OMAN ISLAMIC FINANCE REPORT 2015:

BUILDING ON A STRONG START

EXCLUSIVE

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President of Islamic Development Bank (IDB) Group Ahmed Muhamed Ali speaks during the "Third IDB 1440H Vision Commission Meeting" in Kuala Lumpur March 23, 2006. REUTERS/Zainal Abd Halim

ABOUT THE ISLAMIC RESEARCH AND TRAINING INSTITUTE

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The Islamic Research and Training Institute (IRTI), a member of the Islamic Development Bank Group (IDBG), was established in 1401H (1981). The principal aim of IRTI is to undertake research, training and advisory activities in Islamic Economics and Islamic Finance to facilitate the economic, financial and banking activities in IDB member countries to conform to Shari'ah. A knowledge-based organization, IRTI, is considered to be one of the pioneers and key centers of excellence around the world in promoting and supporting the development and sustenance of a dynamic and comprehensive Islamic Financial Services Industry (IFSI), which supports the socio-economic development of IDB member countries and Muslim communities across the globe.

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General Council for Islamic Banks And Financial Institutions

المجلس العام للبنوك والمؤسسات المالية الإسلامية

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About CIBAFI

General Council for Islamic Banks and Financial Institutions (CIBAFI) is a non-profit institution that is the umbrella for Islamic financial institutions worldwide. It was founded by the Islamic Development Bank (IDB) and a number of leading Islamic financial institutions, CIBAFI is affiliated with the Organisation of Islamic Cooperation (OIC). Established on 16 May 2001, in the Kingdom of Bahrain, today CIBAFI is recognised a key piece in the international architecture of Islamic finance.

CIBAFI was established with the objectives of developing the Islamic financial services industry (IFSI) and promoting the industry in various fields through information and financial analysis, communication, awareness, human resources and rating of Islamic financial products.

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3: Awareness and information sharing

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ABOUT THOMSON REUTERS

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FOREWORD

The Oman Islamic Finance Report 2015 is the fourth in our series of Islamic Finance Country Reports (IFCR) designed to provide key insights on the development of the industry in emerging and frontier Islamic finance markets. The Report provides accurate data and insightful analysis to promote transparency and access to information among stakeholders of the Islamic finance industry.

Oman was the last GCC country to welcome Islamic finance and its introduction in the Sultanate was eagerly anticipated by the global Islamic finance community. They understand the potential that exists in Oman for the industry to develop and flourish. With strong economic growth projections, significant government expenditure on infrastructure projects and a young, sharia-sensitive population, the Sultanate has all the ingredients required for establishing a successful Islamic finance sector. Add to that an enabling environment fostered by the regulator, it is not surprising that most leading Islamic finance institutions see Oman as a key growth market.

And the country has not disappointed. Although there was already a limited offering of Islamic home financing, the mainstream launch of Islamic finance broke through in 2013 with the establishment of the first full-fledged Islamic bank. Today, Islamic banking assets, which are in excess of OMR 1 billion, make up 4.4% of the banking industry in Oman. This is even more impressive when compared to countries like Indonesia (5%), Turkey (5.6%) and Egypt (5%), which have older and more established Islamic finance sectors.

This Report includes the outcomes of a retail banking consumer survey, conducted in May 2014, and perspectives and insights from key players in the industry including regulators and practitioners. They highlight the demand from the retail segment for financing solutions that are truly "Islamic" and the challenges facing the industry.

This Report emphasizes the need to implement multi-channel awareness campaigns to better explain the industry to the consumer segment, a large portion of whom feel that current Islamic banking practices are not authentic. The Report also addresses the need to develop a local talent pool of Islamic finance professionals to carry the industry forward, in line with the broader government strategy to make the economy less dependent on foreign talent.

The Report further identifies unique opportunities in Oman, such as the growth potential for general takaful (via bancatakaful) and opportunities in the broader Islamic economic sectors such as tourism and pharmaceuticals.

It gives us great pleasure to present the Oman Islamic Finance Report 2015. We hope this report will provide you with the necessary information and insights required to better understand the current state and future potential of the Islamic finance industry in the Sultanate of Oman.

Dr. Sayd Farook
Global Head Islamic Capital Markets
Thomson Reuters

Dr. Mohamad Azmi Omar
Director General
IRTI

Mr. Abdelilah Belatik
Secretary General
CIBAFI

EXCLUSIVE TO THE REPORT

Exclusive to this report are a retail banking consumer survey which was conducted in May 2014 and a series of interviews and commentary pieces written by experts and industry leaders. We provide our analysis of Oman's Islamic finance potential and present our recommendations for the way forward. In sum, this report presents a comprehensive picture of Oman's Islamic finance industry and its potential.

Exclusive interviews with:

1. H.E. Hamood Sangour Al Zadjali
   Executive President,
   Central Bank of Oman
2. Sulaiman Al Harthy
   Group General Manager,
   Meethaq Islamic Banking
3. Ahmed Al Qassabi
   Acting DG, Issues & Disclosures, Capital Market Authority
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3. Insurance regulatory framework and its impact on takaful sector growth
   by Khalid Yousaf

Analysis:

1. Islamic banking analysis 2013 to June, 2014
2. Regulatory framework overview
3. Exclusive retail banking consumer survey findings
4. Islamic finance demand and supply potential
5. Priority areas essential to foster exponential growth of Islamic banking assets in Oman
6. Growth opportunities via six strategic orientations: Demographics, Multi-channel, Customer Experience, Multi-banking, Target Audience and Latent Opportunities
7. Sukuk market outlook
8. Islamic funds outlook
9. Challenges and opportunities for Islamic banking and takaful

Oman's first Islamic bank opened in January 2013. 12 months later Islamic banking assets reached 3.5% of the country's total banking assets (including Meethaq's OMR 100 million sharia-compliant home financing assets from pre-2013) and by June 2014 sharia-compliant banking assets hit 4.4%, equivalent to OMR 1.07 billion ($2.78 billion).

Oman's Islamic banking sector has had an impressive start, especially if we compare that 4.4% against more mature Islamic finance markets: Indonesia's Islamic banking sector, which welcomed its first Islamic bank in 1992, makes up approximately 5% of total banking assets and Pakistan, which has been trying to fully Islamise its financial system since the 1980s, has approximately 10% sharia-compliant banking assets out of its banking system. Omanis' rush to Islamic banking could be attributed to initial euphoria and pent-up demand for sharia-compliant finance but while growth has slowed in the second year we can't deny it's been a remarkable start. As it stands, Oman has two Islamic banks and five Islamic banking services of conventional banks. There are two takaful operators and one sukuk has been issued.

Key headlines

1. **Oman's demographic dividend is a growth driver for Islamic banking**
   Young people aged 20-34 comprise a staggering 42% of Oman's total population and the median age of the population is 25.88 (WHO, 2012). Oman's young demographic will drive the growth of Islamic finance in the country. Approximately 74% of our survey sample size of 835 are aged between 18 and 34 and 34% of these young people with bank accounts have them at either Islamic banks only (9%) or at both conventional and Islamic banks (22%). 74% of the survey respondents say that adhering to Islamic rules is the most important factor that would encourage them to deal with Islamic banks and 43% of them say that what holds them back from dealing with an Islamic bank is that current practices are not authentic. When asked how they could be convinced that Islamic banking products/services are really

WORLD'S 3RD MOST DEVELOPED ISLAMIC FINANCE MARKET

Oman's Islamic finance industry is the world's third most developed, behind Malaysia and Bahrain, according to the ICD-Thomson Reuters Islamic Finance Development Indicator (IFDI). Oman's well-rounded performance in the world rankings is propped up by its leading positions on the Corporate Social Responsibility and Awareness Indicators. Its performance along with the other quantitative indicators are expected to improve as its new Islamic financial institutions work towards achieving higher profitability and the industry witnesses a takeoff in funds, Sukuk, and non-bank IFIs. The IFDI 2014 report is available from this link: https://www.zawya.com/islamic-finance-development-indicator/

Islamic, only 3% would leave the responsibility to regulators while others would depend on the bank's word (32%), evidence from the bank (29%), their local sharia scholar (24%) and confirmation from others (12%).

In order to win the market, Oman's Islamic banks must go on a national charm offensive that focuses on the main value proposition of Islamic finance. There is a huge Islamic finance potential in Oman. The population is sharia-sensitive — approximately 40% of respondents want conventional finance to be completely replaced by Islamic finance. The key to winning over banking customers lies in multi-channel communications, enhancement of customer service and leveraging multi-banking opportunities. Additionally, there are latent opportunities in general takaful which could be exploited via bancatakaful.

2. Islamic banking assets to reach 10% of total banking assets by 2018

Based on our survey findings and the current growth rate of Islamic banking in Oman, we estimate that in the best case scenario, Islamic banking assets will reach $7 billion, or 10%, of total banking assets by 2018 from the current 4.4% as of June 2014. In order for this to be achieved, there has to be continued government support to facilitate effective operations of Islamic banks, including the provision of solutions for liquidity management. Oman's domestic Islamic banking sector will also benefit from greater cross-border harmonisation of Islamic finance standards and practices.

3 Current limitations

Oman's greatest asset (apart from hydrocarbons) is its people and Oman must transform its human capacities and resources to innovate for the Islamic finance industry. In line with its Omanisation policy which insists on the employment of more nationals in the workforce, especially in the private sector, there is a pressing need to enhance the competency of the domestic human resources. This will provide a fillip to Oman's competitiveness and lead to SME growth and development. Similarly, Oman's Islamic finance industry relies on a well-qualified and skilled workforce. Looking towards the long-term, this is a concern that has prompted Omani authorities to emphasise the development of a Knowledge Economy and improve higher education and professional training programmes.

Oman is behind the curve on development of its Islamic Economy. Two of the country's investment opportunity sectors — Tourism and Pharmaceuticals — are pillars of the Islamic Economy earmarked for their increasing Muslim demand and growth potential. Out of the countries Oman has targeted for these two sectors only the GCC, Jordan and Iran are Muslim-majority. If Oman wants to cater to and reach the growing Islamic Economy worldwide, it should be formulating strategy to provide for a halal base of processes and operations within the country and expand its global tourism marketing to attract more Muslim visitors.

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REUTERS/Ahmed Jadallah

Strategic location for trade and commerce

Oman is strategically located on the western shore of the Gulf of Oman, which links the Arabian Sea to the Strait of Hormuz, the most important transit point of crude oil in the world. The country has attracted a large number of foreign workers, who constitute 44% of the population, according to data from the country's National Center for Statistics and Information.

Exchange rate pegged to USD

Except for Kuwait, all GCC countries peg their currencies to the US dollar. The currency of the Sultanate of Oman, the Omani Rial, is pegged to the USD at a rate of about 1 OMR for 2.6 USD. On June 6, 2014, the "indicative" exchange rate announced by the CBO was $1 for .384 (buy), and .385 (sell).

AREA
312,460 km²/120,641 sq. miles

INTERNET DOMAIN
.om

LIFE EXPECTANCY
74.7 Male
78.9 Female
(UN)

GDP (CURRENT US$, 2013)
$80.57 billion
(World Bank)

LARGEST CITY
Muscat

MAJOR RELIGION
Islam

CAPITAL
Muscat

MAIN EXPORTS
Fuels
Raw Aluminium
(World Bank)

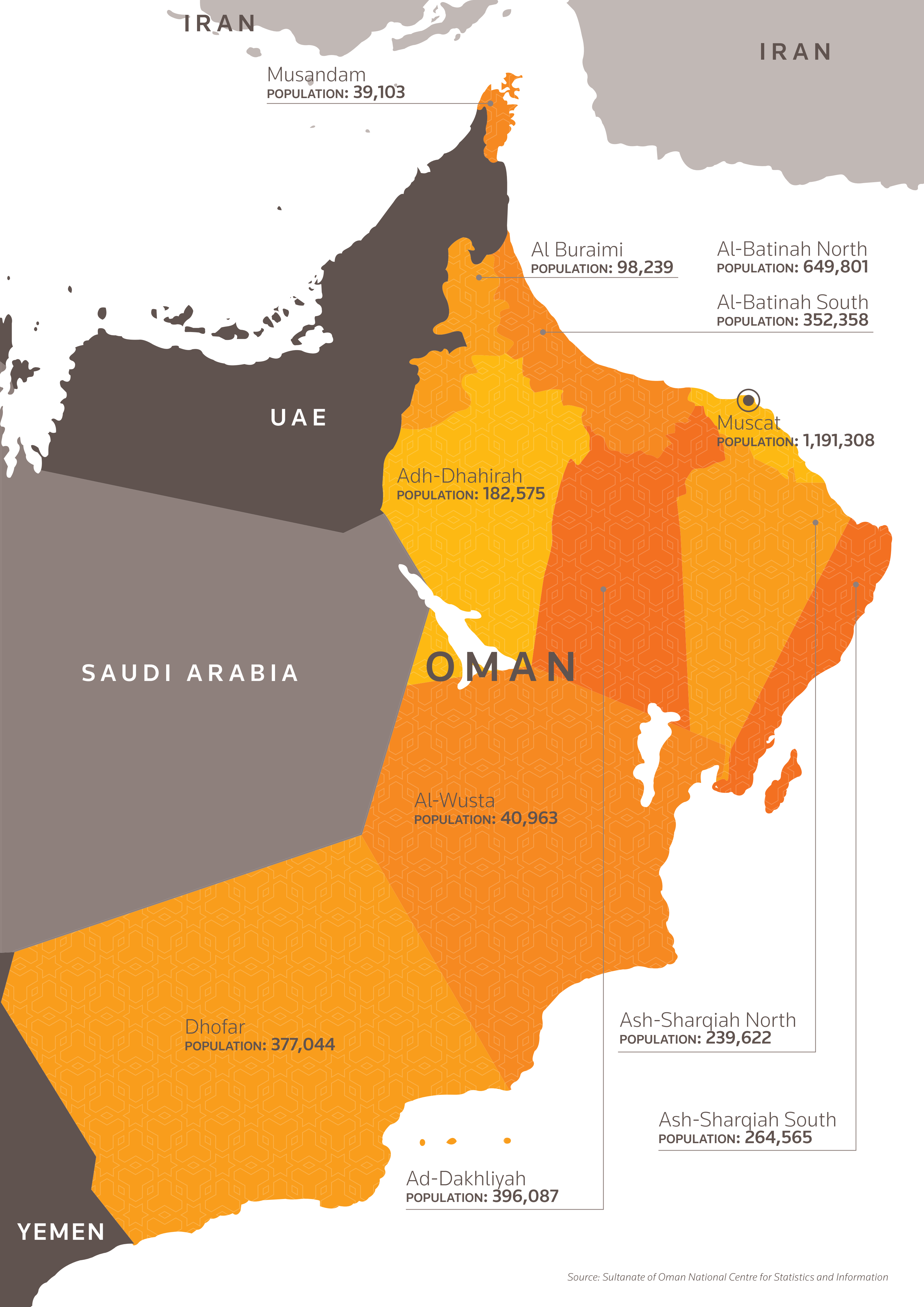
MAJOR LANGUAGES
Arabic (official language)
English

FULL NAME
Sultanate of Oman

MONETARY UNIT
Omani Rial

POPULATION (END JULY 2014)
3.988 million
(National Centre for Statistics and Information, Jun 2014)

MEDIAN AGE
25.88
(World Health Organisation, 2012)



Source: Sultanate of Oman National Centre for Statistics and Information

MACROECONOMIC ENVIRONMENT

With a gross domestic product per capita in 2013 reaching $25,288 (IMF), the Sultanate of Oman is a high-income country. Oman has made significant progress in the last 50 years, starting as a low-income country with an income per capita under $200 in the early 1960s.

Oman was the Gulf Cooperation Council's (GCC) weakest GDP per capita performer in the 1980s but has closed the wide gap and its GDP per capita is now competitive with Saudi Arabia ($24,847, 2013 IMF). Oil is the primary contributor to the public purse. Oman needs to diversify its economy away from hydrocarbons and welcoming Islamic finance in 2013 has served as a prominent signal that the country is keener on (and now more open to) new opportunities in terms of diversifying and growing its economy. Oman needs to improve its competitiveness along several fronts such as economic diversification, outward FDI, and trade relations with economies outside its immediate region.

Oman is built on a top-ranked, stable macroeconomic environment characterised by moderate inflation levels, current account surpluses, and a low debt-to-GDP ratio. It has a high human development environment that offers citizens a long and healthy life, high levels of literacy and access to education, and a decent standard of living. However, Oman's economy is neither well-rounded nor well-balanced. It is heavily reliant on oil resources. Doing business in Oman is relatively easy compared to selected countries in the region; the country ranks 47 out of 189 countries in terms of the World Bank Ease of Doing Business Index.

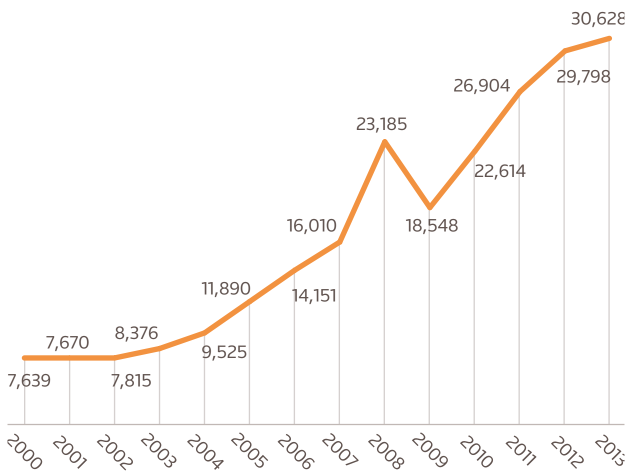
Stable macroeconomic indicators

Unsurprisingly, high oil prices have boosted the macroeconomic standing of oil-producing countries. On the World Economic Forum's World Competitiveness Ranking 2013-2014, Oman is ranked a solid 5th behind Brunei, Norway, Kuwait and Saudi Arabia. The other GCC economies that make the top 10 for macroeconomic environment are Qatar (6th) and UAE (7th). Bahrain, the GCC country with the lowest oil reserves, is ranked No. 21.

Moderate inflation since 2000

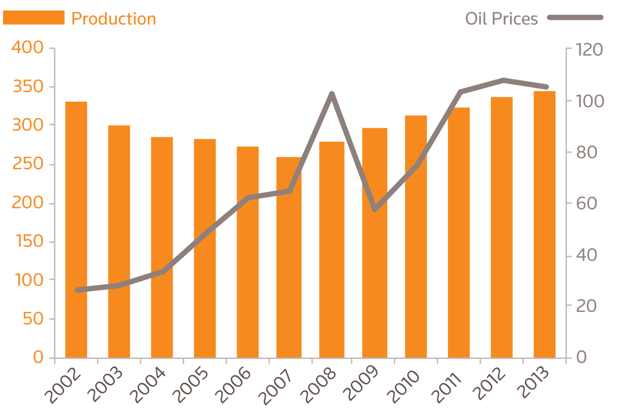
Oman has seen moderate inflation since 2000; the average rate of 2.6% is low compared to other IDB countries, MENA oil exporters, and the other five GCC member countries. However, money supply has been increasing at double-digit rates since 2010 along with a rise in government spending from 34% of GDP in 2010 to 42% in 2013.

GDP at current prices (OMR million)



Source: Central Bank of Oman

Evolution of oil production and prices



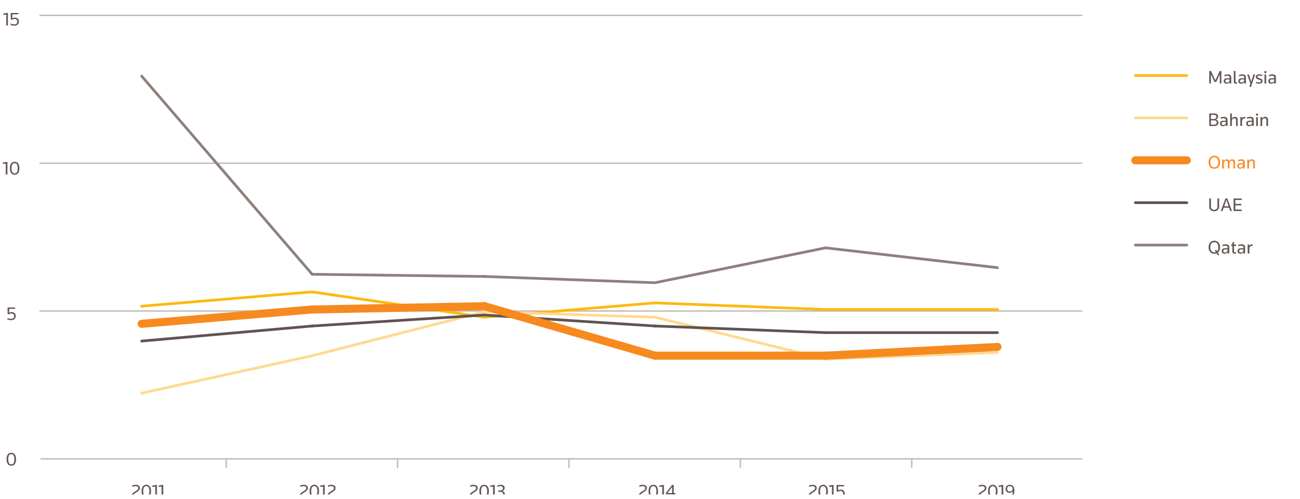
Current account in the black

In spite of the recent rise in government expenditures, the country exhibits strong macroeconomic fundamentals with persistent surplus in the current account and sustainable budget deficits. The current account consistently registered surpluses (except in 2009) with an estimated average of 9.85% of GDP. On the internal side, the public sector saw small deficits of less than 1% of GDP in the last five years. These deficits are sustainable considering the burden of debt below 15% of GDP during the same period.

Benchmarking against GCC and top 10 IFDI countries

In positioning Oman's macroeconomic environment, we compare the country to two groups: the other five GCC member countries, and the other four most developed Islamic finance countries as ranked by the ICD-Thomson Reuters Islamic Finance Development Indicator (IFDI). The IFDI is a composite weighted index that measures the overall development of the Islamic finance industry by providing an aggregate assessment of the performance of all its parts, in line with the objectives of Islamic principles. The key priority areas identified and addressed are quantitative development, knowledge, governance, corporate social responsibility and awareness, which have been aggregated to provide global and country level Indicators.

% GDP growth for top 5 IFDI countries 2011-2019



% GDP growth 2011-2013 (actual), 2014, 2015, and 2019 (projected). Source: IMF World Economic Outlook April 2014

Economic diversification, industrialisation and private sector development

The oil and gas producing countries of the GCC have all delved into economic diversification to balance growth of their economies in full knowledge of dwindling reserves. The Omani government, while acknowledging that GDP contraction in 2009 at the height of the global financial crisis was due to the 44% drop in oil prices, argues that 3.7% growth was still achieved in 2009 because of the economy's strong fundamentals and diversification efforts.

The goal for diversification away from hydrocarbons is to increase non-oil GDP from 62.4% during 1991-1995 to 81% in 2020, i.e. reduce oil GDP to 19%. Industrialisation, private sector development and increased integration into the global economy also figure prominently in Oman's national economic plans. Ultimately, all policies are driven to enhance Oman's competitiveness in the global arena.

Oman has had state-driven national economic plans since 1976 and is currently on its Eighth Five-Year Plan, for 2011-2015. More than half of total expenditure in the Eighth Five-Year Plan is allocated to the construction of airports and roads and about a quarter to seaports, water and housing.

Heavy reliance on oil

The country has seen sustained economic growth over the last decade driven by a dynamic energy sector dominated by oil and gas. The growth rate of real GDP averaged 5.3% over the last 10 years, which is comparable to the 5.53% for the oil exporting member countries of the IDB. At the height of the world economic and financial crises growth rates dropped from 7.7% in 2007 and 7.8% in 2008 to 3.3% in 2009. The slowdown resulted from a 44% plunge in Omani oil prices from $101.1 per barrel in 2008 to $56.7 in 2009 and a subsequent contraction in the petroleum sector's GDP. This illustrates the vulnerability of the economy to negative shocks to the world economy and to global energy demand.

WORLD OIL PRICES WILL CONTINUE TO AFFECT GDP GROWTH

In May 2014, the Central Bank of Oman forecasted that in the worst case scenario, where lower global growth combined with adverse oil price movement, Oman's GDP growth will be in the range of 1.9-2.5%. However, IMF projects that Oman will have one of the lowest GDP growth rates for 2014 and 2015 among the GCC and other top 10 IFDI countries. From 5.1% in 2013, IMF projects Oman's real GDP growth to slip to 3.4% for 2014 and 2015 and rise slightly to 3.7% in 2019.

REUTERS/Jumana El-Heloueh

Non-oil sector slowly growing

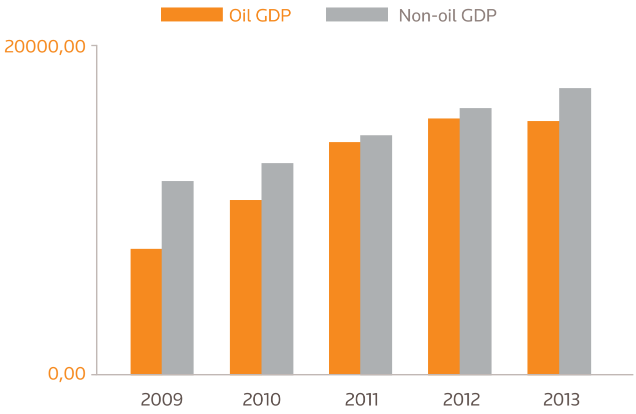
Non-oil GDP dropped more than 10% from 2009 to 2011, from 64.61% to 55.48% to 53.64%. It started rising in 2012 on 53.72% and reached 56.25% in 2013. The GDP growth rate for the non-oil sector surpassed the oil sector in 2012 (11.6% v 11.5%) and 2013 (7.6% v 2.8%), a development that reflects well on the Sultanate's diversification efforts although there is a long way to go to reach 2020 goals.

DIVERSIFICATION: OIL VERSUS NON-OIL GROWTH

An analysis of the sources of GDP reveals that oil and gas contribute approximately 67% of the value-added, with a minuscule 1% for the agricultural sector, and the rest coming from the services sector. Traditionally, this would suggest an economy in the second stage of economic development, where mechanisation is moving labour from the primary to the secondary sector. However, the details of the industrial contribution point to an economy still dominated by hydrocarbons. Crude petroleum accounts for 68.2% of production, with natural gas adding 5.8% and manufacturing 16.6%.

