Population	% Muslim
1	Indonesia	207,000,105	88.20%
2	Pakistan	159,799,666	97%
3	India	151,402,065	13.40%
4	Bangladesh	124,872,121	83%
5	Egypt	70,530,237	85%
6	Turkey	68,963,953	97%
7	Nigeria	64,385,994	45%
8	Iran	64,089,571	98%
9	Algeria	32,999,883	99%
10	Morocco	32,300,410	99%
11	Afghanistan	31,571,023	99%
12	Saudi Arabia	26,417,599	100%

Top 25 Countries of Muslims by Population			
Rank	Country	Muslim Population	% Muslim
13	Sudan	26,121,865	65%
14	Iraq	25,292,658	97%
15	Uzbekistan	23,897,563	89%
16	Ethiopia	22,533,500	31.20%
17	Russia	21,513,046	15%
18	Yemen	20,519,792	99%
19	China	19,594,707	1.50%
20	Syria	16,234,901	88%
21	Malaysia	14,467,694	60.40%
22	Tanzania	12,868,224	35%
23	Mali	11,062,376	90%
24	Niger	10,499,343	90%
25	Senegal	10,459,222	94%



## Investment Opportunities

- Islam is the fastest growing religion 1996 to 2005, 1.9% growth in population vs. world rate of 1.3%
- Now a quarter of world population Muslim at 1.8 billion, one third by 2025
- Two thirds in Asia, the rest mainly in Africa. Europe has 3% Muslims, more in certain countries. Indonesia largest population
- Growth rates in Central Asia OIC countries about 10.3% currently and generates 70% of global energy needs. Generally reliant on commodities for economic growth but beginning to diversify
- Wealth largely concentrated in about 70 families. Country wealth in agencies who are acquiring companies and assets outside Middle East (US\$ 17Bn in 6 months 2006)
- World Bank estimates ME infrastructure spend over next 5 years, US\$ 15Bn pa. Principally electricity 49% roads 22% and telcos 21%

# Global Economy & Growing Middle Class

## Middle East

- Personal wealth is expected to rise to \$2.2 trillion by 2011 from \$1.4 trillion in 2006, Merrill Lynch and Capgemini said in a 2007 world wealth report.
- The number of millionaires in the region, in dollar terms, rose 11.9 % to more than 300,000 last year, according to the report.

## United States

- Muslims with disposable income estimated at USD170 billion yearly (mid-2007)



### Facts and Figures

## Germany

- Is home to some 3.2 million Muslims (estimated to reach 7 million by 2020)
- Majority is of Turkish descent — 2.4 million, constituting around 75% of German Muslims or 2.91% of Germany's populations.
- Their annual net income is estimated at €10.5 billion to €13 billion (US\$15.29 billion to US\$18.93 billion).



Challenges

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# Challenges in the Development of Islamic Finance

## Challenges

### Accounting

- Substance over form
- Profit Equalisation Reserves (PERs)
- Fair value accounting
- Comparability
- Arbitraging
- Adequacy of disclosures (in relation to Investment Accounts)
- The use of time value in IFRS
- Hedging

### Operational

- Product Development
- Risk Management
- Human Capital
- Few Shariah scholars with banking / finance knowledge
- Too fragmented
- Inconsistent Shariah interpretations across the globe

### Tax / Regulatory

- The industry is still government-driven
- The need of proper tax structure
  - Islamic banking and takaful
  - Fund Management
  - Islamic capital market

# Indonesia Taxation

- Existing Income Tax Law and VAT Law
- Draft of the Income Tax and VAT Law

# Substance of transaction: Financing or Trading of Goods

a. If conventional financing



No withholding tax and no VAT

b. If “trading”



Potential Tax Implications, as follows:

	Income Tax	VAT	L&B Transfer Duty
Goods (other than L&B)	N/A	10%	N/A
Land / Building	5%	10%	5%

Three interlocking puzzle pieces are arranged on a light gray surface. Two pieces are white, and one piece is blue. The pieces are positioned in a triangular pattern, with the blue piece at the bottom and two white pieces above it.

# Conclusions

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## Islamic Finance – The Way Forward

### Growth

Mainly attributed to :-

- Growing Muslim populations
- The need for alternative financing catering for Muslims
- Government driven

### Issues

- Lack of consistency in Shariah views and adoption of accounting standards
- Lack of understanding of Islamic products
- Regulatory and tax neutrality

### Economic factors

- Ability to attract investors from Middle East
- Acceptability of Islamic products by non-Muslims
- Increasing product innovations

### Socio-political landscape

- Growing middle class Muslims
- Greater use of banking / takaful products
- Wealth imbalance



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