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
Indonesian Islamic Banking developments

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

- Introduction
- Opportunities
- Challenges
- Conclusion
Introduction
Introduction

The Journey of Islamic Finance

1963
- Mit Ghamr, Local Savings Bank, Egypt
- Lembaga Tabung Haji Malaysia

1971
- Nasser Social Bank, Egypt

1975
- Islamic Development Bank, Jeddah
- Dubai Islamic Bank, Dubai

1977
- Faisal Islamic Bank, Sudan

1979
- Bahrain Islamic Bank, Bahrain

1982
- Al-Baraka

1983
- Bank Islam Malaysia, Berhad
- Islamic Bank, Bangladesh
- Qatar Islamic Bank

1984
- Dar al Mal al Islamic Trust, Geneva

1989
- AHZ Global Islamic Finance, UK

1993
- Islamic Bank of Brunei

1994
- Islamic Inter-banks Money Market, Malaysia
- Accounting and Auditing Organization for Islamic Financial Institutions, Bahrain

1999
- Bank Muamalat Malaysia Berhad

2002
- International Islamic Financial Market, Bahrain
- Islamic Financial Services Board

2006
- INCEIF

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

Foundations of Islamic Finance

Islamic Finance

- Prohibitions of Riba
- Prohibitions of Gharar (uncertainty)
- Prohibitions of Maisir (gambling)
- Prohibitions of Haram transactions
- Application of the Al-Bay (trading) concept

Shariah
- centerpiece and backbone of Islam

- Al-Quran
- Hadith (saying of The Prophet)
- Sunnah (practice of The Prophet)
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
Introduction

Islamic Finance Assets of Key Countries

**Bahrain**
As at March 2007, amounted to USD12.1 billion, equals to 6.3% of Islamic banks market share.

**Pakistan**
As at March 2007, amounted to USD2.23 billion equals to 3.2% in assets of the total banking sector.

**Indonesia**
As at June 2007, amounted to USD313.69 million making up 1.7% of the industry’s total domestic assets.

**Saudi Arabia**
As at end of Q2 2007, banking industry’s assets are USD250 billion. It is estimated that more than 30% of bank assets are now classified as Shariah’s compliant.

**Malaysia**
As at the end of 2006, amounted to USD34 billion, equals to 13% in terms of market share.

**UAE**
UAE total banking industry has USD273 billion in assets at the end of Q2 2007.
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.

**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.

**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.
Opportunities
Opportunities in Islamic Finance

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

### Population Demographics

Top 25 Countries of Muslims by Population

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>Muslim Population</th>
<th>% Muslim</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Indonesia</td>
<td>207,000,105</td>
<td>88.20%</td>
</tr>
<tr>
<td>2</td>
<td>Pakistan</td>
<td>159,799,666</td>
<td>97%</td>
</tr>
<tr>
<td>3</td>
<td>India</td>
<td>151,402,065</td>
<td>88.40%</td>
</tr>
<tr>
<td>4</td>
<td>Bangladesh</td>
<td>124,872,121</td>
<td>83%</td>
</tr>
<tr>
<td>5</td>
<td>Egypt</td>
<td>70,530,237</td>
<td>85%</td>
</tr>
<tr>
<td>6</td>
<td>Turkey</td>
<td>68,963,953</td>
<td>97%</td>
</tr>
<tr>
<td>7</td>
<td>Nigeria</td>
<td>64,385,994</td>
<td>43%</td>
</tr>
<tr>
<td>8</td>
<td>Iran</td>
<td>64,089,571</td>
<td>98%</td>
</tr>
<tr>
<td>9</td>
<td>Algeria</td>
<td>32,999,883</td>
<td>99%</td>
</tr>
<tr>
<td>10</td>
<td>Morocco</td>
<td>32,300,410</td>
<td>99%</td>
</tr>
<tr>
<td>11</td>
<td>Afghanistan</td>
<td>31,571,023</td>
<td>99%</td>
</tr>
<tr>
<td>12</td>
<td>Saudi Arabia</td>
<td>26,417,599</td>
<td>100%</td>
</tr>
</tbody>
</table>

Top 25 Countries of Muslims by Population

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<tr>
<th>Rank</th>
<th>Country</th>
<th>Muslim Population</th>
<th>% Muslim</th>
</tr>
</thead>
<tbody>
<tr>
<td>13</td>
<td>Sudan</td>
<td>26,121,865</td>
<td>65%</td>
</tr>
<tr>
<td>14</td>
<td>Iraq</td>
<td>25,292,658</td>
<td>97%</td>
</tr>
<tr>
<td>15</td>
<td>Uzbekistan</td>
<td>23,897,563</td>
<td>89%</td>
</tr>
<tr>
<td>16</td>
<td>Ethiopia</td>
<td>22,533,500</td>
<td>31.20%</td>
</tr>
<tr>
<td>17</td>
<td>Russia</td>
<td>21,513,046</td>
<td>15%</td>
</tr>
<tr>
<td>18</td>
<td>Yemen</td>
<td>20,519,792</td>
<td>99%</td>
</tr>
<tr>
<td>19</td>
<td>China</td>
<td>19,594,707</td>
<td>1.50%</td>
</tr>
<tr>
<td>20</td>
<td>Syria</td>
<td>16,234,901</td>
<td>88%</td>
</tr>
<tr>
<td>21</td>
<td>Malaysia</td>
<td>14,467,694</td>
<td>60.40%</td>
</tr>
<tr>
<td>22</td>
<td>Tanzania</td>
<td>12,868,224</td>
<td>35%</td>
</tr>
<tr>
<td>23</td>
<td>Mali</td>
<td>11,082,376</td>
<td>90%</td>
</tr>
<tr>
<td>24</td>
<td>Niger</td>
<td>10,499,343</td>
<td>90%</td>
</tr>
<tr>
<td>25</td>
<td>Senegal</td>
<td>10,459,222</td>
<td>94%</td>
</tr>
</tbody>
</table>
Opportunities

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%
Opportunities

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)

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 in the Development of Islamic Finance

**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:

<table>
<thead>
<tr>
<th></th>
<th>Income Tax</th>
<th>VAT</th>
<th>L&amp;B Transfer Duty</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goods (other than L&amp;B)</td>
<td>N/A</td>
<td>10%</td>
<td>N/A</td>
</tr>
<tr>
<td>Land / Building</td>
<td>5%</td>
<td>10%</td>
<td>5%</td>
</tr>
</tbody>
</table>
Conclusions

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