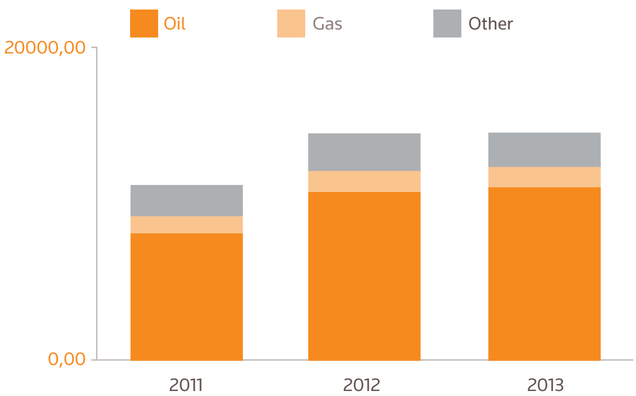
REUTERS/Ahmed Jadallah (OMAN)

Oil and non-oil GDP in OMR millions



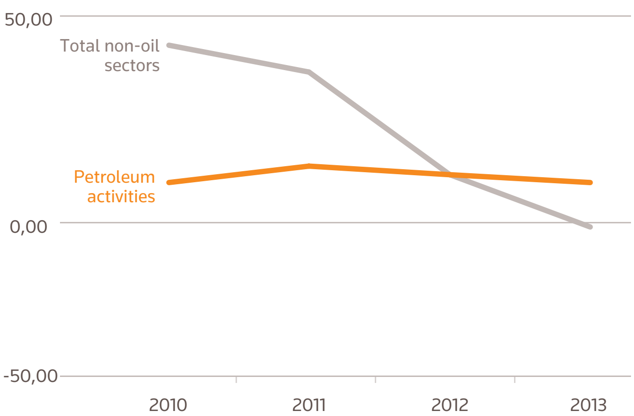
Source: Central Bank of Oman Statistical Bulletins

Oil, gas and other government revenue in OMR millions



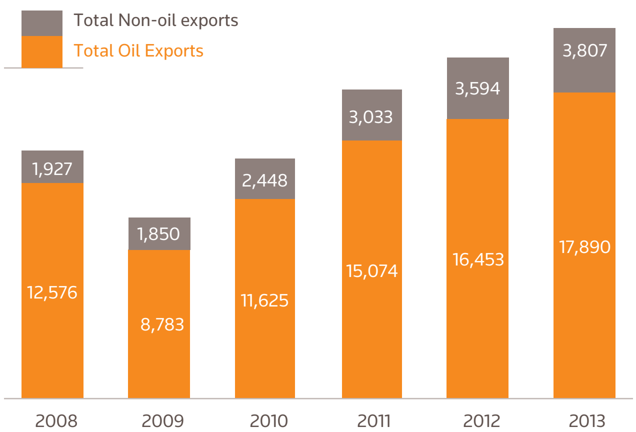
Source: Central Bank of Oman Statistical Bulletins

Oil and non-oil GDP in OMR millions



Source: Central Bank of Oman Statistical Bulletins

Oil and non-oil exports, in OMR millions



Source: Central Bank of Oman Statistical Bulletins

Industrialisation: Large PPP investments

Oil revenues are fueling public spending on big investment projects the Omani government hopes will foster private sector participation in economic growth and diversification. The Sultanate is leveraging on its competitive advantage in the oil sector to develop large-scale petrochemical projects in partnership with private firms. For example, Liwa Plastics, in partnership with the national company Oman Oil Refineries and Petroleum Industries will develop a $3.6 billion project in Sohar, and a joint venture of Oman Oil Company and UAE-owned International Petroleum Investment Company is developing an oil refinery in Duqm to the cost of $6 billion, with plans for an associated complex in the second phase possibly pushing all investments to $15 billion.

These developments outside of the capital Muscat also support national plans to improve economic opportunities in the regions and spread the geographic distribution of investments.

There are also large infrastructure projects planned, including the $13 billion 170-kilometer railway connecting the northern town of Buraimi (which borders Al Ain in the UAE) and Sohar with the ports of Duqm and Salalah towards the Yemeni border in the south. (Read more about this in our sukuk potential section)

Private Sector: Business Environment

A good business environment is a necessary condition for stimulating both domestic and foreign investment. The Omani business environment is dominated by the oil and natural gas sectors driving the economy, but with the government providing incentives through successive 5-year development plans to diversify the economy by promoting the sectors outside of of oil and gas. The Foreign Capital Investment Law of 1994 rules all issues of foreign investment in the country.

The Sultanate, like many GCC countries, has embraced the gradual opening of its economy to foreign capital. Efforts are made through incentives such as subsidised loans, tax incentives, land in industrial and free-trade zones and administrative benefits in supporting the development of the industrial sector, particularly when companies contribute to the diversification of the economy away from oil and gas, and to the hiring of Omani labour. As in most GCC countries, joint ventures with residents are encouraged, although total foreign ownership can be authorised by the Ministry of Commerce and Industry if investment projects are in line with the government's long-term strategy.

REUTERS/Fahad Shadeed

Private Sector: Competitiveness and Ease of Doing Business

Oman's ease of doing business ranking dropped three places to 47 out of 189 countries in 2013. In the GCC, Oman is fourth easiest place to do business behind UAE, Saudi Arabia and Bahrain. Among the top 10 most developed Islamic finance markets Oman is pushed down to fifth, with Malaysia taking top spot.

The top 3 countries on the *World Bank Ease of Doing Business Index* are Singapore, Hong Kong, and New Zealand

Oman's most problematic factors for doing business are: restrictive labour regulations, poor work ethic in national labour force, and inadequate educated workforce (the lattermost is a long-term competitiveness concern).

Oman weakened in critical areas that contribute to its goal of economic diversification via fostering private sector participation. It dropped six places from 2013 to 2014 rankings for Starting a Business and Dealing with Construction Permits; it dropped four places for Getting Credit and Enforcing Contracts; and down three places for Registering Property and Protecting Investors.

Ranking of Doing Business for the GCC and the other top 4 Islamic finance countries Malaysia, Jordan, Pakistan and Brunei, 2013

	2013 TOP 10 IFDI RANK (OUT OF 92 COUNTRIES)	ECONOMY (OUT OF 189 COUNTRIES)	EASE OF DOING BUSINESS RANK	STARTING A BUSINESS	DEALING WITH CONSTRUCTION PERMITS	GETTING ELECTRICITY	REGISTERING PROPERTY	GETTING CREDIT	PROTECTING INVESTORS	PAYING TAXES	TRADING ACROSS BORDERS	ENFORCING CONTRACTS	CLOSING A BUSINESS
GCC	4	UAE	23	37	5	4	4	86	98	1	4	100	101
GCC	9	Saudi Arabia	26	84	17	15	14	55	22	3	69	127	106
GCC	2	Bahrain	46	99	4	52	32	130	115	7	81	122	27
GCC	**3**	**Oman**	**47**	**77**	**69**	**58**	**21**	**86**	**98**	**9**	**47**	**107**	**72**
GCC	5	Qatar	48	112	23	27	43	130	128	2	67	93	36
GCC	6	Kuwait	104	152	133	59	90	130	80	11	112	119	94
	1	Malaysia	6	16	43	21	35	1	4	36	5	30	42
	7	Jordan	119	117	11	41	104	170	170	35	57	133	113
	8	Pakistan	110	105	109	175	125	73	34	166	91	158	71
	10	Brunei	59	137	46	29	116	55	115	20	39	161	48

Source: World Bank/IFC, Doing Business Report 2014; ICD-Thomson Reuters Islamic Finance Development indicator 2014

Private Sector: Constraints on SME participation

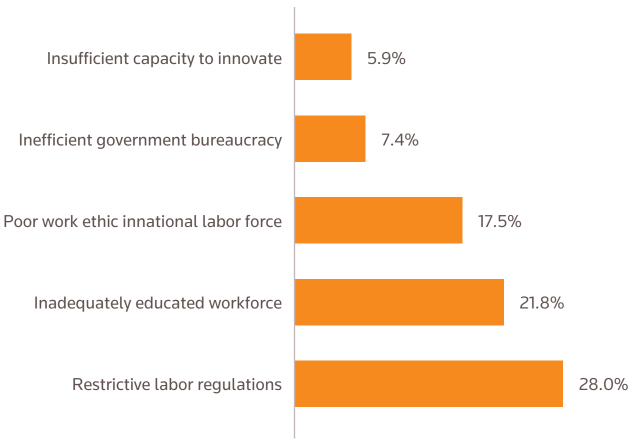
Tourism, industry, agriculture and fisheries are investment and development focus areas for SMEs. Oman faces substantial challenges to develop its SME sector. According to a 2011 International Labour Organization survey (see inset box) 70% believe the regulatory environment makes it difficult for small businesses to compete with large ones, which adds to Omanis' concerns about starting their own companies.

The 2013 World Bank Ease of Doing Business Index maintains ILO's 2011 survey results. Oman's ease of doing business contrasts markedly with that of the UAE, which has also been pursuing its own diversification plans for the last three decades (as has the rest of the GCC). The UAE, Oman's biggest trading partner, is the easiest place to do business in the GCC, ranking No.23 in the world compared to Oman's No. 47. However, the two are tied at No. 86 for access to credit.

Access to credit for private sector companies

Improving access to credit and financing for private sector companies is another national focus. Omani authorities, including the Central Bank of Oman, have put in place rules for all banks, conventional and Islamic, to increase their loans and financing to SMEs. (See our interview with CBO) Over the years the government has also extended subsidies for soft loans to the private sector.

Oman's most problematic areas for doing business



Source: World Bank/IFC, Doing Business Report 2014

A 2011 survey conducted by the International Labour Organization (ILO) of 150 firms revealed critical concerns that constrain the success of economic diversification. Four of the five top challenges related to the labour legislation and skills of the labour force:

1. Lack of skilled local workforce
2. Omanisation laws
3. Labour legislation
4. Education and training system (ILO, 2011)

REUTERS/Fahad Shadeed

FOCUS: Developing local workforce for the long-term

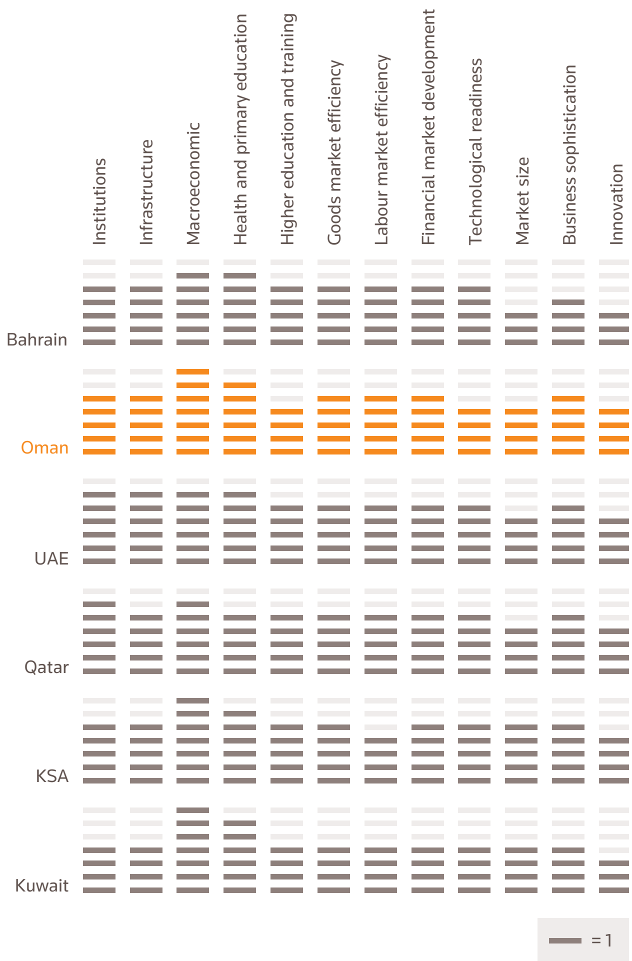
The World Economic Forum's Global Competitiveness Index ranks Oman overall 33rd for 2013-2014, down one rank from 2012-2013 and 2011-2012. Although Qatar is the most competitive economy In the GCC, only UAE has considerably improved its competitiveness ranking from 2011, moving from 27th to 19th. Across the 12 indicators of global competitiveness Oman is second in the GCC behind Qatar for financial market development, which bodes well for the new Islamic finance industry in the Sultanate. Oman sits mid-table for Institutions, Macroeconomic Environment, Health and primary education and Goods market efficiency.

DEFICIT OF ADEQUATE AND SKILLED WORKFORCE

Looking towards the long term, there is a concern with regards to Oman's Higher Education and Training. As the next few pages will show, Oman's relative lack of skilled workforce is a constraint on greater private sector and SME participation in the economy. This also pertains to the Islamic finance industry. In the Islamic Banking Regulatory Framework (IBRF), Islamic banks in Oman are encouraged to develop Omani expertise in "Islamic banking related finance, economics, accounting, law etc so as to facilitate progressive increase in membership of Omanis" on sharia boards.

2013 TOP 10 IFDI RANK	COUNTRY	2013-2014 RANK	2013-2014 SCORE	2012-2013 RANK	2012-2013 SCORE	2011-2012 RANK	2011-2012 SCORE
5	Qatar	13	5.24	11	5.38	14	5.24
4	UAE	19	5.11	24	5.07	27	4.89
9	Saudi Arabia	20	5.10	18	5.19	17	5.17
1	Malaysia	24	5.03	25	5.06	21	5.08
10	Brunei	26	4.95	28	4.87	28	4.78
3	**Oman**	**33**	**4.64**	**32**	**4.65**	**32**	**4.64**
6	Kuwait	36	4.56	37	4.56	34	4.62
2	Bahrain	43	4.45	35	4.63	37	4.54
7	Jordan	68	4.2	64	4.23	71	4.19
8	Pakistan	133	3.41	124	3.52	118	3.58

GCC Competitiveness Comparison 2013-2014



Data source: World Economic Forum, Global Competitiveness Report 2013-2014, 2012-2013, 2011-2012

Marginal decrease in unemployment

National plans to spur on diversification, industrialisation and private sector development are intended to create more jobs for local Omanis, albeit with slow growth on all three fronts. Oman's unemployment rate has only been marginally reduced from 8.7% in 2000 to 8.1% in 2012. Overall, the country's employment to population ratio stands at 58% (World Bank, 2012), with the adult male population's labour force participation rate at 82%. Omani women have full and equal access to education as Omani men, but their participation in the workforce remains low. Oman's labour force participation rate for females (aged 15 and over) was a very low 29% in 2012 — higher only to Saudi Arabia's 18% — compared to Qatar's 51%, UAE's 47%, Kuwait's 43%, and Bahrain's 39%.

The services sector provided jobs to 57.9% of the employed population in 2012; the industrial sector absorbed 36.9%, and the agriculture sector employed 5.2% of the population.

Not enough Omani graduates and specialised professionals

Since the 1970s Oman has focused on developing its people by providing free access to education which has helped push up literacy rates significantly. However higher education in Oman is very young; the first university in the Sultanate — Sultan Qaboos University — opened in 1986. Enrolment in higher education is low and education and training Omanis remains a long-term strategy. In 2013 there were 20,025 Omani graduates compared to 36,046 expatriate graduates working in the private sector. (Data from Ministry of Manpower)

Omanisation: Developing local workforce for the long-term

The lack of a skilled local workforce is a constraint on private sector and SME development and Oman is addressing its long-term needs in this respect. The long-term strategy includes moving toward a knowledge-based economy and the Sultanate has made progress in this over the years. Oman has improved significantly in the World Bank's Knowledge Economy Index (KEI) — its ranking rose from 65th in 2000 to 47th out of 146 countries in 2012.

In the GCC plus Malaysia grouping, UAE and Bahrain lead; overall they rank No. 42 and No. 43, respectively. Oman is No. 47, just one rung up from Malaysia. The Sultanate's greatest strength is on the Economic Incentive Regime indicator, which is a sign that the country fully understands and acknowledges the need to incentivise individual citizens and organisations to advance in the Knowledge Economy. The GCC as a whole is less competitive than Malaysia for Education and HR, while Bahrain is the grouping's Innovation and Technology and ICT Infrastructure leader. The GCC plus Malaysia grouping has a long way to go to reach the Knowledge Economy levels of the top 3 countries Sweden, Finland and Denmark.

OMANISATION OF THE WORKFORCE

The 'Omanisation' policy was introduced in 1988 to increase the number of Omanis working in the private and public sectors. Omanis make up 85.8% of the public sector and at the end of June 2014, there was a total of 189,931 Omanis employed in the private sector, up 4% from 181,860 at the end of 2013. (National Centre for Statistics and Information, NCSI)

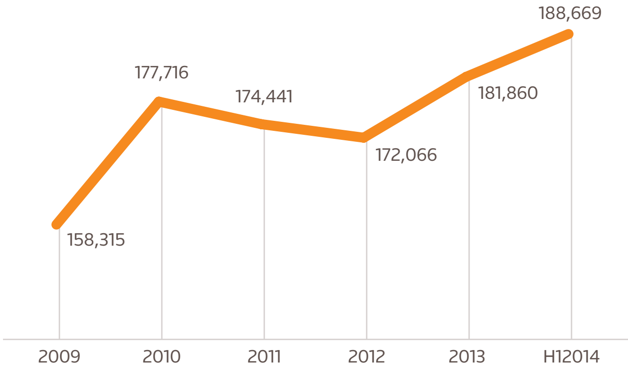
REUTERS/Ahmed Jadallah (OMAN)

Low wages addressed as a result of Arab Spring

One of the grievances that led to Oman's Arab Spring was lower private sector wages (relative to public sector wages) for nationals. The minimum wage was increased from OMR 140 to OMR 200 in 2011 and again to OMR 325 in 2013. 61% of Omanis working in the private sector earn less than a basic salary of OMR 300 per month.

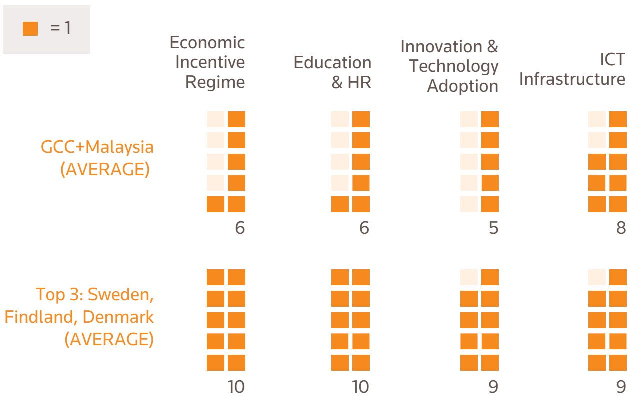
REUTERS/Jumana El-Heloueh

No. of Omanis in the private sector



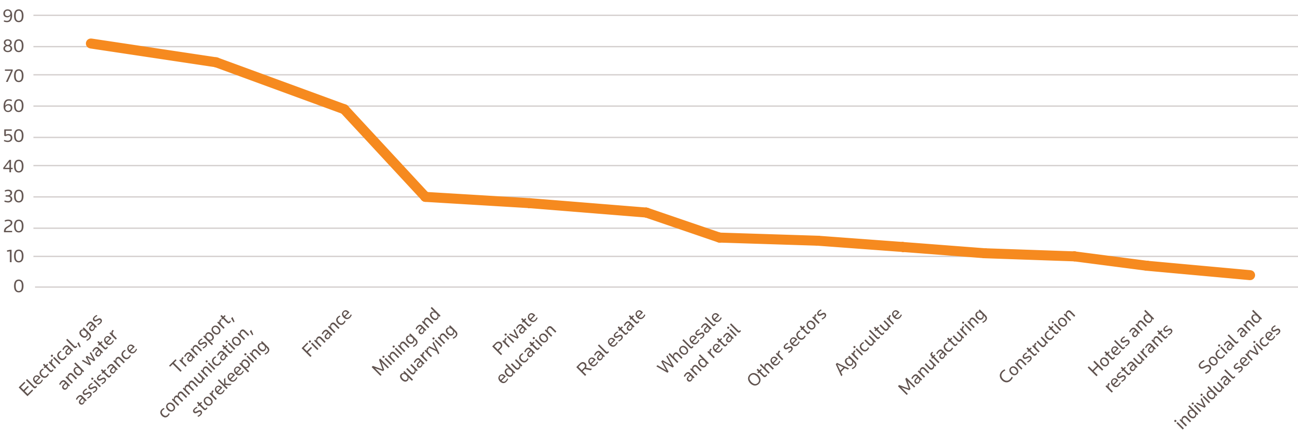
Data source: Oman National Centre for Statistics and Information, NCSI

Knowledge Economy — GCC + Malaysia vs. Sweden, Findland, Denmark



Data Source: World Bank Knowledge Economy Index (KEI)

Omanis in private sector, by sectors, %



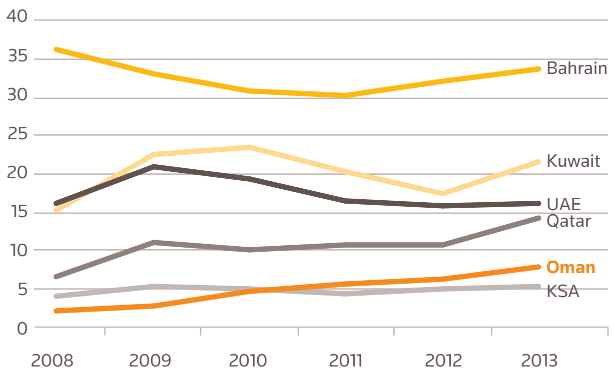
Data source: Oman National Centre for Statistics and Information, NCSI

Investment: FDI increasing steadily

Oman is not as big an FDI magnet as its neighbours but it has been holding steady over the years without any booms or busts. In the GCC Oman's FDI as a proportion of GDP was 7.88% in 2013; this was higher only to Saudi Arabia's 5.43%. Bahrain leads the six-member bloc with 33.68% in 2013. Oman was the only GCC country not to see any drops in its FDI stocks as a percentage of GDP post-global financial crisis from 2008 to 2013, a testament to its strong fundamentals that have averted major volatility.

Gross inflows under FDI were OMR 625 million in 2013 compared to OMR 400 million in 2012. FDI composition has remained largely unchanged during the recent years. Leading FDI in 2012 were oil and gas (46.6%), manufacturing (18.3%) and financial intermediation (16.1%).

GCC FDI Inward and Outward Stocks as % of GDP

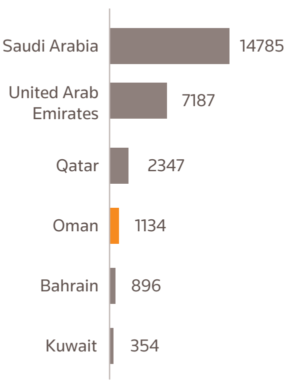


BEHIND THE CURVE ON ISLAMIC ECONOMY OPPORTUNITIES

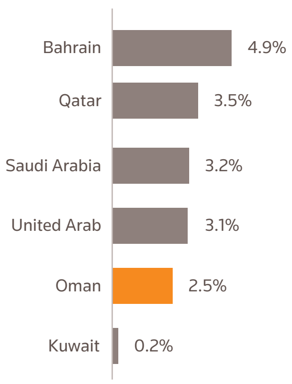
Two of Oman's investment opportunity sectors — Tourism and Pharmaceutical — are pillars of the Islamic Economy earmarked for their increasing Muslim demand and growth potential. Only the countries of the GCC, Jordan and Iran are Muslim-majority out of the countries targeted by Oman for these sectors. If Oman wants to cater to and reach the growing Islamic Economy worldwide, it should be formulating strategy to provide for a halal base of processes and operations within the country and expand its global tourism marketing to attract more Muslim visitors. In the GCC, only Dubai has made clear its aim of growing and developing the Islamic Economy, and Malaysia has a long history of developing its halal industries.

REUTERS/Martin Dokoupil

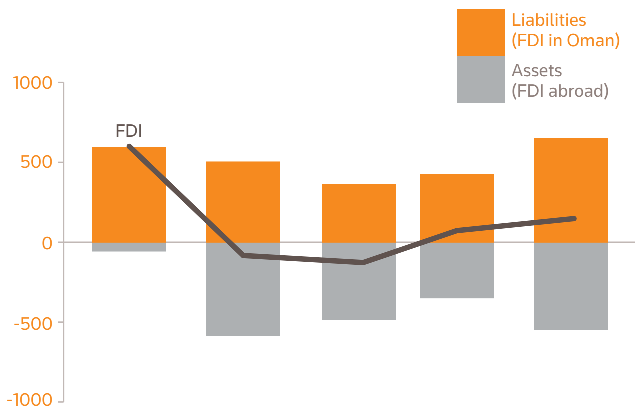
Foreign Direct Investment in GCC countries (In millions of USD; Average 2000-2012)



Foreign Direct Investment in GCC countries (% GDP; Average 2000-2012)



FDI in OMR million



Source: Central Bank of Oman, Central Banks, UNCTAD Foreign Direct Investment Database

Priority areas for investment and trade

The Omani Centre for Investment Promotion and Export Development (OCIPED) has identified nine priority sectors for investment and trade: Tourism, Information & Communication Technology (ICT), Alternative Energy, Marine, Services, Automotive, Chemicals & Pharmaceuticals, Metals, and Plastics.

OCIPED has also identified 26 countries it believes will provide the greatest potential successful investment promotion for Oman.

SECTOR	TARGET COUNTRIES
Tourism	Asia: GCC, Hong Kong, Jordan, Iran Europe: France, Spain, UK Americas: Canada, USA
ICT	Asia: China, GCC, Hong Kong, India, Japan, Pakistan Australasia: Australia Europe: Denmark, France, Germany, UK Americas: Canada, USA, Chile
Alternative Energy	Asia: China, GCC Australasia: Australia Europe: France, Spain, Sweden, UK Americas: USA, Chile
Marine	Asia: China, GCC, India, Japan, Korea, Russia Europe: France, Norway, Sweden Americas: USA, Brazil, Chile
Services: **Legal; Accounting; Market research; Business & Management consultancy; Architecture; Advertising**	Asia: China, GCC, India, Japan, Jordan, Iran Australasia: Australia Europe: France, Germany, Netherlands, UK Americas: Canada, USA
Automotive	Asia: China, GCC, India, Japan, Iran Europe: France, Germany, Italy, Sweden, UK Americas: Canada, USA
Chemicals & Pharma **Manufacture of methanol derivative products; manufacture of pharma and their raw materials; manufacture of specialist and consumer products**	Asia: China, GCC, India, Iran Europe: France, Germany, Italy, Netherlands, UK Americas: Canada, USA, Brazil
Metals	Asia: GCC, India, Japan, Korea, Russia, Iran Europe: France, Netherlands, Switzerland, UK Americas: USA
Plastics	Asia: GCC, india, Japan, Russia, Iran Europe: Germany, France, Denmark Americas: USA

Source: The Omani Centre for Investment promotion and Export Development.

POLITICAL ENVIRONMENT

Stable political environment but outlook unclear

A stable political environment is a prerequisite to the economic and social progress and wellbeing of a country. Oman's relatively stable political system under the rule of Sultan Qaboos bin Said Al Said during the last 30 years has built secure channels for doing business for both local and foreign investors.

The absolute political decision-making rests with Sultan Qaboos who has ruled the country since 1970 and who holds the positions of Prime Minister and Head of State. He has also previously held the posts of head of defense, finance and foreign affairs, according to an International Labour Office paper (ILO, 2011)[1].

Sultan Qaboos has led the Sultanate along a stable economic course with emphasis on creating well-established infrastructure and providing decent public services, a path which has been largely welcomed by the country's citizens despite the absence of a Western form of democratic system.

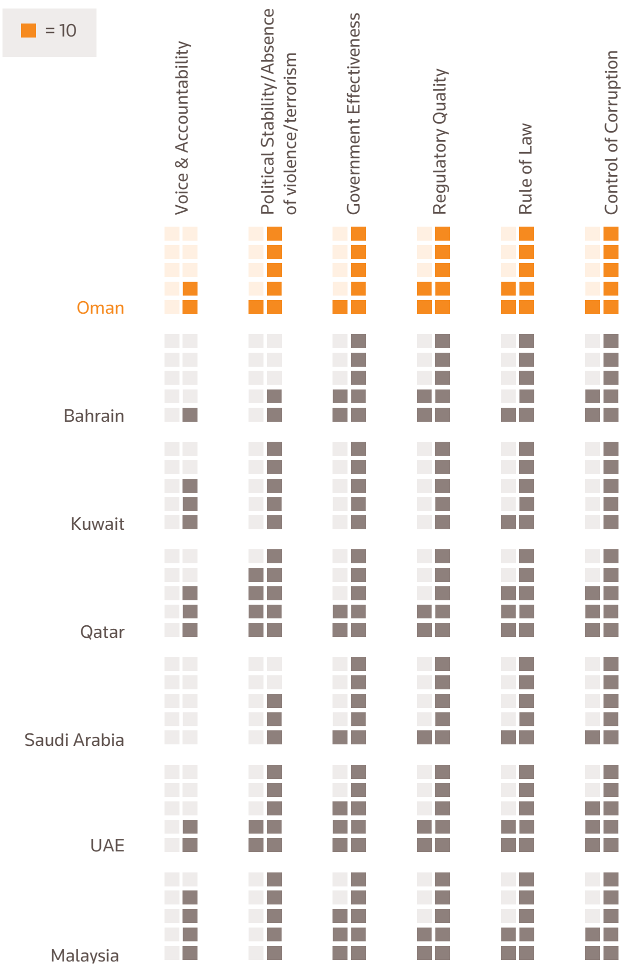
Democratic representation, however, has been gradually introduced. The democratically elected Majlis Al-Shura (Consultative Council) was formed in 1991 and its powers have evolved and increased. The Council consists of 84 members, which since a change of law following Oman's Arab Spring protests in the first half of 2011, has the power to approve or propose recommendations to laws drafted by the Council of Ministers. Majlis Al-Shura previously only played an advisory role with no legislative powers.

In 1996, the Sultanate's first constitution led to the establishment of Majlis Al-Dawla (State Council), which is the Upper House to Majlis Al-Shura's Lower House. Majlis Al-Dawla consists of 53 members who are all appointed by the Sultan himself for a four-year term (ILO, 2011).

The pivotal concern that may cause a change in Oman's political environment is the uncertainty of who will succeed the long-serving Sultan. In terms of the selection process for a successor, article 6 of the 1996 Basic Statute of the State states: "The Ruling Family Council shall within three days of the throne falling vacant, determine the successor to the throne. If the Ruling Family Council does not agree on the choice of the successor to the throne, the Defense Council shall confirm the appointment of the person designated by the Sultan in his letter to the Ruling Family Council." Whatever the outcome of the process, the Sultan's leadership style and legacy will be relatively hard to follow, and his successor may have to struggle with many challenges such as demands for more democratisation and possible regional tensions in Iran over its nuclear programme and the political instability in Yemen.

1 *The Sultanate of Oman The enabling environment for sustainable enterprises: An "EESE" Assessment by Graeme*

GCC + Malaysia Governance Indicators
(Percentile Rank between 0 - 100, higher values correspond to better outcomes)



Source: Data from World Bank Governance Indicators 2013

REUTERS/Said Al Bahri

Calls for more transparency and better governance efforts

Oman's Arab Spring protests centred on issues of unemployment, private sector low wages and corruption. While small in scale compared to other countries such as Tunisia and Egypt, they have had enough impact to result in a restructuring of government positions, officials and ministers, including the expansion of Majlis Al-Shura's powers to improve transparency and governance. A milestone in this regard has been the increase in the minimum wage by over 125% over the last three years.

Oman registered a marginal improvement in the areas of Voice and Accountability and Rule of Law during 2007-12, but its performance has not been as impressive with respect to the remaining four subcategories of the World Bank's Governance indicators during the same period. It dropped 21.26% for Political Stability/Absence of Violence and along with and/or due to that drop in stability Control of Corruption went down 6.55% and Government Effectiveness dropped 5.86%. Regionally, Oman wasn't the worst performer; Bahrain registered much lower percentile ranking scores for Political Stability/Absence of Violence, plunging a substantial 57% from 2007 to 2012. Bahrain was the GCC country most affected by the Arab Spring.

Comparing Oman's standing among the top 10 Islamic finance countries: Qatar, Brunei, UAE and Malaysia perform the best across all categories, and Pakistan is the overall worst performer. The group of 10 is weakest for 'Voice and Accountability' which the World Bank defines as: "Reflects perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media."

Independent but unquestioned foreign policy approach

Under the leadership of Sultan Qaboos Oman is known to pursue an independent and pragmatic approach in its foreign policy affairs. Despite holding a membership in the Gulf Cooperation Council (GCC), Oman has often followed foreign policies outside the grouping's accepted norm. This is evident by the country's stance on facilitating the conclusions of the Iran and P5 + 1 group nuclear deal in late 2013. The country continues to pursue ongoing engagement with Iran in a wide array of areas, including economic and military, a direction GCC members and U.S. policy do not favour. Given that Iran holds one of the world's highest level of Islamic finance (although much of the information and data from the country are undisclosed), Oman's Islamic finance industry is likely to boom in the next five years should the two countries continue to build stronger ties in areas of economic development.

Oman is also considered to adopt an independent style of affairs relatively different from those in the GCC. In a GCC members meeting in 2012, Saudi Arabia introduced a planned proposal to unite the members politically. While Saudi Arabia's proposal received strong support from certain member states, the plan has not been pushed through due to concerns about the possibility of the loss of sovereignty. As is the case with Qatar, Oman is also seen by observers to be amongst the opponents of Saudi Arabia's endeavours to further integrate the region. However, Oman's pragmatic and independent approach to its foreign policy has not been widely questioned by Washington or other Western powers.

Oman's Sultan Qaboos bin Said (R) walks with Iran's President Hassan Rouhani upon Rouhani's arrival in Muscat March 12, 2014. REUTERS/Sultan Al Hasani

RECENT DEVELOPMENTS IN ISLAMIC FINANCE

Inside

RECENT DEVELOPMENTS IN ISLAMIC FINANCE

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REUTERS/Fahad Shadeed

HISTORICAL TIMELINE AND KEY MILESTONES

Solid foundation for Islamic finance growth
Oman's Islamic finance industry is in its early stages of development and outlook is promising.

Oman is the last Gulf Arab state to allow banks to offer sharia-compliant products. In May 2011, Sultan Qaboos allowed the establishment of standalone Islamic banks and Islamic windows of conventional banks. This decision emerged from the need to meet the untapped demand for sharia-compliant products. Immediate action was then taken leading to the release of the comprehensive Islamic Banking Regulatory Framework (IBRF) by the Central Bank of Oman (CBO) in December 2012. The IBRF covers licensing requirements of Islamic banks, rules governing sharia supervisory boards, accounting and auditing standards, the operation of conventional banks with Islamic windows, liquidity management and other comprehensive guidelines for each Islamic transaction. As of this writing, legislation covering sukuk and takaful have not been finalised.

Two full-fledged Islamic banks — Bank Nizwa and Al Izz — started operations in 2013. In addition, six Omani banks opened Islamic windows offering sharia-compliant products. Developments have also taken place in the Sultanate's securities market; in November 2013 Oman's first ever sukuk, a corporate sale, was issued. Further, three sharia-compliant funds have been launched.

Oman Central Bank Governor Hamood Al-Zadjali speaks during the Capital Markets Conference in Doha September 18, 2012. REUTERS/Mohammed Dabbous

2011

May

Bank Nizwa granted a license from the Central Bank of Oman (CBO) to establish the first Islamic Bank in the sultanate

A royal decree was issued authorizing the offering of Islamic finance products

August

Oman's Al Izz International Bank granted a license from the Central Bank of Oman (CBO) to operate as a full-fledged Islamic bank

Al Madina insurance Co. granted approval to become a full-fledged takaful company

Investment Bank Alphen Capital received the first Islamic advisory license in Oman

REUTERS/Fadi Al-Assaad

REUTERS/Susan Baaghil

December

Oman's Central Bank issued the Islamic Banking Regulatory Framework (IBRF)

2012

2013

January
Ahli Bank launched its Islamic banking operations named "Al Hilal Islamic Banking Services"

Bank Muscat launched its Islamic banking operations named "Meethaq"
Bank Nizwa started operations

Vision Investment Services launched the first Shari'a compliant fund

National Bank of Oman began its Islamic window operations named "Muzn"

February
BankDhofar granted "Maisarah Islamic Banking Services" license from the Central Bank

May
Ahli Bank launched a Shari'a compliant fund and became the first Omani bank to launch such type of funds

June
National Investments Funds Company (NIFCO) launched a Shari 'a compliant fund

July
Muscat Securities Market (MSM) launched its Shari'a compliant index

Bank Sohar opened its first Islamic banking branch (Sohar Islamic)

Oman Arab Bank (OAB) started its Islamic banking operations named "Al Yusr"

September
Alizz Islamic bank started operations

October
Oman announced its plan to establish a National Shari'a Board

November
Tilal Development Company issued Oman's first corporate sukuk (Al Ijara), worth OMR50 million ($130 million)

December
Takaful Oman Insurance Company completed an Initial Public Offering of OMR23 million ($60 million)

January
Oman government announced its plan to float OMR200 million ($520 million) sovereign sukuk

Al Madina insurance Co. converted itself from conventional insurer to a takaful company

March
Bank Muscat's Islamic window (Meethaq) announced its plan to establish a 500 million rial ($1.3 billion) Islamic bond programme

September
Central Bank of Oman selects members for the Sharia Supervisory Authority, the national sharia board of Oman for Islamic banking and finance

2014

MEETHAQ
الصيرفة الإسلامية
Islamic Banking

Exclusive Interview with Sulaiman Al Harthy
Group General Manager, Meethaq Islamic Banking

(Interview conducted in August, 2014)

How would you describe the current state of Islamic Finance in Oman?
Islamic finance in Oman was introduced only recently in 2013. The regulator has done extensive groundwork in terms of developing a robust Shari'a governance framework and defining boundaries which protect from venturing into the grey areas of Islamic banking.

The current state of Islamic finance is favourable — a booming Omani economy, liquidity among the masses, foreign investors exploring opportunities and dynamic demographics with over 50 per cent young population — all provide a firm foundation for Islamic banks. The challenge, however, is to understand the market dynamics and establish diversified portfolios on the asset side along with expanding the penetration of Islamic banking.

Further, there is a need to develop Islamic money markets, Islamic Equity index, Mutual funds (REITS and others) to provide stability to the Islamic banking industry.

Where do you see the Islamic Banking share of Oman's total banking sector in the coming 3-5 years?
Currently, the Islamic banking share in the total banking sector credit is approximately 5 per cent. Considering that Islamic banking in Oman is only one year old, this is a positive trend. As Islamic banks consolidate operations, this market share is set to increase. However, a crucial aspect is how the Islamic banks will attract customers by raising awareness on Islamic banking.

How do you evaluate the legal framework that governs Islamic banking? And where do you see the gap (if any) in that framework?
The Islamic Banking Regulatory Framework (IBRF) adopted by the Central Bank of Oman (CBO) is one of the most comprehensive regulatory frameworks in existence in the Islamic banking industry the world over. The Islamic banking industry in Oman is nascent hence the regulatory framework will evolve to accommodate new areas of operations. The Islamic banking industry anticipates guidelines from the CBO on areas such as Profit and Loss Distribution and Liquidity Management.

As profit and loss distribution is the core of Islamic banking, the industry awaits the framework to define the methodology of profit and loss distribution with respect to deduction of provisions and their reversals, limits to the distribution of Hiba, minimum profit allocation to depositors, declaration of weights before the beginning of the period along with various methods of profit distribution based on the underlying contract.

Similarly, in the case of liquidity management, the Islamic banking industry expects that the framework would propose various options for managing liquidity.

How does Meethaq manage its short liquidity requirements? And what challenges are hindering the bank's performance with respect to liquidity management?
Meethaq manages short-term liquidity through interbank borrowing. The bank has signed a number of Wakala agreements with local and international Islamic banks

and windows such as IDB, ICD, KFH (Bahrain), Ahli United (Bahrain) etc. to facilitate short-term liquidity. Meethaq can also access funds from the parent bank under Shari'a compliant Mudaraba structure as allowed by IBRF.

The challenge is in tackling long-term funding requirements, as our flagship product is home finance with long-term maturities. Subject to regulatory approvals, Meethaq is considering issuing Sukuk, which will be the first Sukuk by any Islamic bank in Oman to address the long-term funding requirements.

What are the current challenges facing Meethaq for Islamic banking in Oman? And what possible solutions does the bank recommend?
Islamic banking in Oman is in its infancy. Hence, a major challenge is to achieve growth. Presently, limits / ratios are applied on Islamic windows' net worth. The Islamic banking windows are seeking a relaxation to maintain the limits / ratios on a consolidated basis i.e. on the parent's net worth instead of maintaining independent limits / ratios on the basis of window's net worth. The Islamic banking windows are of the view that such a concession will allow them to play an active role in the economic growth of the Sultanate and the development of Islamic banking industry. In consideration of the overall size of the Islamic banking industry, the windows suggest that a concession will help the industry achieve critical mass.

How would you assess the Omani Sukuk market in the medium-term? What are your plans for Sukuk in the coming two years?
In the medium term, the Omani Sukuk market is expected to attract a good response as there is a dearth of similar investment opportunities. Investors, locally and across the GCC, are positive on the investment opportunities in Oman. Therefore, in the medium- term, Sukuk should prove to be a good investment opportunity.

The Omani government is considering a sovereign Sukuk issue which will give confidence and create a benchmark for corporate issuers. The Sukuk issue by the government can be easily absorbed by Omani institutions. This will not require assets to be transferred to overseas markets since the buyers are Omani institutions. The government can allocate assets like ports, airports, hospitals or designated land for construction, which are good for securitisation.

The issuance of Sukuk is an important ingredient in developing the Islamic banking industry in Oman. Meethaq plans to establish RO 500 million ($1.3 billion) Islamic bond programme this year. Shareholder approval is already in place for the Sukuk programme and Meethaq is in the process of obtaining regulatory approvals. The Meethaq Sukuk tranches will be of varying maturities and currencies; some will be issued in international markets, and both public subscription and private placements will be used.

How do you evaluate public awareness on Islamic banking in Oman? And what are the actions that the bank is taking to increase public awareness?
Islamic banking is a recent development in Oman. Individuals and corporates are concerned about the conformity of this system with their ethical beliefs and they are eager to understand the principles on which the system is based. Continuous awareness programmes are required to create understanding of the Shari'a principles that govern Islamic banking operations.

Meethaq has taken the lead to engage people at all levels in order to familiarise them with the fundamentals of Islamic banking and finance. We have been conducting awareness programmes, educating people on all aspects of Islamic banking, and concentrating on products and services. Meethaq also organised two high level seminars in association with Thomson Reuters, bringing together the Islamic banks and regulators to discuss how best to manage and deal with the Islamic banking liquidity issues.

What share will Meethaq Islamic window attain out of the total Islamic banking share in 2014 and 2015?
Within a short span of one-and-a-half years, Islamic banking and finance has emerged as one of the fastest growing segments within the financial services industry in Oman. Presently, there are two dedicated Islamic banks and six Islamic banking windows operating in Oman.

Meethaq Islamic financing receivables amounted to RO 352 million as of 30th June 2014 compared to RO 214 million in the same period of 2013. Meethaq customer deposits amounted to RO 179 million as of 30th June 2014 compared to RO 133 million reported in 30th June 2013. As the pioneer of Islamic banking in Oman, Meethaq is well positioned to sustain growth in 2014 and 2015.

SHARIA ECOSYSTEM

Sharia Governance Framework

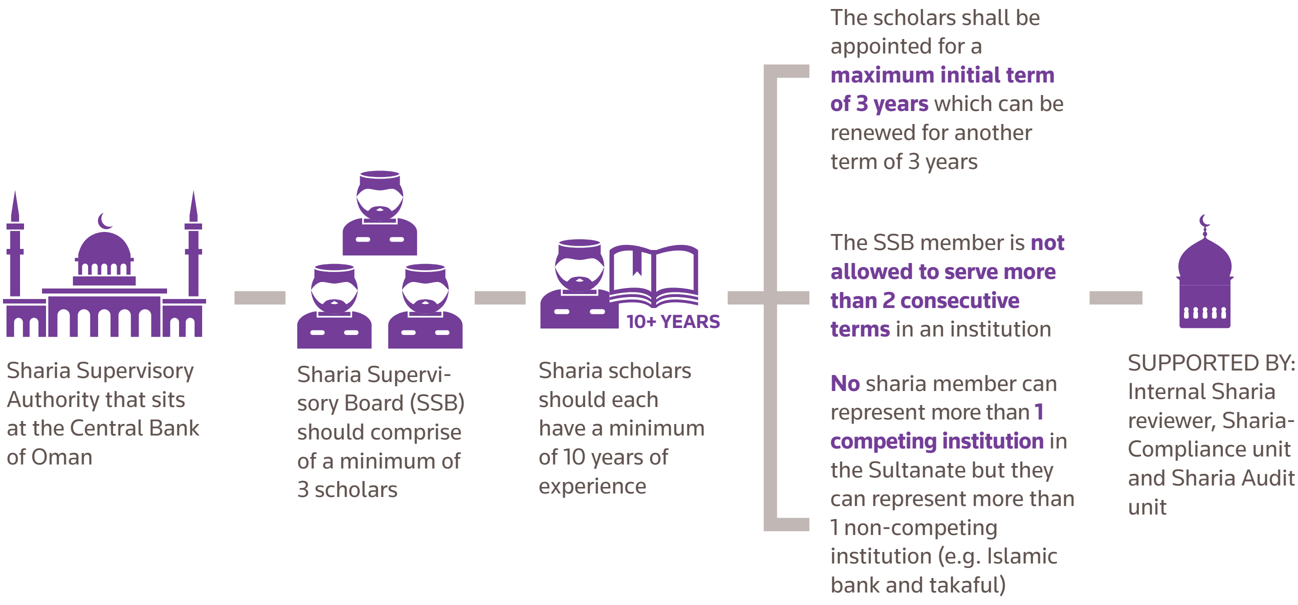
Oman's Islamic Banking Regulatory Framework (IBRF) provides detailed regulations to uphold corporate governance in the management of Islamic banking operations. Islamic banks are prohibited from appointing any senior management or top management (e.g. Chief Executive Officer or General Manager) to board positions and board members are not allowed to hold directorships in more than one domestic Islamic bank.

In late September 2014 the Central Bank of Oman selected five members for the national-level sharia board, the Sharia Supervisory Authority. The Authority will advice the central bank on issues concerning sharia-compliant products and be the reference point for Islamic financial institutions. At the IFI level, the IBRF requires sharia scholars on Sharia Supervisory Boards (SSBs) to be 'fit and proper' for their roles, with minimum levels of relevant qualifications and experiences. There is also a limit to the number of boards a scholar can be a member of to avoid multiple representations of scholars.

Further, no sharia scholar can be on the Sharia Supervisory Board (SSB) of more than one competing institution i.e. institution covering the same scope of business practice but they can represent more than one non-competing institution (e.g. Islamic bank and takaful firm). Overall, no sharia member can be on the board of more than four institutions in Oman. The IBRF does make a concession for 'small financial institutions' which it says "maybe allowed exceptionally to use an outsourced Sharia board, subject to the central bank approval".

These regulations address any potential conflict of interests and lax standards for sharia boards that have been the case for the Islamic finance industry in most other markets.

Sharia Governance Framework



Exclusive Interview with H.E. Hamood Sangour Al Zadjali, Executive President, Central Bank of Oman

(Interview conducted on May 1, 2014)

How would you describe the current state of Islamic finance in Oman?

In December 2012 amendments were made to the Banking Law and the Islamic Banking Regulatory Framework (IBRF) was issued. Shortly thereafter in the course of 2013 itself, as many as two full-fledged Islamic banks and six Islamic banking windows by six of the seven local commercial conventional banks commenced operations.

Obviously, since this is a new and faith-based mode of banking, care and preparedness were to be ensured by these institutions; this was emphasized in the IBRF. All these institutions have established their own Sharia Supervisory Boards to guide them in sharia-related matters.

The platform for progress of Islamic finance can definitely be considered appropriate and these organisations are established on a firm footing and poised for progress. In all, as many as 29 dedicated Islamic banking branches (set up by full-fledged Islamic banks and Islamic banking windows) were operational as of December 2013.

Thanks to previous and ongoing campaigns, reasonable awareness has been created in the market and we can look forward to good response.

What are your projections for the share of Islamic banking out of Oman's total banking sector for the coming three to five years?

As a matter of policy, CBO does not make any business forecast. However, given the robust preparedness and market enthusiasm, we can say that outlook is good.

Islamic banking has been received well. Islamic banking providers are actively working to reach out to the market more and more in a bid to increase market share by capitalising on market enthusiasm. They are also leveraging on existing conventional banking connections and tapping into the unbanked population. We believe the capacity building and market response to be quite positive.

Islamic banking providers need to focus on non-retail business as well to diversify their portfolio and adhere to regulatory limitations on personal and housing finance. That will be a challenge. They need to respond quickly to corporate finance requirements which demand speed and efficiency.

How big is Oman's opportunity to diversify its economy through Islamic banking?

Islamic banking in Oman has been ushered in at the right time. Oman is in the thick of diversifying its economy. The government has kick started many economic initiatives that the private sector has benefited from. In turn, the private sector is also an active contributor to Oman's economic diversification and development.

Islamic banking focuses on real activity and there is significant liquidity in the market to *be tapped for productive purposes. Unlike conventional banking which deals mostly in monetary terms, Islamic banking sees the purpose behind banking transactions and relationships. Hence, there is a good opportunity to leverage Islamic banking for growth in Oman's multi-dimensional economic diversification efforts. These will also serve the purpose of avoiding concentration risks for Islamic banks.*

The thrust on new and prospective economic sectors and the business opportunities arising from SME development and increasing number of Omani entrepreneurs and employees, too, are some dimensions that augur well for the development of Islamic banking.

While Islamic banking providers should rise to the occasion and seize profitable opportunities, there are initiatives in the pipeline such as sukuk regulation and the like which will go a long way to fill current gaps and provide Islamic banking institutions more tools to benefit from and contribute to economic diversification.

What impact will Islamic windows linked to conventional banks have on existing conventional banks?

The main thrust in the IBRF is maintaining the authenticity and credibility of Islamic banking. In particular, emphasis has been made for the windows of conventional banks to maintain independence of operations.

The choice for conventional banks to operate Islamic banking windows rests with them. Some see windows as a defensive strategy while others see them as opportunities.

Given the additional room available in the country's enlarging economic landscape, and since one of the objectives of opening up the financial sector and introducing Islamic banking is financial inclusion, Islamic windows and conventional banks should operate on the basis of healthy competition. The CBO encourages this without undermining the need for care with regards to comingling and proximity issues, real and perceived. The two need to coexist and prosper amicably.

In fact, both conventional banks and their Islamic windows can prosper along with standalone Islamic banks.

What is CBO's plan for Islamic liquidity management?

Given the long history of conventional banking and the legal, regulatory and other tools attuned to it, Islamic banking has faced certain difficulties initially in almost all new jurisdictions. Lack of sharia-compliant liquidity management tools is one of the constraints. To the credit of Islamic banking providers in Oman, they have managed to operate successfully given the constraints they face in the interbank market.

CBO is actively working with the government on a possible early issue of a government sukuk and the government's response is very positive. Also, a task force has been set up within CBO to look into new liquidity management tools and external consultation has been sought.

Financing to small and medium enterprises (SMEs) accounts for only two percent of total financing. What is CBO's plan to increase this percentage and support the SMEs sector?

There is a multi-faceted national thrust to develop SMEs, which can generate employment opportunities and other benefits. There have been many public initiatives, and the private sector is committed and actively involved.

The focus is not targeted at finance alone. Banks have to be well equipped to provide *financial and non-financial assistance to SMEs. Local banks are required to set up dedicated SME departments to cater to the needs of SMEs, and banks must allocate a minimum of 5% of their total credit to SMEs by the end of 2014. With these in place, and given the liquidity and commercial outlook of banks, there is no reason for bank credit to SMEs not to go up progressively.*

The Government has identified and ear-marked sectors for SMEs (for example, tourism and hospitality sectors). Contractors and projects are required to allocate a percentage of work to SMEs. The Public Authority for Development of Small and Medium Enterprises was established in 2013 to promote and coordinate SME development. This independent apex body will ensure continuous dialogue among all stakeholders.

As indicated earlier, the CBO has fixed a target of 5% bank credit to the SME sector. As part of encouraging regulatory relaxation, CBO has granted to banks certain concessionary norms on general provisioning requirements on SME financing; banks may maintain a lower capital requirement on SME finance exposures.

Given the favourable overall atmosphere for growth, the recognition of the importance and relevance of SMEs to the national economy and commitment on the part of all stakeholders, including banks, we see steady and meaningful growth in SME financing.

There shall be periodic reviews to effect changes and improvements, and whatever steps will be further necessary for the healthy growth of SMEs will be implemented.

Given that financial inclusion in Oman is one of the highest in the region, what is CBO's plan to further increase this percentage?

SME development is receiving considerable and increased attention. While finance is one aspect, there are other pre-requisites that are non-financial in nature.

Appropriately, SME development is part of any meaningful financial inclusion drive. Given the entrepreneurial skills available and the scope and need for greater employment potential for Omanis, CBO and all other concerned authorities continue to exert all efforts in promoting this sector.

Large projects, construction and other sectors can work with SMEs throughout their value chain, and there is emphasis for SMEs to seize opportunities in down-stream activities and in newly developing sectors such as tourism and hospitability. With increased economic activities and growth, there is increasing scope for participation by all companies, including SMEs.

Progress will be reviewed not only in terms of credit growth but also in the implementation of facilitating enablers. We are confident of coordinated progress.

Other than financing the budget deficit, why will the Omani government resort to sukuk issuance? Will there be a need to turn to the sukuk market to fund infrastructure projects, for example?

The market is dynamic and it is one reason why all players need to be in constant contact with it all the time. Such interactions are necessary for issuers of instruments, investors, brokers, market makers and all other stakeholders.

The government is not in the market to cover budget deficit per se. As a matter of monetary policy intervention both the government and CBO take part in market operations and they assume many dimensions in terms of scrips, tenor, absorption and contraction of liquidity etc.

There are many who look for periodical government issues as indicative bench-marks for the level of liquidity, reference for other interest rates etc.

While the Government Development bonds serve many such purposes, sukuk, too, will have such objectives applicable to them. Sukuk, by their nature, are generally construed to serve a particular market. This is not so in reality and one can see sukuk having a wider appeal. Sukuk can serve the purpose of not only liquidity/monetary management but also the larger market. The instrument can promote basis and scope for interactions between the CBO and concerned banks for the financial institutions' needs on the one hand and CBO's regulatory and operational needs on the other. These will, of course, be sharia-compliant.

Given the increasing government initiatives on public spending in general and infrastructure/large project initiatives, sukuk may provide a very useful and effective mode of finance for the government and the private sector as and when necessary.

H.E. Hamood Sangour Al Zadjali
Executive President
Central Bank of Oman

H.E. Hamood Sangour Al Zadjali was appointed by Royal Decree as Executive President of the Central Bank of Oman (CBO) in June 1991. He continues to serve as Executive President of CBO since then. H.E. Al- Zadjali is a renowned expert on financial and economic policy making in the GCC region. While serving as Executive President of CBO, he is widely recognized for nurturing and steering the banking sector in Oman into a stable, sound and resilient financial system, by developing not only the banking sector but also deepening and widening other segments of the financial markets. He continues to serve in the Boards of several financial institutions.

H.E. Al Zadjali started his banking career with HSBC Bank in 1969. Before taking over as Executive President of CBO, he held executive positions in various capacities in the financial sector including CBO. Born in 1947, H.E. Al-Zadjali holds a Management degree from Boston University's School of Management, USA.

SUPPORTING INFRASTRUCTURE INSTITUTIONS

Education and Research

Building an Islamic Finance Knowledge Base

The previous pages outlined Oman's challenges vis-à-vis Omanisation and the development of a qualified and professional workforce to serve all sectors of the economy. Similarly, growth of the Islamic finance industry relies on a well-qualified and skilled workforce whose talents can be channeled to meaningful and productive development and innovation. This requires an ecosystem that includes education, training and research. Oman has relied heavily on foreign expertise to establish its new Islamic finance industry and now needs to grow its own talent pool. This is acknowledged in the Islamic Banking Regulatory Framework (IBRF) released by the Central Bank of Oman in December 2012.

Globally, there are over 450 institutions that offer Islamic finance courses and degree programmes and there were around 1,363 published research papers on Islamic finance from 2011-2013, according to the ICD Thomson Reuters Islamic Finance Development Indicator (IFDI) 2013.

Oman dropped out of the IFDI top 10 countries for the 2013 Knowledge Indicator from eighth position the previous year. Although there was an increase in both the number of institutions offering Islamic finance courses and published research, Oman was outperformed by other countries in 2013. For 2012's assessment, Oman had three institutions offering Islamic finance courses and produced six published research papers throughout 2011-2013. In 2013, this jumped to six institutions and 19 published research papers.

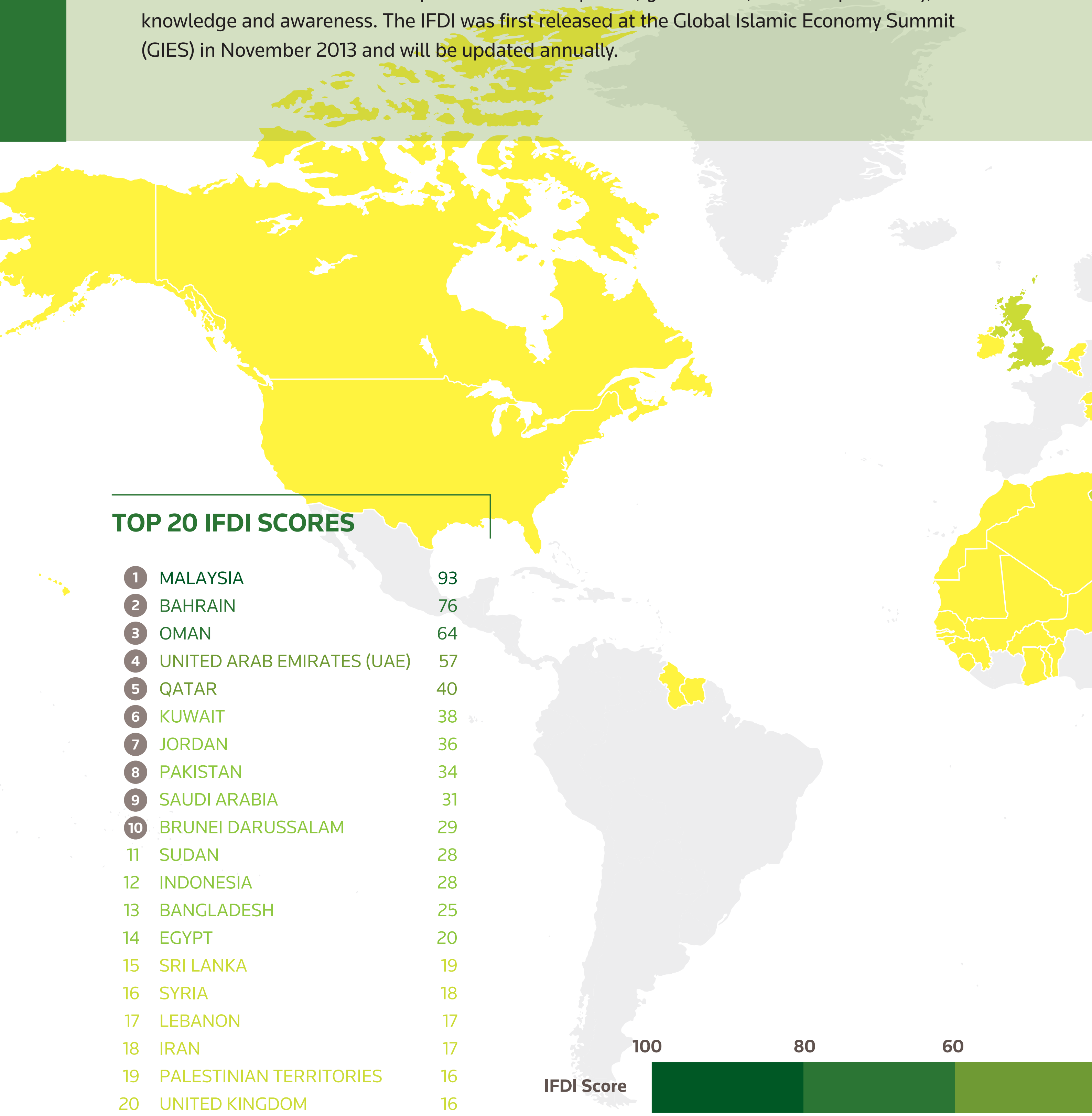
The knowledge indicator is based on two sub-indicators: Education and Research. The education sub-indicator is based on the number of institutions that offer Islamic finance courses and/or degrees. The research sub-indicator is based on the number of research papers published on Islamic finance from 2011-2013, including peer-reviewed research.

In 2013, the 10 most developed countries for Knowledge were (in descending order): Malaysia, Bahrain, Jordan, Pakistan, UAE, Lebanon, Brunei, Tunisia, UK and Sudan.

The ICD Thomson Reuters Islamic Finance Development Indicator (IFDI) is a composite weighted index that measures the overall development of the Islamic finance industry by providing an aggregate assessment of the performance of all its parts, in line with the objectives of Islamic principles. The key priority areas identified and addressed are **quantitative development, knowledge, governance, corporate social responsibility** and **awareness**, which have been aggregated to provide global and country level Indicators.

Each indicator value is calculated using a rationalizing coefficient which is specific to each country and designed to adjust the scale based on the size of the country. The rationalizing coefficient is used to compare the relevant size of countries based on the size of their GDP, population and banking sector. These are compared to median value for all countries.

The ICD-Thomson Reuters Islamic Finance Development Indicator (IFDI) is the only numerical measure representing the overall health and growth of the Islamic finance industry worldwide. It is an unbiased multi-dimensional barometer that considers the development of the Islamic finance industry beyond mere assets growth. The IFDI measures five key components that combine to depict the bigger picture of the state of Islamic finance in 92 countries: quantitative development, governance, social responsibility, knowledge and awareness. The IFDI was first released at the Global Islamic Economy Summit (GIES) in November 2013 and will be updated annually.



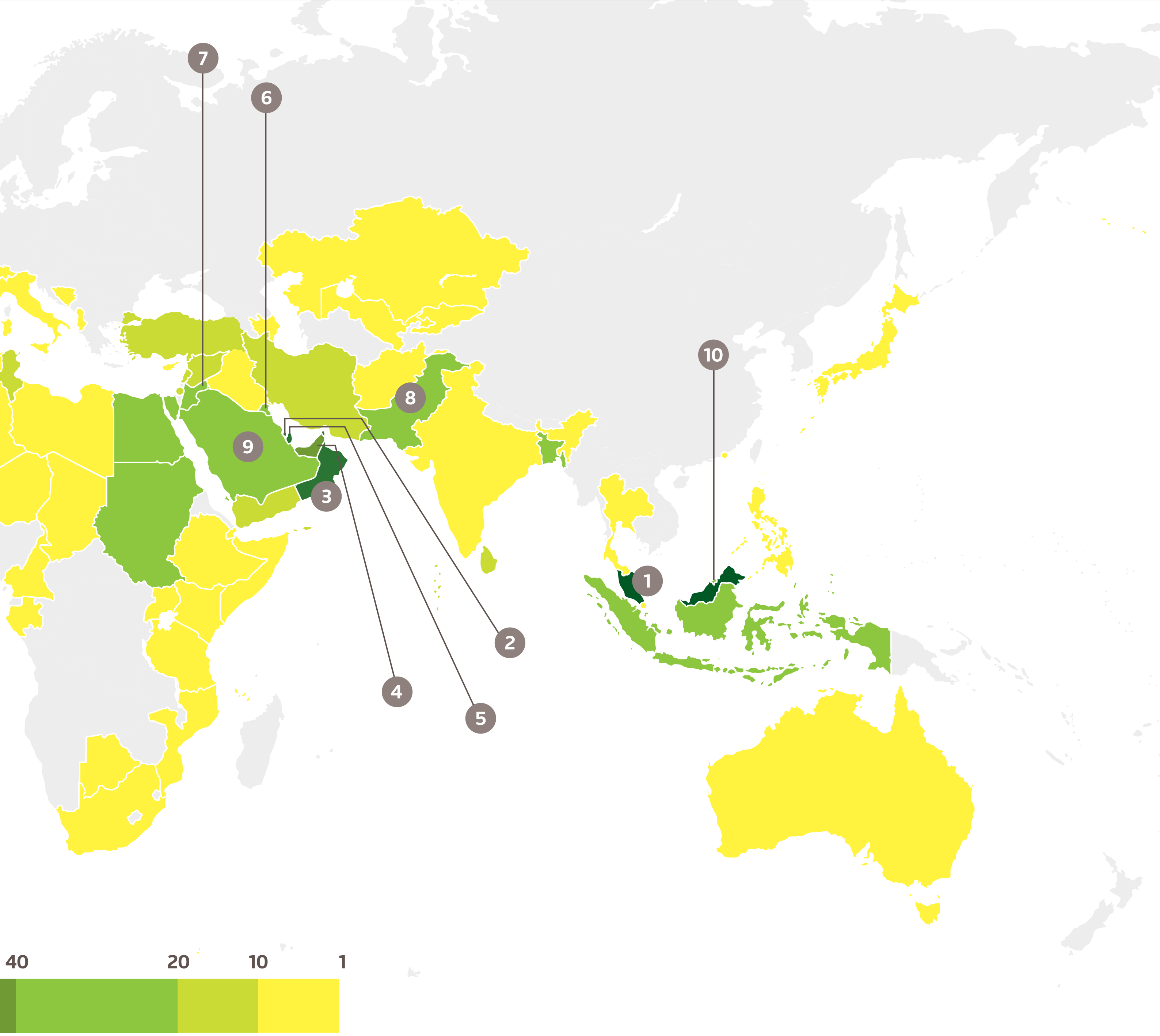
TOP 20 IFDI SCORES

1	MALAYSIA	93
2	BAHRAIN	76
3	OMAN	64
4	UNITED ARAB EMIRATES (UAE)	57
5	QATAR	40
6	KUWAIT	38
7	JORDAN	36
8	PAKISTAN	34
9	SAUDI ARABIA	31
10	BRUNEI DARUSSALAM	29
11	SUDAN	28
12	INDONESIA	28
13	BANGLADESH	25
14	EGYPT	20
15	SRI LANKA	19
16	SYRIA	18
17	LEBANON	17
18	IRAN	17
19	PALESTINIAN TERRITORIES	16
20	UNITED KINGDOM	16

To view the findings for the Islamic Finance Development Indicator 2014:

Growth of the Islamic finance industry worldwide is most often measured by level of assets. While this indicator is a reliable gauge of the industry's quantitative health it is not representative of the complete picture of a financial system that operates in alignment with Islamic teachings and values that aim for social good.

For the second consecutive year, the Islamic Corporation for the Development of the Private Sector (ICD), the private sector development arm of the Islamic Development Bank (IDB), presents findings for the Islamic Finance Development Indicator 2014, developed in collaboration with Thomson Reuters, the world's leading provider of intelligent information for businesses and professionals.



CLICK HERE

https://www.zawya.com/islamic-finance-development-indicator/

Education

The Sultanate of Oman ranks 15th in terms of Islamic finance education according to the IFDI Education sub indicator. The number of institutions offering Islamic finance courses jumped 100 percent from three in 2012's assessment to six in 2013. However despite the rise, the better performance of other countries meant the Sultanate does not make the top 10 in the 2013 Education sub-indicator, and sits at No. 15. There is as yet no academic degrees for any Islamic finance disciplines in Oman.

The top 10 countries for 2013 on the Education Sub-Indicator are (in descending order): Bahrain, Jordan, Malaysia, UAE, Lebanon, Pakistan, Sudan, Brunei, UK and the Palestinian territories.

Academic

Oman's Islamic finance education sector is in its infancy; the Islamic banking market opened up two years ago before any solid foundations were set in place for Islamic finance education. Islamic finance education is delivered through academic and training/professional courses. At the academic level, some universities have started introducing courses such as Islamic finance and Islamic insurance to their academic curriculums. These subjects were introduced at three institutions:

Majan College: undergraduate level, one Islamic banking and finance course for BA Accounting and BA Finance

Dhofar University: undergraduate level, one Islamic finance course for Diploma or Bachelor in Finance, and one Islamic insurance course for Bachelor in Insurance

Arab Open University (Oman Branch): Undergraduate level, one Islamic finance course for BA Accounting, BA Economics, and BA Management.

However, there are no dedicated degrees for Islamic banking, Islamic economics, Islamic capital markets, Islamic finance or takaful as specialties. Students looking for education in Islamic finance with the aim of eventually working in this new field in Oman face a current dearth of academic programmes.

Professional training and qualifications

Given the recent introduction of Islamic finance in Oman and the gradual evolution of Islamic finance education and training, the Sultanate has been relying on foreign expertise to run its Islamic finance sector. Islamic banking and Takaful education and professional training take precedence, as these two sectors were the first to be introduced in the country. Continued efforts are being made to enable Omanis to lead their country's Islamic finance industry.

The Central Bank of Oman requires Islamic banks and windows to appoint senior management that have adequate knowledge of Islamic banking contracts, products, processes, and sharia principles. This was particularly mentioned in the Islamic Banking Regulatory Framework (IBRF).

The two Islamic banks and six Islamic windows that started operating in the Sultanate in 2013 have employed banking professionals willing to take training and professional certificates to qualify for work in the Islamic finance sector. Oman has been depending on the experience and expertise of foreign companies and qualifications to train its workforce for Islamic finance.

Overseas professional training qualifications are offered by the College of Banking & Financial Studies, which falls under the supervision of the Central Bank of Oman.

The College of Banking and Financial Studies (CBFS) offers preparatory training for:

- Islamic Finance Qualification (IFQ) set by the Chartered Securities and Investment Institute (CISI) of the UK and Ecole Supérieure des Affaires (ESA) of France

- Chartered Institute of Management Accountants (CIMA) Diploma in Islamic finance

Banks and government bodies took it upon themselves to prepare their employees for Islamic finance by organising specialised in-house training programmes. For example, the CBO organised a training programme in collaboration with the UK-, France- and Bahrain-based Islamic Finance Advisory & Assurance Services (IFAAS), and Al Izz Islamic Bank completed a comprehensive training programme for its employees by outside experts and in-house advisors ahead of its launch. Islamic windows took similar steps; Bank Dhofar's Islamic window Maisarah partnered with Dubai-based Ethica Institute of Islamic Finance to provide training and certification for its employees.

Research

Oman ranked 8th in 2013 on the Research Sub-indicator. The country produced six research papers throughout 2010-2012 and 19 for 2011-2013.

The top 10 countries on the 2013 Research Sub-Indicator are (in descending order): Malaysia, Pakistan, Tunisia, Bahrain, Jordan, UAE, Brunei, Oman, Kuwait and Bosnia and Herzegovina.

Klemen Misic / Shutterstock.com

Understanding & Awareness

Increasing awareness

One of the key challenges faced by the Islamic finance industry is the lack of consumer and public awareness about its products, services and value proposition, especially how it is different from conventional finance. Spreading awareness about Islamic finance can be achieved through various channels including seminars, conferences and news.

There was a plethora of news reports, press attention and industry events leading up to the launch of Islamic banking in Oman in early 2013. This pushed the country to the top of the IFDI 2012 Awareness Indicator, a position the country maintained in 2013's ranking. The awareness indicator is divided into three sub-indicators: Seminars, Conferences and News.

The seminars sub-indicator is based on the number of seminars (events with fewer than 100 participants) held on Islamic finance. The conferences sub-indicator is based on the number of conferences (events with more than 100 participants) held on Islamic finance. The news sub-indicator is based on the number of English-language news articles that relate to Islamic finance. This includes both news articles related to a specific country and regional articles that have been allocated to all countries in the respective region.

The top 10 countries on the 2013 Awareness Indicator are (in descending order): Oman, Malaysia, Bahrain, UAE, Qatar, Tunisia, Djibouti, Egypt, Kuwait and Brunei.

Seminars

After adjusting for GDP and population size, Oman maintains its top ranking on the Seminars sub-indicator for 2013. The country hosted 29 seminars throughout 2012 and 10 in 2013. These covered different aspects of the Islamic finance industry including:

- Accounting for Islamic finance
- Takaful
- Islamic Banking
- Risk Management for Islamic finance
- Islamic asset management
- Corporate and sharia governance
- Sukuk
- Islamic funds

The top 10 countries for the 2013 Seminars Sub-Indicator are (in descending order): Oman, Malaysia, Qatar, Bahrain, UAE, Sri Lanka, Kyrgyzstan, UK, Sudan and Senegal.

Conferences

Oman dropped two places on the Conferences sub-indicator, from fourth in 2012 to sixth in 2013. The Sultanate hosted its first Islamic finance conference, aptly named "Oman First Islamic Finance & Banking Conference", in January 2012. The conference marked a turning point in Oman's journey toward Islamic finance and attracted more than 300 representatives including industry regulators, sharia scholars, local and regional banks, international banks, investment companies and consulting firms. Oman's first Islamic finance conference paved the way for a series of conferences. Six conferences were held in the country throughout 2012, and three in 2013, that tackled different areas of Oman's Islamic finance sector.

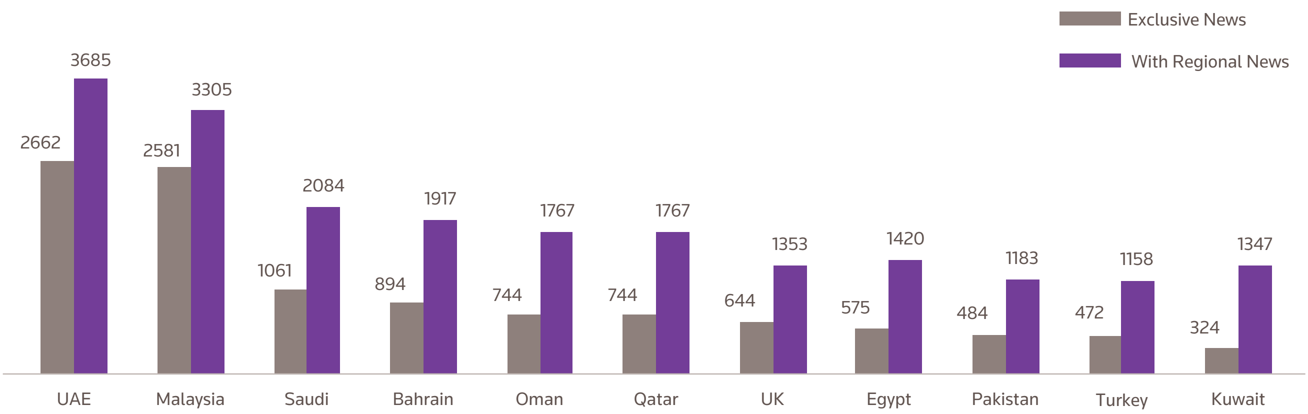
The top 10 countries on the 2013 Conferences Sub-Indicator are (in descending order): Malaysia, Bahrain, Tajikistan, UAE, Brunei, Oman, Morocco, Djibouti, Sri Lanka and Singapore.

News

Oman is ranked first on the News Sub-indicator for 2012 and 2013. The country's recent entrance into the Islamic finance sector grabbed media attention that generated a total of 531 news articles in 2012 and 1,088 in 2013.

The top 10 countries on the 2013 News Sub-Indicator are (in descending order): Oman, Bahrain, UAE, Malaysia, Qatar, Kuwait, Egypt, Tunisia, Djibouti and Saudi Arabia.

No. of news articles in 2013



Source: ICD Thomson Reuters Islamic Finance Development Indicator (IFDI) 2014

Exclusive Interview with Sohail Niazi, Chief Islamic Banking Officer, Bank Dhofar — Maisarah Islamic Banking Services

(Interview conducted on April 17, 2014)

How would you describe the current state of Islamic finance in Oman?

The Islamic banking industry in Oman is off to a good start and progress made so far has been quite notable on many fronts. The following milestones have been achieved within a very short span of 12 to 18 months:

- *Central Bank of Oman (CBO) has issued a comprehensive Islamic Banking Regulatory Framework (IBRF) covering different aspects of Islamic banking. This framework is based on best practices and lessons learnt by different countries where Islamic banking has been practised for many years.*
- *Today two full-fledged Islamic banks along with six Islamic windows of conventional banks are offering Islamic products and services in the country.*
- *Many innovative products and services have been developed and launched to cater to the financial needs of individuals, corporates and government institutions in Oman.*
- *Muscat Security Market (MSM) has already issued a sharia-compliant index to assist investors and fund managers interested to invest in sharia-compliant securities.*
- *In November 2013 the first corporate sukuk was successfully issued by Tilal Development Company, opening the doors for others to explore the market.*
- *Sovereign sukuk has been announced and work is under way to make it a reality.*

Despite these achievements, there is a lot of work that needs to get done to fully establish and further grow the Islamic banking sector. However, in Oman the industry is off to a good start.

Where do you see the Islamic banking share of Oman's total banking sector in the coming three to five years?

We estimate that in the first year of operations windows and Islamic banks have successfully achieved approximately OMR 775 million in assets; this is around 3.5% of total banking assets. This number is expected to increase in 2014 and beyond as Islamic banks and windows will continue to expand in different parts of the Sultanate.

Currently, Oman's GDP is nearly OMR 30 billion and this is expected to continue to grow in the range of 4 to 4.5%. Similarly, current total banking assets are around OMR 22 billion and it is expected that the assets will continue to grow in the range of 8 to 10%. This means that if the assets grow at the rate of 10% total assets will reach around OMR 35 billion.

What portion of OMR 35 billion will be captured by Islamic banks in the next five years is the key question. We expect that Islamic banks will able to get 8 to 10% share of total banking assets in Oman in the next five years. If Islamic banks get the basics right, they can end up with a larger market share.

How do you evaluate the legal framework that governs Islamic banking? And where do you see the gap (if any) in that framework?

The Central Bank of Oman (CBO) as regulator plays a key role in the development of the banking industry in Oman. After the issuance of the Royal Decree permitting Islamic finance in the Sultanate, CBO issued a detailed Islamic Banking Regulatory Framework (IBRF) based on best practices adopted in different jurisdictions where Islamic banking has been practised for decades.

IBRF is one of the most comprehensive frameworks issued by any regulator so far for the Islamic banking industry and has covered all the major aspects of Islamic banking on which the regulator's input is required. This extensive framework has helped Islamic financial institutions in terms of clarity on regulatory requirements on key aspects and has led to standardization of practices across the industry.

Draft guidelines are available for capital market instruments. However, more work needs to be done in developing guidelines and framework for capital market instruments in order to have more clarity and transparency on the subject.

How do you evaluate public awareness about Islamic banking in Oman? What are the actions that your bank is taking to increase public awareness?

At present customers still lack awareness on the products, services and practices pertaining to Islamic banking because the fundamentals of Islamic banking are different from that of conventional banking. In Oman the industry is in its nascent stage. It is expected that customer awareness of Islamic banking products, transaction structures, and practices will increase with the passage of time and the public's more regular interaction with Islamic banks. However, Islamic financial institutions along with other stakeholders such as regulators, consultants, academic institutions, training institutions and the media must play a role in increasing the awareness of Islamic finance in the country.

At Maisarah, we continue to play our part by providing training to our employees so that they are able to pass on the knowledge to customers. We interact with media through interviews and public relations campaigns to ensure that information related to Islamic finance is shared with the market on a regular basis. We also participate in seminars and conferences that play an important role in increasing the awareness of Islamic finance.

What share will Islamic windows attain out of the total Islamic banking share?

In terms of growth and market share we expect the performance of Islamic windows to be similar to the experience of other GCC countries.

In five years if the expected economic growth rate in Oman is achieved and overall banking assets continue to grow as per market expectations then overall Islamic banking assets could grow to 8 to 10% and windows can get half of the market share of Islamic assets.

Where do you expect the major demand for Islamic banking in Oman to come from, retail or corporate, and why?

In the first year of business we have seen acceptance of Islamic banking among retail and corporate customers equally. In future the growth will depend on how well the Islamic banks can address the financing and investment needs of their retail and corporate customers by offering new and innovative products. If the Islamic banks are able to offer a complete range of product mix that can meet customer expectation and provide them superior customer service then they will be able to expand their retail and corporate business. However, we expect *the corporate banking side to grow faster once acceptance, awareness, customer services and product satisfaction reaches the next level. The main reason for growth and demand of the corporate side will be general level of healthy economic activity and increased demand for financing.*

How would you assess the Omani sukuk market in the medium-term?
The Omani sukuk market is expected to perform well in the medium- to long-term because of two main reasons: first the IBRF has restricted Islamic banks from entering into commodity murabaha transactions. Therefore to address liquidity constraints Islamic banks will invest in sukuk as an alternative. Secondly, both private and public sectors are increasingly investing in development of infrastructure and projects which will increase the demand for financing. Sukuk can play an important role in addressing this demand.

Sohail Niazi
Chief Islamic Banking Officer
Bank Dhofar — Maisarah Islamic Banking Services

Sohail Niazi is Chief Islamic Banking Officer at Maisarah — Bank Dhofar in Muscat, Oman. Prior to joining Bank Dhofar he was Acting CEO at Elaf Bank in Bahrain. Sohail has nearly 20 years of financial services and banking experience in the USA, Asia and the Middle East. He has previously held positions at Bank of America, Morgan Stanley and KPMG Consulting. He holds an MBA from Thunderbird School of Global Management in Arizona and a Master of Science in Finance from the Illinois Institute of Technology in Chicago, USA.

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Oman is a signatory to the United Nations' Millennium Development Goals (MDG). In tracking poverty, MDG1 aims to Eradicate Extreme Poverty and Hunger, and is measured by three indicators: proportion of population below $1 (PPP) per day; poverty gap ratio; and share of poorest quintile in national consumption.

It is difficult to objectively measure Oman's progress towards meeting MDG1; there is neither data from UN agencies nor from the World Bank. However, local press reports point to widespread child labour and the Ministry of Social Affairs distributes social security income to low-income families. Within this context, there is a need to step up the management and use of Islamic social finance tools.

Prevailing high poverty and unemployment levels have highlighted the importance of reviving Islamic social finance tools such as zakat, waqf, sadaqah and Islamic microfinance as main stimulators for achieving social and financial inclusion.

Conventional microfinance has not helped uplift the socio-economic condition of the hardcore poor as its win-win rule concentrates only on financing the low-income group. Within Muslim communities, conventional microfinance is also not taken up by those who reject the riba component of credit finance. Unlike the low-income group, the basic needs of the extremely poor, or the hardcore poor, must first be satisfied before they can be transitioned into becoming productive borrowers. Islamic social finance has the system and tools to help the extremely poor.

Development of waqf management in Oman

Awqaf (plural of waqf, endowments) in Oman started during the time of Prophet Muhammad (peace be upon him), and initiated when Imam Al-Harth bin Ka'b (179H) transferred 40% of dates farms into waqf to assist his supporters. This property now represents the oldest existence of waqf in Oman. One of the followers of the prophet Muhammad (pbuh), Mazin bin Gutona, then built the first mosque in Oman called Al-Midmar Mosque, in the sixth year Hijri.

At the time, waqf was limited to renovating mosques. Over time, the people of Oman became aware of the importance of the role of waqf to society and started to transfer part of their wealth into waqf to help the poor and to build mosques, before the government took over the supervision of awqaf in the country. The Omani government relied on awqaf revenue before the discovery of oil in 1956.

The types of waqf in Oman are categorised based on their objectives. There are more than 13 types of waqf, including Mosques waqf, Education waqf used to pay teachers' salaries and books, Qur'an school waqf used for building and renovating these schools, Quran Karim Waqf which is used for those who teach Qur'an in the mosques, Graves waqf which is used to maintain graves, Waqf Ramadan, and the day of Arafah waqf.

Awqaf in Oman used to be managed under Imams. In the modern era Sultan Saeed Bin Taymor established the Awqaf Management in 1950. This management has developed to become the Ministry of Awqaf in 1997 during the era of Sultan Qaboos. This was followed by the Awqaf law in 2000. Today the management of awqaf in Oman falls under either the Ministry of Endowments and Religious Affairs or an appointed agent of the ministry.

Waqf in Oman is still managed along traditional and simple lines. More needs to be done by the government to institutionalise waqf and strategise its role in economic development and human integrity. Current waqf activities do not contribute as much to social and financial inclusion as it could. In order to contribute in the social arena, there is a need to link waqf in Oman to the social finance and poverty alleviation schemes.

Zakat in Oman

Oman believes in the essential role of zakat as an Islamic social tool for empowering the poor. The government has established a zakat fund under the Ministry of Endowments and Religious Affairs. However, the government has left the payment of zakat to the individual who can directly distribute zakat to the needy/asnaf or channel it to the zakat funds under the Ministry of Endowments and Religious Affairs. Nevertheless, in addition to the distribution of zakat, the fund plays an important role in educating Omanis on zakat (via free education), including the organisation of awareness programmes to educate citizens on the payment of zakat.

Similar to the status of waqf in Oman, the country's zakat system needs to be strengthened further to play a more effective role in fulfilling the community's needs.

Islamic microfinance in Oman

Given the role of Islamic social funds in supporting unemployment and poverty reduction among the poor and low-income groups, Islamic microfinance has become the most prominent tool in the contemporary era. Microfinance and Islamic microfinance in particular is not developed in Oman. There have, however, been recent developments; international investors, primarily from UAE, are now attempting to contribute to the development of the microfinance sector in Oman. Further efforts are certainly needed to use zakat and waqf funds to support the Islamic microfinance sector in Oman.

For a comprehensive study of Islamic social finance our Islamic Social Finance Report 2014, written by IRTI, is available for download here at https://www.zawya.com/islamic-finance/isfr/

ANALYSIS OF POTENTIAL SUPPLY AND DEMAND FOR ISLAMIC FINANCE

Inside

ANALYSIS OF POTENTIAL SUPPLY AND DEMAND FOR ISLAMIC FINANCE

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ISLAMIC FINANCE ASSETS GROWTH SCENARIOS

ISLAMIC BANKING ASSETS IN OMAN ARE ESTIMATED TO REACH $5 BILLION TO $7 BILLION BY 2018

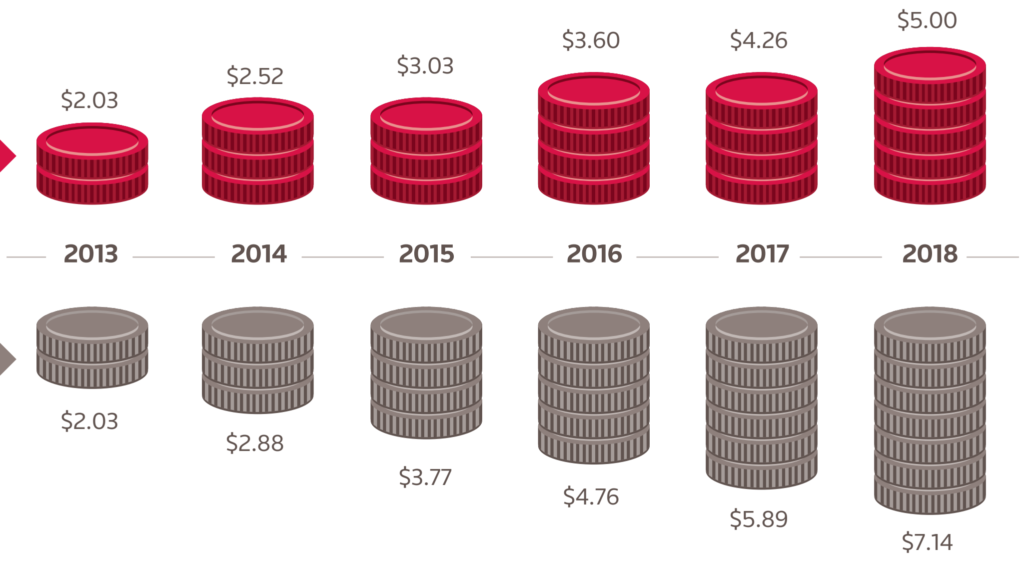
Oman Islamic Banking Assets Projection

ISLAMIC BANKING ASSETS BASE-CASE (SCENARIO 1)

Our base case (scenario 1) assumes Islamic banking assets in Oman to reach 7% of total banking assets by 2018.

ISLAMIC BANKING ASSETS BEST-CASE (SCENARIO 2)

Our best case (scenario 2) assumes Islamic banking assets in Oman to reach 10% of total banking assets by 2018.




= $1 Billion

FIVE PRIORITY AREAS ARE ESSENTIAL TO FOSTER GROWTH OF ISLAMIC BANKING ASSETS IN OMAN

PRIORITY

REGULATION AND STANDARDISATION

Legal Framework & Standardisation
- Continued government support to facilitate effective operations of Islamic banks
- Providing solutions for Islamic banking liquidity management is vital
- A greater level of international harmonisation and cooperation is needed to facilitate faster growth of the Islamic banking sector in Oman.

EDUCATION AND AWARENESS

Capacity Development & Knowledge Resources
- Develop human capacity to service and generate innovation for the Islamic finance industry
- Continue to improve the awareness of Islamic banking productsand services among the Omani population

INVESTMENT INTELLIGENCE

Market & Investment Research
- Develop market research capabilities for Oman in order to increase accessibil-ity on information about investment projects
- Provide research to support the alignment and mapping of investment projects with Islamic finance funding mechanisms, e.g. Islamic syndication and sukuk

PROFESSIONAL CONNECTIVITY

Community Facilitation & Support Infrastructure
- Develop connectivity for professional community through Islamic Banking Associations
- Develop advisory support for institutions wishing to gain access to Islamic financial transactions and deals

SOCIAL AND GLOBAL RELEVANCE

Innovative Branding Approach
- Develop an exclusive ethical and Islamic-based branding vision for Islamic banking in Oman in line with other jurisdictions.

** Our estimate is based on our experience in other markets that have launched Islamic banking.*

RETAIL CONSUMER BANKING SURVEY

Our exclusive retail consumer banking survey reveals a number of growth opportunities for Islamic banking in Oman.

These opportunities are elaborated using six strategic orientations

Demographics
Young population to drive Islamic banking growth (median age 25.88, WHO 2012 data)

Multi-channel
Enhancing the understanding and awareness of Islamic banking is key to success

Customer Experience
Banks need to improve customer experience

Multi-banking
By seeking better services and rates customers are likely to have more than one bank account

Target Audience
Customers may still be interested in Islamic banking despite possible higher fees

Latent Opportunities
High potential for general takaful

DEMOGRAPHICS

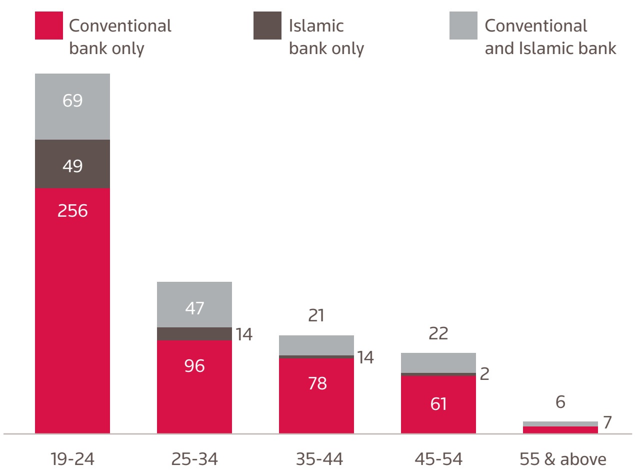
Young population to drive Islamic banking growth

The expansion of Islamic banking in Oman will be driven by the younger generation who are expected to become Oman's most valuable assets. Oman's median age was 25.88 in 2012, and 20 to 34-year olds in the country represent approximately 42% of the population (National Centre for Statistics and Information, mid-2013). Approximately 74% of our survey sample size of 835 are young people aged between 18 and 34. In the coming years, Oman's banking sector should focus on targeting this demographic as it is fundamental to meet the potential demand for Islamic banking in the Sultanate.

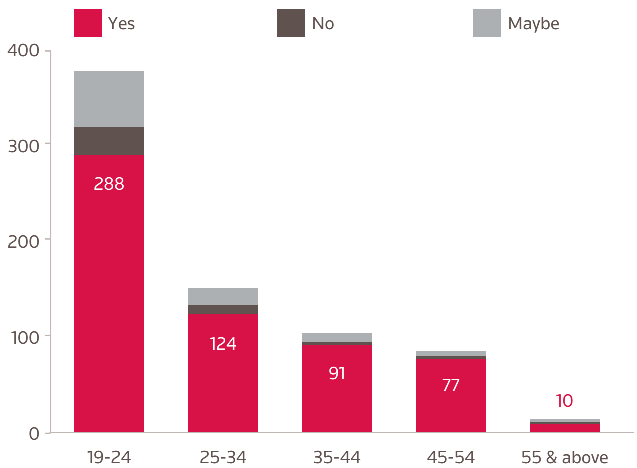
352 respondents between the ages of 18 and 34 deal with conventional banks when using financial services, while 63 respondents only use Islamic banks; this is an indication of the large untapped demand for Islamic banking. Further, a large number of respondents between the ages of 18 to 34 are interested in Islamic banking.

The next step is to reach young people before they embark on their professional careers, ideally while they are still in school or higher learning institutes. New service lines could include youth savings accounts, youth credit cards and educational savings and financing. Maintaining and sustaining relationships with today's young consumers will be a significant growth driver for retail banking.

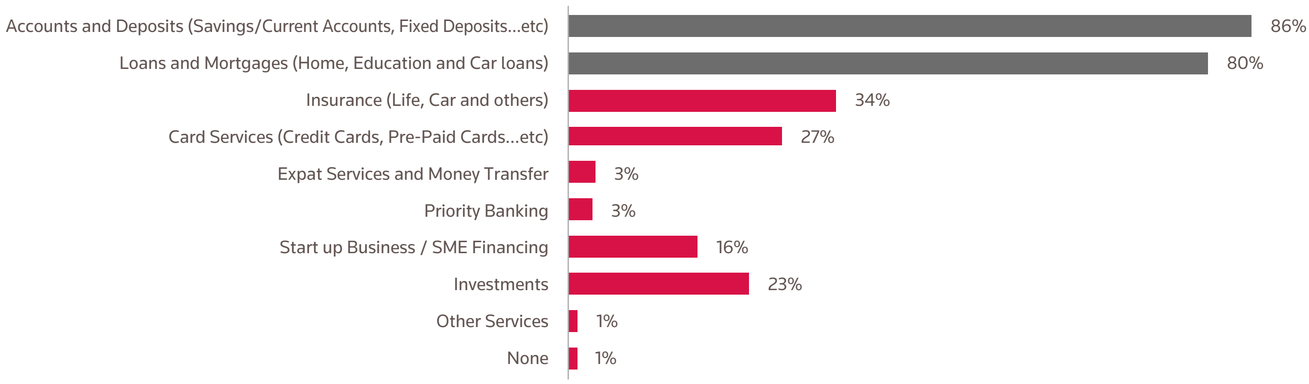
What type of bank do you deal with?



Would you be interested in Islamic Banking?



If Islamic banking is functioning under full capacity in your country, which of the following facilities will you be most interested in?

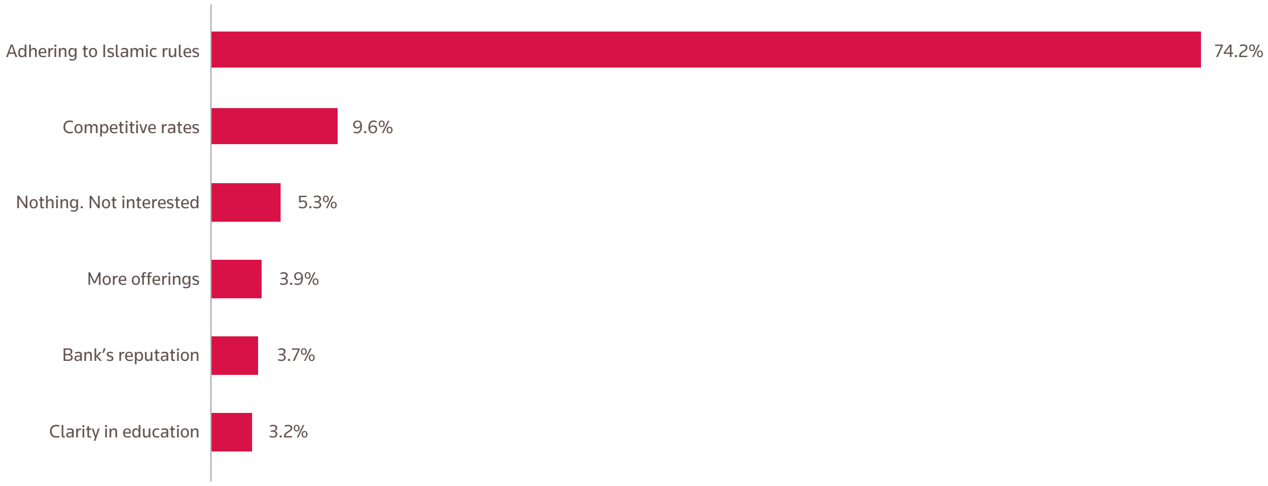


MULTI-CHANNEL

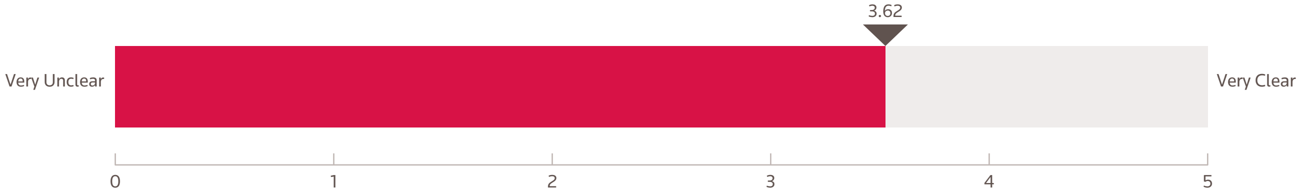
Enhancing the understanding and awareness of Islamic banking is key to success

74% of respondents consider adherence to Islamic rules the most important factor that would encourage them to deal with Islamic banks. Improving the level of Islamic finance awareness would help to dispel any assumption or perception that Islamic banks in Oman do not adhere to sharia rules and principles. Banks must focus on the main value proposition of Islamic finance when advertising and marketing their services. A practical implication to achieve such strategy is for banks to devise marketing programmes that deliver this message effectively.

Choose the most important factor that would encourage you to deal with Islamic bank?



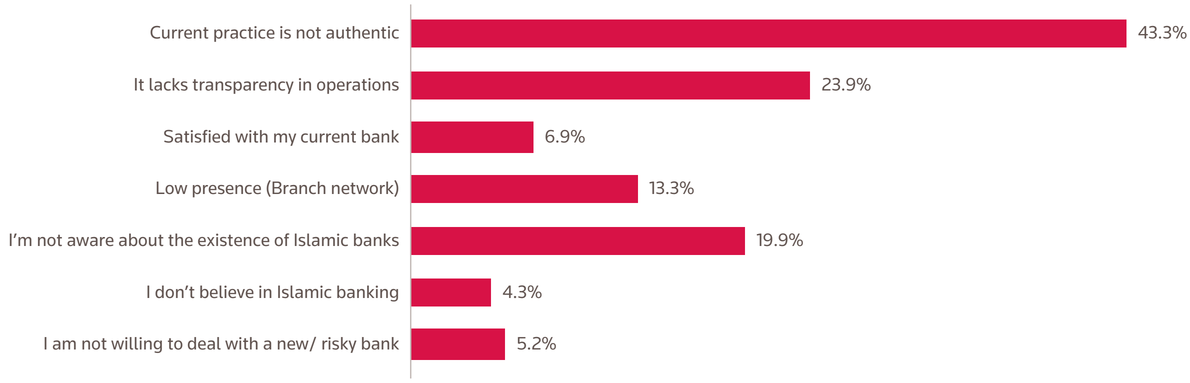
How well do you understand Islamic Finance concepts?



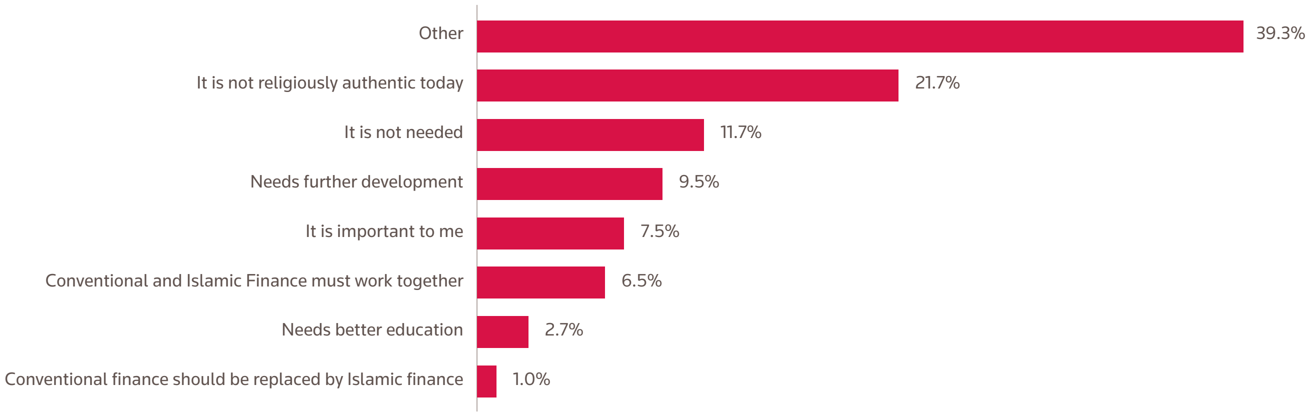
43% of respondents believe the current practices of Islamic finance is 'not authentic'. In addition, 24% of respondents do not deal with an Islamic bank because they believe it lacks transparency in operations; a perception that could hinder the growth of Islamic banking in Oman.

This perception of non-authenticity could be allayed by strong recognised brands, particularly conventional banks that have Islamic windows. A well-established and trusted bank could leverage its brand and reputation to increase consumer trust in their Islamic finance offerings. The operations of Oman's Islamic banking windows are completely segregated from their conventional parents and this should allay concerns about any co-mingling of funds.

What are the reasons that hold you back from dealing with an Islamic Bank?



In general, what is your view about Islamic Finance?



Approximately 40% of survey respondents want conventional finance to be replaced completely by Islamic finance, reflecting the level of sharia sensitivity in Oman. Business and industry players must tackle the perception that current practices of Islamic banks are not authentic. Banks in Oman could gain control over this issue through marketing communications to better position themselves in the eyes of the public.

Multi-channel communications to tackle negative perception of Islamic finance

Relevant financial institutions, regulators and policymakers all have a role to play in reducing this perception about Islamic finance, its practice and authenticity. Above all, regulators and policymakers have a crucial duty to fulfil by creating a transparent regulatory environment and installing and enforcing an appropriate supervisory framework. This will build a culture of trust in Islamic finance among the public who are more receptive to government initiatives.

Technology advancement and the transition to digital-based transactions dictate that business-to-consumer methods of communication in financial services should evolve. The respondents to the survey prefer to engage with financial institutions through the internet when learning about Islamic banking concepts.

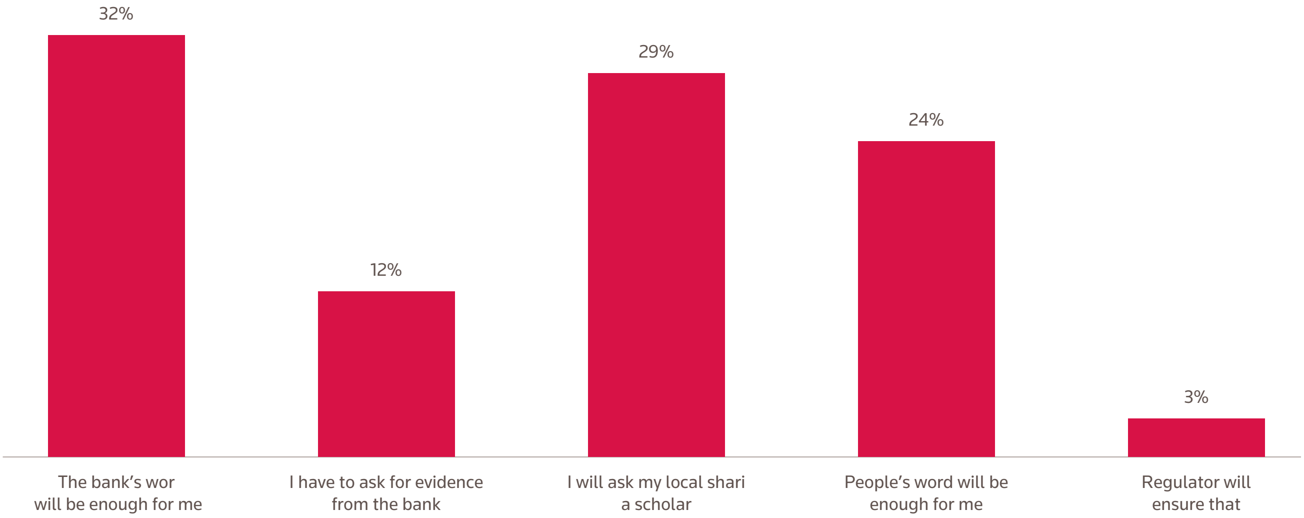
Customers now prefer (and expect) easy access to information via direct channels. As such, Islamic banks must establish customer-centric infrastructure based on innovative technologies and strategies. Any customer engagement strategy must include digital marketing campaigns that meet consumer preferences and improve customer relationship management. It is becoming more essential for Islamic banks to adapt and integrate multi-banking channels using the Internet, branch network, and mobile banking channels in order to attract new customers.

What is your preferred media channel to learn about:

	ISLAMIC BANKING CONCEPT	ISLAMIC BANKING PRODUCTS	ISLAMIC INSURANCE (TAKAFUL)	THE ROLE OF SHARIA'A SCHOLARS
Bank Staff	10%	12%	12%	13%
Events & Seminars	24%	25%	26%	27%
Online	31%	27%	28%	29%
Billboards	15%	20%	16%	16%
Brochures	20%	16%	18%	16%

Islamic banks must also dispel the perception that their current practices are not 'authentic' in order to win new customers and increase retention rates. They must include proof of authenticity in their brand marketing campaigns using appropriate communication channels. 32% of respondents will consider the bank's confirmation of its Islamic authenticity to be satisfactory, whereas 12% will seek evidence from their banks. Sharia scholars also have a role in instilling confidence of the industry to the public; 29% of respondents will seek assurance from their local sharia scholars.

How will you believe that your Islamic Bank products/services are really Islamic?



CUSTOMER EXPERIENCE

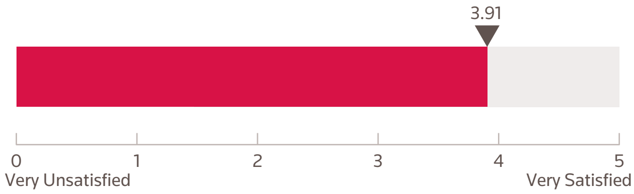
Banks need to improve customer experience

Measuring the level of satisfaction is imperative to improve and further develop the Islamic banking sector. In Oman, consumers display a high level of satisfaction with their main financial provider and therefore there is scope for differentiation. Banks should rigorously and continuously study existing consumers' behaviours in order to personalise their products and services to individual consumers' needs. Despite the encouraging responses in satisfaction level, banks need to focus on additional enhancements, improve customer services and provide competent ATM and Online services.

Enhancing the services provided by ATMs should be on banks' priority list because 71% of respondents ranked ATM services as the most important factor when using financial services. Banks also need to strengthen relationships through customer and personalised services as cited by 34% and 52% of respondents, respectively. The second most important driver of consumers' satisfaction is online banking as a distribution channel. With young people a large target demographic, and an increased level of confidence in online security and technology, customers are more likely to rely on online banking which ultimately could reduce transaction costs.

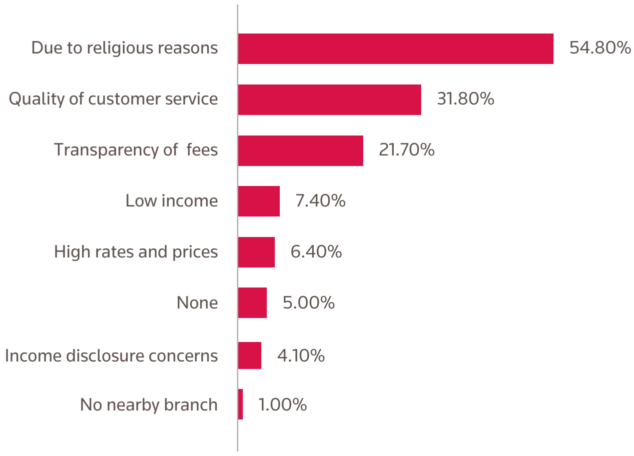
Islamic banking should strengthen its financial inclusion in the market; 55% of our survey respondents cite religious reasons as a main concern when dealing with banks. Far from fees and pricing, the main concern for retail banking users — other than customer service quality — is the transparency in fees. Frontline staff are the key drivers towards delivering better service quality; the human resources development department should play a vital role in enhancing quality and experience. Based on the survey's results, consumers are demanding clearer communication and transparency about fees which will require banks to invest heavily in programmes that will improve relationships and engagement with consumers.

How satisfied are you with your primary financial service provider?



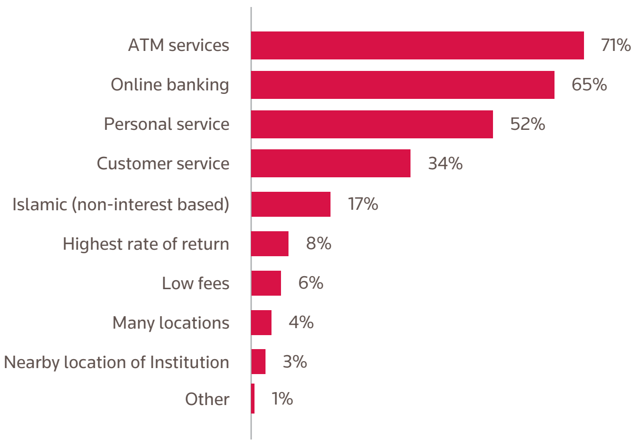
BESIDES RELIGIOUS CHARACTERISTICS, CONSUMERS ARE MAXIMISING THEIR FOCUS ON CUSTOMER SERVICE QUALITY AND TRANSPARENCY OF FEES

What are your main concerns when dealing with a bank?



KEY DRIVERS OF CONSUMER SATISFACTION: MAINTAINING BANKING RELATIONSHIPS AND ENHANCING ONLINE BANKING

Overall, which of the following is important to you when using financial services?



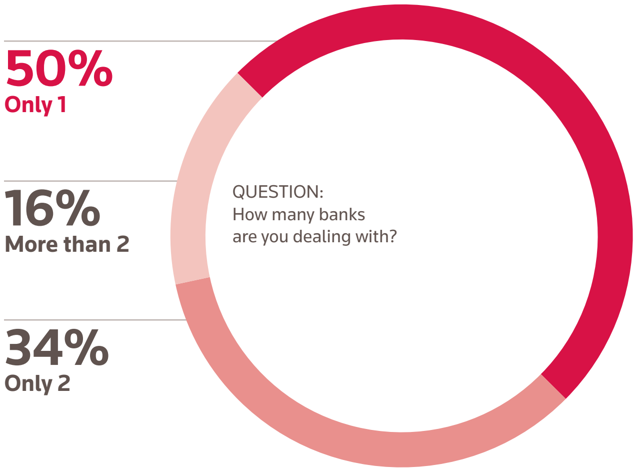
MULTI-BANKING

Customers seek better services and rates; likely to have more than one bank account

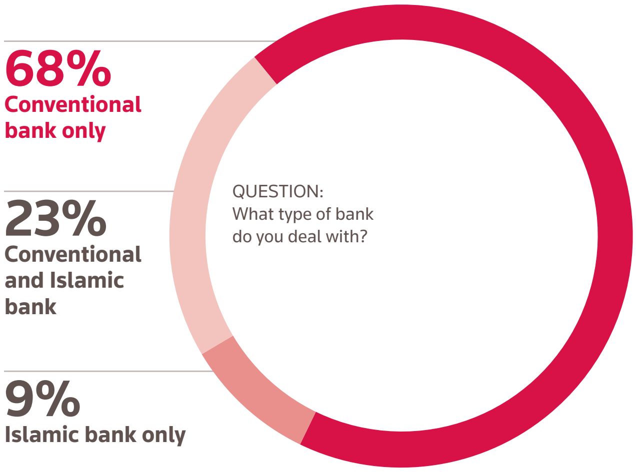
There is a tendency for customers in Oman to have two or multiple accounts; this is a growth opportunity for banks. Half of our survey respondents have either two or more than two bank accounts and 23% have both conventional and Islamic banking accounts. Banking customers now distribute their assets across multiple banks. Banks must then be promoting the benefits of multi-banking, and exploit any unsatisfactory rates and quality of services in the market. The increase in consumer knowledge and awareness has changed the power paradigm and consumers now have the upper hand. Banks must adapt to increasingly changing customer needs, behaviour and preferences in order to create new business opportunities

Banking customers today are better informed when choosing providers. Customers are now more willing to purchase products and services from multiple banks simultaneously than they were in the past, depending on their preferences, fees and customer service quality. Managing different accounts and banking relationships have now become easier with the use of direct channels, internet banking and social networks when updates are announced. In light of this, Islamic banks in Oman must be adaptive to changes in customer behaviour, and offer innovative and more personalised products and services. Further building and investing in internet and digital channels is important to increase and retain customer satisfaction.

How many banks are you dealing with?



What type of bank do you deal with?

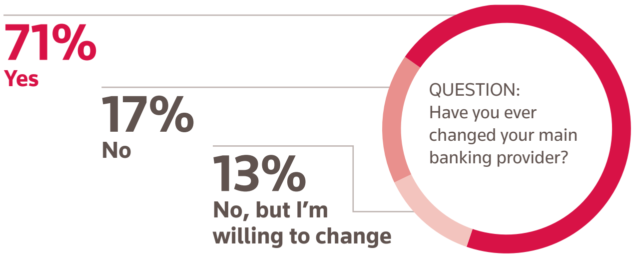


TARGET AUDIENCE

Consumers may still be interested in Islamic banking despite possible higher fees

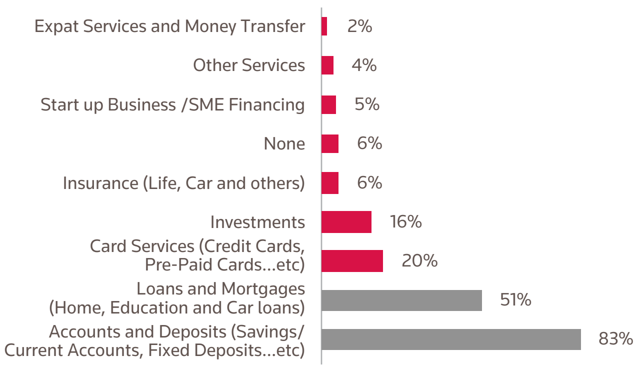
71% OF BANKING CONSUMERS IN OMAN CHANGED THEIR MAIN BANKING PROVIDER AND 13% ARE CONSIDERING A CHANGE

Have you ever changed your main banking provider?



DEPOSIT ACCOUNTS AND MORTGAGES ARE THE TWO MOST USED SERVICES BY BANKING CONSUMERS IN OMAN

Which financial services do you use today or have used?



There is a substantial challenge for Oman's new Islamic banks, especially standalone ones — Omanis' level of consumer satisfaction and loyalty are high toward their primary financial provider; respondents were 4/5 satisfied with their main bank, and 71% have never switched their main banking provider. However, with the introduction of Islamic banking, consumers are more likely to change, or at the least consider changing, their behaviours and demand. Banks should embrace these developments by providing consumers more offers and transparent rates with respect to accounts, deposits and financing.

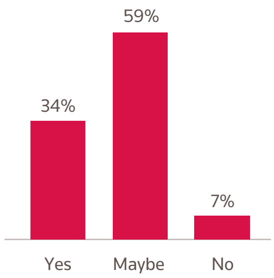
As shown in an earlier chart (bottom-most chart on page 64), pricing and rate of returns are not high on the list for retail users (6% and 8%); they would switch to another provider as long as it adheres to their religious values independent of pricing.

Regardless of the high fees and rate of return, 93% of consumers are actively considering moving their transactions to an Islamic bank.

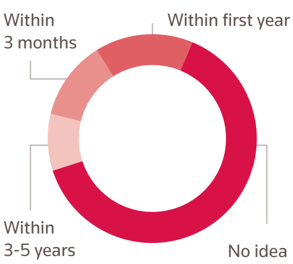
Loyal consumers of conventional retail banks that have opened Islamic windows have the potential to become the bank's biggest ambassador, with increased investment in transparency, flexibility, personalised products and branch interaction.

DESPITE POSSIBILITY OF HIGHER FEES, 93% OF RESPONDENTS WOULD SWITCH TO AN ISLAMIC BANK

Will you switch to an Islamic bank even if the conventional one offers better rate of return?

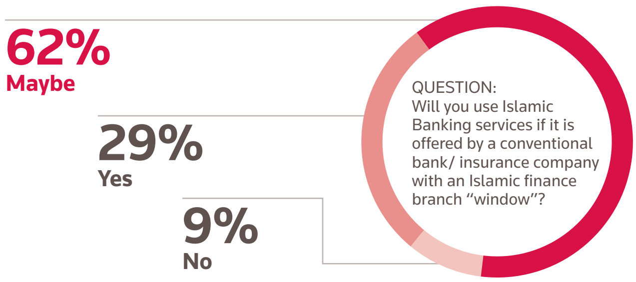


When do you expect to switch/ open an Islamic bank account/ financing loan?



62% OF RESPONDENTS MAY STILL USE ISLAMIC FINANCIAL SERVICES IF OFFERED BY A CONVENTIONAL BANK THROUGH A DEDICATED BRANCH

Will you use Islamic Banking services if it is offered by a conventional bank/ insurance company with an Islamic finance branch "window"?



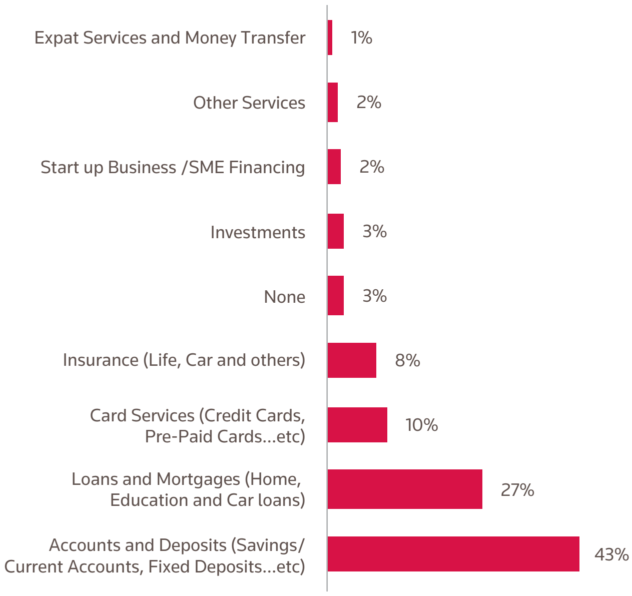
LATENT OPPORTUNITIES

High potential for general takaful in Oman

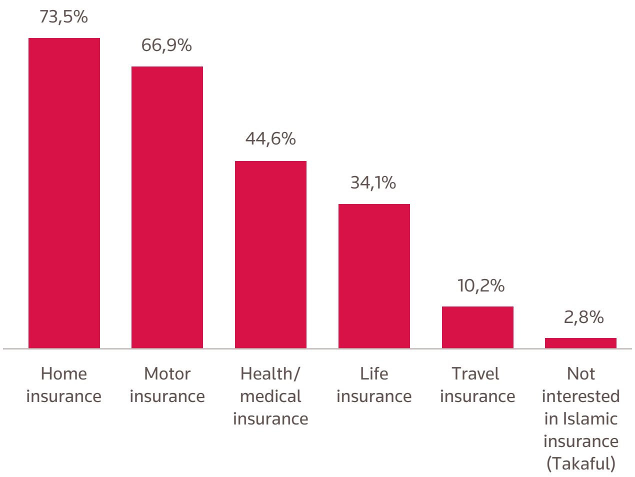
In terms of in-demand financial products and services, insurance products ranked fourth in the survey, after banking products and services. 8% of respondents currently use or have used insurance products in the past. This represents a growth opportunity for takaful products in Oman.

Respondents to the survey showed interest in general takaful products such as home insurance, motor insurance and health/medical insurance. Given the recent establishment of takaful companies in Oman, operators must explore new channels to sell general takaful products and services, such as Bancatakaful. There is a much lower demand for family takaful — 34%. Conventional life insurance in Oman constitutes 9% of total gross written premiums, down from 12% in 2012 and non-life Insurance penetration increased 91% in 2013, compared to 88% in 2013. Takaful operators must educate customers about the value proposition of family takaful.

Which financial services do you use today or have used?



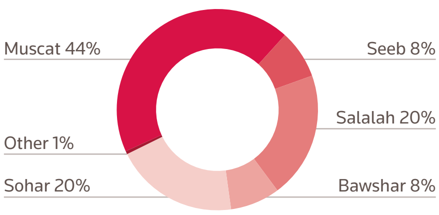
What Islamic insurance (Takaful) policies would you take if they become available in Oman?



METHODOLOGY

The retail consumer survey was conducted in May 2014 in collaboration with Muscat College. The survey was distributed to a sample of Omani residents over 18 years old1. Apart from responses to the survey questions we also gathered economic and demographic data about respondents' age, gender, educational level, place of residence and work, and monthly family income.

Location

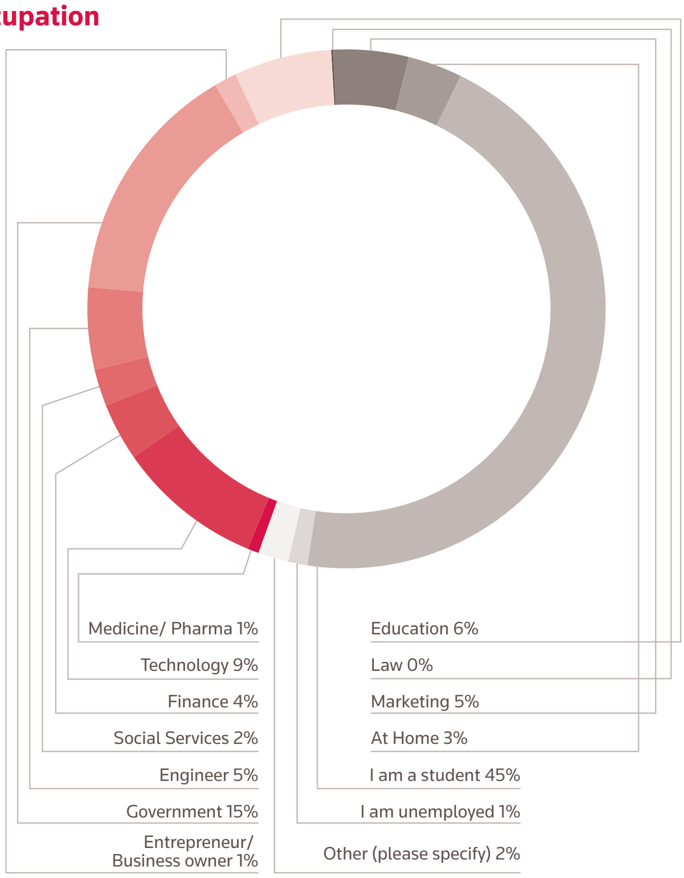


SAMPLE SIZE

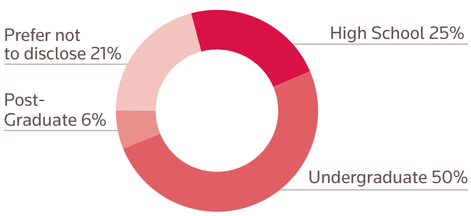
835

Nationality

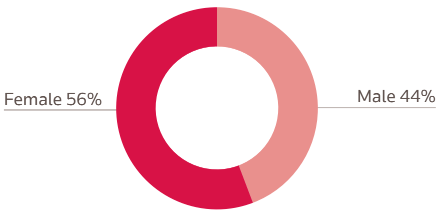
Occupation



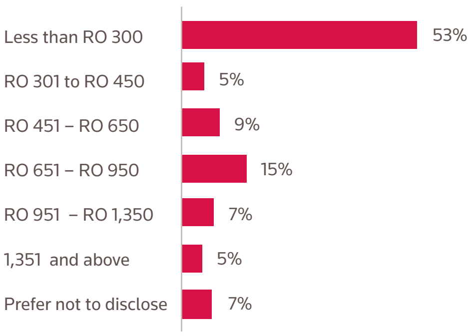
Educational level



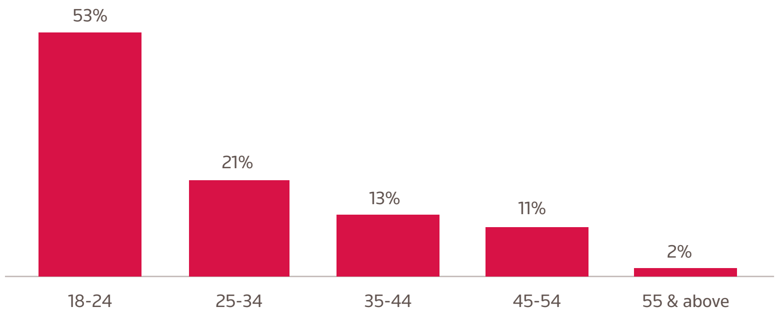
Gender



Monthly family income



Age



Disclaimer: Sample is not entirely representative of the population in Oman

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Klemen Misic / Shutterstock.com

Promising outlook

To date there has only been a single issuance of sukuk in Oman — an OMR 50 million ($130 million) corporate issue from real estate developer Tilal Development Company in November 2013. However, growth outlook is very promising.

The demand for sukuk in Oman's domestic market is driven by excess liquidity available in the newly opened Islamic financial institutions which require investments to deploy these funds. In terms of regulation, the authorities are yet to finalise the sukuk law, which has been drafted and is expected to be approved by parliament in the second half of 2014.

The Sultanate's population is almost entirely Muslim and there remains a huge untapped demand for sharia-compliant instruments although the banking sector is competitive and dominated by conventional banks given the prohibition of Islamic banking prior to 2013. The attitude of both government and the Omani people toward Islamic finance has moved in a positive direction since the central bank allowed Islamic financial institutions to start operations.

Government to lay the tracks for sukuk market

The private sector is keen to tap the sukuk market given the strong demand but the roadmap is yet to be drawn by key players, mainly the regulator. As a result, corporates are awaiting the government's lead which will create a benchmark yield curve to ensure an efficient price methodology is in place.

However, the government is not far off from issuing sukuk; it announced in September 2014 plans to issue the first sovereign sukuk after it assigned a specialized institution to structure the paper. The central bank of Oman has said the sukuk will be issued early 2015, if not by the end of 2014. A major project is the construction of a $13 billion 170-kilometer railway connecting the northern town of Buraimi (which borders Al Ain in the UAE) and Sohar with the ports of Duqm and Salalah towards the Yemeni border in the south. The railway project would definitely be a boost for the Omani sukuk market. Railway construction would ultimately be divided into two major financing components: a) the construction of the railway itself, and 2) the trains which would come following the completion of the railway.The potential sukuk structure for the railway project could be a hybrid of istisna and ijara. The construction of the railway would suit an istisna structure, which is primarily used for the funding of a project or asset which is to be manufactured or constructed. Alternatively, forward Ijara would also work well for construction projects.

Thereafter, using an ijara contract could be used to finance the purchase of the trains; investors would buy them and lease them back to the issuer, which would be the Omani government. Forward ijara is potentially a better option as it enables investors to undertake payment during the construction period, while the obligor payments will start within a specific period after completion. This could benefit the issuer until the project is completed. Although forward sales are impermissible under sharia, forward contracting through ijara is permissible provided the rent amount will be paid only after delivery of the underlying asset.

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Sukuk Preceptions and Forecast Study 2015

The study is designed to capture the outlook and appetite for Sukuk and the specific characteristics (break-down by country, sector, tenor, structure, rating, etc.) that are of appeal to the financial market based on primary empirical data from key investors and lead arrangers.

Unique Value Proposition

- Delivers insights based on primary empirical data from investors & lead arrangers
- Provide forward looking analytics on the appetite & preferences of Sukuk investors for 2015 and beyond
- Analyze what key trends have shaped the market and challenges that affected the industry
- Examine the forecasted supply and demand of the sukuk market

"The Thomson Reuters Sukuk Pereceptions and Forecast report series is the one stop source providing upto date reports, data and analysis regarding the sukuk markets from across the globe. Together with providing developments of the past years and insights into the future the report is a comprehensive guide for investors, issuers, originators and researchers to seize the pulse of the market."

Suleman Ali, Vice President, Meezan Bank

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Corporates in the Pipeline

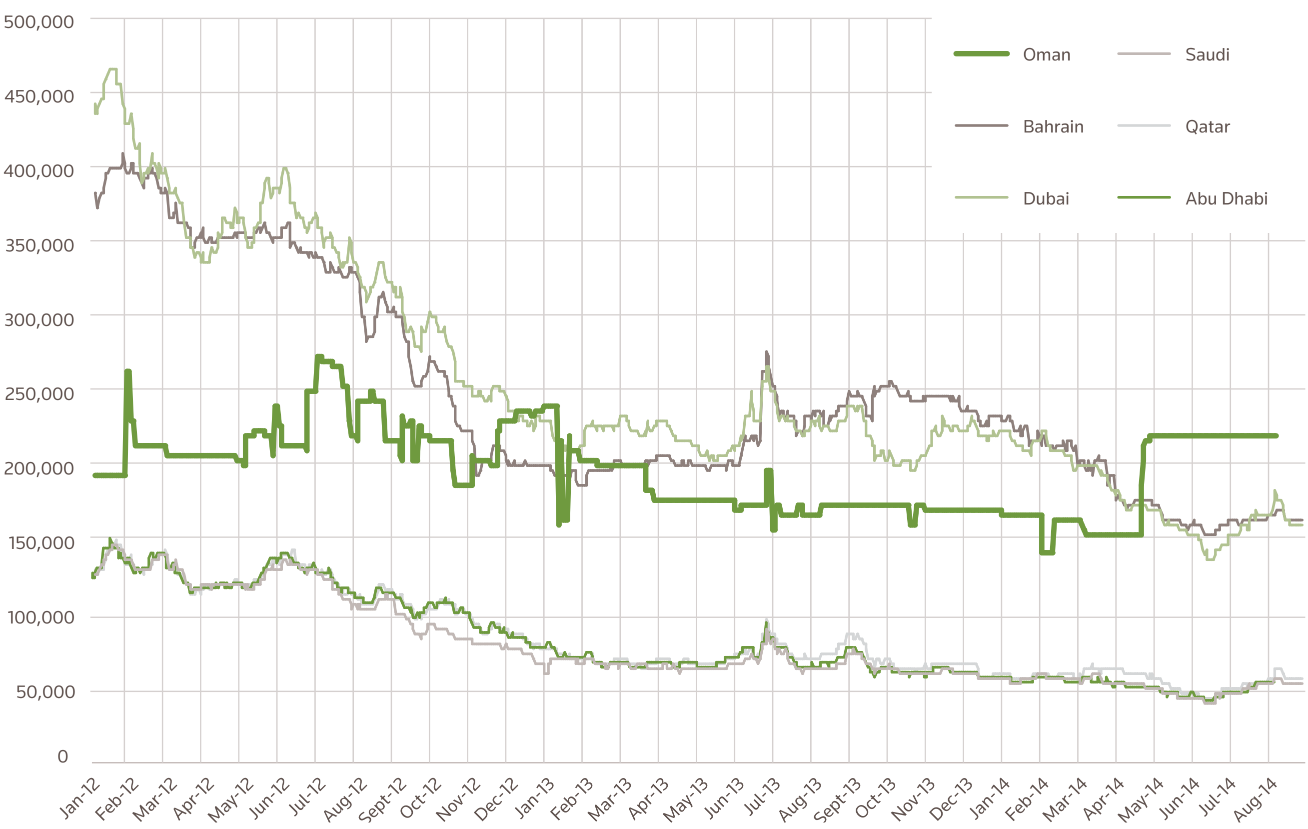
There is the possibility of three corporates issuing sukuk to finance their funding needs, according to Dr Daud Mohd Bakar, chairman of global sharia consulting firm Amanie Advisors, in a May 2014 press report.[2] These companies are engaged in different sectors, namely construction, property development, telecommunication and logistics services, and are seeking to capitalise on the high demand and lower funding cost compared to conventional bonds. However, to date, there has neither been official announcements from the three companies nor from any other corporates regarding potential sukuk issues.

Financial Institutions with excess liquidity

At the banking level, two standalone Islamic banks started operations early 2013. It is unlikely these banks would consider issuing sukuk in the short term given the excess amount of liquidity they currently enjoy. If these Islamic banks do not play a significant role in developing the sukuk market in terms of issuance, they would definitely play a bigger role in terms of creating demand.

2 *Times of Oman, "Three Omani firms plan sukuk issue," May 10, 2014. Available from: http://www.timesofoman.com/News/33615/Article-Three-Omani-firms-plan-sukuk-issue*

Oman's CDS Vs. Other Developed Countries' CDSs



Financing budget deficit in case of drop in oil prices

The Omani economy is heavily dependent on oil and gas; the sector brings in about 84% of the Sultanate's total income. The country reported a total income of OMR 11,155 million at the end of 2013 out of which OMR 9,355 million was from oil and gas alone. In terms of expenditures, Oman allocated its total budget of OMR 12,855 million mainly to defence and security as well as capital expenditures of different civil ministries. This puts Oman in an estimated OMR 1,700 million budget deficit for 2013. While the budget deficit is slightly lower than other GCC countries, it needs to be converted into a surplus to pay for the country's extensive infrastructure plans if Oman does not want to further plunge itself into debt.

Oman's CDS sits at the mid-point for the GCC, inferior to Abu Dhabi and Saudi Arabia, given the latter two's greater oil wealth. In terms of credit rating, Oman is in the A category with its other GCC neighbours (except Bahrain which was downgraded to BBB- in 2011 by the top three rating agencies due to its unstable political environment).

Rating by S&P

Oman	A	Qatar	AA
Bahrain	BBB	Saudi	AA-
Abu Dhabi	AA	Kuwait	AA

All the indicators prove that Oman is considered a resilient country. As a result, if the Sultanate decides to finance its budget deficit or infrastructure projects through sukuk, it would probably be in the 200-300 bps plus mid swaps which is considered economic, as it compares well with other GCC countries such as Bahrain which issued in November, 2011 at a spread over mid swaps of 450 bps to yield 6.237%.

The price parity for bonds and sukuk in Oman would be analogous with exception to the demand factor. The high demand mainly from Islamic finance institutions for sharia-compliant instruments in Oman would leave issuers enjoying a better pricing position for issuing sukuk compared to bonds.

Exclusive Interview with Ahmed Al Qassabi, Acting DG, Issues & Disclosures, Capital Market Authority

(Interview conducted on April 21, 2014)

How would you describe the current state of Islamic Finance in Oman?

Very promising. Within a short span of less than a year and a half, Islamic banking and finance has emerged as one of the fastest growing segments within the financial services industry in Oman since the issuance of the Islamic Banking Regulatory Framework (IBRF) on December 18, 2012 and the establishment of two new dedicated Islamic banks and six Islamic banking windows. Since then, three sharia funds have been launched, a corporate sukuk was issued, the new MSM Shariah Index was launched for the Muscat Securities Market and two new takaful operators are currently operating in the market. This indicates the strong potential demand and interest from both issuers and investors/consumers. Based on what we have seen thus far, Islamic finance will play a key role in meeting the funding requirements of the country and growth in the economy.

Oman has had only one sukuk todate, a corporate issue from Tilal Development Co in November 2013. Which sectors do you expect the most issuances to come from?

We hope to see more acceptance and sukuk issuances from the corporate players particularly from the financial, infrastructure, real estate and utilities sectors, to fund the economic growth of the country.

How would you assess the Omani sukuk market in the medium-term?

Positive and exciting.

In early 2014, Oman announced its plan to issue a debut sovereign sukuk. Once issued, where do you think the bulk of investors will come from, in geographical and sectoral terms?

Any new sovereign sukuk issuance of good credit quality would definitely provide excitement and have a positive impact to both the domestic and global sukuk market and Islamic financial market as a whole.

There is pent-up demand for sharia-compliant instruments in the domestic market alone due to the surplus liquidity, particularly from the new Islamic financial institutions (i.e. new Islamic banks/windows, takaful operators and Islamic funds), and shortage of sharia-compliant instruments.

In addition, due to the shortage of good quality sukuk papers in the global market and the tendency for most investors to hold these papers to maturity rather than trading them, there is also plenty of demand by investors in the global market.

Ultimately, the composition of investors would depend on the strategy intended for the sukuk issuance while enhancing the profile of Oman's Islamic papers within the global market in the long term.

For the first OMR 50 million ($130 million) sukuk issuance in Oman by Tilal Development Company SAOC, tremendous interest was shown by both domestic and regional investors during their roadshows. Nevertheless, in the end, the company decided to give priority to the domestic Omani investors due to the surplus liquidity in the market.

What types of sukuk structures will the law allow?
The Sukuk Regulation has been drafted to provide flexibility of structuring to the market players and to spur innovation, subject to the approval of the issuers' respective Sharia Supervisory Boards (SSB). Hence, the SSB will be held accountable. In the end, it is also up to the investor's and market's acceptance of the sukuk structure.

When do you expect the sukuk law to be ready?
The CMA has finalised the draft Sukuk Regulation. Nevertheless, certain amendments had to be made in the existing Capital Market Law (CML) in order for the CMA to issue the Sukuk Regulation and to facilitate the issuance of a sukuk, particularly to ensure the tax-neutrality of a sukuk vis-à-vis a conventional bond. The amended CML is currently pending the Majlis Oman or Council of Oman (Oman's parliament) approval. Nevertheless, we are targeting the approval of the CML and issuance of the Sukuk Regulation by the second half of 2014. The new Sukuk Regulation would provide clarity and transparency to the market players. Notwithstanding, there is an existing bond regulation framework which can still be used to facilitate the issuance of a sukuk, provided it complies with sharia requirements. This was used for the first issuance in Oman by Tilal Development Co via private placement.

Other than financing the budget deficit, why will the Omani government resort to sukuk issuance?
The issuance of the sovereign sukuk is not only to efficiently fund the budget needs of the government, but also to establish a benchmark yield curve to spur the development of the bond/sukuk market in Oman and ensuring an efficient price discovery process. In addition, there is pent-up demand for sharia-compliant instruments in the domestic market alone due to the surplus liquidity in the market, particularly from the new Islamic financial institutions, and shortage of sharia-compliant instruments. This is part of the overall strategy to add more depth and breadth to the rapidly growing Islamic financial market in Oman.

In addition, the growth of sukuk issuances alongside Islamic funds will see the channeling of investments to fund the economic growth of the country, such as for infrastructure development and manufacturing industries, while diversifying the financing base and risk away from the traditional banking sector.

Ahmed Al Qassabi
Acting DG, Issues & Disclosures
Capital Market Authority

Ahmed Al-Qassabi is currently the Director General of Issues and disclosures at Capital Market Authority. Mr Ahmed focuses on corporate finance, issues, IPOs, audits and investigations of public listed companies, mutual funds and accounting firms. He also overlooks market disclosures and companies filing. Prior to his appointment, he served more than 10 years in numerous areas such as corporate governance, corporate finance, and audit. He is a board member of the Muscat Clearing and Depositary Company since 2011. He is a Chartered Certified Accountant ACCA (UK) and holds a Bachelor's degree in accounting and finance.

Untapped Oman funds sector to grow once law is approved

Since Oman opened its doors to Islamic finance in 2013, the market has witnessed the launch of only three small Islamic funds: Al Hilal MENA fund by Ahli United Bank, Vision Al Khair GCC Fund by Vision Management Services and Al Kawthar Fund by National Investment Funds.

The Sultanate is an untapped market for Islamic investment funds, particularly for mutual funds, Exchange-Traded Funds (ETF) and equities. Oman could establish itself to become a marketplace for businesses to raise Islamic funds.

Oman's three Islamic funds were all launched in 2013 with the same characteristics as open-ended funds. The initial total size of the Islamic funds market is approximately OMR 5 million ($13.2 million); with the highest share for Vision Al Khair GCC fund and Al Hilal MENA fund each with OMR 2 million and Al Kawthar fund's OMR 1 million. The three funds are domiciled in Oman with GCC being the geographical focus area. Sharia-compliant funds in Oman are limited to equities.

In addition, well-established Islamic banks from the Arab Gulf region, such as Al Baraka and Al Rajhi, are showing interest in moving into Oman's banking sector. These banks are also expected to offer their expertise in asset management by introducing various services to their potential clients in the country.

However, generally speaking, the size of funds in Oman is trivial as there are only 14 funds in total in the country out of which three are Islamic.

Oman does not swim alone in its small pool of funds. Qatar, a top rated GCC country, also has the lowest number of funds, with only 14. Saudi Arabia tops the list with 364 funds followed by Bahrain with 70 funds. Nevertheless, Oman is moving closer towards the introduction of a new regulation enabling the establishment of funds with no interest bearing securities which will boost the sector. The regulation is expected to come into play in the second half of 2014.

If parliament approves the Islamic funds law, we expect an increase in the number of sharia-compliant firms to offer their services, although not significantly given the overall size of the market. The market could also see attraction for sukuk funds given the excess liquidity in Islamic banks that need to deploy their liquidity in sukuk; however, this could only take place once more sukuk are issued. The development of Islamic funds in Oman would also activate the takaful and retakaful markets as there will be more products and structures that require insurance.

Number of mutual funds in GCC countries as of June, 2014

COUNTRIES	TOTAL FUNDS	ISLAMIC FUNDS	ISLAMIC FUNDS AS % OF TOTAL FUNDS
Bahrain	70	24	34.3%
Kuwait	55	26	47.3%
Oman	14	3	21.4%
Qatar	14	4	28.6%
Saudi	364	224	61.5%
UAE	54	14	25.9%

REUTERS/Randolph Caguintuan

EXPERT COMMENTARY

Mr. Ahmed Saleh Al Marhoon

THE PERFORMANCE OF THE MSM SHARIA INDEX

By Mr. Ahmed Saleh Al Marhoon, Muscat Securities Market

The Muscat Securities Market (MSM) Sharia Index grew by 68 points, or 6.8%, since its launch on July 1, 2013 until the end of May 2014.

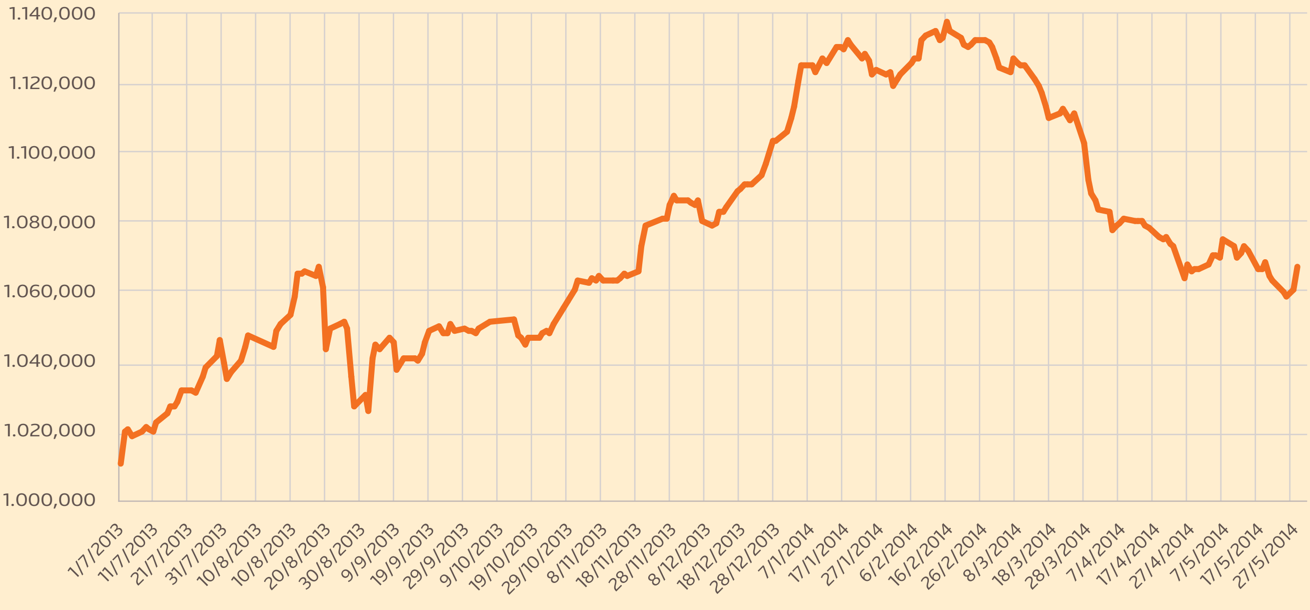
Why sharia index?

There are many reasons for the establishment of the MSM sharia index:

1. To activate trading in the market by attracting investors who are reluctant to invest in shares for the lack of specific standards differentiating between sharia-compliant shares and those which are not.

2. Providing new investment instruments in the market, as a sharia index would encourage Islamic banks and Islamic windows to offer sharia-compliant open-ended or closed-ended Islamic investment funds.

MSM Shariah Index



3. The MSM sharia index would contribute to attracting local capital which has migrated abroad seeking sharia-compliant products. The sharia index creates a conducive environment attractive to foreign capital seeking sharia-compliant products.

Outlook for the Islamic equity market in Oman

The initiation of Islamic banking in the Sultanate in 2012 constitutes the beginning of a promising Islamic financial market. Two Islamic banks have been established and listed at MSM since the beginning of 2013 in compliance with the newly enacted laws issued by the Central Bank of Oman and the Capital Market Authority.

The activities of these two Islamic banks have boosted the banking sector in the Sultanate. Most conventional banks have raised their capital to open new windows for sharia-compliant activities. In all, Islamic banking capital has reached approximately OMR 500, 000,000.

Islamic banking constitutes a remarkable value and a positive step for the Omani economy as it generates investment opportunities for segments which want to deal in sharia-compliant products.

Legislation to regulate the trading of sukuk have been issued by the CMA and MSM in addition to the issuance of regulations organising takaful as one of the products which enhances the capital market sector.

Overcoming the challenge of limited IPO issues in Oman

The primary market plays an important role in economic development, as it is one of the avenues for financing short- and long-term investments for newly established enterprises to run their operations.

Statistical analysis shows an average of two initial public offerings (IPO) per annum at MSM during the last seven years, representing 10% as per the average of IPOs in the GCC stock markets during the same period. During the preceding period the MSM succeeded in inviting high profile companies for public offerings. These new offerings attracted investments from new investors who have entered the market to benefit from the reasonable prices of the IPOs.

Encouraging family businesses to go public

The significant challenge facing the primary market is the reluctance of family enterprises to go public. No family owned-company has gone public in the last five years, and only one family-owned company has gone public in the last 10 years.

The Omani government as well as regulatory body the Capital Market Authority (CMA), and MSM have made it a point to address this specific issue. In 2013 the MSM invited family enterprises to a conference dedicated to encourage them to go public, prepare for international competition and contribute effectively in building the economy and creating employment opportunities for the Sultanate's future generations. The MSM also invited officials from public and closed companies as well as owners of family companies from all GCC countries to address issues pertaining to the transformation of family owned enterprises to go public, and the relevant mechanisms for this transformation. The positive feedback from speakers with hands-on experience has helped Omani family companies familiarise themselves with the merits and challenges of IPOs, such as restructuring ownership models to ensure business sustainability.

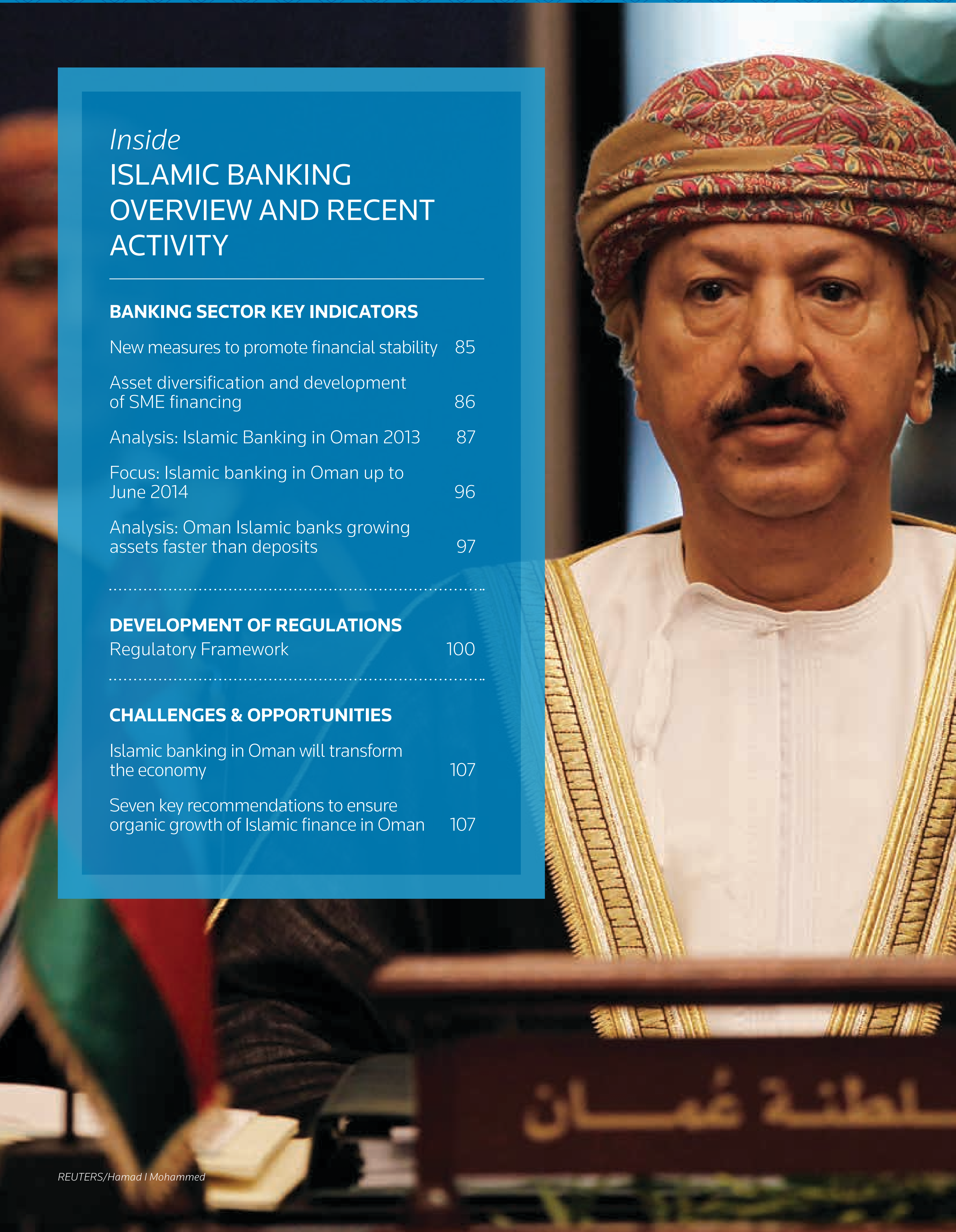
However, the long-term benefits of going public is not enough to make a family-owned business take the first step towards an IPO; the decision will be taken when short- and long-term benefits are realisable especially with successful family-owned companies that have enjoyed easy access to cash through bank financing. Many Omani family-owned businesses have thrived in the boom years but today's economic landscape has changed and post-2008 financial crisis there are companies now considering the IPO route.

More listed companies will boost MSM's indexes, including the sharia index, and open up the bourse to a bigger investment universe.

Ahmed Saleh Al Marhoon,
Director General
Muscat Securities Market

Mr. Ahmed Saleh Al Marhoon assumed his duties as the Director General of the Muscat Securities Market after receiving his MBA from a reputed university in the United Kingdom in 2001. He has also worked for Oman's public and private sector organisations — such as the Ministry of Oil & Minerals and a brokerage firm — in leading positions. He serves as board member in many banking and financial institutions.

ISLAMIC BANKING OVERVIEW AND RECENT ACTIVITY



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REUTERS/Hamad I Mohammed

BANKING SECTOR KEY INDICATORS

New measures to promote financial stability[3]

Oman's banking system comprises of the regulator the Central Bank of Oman (CBO), commercial banks, specialised banks, finance and leasing companies, money exchange establishments and Islamic windows of conventional banks. The Sultanate has seen several mergers since the 1990s and as a result the number of commercial banks at the end of 2013 stood at 16, of which half are locally incorporated and half are branches of foreign banks. During 2013, the balance sheet of commercial banks further strengthened due to robust growth in deposits and credit. There was significant improvement in the asset quality and profitability of banks with total assets of commercial banks increasing by 10% to OMR 23.2 billion in 2013.

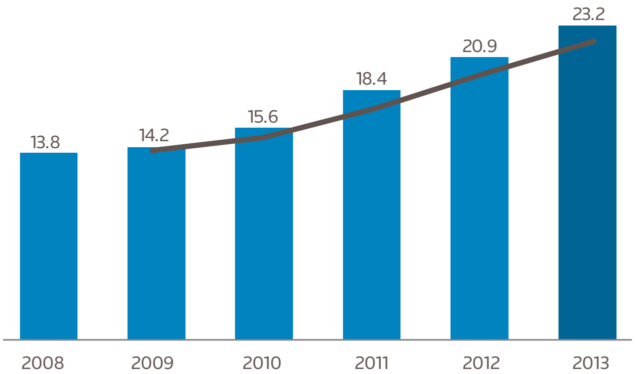
The entire banking system is dominated by four major commercial banks. Meethaq - Bank Muscat enjoys the largest share of assets with nearly 40%, according to data from bank financial statements. Only three other banks — National Bank of Oman, Bank Dhofar and HSBC Oman — have more than 10% market share each.

In addition to maintaining monetary stability, the CBO has initiated a number of regulatory and supervisory measures to promote financial stability in general and improve efficiency of the banking system in particular. To this effect a financial stability unit has been set up within the CBO. The minimum regulatory capital was raised from 10% to 12% of risk weighted assets. Risk-based supervision was implemented in full to cover the entire banking system from the year 2012.

3 *The content in this section is adapted from an IFG article written by Blake Goud that was published in the IFG Weekly Issue #83 on Sunday, May 4, 2014*

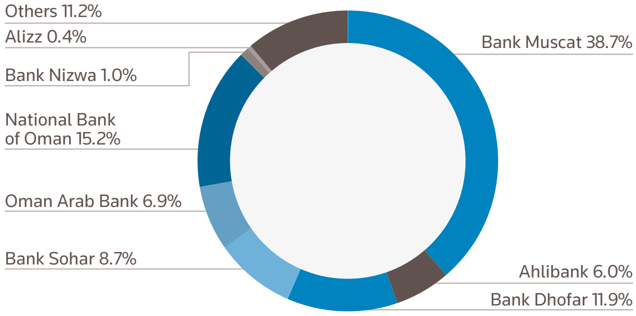
Islamic banks are expected to complement the conventional banking system in promoting growth in the economy, push for greater diversification of banking services and increase financial inclusion. Banks are optimistic that they will be in a position to significantly increase business and this augurs well for the economy as a whole.

Commercial Banking assets, 2013 (in OMR billion)



Source: Central Bank of Oman (CBO)

Islamic Banking Market Share (By total assets, 2013)



Source: Oman Observer , bank financial statements and IFG analysis

Asset diversification and development of SME financing

Innovative asset-based financing including prospects for sukuk provide immense opportunities. This will enhance product diversification in the banking system. Several measures have been taken by the CBO and the Government to develop the required infrastructure and devise necessary policies for the Small and Medium Enterprises (SMEs) sector. The CBO has advised banks to formulate a liberal lending policy for SMEs and requires that SME financing be considered in the context of the larger economic development of the country. Further, banks have been advised not to be guided primarily by collateral in their credit decisions; they should have a separate department with adequate staff and proper delegation of work to deal with SME finance. The banks should allocate 5% of their total credit to SMEs (see interview with the CBO). This target will be reviewed periodically. To encourage lending to SMEs, the prudential requirement for banks to lend to SMEs has been relaxed.

Islamic banking will provide further impetus to SME financing particularly as Islamic banking entities will be looking for financing based on acquisition of assets. The government is also taking steps to bridge the gap through special initiatives in coordination with banks. To this effect, a Royal Decree was issued to set up the Public Authority for Development of SMEs (see interview with the CBO).

The banking sector in Oman continues its positive growth trend consistent with the sustained growth of the real economy. The future of Oman's financial sector remains promising taking into account the pace of economic diversification and the growing role of the private sector in the development process. The most significant achievement has been improvement in recent years of the financial health of banks in terms of asset quality, provision coverage, capital adequacy and profitability, along with an increased focus on risk management.

With greater participation of commercial banks in the development process together with large investments by the government, the balance sheet and profits of commercial banks are expected to remain healthy. With the banking sector acting as an enabler and facilitating growth in the real sector, delivery of bank credit becomes crucial. With abundance of liquidity in the system, it is expected that banks will continue to promote credit towards the growing sectors.

REUTERS/Fahad Shadeed

Analysis: Islamic Banking in Oman 2013

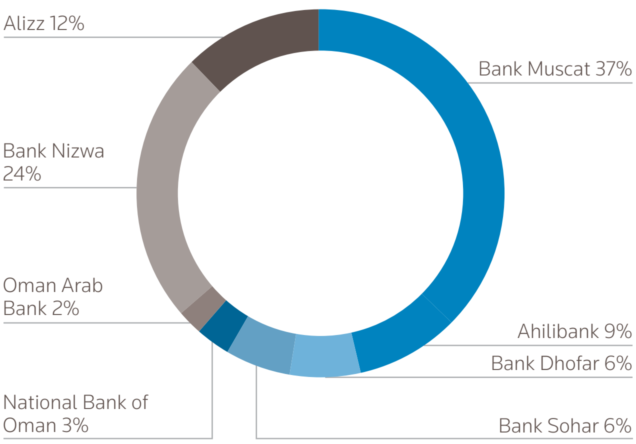
Meethaq is the largest Islamic player with 37% of total assets

The banking system in Oman has embraced Islamic banking with nearly all of the country's banks offering Islamic banking services except HSBC's Omani subsidiary. Pursuant to Royal Decree 69/2012 issued on 6th December 2012, Bank Nizwa was licensed as an Islamic bank and started operations in January 2013 with two branches. It raised OMR 60 million in an initial public offering of 40% of its shares in May 2013.

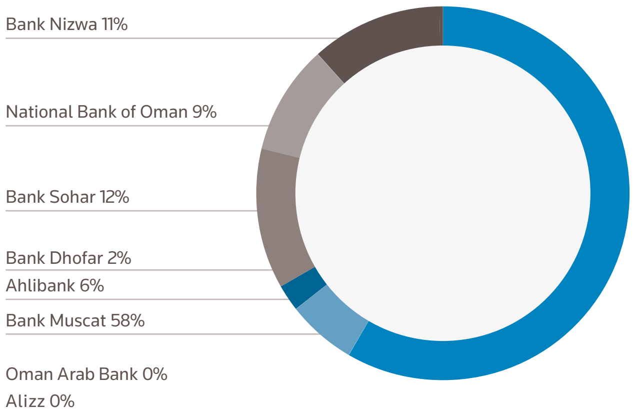
The second standalone Islamic bank, Alizz Islamic Bank, which has 40% capital from public investors and 60% from other promoters, was established with OMR 100 million. Further, four local banks set up Islamic banking windows with nine branches during the first quarter of 2013 (Meethaq, Al Hilal, Maisarah, Sohar Islamic, Muzn and Al Yusr).

Since the launch of Islamic banking services there has been limited quantitative analysis comparing the overall banking system assets with Islamic banking assets, as well as showing the progress of these banks in generating income and becoming profitable.

Islamic banking market share by assets



Islamic Deposits (% of Total)



Source: Oman Observer, bank financial statements and IFG analysis

3.5% of total banking assets is Islamic

Oman's Islamic banking sector reported total assets of OMR 808 million ($2.1 billion) at the end of 2013, which represents 3.5% of total banking assets in Oman. The largest player is Bank Muscat's Meethaq Islamic Banking Service with 37% of total assets, just below its share in the overall banking market. Behind Meethaq are the two standalone Islamic banks Nizwa and Alizz which have 24% and 12% respectively. There has been a significant challenge in deploying assets, most of which are the banks' own capital, not deposits raised from the public.

The remaining conventional banks which provide Islamic banking services have not made as much of an impact in total assets. Ahlibank leads the pack with 9% of Islamic banking assets while Dhofar and Sohar each have 6%. The others — National Bank of Oman and Oman Arab Bank — represent a combined 5% of assets. Many of the conventional banks in Oman view Islamic banking as a potential threat and have set up their Islamic banking services as a defensive strategy.

Deposits rose to OMR 25 million

The same picture is clear in terms of Islamic deposits, except the growth in the standalone Islamic banks has been even slower although both have seen more than 30% growth from the end of 2013 to the end of the first quarter of 2014. Total deposits have risen to OMR 25 million (total Islamic deposits were OMR 170 million at the end of 2013).

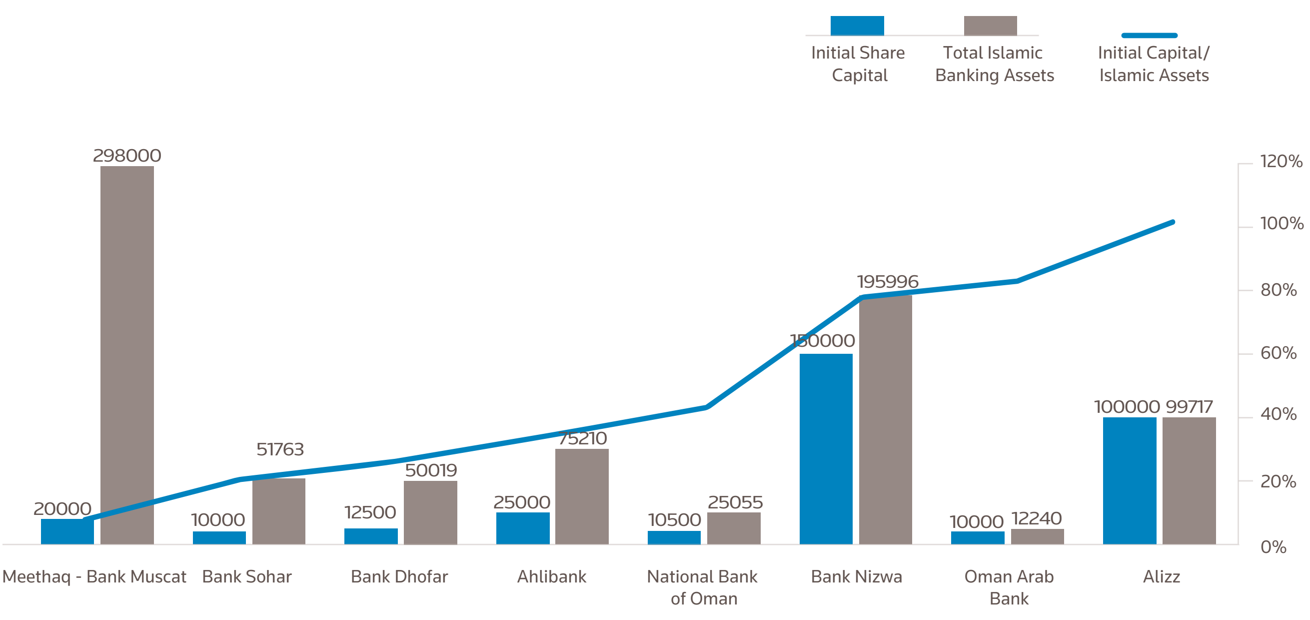
Meethaq - Bank Muscat lower ratio of capital to assets due to existing customers

The development of the Omani Islamic banking sector is explained by measuring the performance of the Islamic banks in the Sultanate by the end of first year of operations i.e. Dec 2013. First, on the right of the chart on this page, the banks with the smallest level of assets in relation to their initial share capital are the standalone Islamic banks (Nizwa and Alizz) and Oman Arab Bank whose Al Yusr service is the smallest in terms of market share in Oman.

In between these and Meethaq - Bank Muscat which had the lowest ratio of capital to assets are most of the conventional banks which have set up Islamic banking services that have expanded their assets, likely largely by their existing customers who are now able to convert their deposits and financing from conventional loans into Islamic financing.

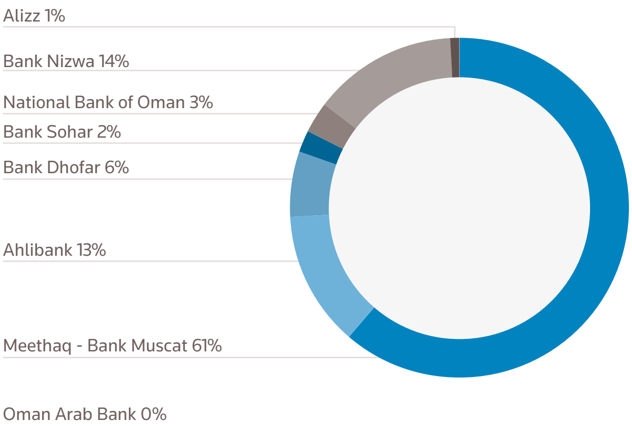
At the other end of the chart is Meethaq - Bank Muscat whose Meethaq service is the largest in the country and also has the advantage of having a portfolio of assets already in existence when the Sultanate allowed Islamic banking (they had been building a portfolio of diminishing musharaka home financing for several years). When the Meethaq service was launched, it had OMR 20 million in capital, which was not even the largest among conventional banks (Ahli Bank started its Al Hilal IBS with OMR 25 million in capital).

Share Capital and Islamic Assets



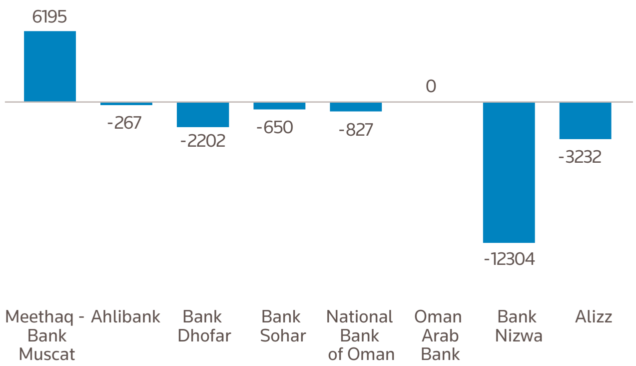
Source: Oman Observer , bank financial statements and IFG analysis

Islamic financings (% of total), as at end 2013



Source: Oman Observer, bank financial statements and IFG analysis

Islamic Banking Profits/(Losses) 2013, OMR



Source: Oman Observer, Bank Financial Statements, IFG Analysis

Undersized financing shares represented by the standalone banks

As expected given the ability of Meethaq - Bank Muscat to originate Islamic financings before the Islamic Banking Regulatory Framework (IBRF) was implemented, it accounts for the vast majority of total Islamic financing assets followed by Ahlibank, which was the second largest conventional bank with an Islamic window in terms of initial capital. Notable in the growth in Islamic financing is how small a share the standalone banks have. However, this is in part due to these banks having started up later than the Islamic banking services. Alizz, the final bank to start operations was able to quadruple its Islamic financings in the first quarter of 2014.

The standalone banks incurred losses on their first year of operation

Looking forward, the challenges for Islamic banking in Oman will be continuing growth in deposits and assets particularly for the standalone Islamic banks. These banks reported the largest losses in 2013, which is not surprising since they could not leverage the existing technology and network that conventional banks had while they set up their Islamic banking services.

The experience of Meethaq - Bank Muscat's service can offer an optimistic hint for the future since it was the only Islamic banking service to be profitable (Sohar Islamic became profitable in the first quarter of 2014). As the Islamic banks in Oman mature, they should also be able to reach profitability, which should give hope for Islamic banking in Oman despite its slower than expected first year.

The Market Leader
Meethaq Islamic Banking - Bank Muscat
Pioneer of Islamic banking in Oman

THE FORMATION:

Bank Muscat, the leading financial services provider in the Sultanate of Oman, has been providing Shari'ah-compliant structured financing solutions since 2008 and therefore is regarded as the pioneer of Islamic banking in Oman. Formally announced on 17th December 2011, Meethaq was established as an independent Islamic banking window to launch Islamic banking operations.

The bank received its Islamic banking license, the third in the market and first in window operations, from the Central Bank of Oman and commenced operations on 13th January 2013. As the pioneer of Islamic banking in Oman, Meethaq stands out for its independent Shari'ah Supervisory Board, separate capital allocation from shareholders' funds, unique risk management tools, complete fund segregation, separate books of account, core banking system which supports Islamic banking operations, standalone Islamic banking branches and proper profit distribution mechanisms among investment account holders/depositors.

Strategic Objectives:

Meethaq is driven to expand the boundaries from a micro scale to a macro level impact. We are passionate to develop as a benchmark financial institution in Islamic finance on a local and regional level.

We are committed to leading the development of an Islamic banking market and working towards an economic system based on the principles of Shari'ah by providing specialised banking services, corporate advisory, Islamic economic solutions; training and awareness creation.

Mission:

"Meethaq will represent the Bank Muscat Standard of Excellence in the delivery of authentic Islamic financial services"

Vision:

"Bank Muscat's Meethaq is committed to make Islamic banking the first choice for all stakeholders by introducing most trusted and innovative Islamic products in the Sultanate of Oman"

Core Values:

Meethaq has based its core values on a three-word relationship with customers:

" Meethaq Shari' ah-compliant services denoted by Transparency. Meethaq premium quality services to develop a relationship of Trust. Meethaq of Partnership in mutual growth and risk"

TRANSFORMING IDEA INTO REALITY:

(Message from Sulaiman Al Harthy, Group GM — Meethaq Islamic Banking)

Meethaq, the pioneer of Islamic banking in Oman, reaches out to customers with the promise of being true to their beliefs, principles and values. Customer satisfaction in terms of quality of service and purity of transaction is considered supreme. Meethaq plays a key role in the economic development of Oman and abides by high standards of service, giving customers the freedom to realise their business and personal goals.

Meethaq products and services have been exclusively developed to satisfy the banking needs of customers.

SHARI'AH COMPLIANCE & AUTHENTICITY:

Shari'ah compliance is the core value which defines the very existence of Meethaq. Since its very inception, Meethaq has aimed for absolute and unwavering adherence to the principles of Shari'ah across all branches, business units and operations. With a team of five leading Islamic Shari'ah scholars, most capable and renowned experts in the field of Islamic banking comprising the Shari'ah Board, Meethaq is able to not just deliver a Riba-free banking experience to its customers, but also develop new and innovative banking products that are designed to delight our customers, whilst addressing their needs — all the while staying within the bounds of Shari'ah.

The Shari'ah governance framework of Meethaq is in line with Islamic Banking Regulatory Framework (IBRF) requirements and market best practices. The Shari'ah governance framework of Meethaq includes (i) Shari'ah Supervisory Board (SSB); (ii) Internal Shari'ah reviewer; (iii) Shari'ah compliance unit; and (iv) Shari'ah audit unit. The Framework also spells out the charter of the Shari'ah Supervisory Board which includes approval of standard agreements and contracts pertaining to the bank's financial transactions, providing Shari'ah opinion regarding the products introduced by the bank and issues fatwas on the questions and transactions, extending enlightenment and guidance to employees and prepare training programs for them related to Islamic financial transactions to assist them in achieving consistency with Shari'ah rules, exercise its right to check and review the bank ledger, accounts and documents at any time and ask for any additional information that might be necessary to be obtained, and to examine the bank assets and liability.

An Internal Shari'ah Reviewer (reporting independently to the SSB) heads the Shari'ah Compliance Unit (SCU) and Shari'ah Audit Unit (SAU) which facilitate the management in ensuring compliance with Shari'ah (as manifested by the guidelines and Fatwa issued by the SSB) and Islamic banking stipulations of the Central Bank on a day to day basis in all its business activities, operations and transactions. This is achieved through review and approval of the contracts, agreements, policies, procedures, products, process flows, transactions, and reports (profit distribution calculations). Meethaq is committed to maintaining a control conscious environment throughout its operations in order to ensure that the operations of the Islamic Banking Window are conducted in a Shari'ah-compliant and controlled manner. It has established policies and procedures so that Islamic Banking Window assets are kept separate and distinct from conventional assets.

As the pioneer of Islamic banking in Oman, Meethaq stands out for its independent Shari'ah Supervisory Board, separate capital allocation from shareholders' money, unique risk management tools, complete fund segregation, separate books of account, core banking system which supports Islamic banking operations, standalone Islamic banking branches and proper profit distribution mechanism among investment account holders/depositors.

New business initiatives and products are approved by the management taking into account the relevant risks and benefit factors, Shari'ah compliance and internal control requirements before any new service/product marketing initiative is commenced; and documents are properly controlled and retained in accordance with established policies and procedures and in line with IBRF requirements. Meethaq has a strong Shari'ah compliance set-up that comprises a dedicated Product Development and Shari'ah Compliance Department. The bank is well-recognized for its product development capability, Islamic banking research, and advisory services, at both national and international levels. The Management ensures Shari'ah compliance by adhering to Shari'ah guidelines as stipulated and interpreted by the Shari'ah Supervisory Board, guidelines issued by the Central Bank of Oman (CBO); and Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) standard on Accounting and Shari'ah Compliance.

BUSINESS AND OPERATIONS REVIEW:

Meethaq delivers products and services to meet all financial needs of customers by ensuring true Partnership, Transparency and Trust. Meethaq has taken the lead in launching a suite of banking products which combine traditional values with modernity. The Meethaq strategy is to attract customers through innovative Shari'ah-based products and services. The operations are managed by an experienced team, separate from conventional banking.

Meethaq offers a wide range of deposit products — current, saving and term deposit accounts — all

RETAIL BANKING

Meethaq retail banking offers a broad range of services

DEPOSITS AND INVESTMENT	FINANCINGS	CARDS	BANCATAKAFUL
• Current Account • Savings Account • Children Saving Account • Investment Term Deposit	• Home Finance • Auto Finance • Soyoula Personal Finance	• Debit Card • Credit Card	• Family Linked Plan • Health Plan • Vehicle & Housing Plan

CHANNELS	CORPORATE	INVESTMENTS	TREASURY

BRANCHES
• Meethaq has developed a network of branches spread across Oman.
 	
ONLINE BANKING
• Internet banking gives the convenience and freedom to do banking anytime, anywhere.
 	
ATM
• Meethaq's ever increasing network of ATMs provides "easy to use" options.
 	
CALL CENTER
• Facilitates banking services over the phone from anywhere, anytime with user-friendly automated service menu.
 	
MOBILE BANKING
• Meethaq mobile app can be downloaded from Apple/ Android store.
	Meethaq Corporate Banking provides comprehensive, competitive and innovative Shari'ah-compliant financial solutions.
	
	WORKING CAPITAL FINANCE
	• The most commonly used product for providing working capital financing is Murabahah. Murabahah is a type of cost plus sale under which the seller dis-closes the cost to the buyer and adds a profit margin to the original cost.
	
	PROJECT FINANCE
	• Ijarah Financing
	• Diminishing Musharakah
	
	TRADE FINANCE
	• Bank Guarantee
	• Letter of Credit
		Meethaq offers a full suite of Shari'ah-compliant investment banking services thereby providing end to end solutions based on specific requirements of clients.
		
		CORPORATE FINANCE & ADVISORY
		• Syndicated Islamic Financing
		• Sukuk Issuance (Islamic Capital Markets)
		• Private Equity Placement
		• Equity IPO
		
		PROJECT FINANCE
		• Meethaq provides long-term non-recourse and limited recourse Islamic project finance and advisory for green field and brown field projects
		
		ASSET MANAGEMENT
		• Meethaq intends to launch Shari'ah-compliant alternative asset class funds in the near future, including:
		  • Real Estate Funds
		  • Asset Leasing Funds
			Meethaq treasury is driven by faith, commitment to serve and unrelenting Omani spirit to preserve and enhance the image of Meethaq and Bank Muscat.
			
			Treasury is involved in Forex, liquidity, reserve and ALM management. Meethaq plans to offer full service Treasury products for customers and also deal in the inter-bank market as an active player.
			
			Meethaq has a full suite of Shari'ah-compliant products for serving the needs of customers in Foreign Exchange for outward and inward remit-tances as well as hedging products for their FX commitments with flexibility, convenience and competitive pricing. In the money market it will be dealing in Wakalah, Mudarabah, and Musharakah in inter-bank RO market and primarily in USD in the regional markets .

designed with flexible features to meet the needs of its customers in a Shari'ah-compliant manner. Meethaq is expanding its geographic outreach and planning to add nine (2013: six branches) new state-of-the-art branches taking the total size of the network to 15 dedicated branches spread across all cities in Oman. Continuous expansion of the network has enabled the bank to serve customers from all walks of life, commensurate with Meethaq's vision.

Today, in the quest to earn customer satisfaction, Meethaq plays a leading role in developing competitive and innovative Shari'ah-compliant financial products and services

MEETHAQ SIGNATURE BRANCHES:

Five exclusive Meethaq branches were opened in 2013 as part of the bank's focus to redefine Islamic banking operations in Oman and thereby offer world-class Islamic banking experience to customers. One of the key objectives of Meethaq is to have its footprint strategically placed throughout the country, enabling the public to avail the benefits of Shari'ah-compliant banking in their neighborhood.

The bank is well positioned to leverage on its large network of branches and other delivery channels to target the growth potential and cross-sell opportunities. The bank is also set to leverage on investments in new technology and state-of-the-art head office building to further increase efficiency, improve customer service and support growth plan.

- World-class customer service environment
- Hotel lobby structure
- Free Wi-Fi facility
- Video Conferencing facility
- Meethaq Smart 24/7
- Virtual Assistant
- Internet Kiosk
- RFID function
- Multi Touch Screen
- Video Call Kiosk
- Interactive ATMs/ CDMs
- Financial Theatre

TECHNOLOGY:

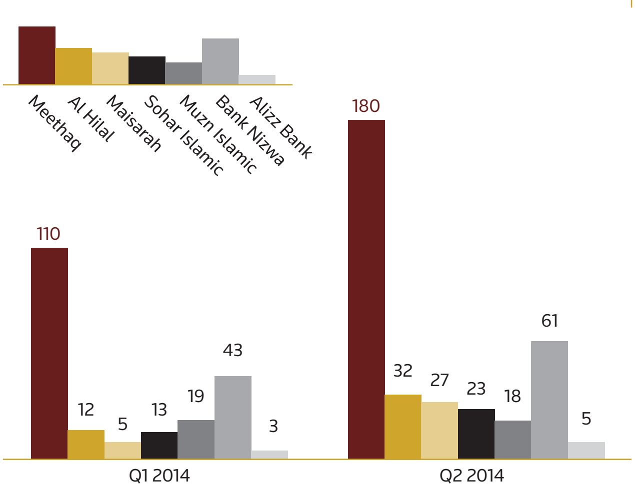
The bank is also set to leverage on investments in new technology and state-of-the-art head office building to further increase efficiency, improve customer service and support growth plan. Meethaq opted for iMal Islamic core banking solution incorporating the latest technology, ideally built to meet the bank's requirements of Shari'ah compliance, cutting costs, improving profitability, servicing customers faster and smoothening processes. The implementation of iMal stems from Meethaq's commitment and focus to take the lead role in offering a suite of Shari'ah-based banking products and services which combine traditional values with modernity and ensure the choice of staying true to one's values. Meethaq has adopted the best practices in Islamic banking and finance worldwide to combine a robust model which protects customers and complements the Islamic banking industry. Meethaq Mobile banking & Cloud application redefines Islamic banking with the concept of '24/7 anytime, anywhere' service offering a wide range of unique features.

FINANCIAL PERFORMACE:

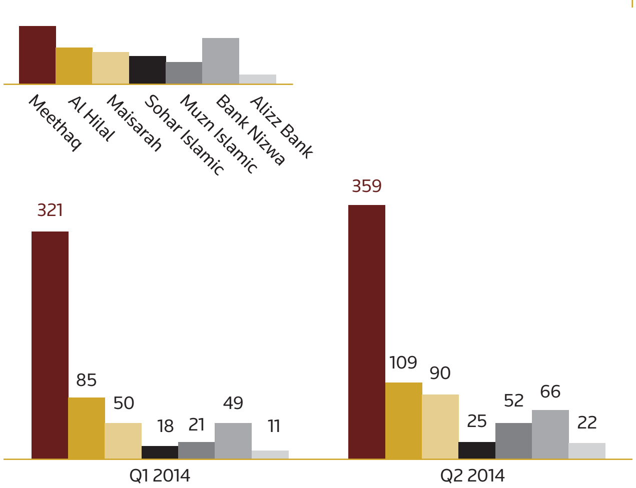
Meethaq (with a capital of OMR 20 million) has been very quick to grow its balance sheet to leverage over 10x against the overall industry norm of 8x leverage. Interestingly, this steep growth is primarily attributed to its inherited musharakah (retail housing) portfolio amounting to OMR 168 million which has grown to a level of OMR 280.66 million as of December 2013. The asset side is dominated by this long-term musharakah portfolio. On the other hand, the unusual growth in deposits on the balance sheet is mainly comprised of deposits from banks and financial institutions which contributed OMR 134 million whereas the remaining OMR 66 million have been driven from the government sector.

The balance sheet structure makes it a difficult situation for the asset-liability maturity profile to manage, wherein 65% of assets are over five years' maturity, which is funded by very low maturity deposits. This leads to asset/liability mismatches. However, supported by the

Deposits



Gross Financing



experience and expertise of Meethaq's parent bank, which enjoys the highest banking penetration in Oman with over 38% of market share, Meethaq is confident of rectifying the situation. Moreover, the high yield (6.3%) of the retail musharakah assets keeps it affordable for the bank to manage its liquidity through interbank markets wherein it can engage relatively low cost liquidity, while keeping its spreads intact.

The uniqueness of Meethaq doesn't end here; when faced with these changing risks the bank unveiled another strategy. Instead of going for an aggressive deposit mobilization to rationalize its deposit mix, the bank opted for an altogether distinctive route. In an Extraordinary Board meeting in March 2014, the Board announced the setup of an OMR 500 million sukuk programme for Meethaq. This can be viewed as an innovative business model, where instead of maintaining saving and term deposit accounts a flexible sukuk structure was opted to fund its assets. However, Meethaq has not lost sight of its core banking business lines. The bank intends to expand its branch network to 15 branches to ensure its outreach to a broader consumer base.

In a short span of one-and-a-half years Meethaq has achieved credible performance:

- A total of nine state-of-the-art branches (2013: six branches) throughout the Sultanate
- Meethaq ended first half of 2014 with an average return on equity of 27.8% (2013: 26.8%)
- Presently, Meethaq has more than 14,000 customers with current accounts amounting to RO 17.589 million (2013: RO 4.54 million), Saving accounts RO 23.174 million (2013: RO 10.35 million) and term deposits RO 139.048 million (2013: RO 78.545 Mn), reflecting a total deposit mobilization of RO 179.811 million
- Gross financing book reached RO 360 million (2013: RO 284 million) with Corporate portfolio at RO 99 million (2013: 74 Mn) and retail at RO 260 million (2013: RO 210 million)
- Total assets reached RO 380 million (2013: RO 298.3 million) with return on assets at 2.1%
- Meethaq's capital adequacy ratio in the first half 2014 stood at 13.03% (2013: 15.3%) compared to the regulatory requirement of 12%

CORPORATE SOCIAL RESPONSIBILTY:

Meethaq's unique mission is not restricted to organizational success. It stretches and encircles the collective growth at macroeconomic and social level. Once again, against the odds Meethaq formed an independent CSR team with a proactive approach towards taking initiatives to serve society. Meethaq has developed a comprehensive Code of Business Ethics and

Conduct which serves as a guiding framework for Meethaq with respect to its responsibilities towards the community.

"Corporate Social Responsibility is at the heart of our business and we believe that giving back to the community and this country is just as important as our Core Brand Values" — Meethaq

Meethaq has established a position in CSR called Meethaq Akhlaq (ethics) in the Sultanate with impactful projects that stand out for its core values.

- Supporting social and humanitarian activities, events and charitable programmes aimed at serving local communities. The bank works in close cooperation with Government establishments, social and voluntary associations to achieve this.

- Adopting policies aimed at sustainable development, the bank acknowledges that its activities should promote sustainable development benefiting society and the environment.

- Encouraging the bank employees to undertake voluntary social activities benefiting society.

- Developing a world-class work environment with Human Resources policies that create a healthy work environment and culture.

- The CSR strategy focuses on the following elements: Close alignment with the bank's vision and values. Identifying strategic areas for social development support. Promoting sustainable development programmes. Developing unique social programmes with Bank Muscat identity as well as in collaboration with government institutions.

Going forward, Meethaq strives to develop unique CSR activities, independently and in collaboration with other organizations, to ensure sustainability and value addition to society.

ACHIEVEMENTS & MILESTONES:

Awards

- "Best in Oman" award by Islamic Banking News – Dubai
- "Pioneer of Islamic Banking in the Sultanate" award by Global Islamic Finance
- "Outstanding Achievement" award by Capital Market Authority
- Reading campaigns
- Food recycling
- Support for home businesses
- Social Entrepreneurship
- Educational workshops
- Children's financial education
- Ethical business seminar
- Entrepreneurship

Operational Achievements

- A highly reputed and recognised Shari'ah Supervisory Board
- 50% market share in Gross Financing to total Islamic banking market in Oman as at June 2014
- Financing portfolio achieved RO 360 million (USD 935 million) milestone in June 2014, another first in the industry in Oman
- Launched Oman's first Shari'ah-based credit card in September 2013
- Well-distributed network of branches

Focus: Islamic banking in Oman up to June 2014

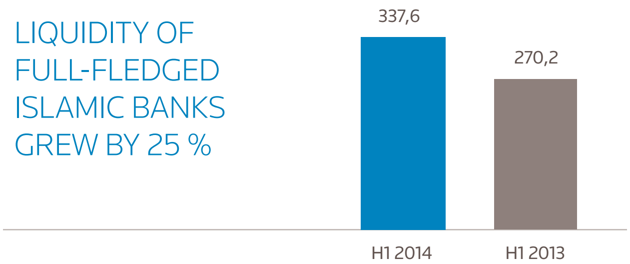
Islamic banking windows buoyant and Islamic banks recover in June 2014

In June 2014, Oman's Islamic banking sector continued to show growth momentum in assets with increases in financing and deposits. The continued growth is mainly supported by Islamic windows of strong conventional banks in the Sultanate. Net revenues generated by Islamic banks grew by 147% to reach OMR 16.6 million in June 2014, compared to OMR 6.7 million in June 2013.

Islamic banks overview (H1 2013 to H1 2014)

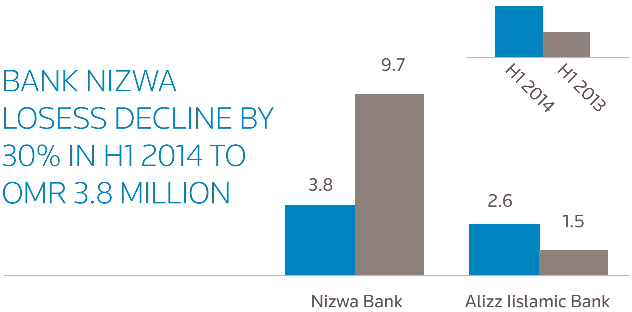
Total Assets by Nizwa and Alizz islamic Bank, in OMR million

LIQUIDITY OF FULL-FLEDGED ISLAMIC BANKS GREW BY 25 %

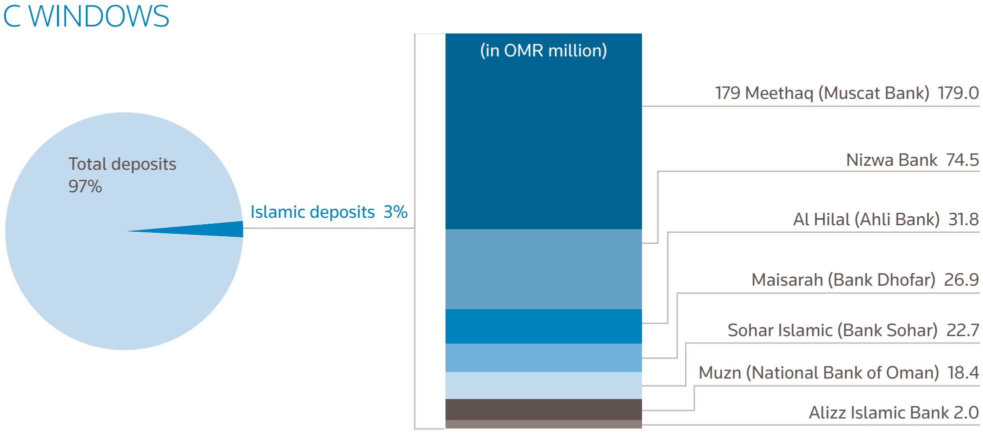


Earnings in negative, in OMR million

BANK NIZWA LOSESS DECLINE BY 30% IN H1 2014 TO OMR 3.8 MILLION



DEPOSITS WITH ISLAMIC WINDOWS GREW BY 74.6%



TOTAL ASSETS

4.4% of total banking assets

OMR 125.2 million out of which OMR 88.7 million net finance and OMR 10.2 million investment in sukuk

TOTAL FINANCINGS

Up by 140.2% to reach OMR 624.7 million

NET REVENUES

Increased by 100% to reach OMR 12.4 million

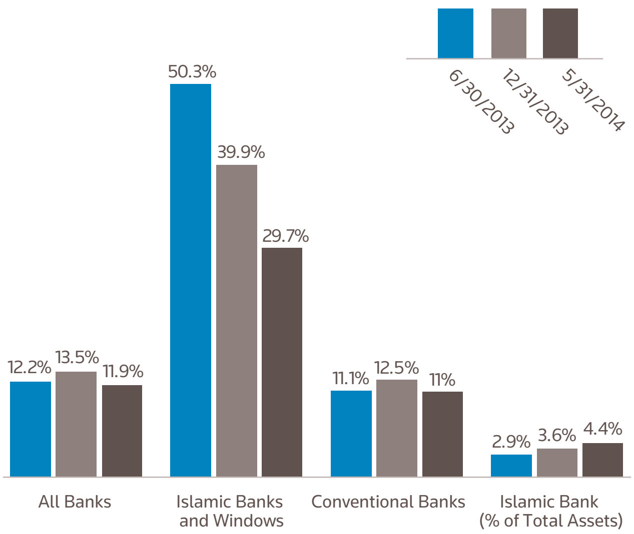
Source: Muscat Daily news article published on Aug 09, 2014.

Analysis: Oman Islamic banks growing assets faster than deposits[4]

When Islamic banking became available in Oman at the beginning of 2013, the growth in assets was concentrated at Islamic windows of conventional banks. Standalone Bank Nizwa and Alizz Islamic Bank, which recently completed Initial Public Offerings on the Muscat Securities Market, were still in the process of launching and lagged without the established internal systems that the windows could leverage from their conventional parents. In total two standalone Islamic banks with a combined OMR 250 million paid-in capital began operations alongside the Islamic banking service of six conventional banks which allocated OMR 89 million in capital.

After the initial burst, growth subsided but only temporarily and by the end of June 2014, total Islamic banking assets reached OMR 1.07 billion, which is 4.4% of Oman's total banking system assets, compared with just 2.9% of assets at the same time a year earlier. With Oman 's banks holding capital on average of 12.5% of total assets, the country's Islamic banks and windows could grow to reach OMR 2.5 billion, a 140% increase from current levels.

Capital Ratios and Islamic Banking Asset Share



Source: Central Bank of Oman, Bank Financial Statements and IFG analysis

More liquid, assets grew faster than deposits

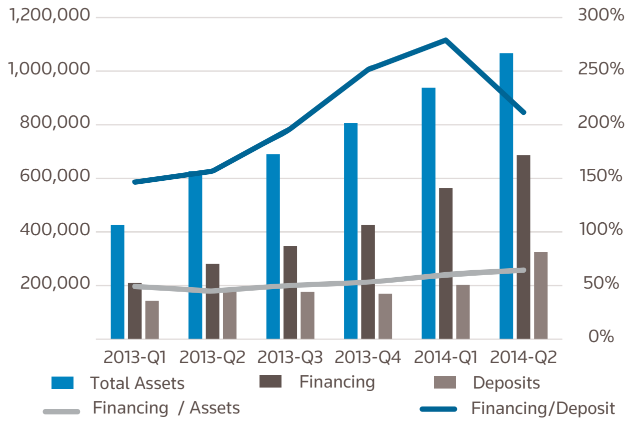
This means that Islamic banks are far more liquid than conventional banks, which has led to many struggling to become profitable even with relatively few deposits that would take a share of the profits being generated from their assets. The experience to date conflicts with my prediction that deposits would grow more rapidly than assets on the grounds that providing financing takes more time due to the necessary credit approvals whereas a bank deposit account can be opened more quickly.

Part of the divergence was the OMR 188 million in home financing assets which Meethaq IBS began with which were originated prior to the official launch of Islamic banking in Oman. However, even excluding these, banks grew assets more rapidly than deposits, in part reflecting the need to find income-earning assets, rather than more deposits, to meet expectations of depositors and shareholders.

There is also something probably reflected in the wait-and-see attitude found in survey results of Omanis who want to use Islamic banks, but only after they see them become established and able to offer comparable products. The first movers were people who moved from conventional accounts to Islamic windows on the deposit side and people who had previously avoided taking interest-based loans. At the end of March 2013, conventional banks dominated deposits, holding 92% of the total. This share has eroded ever since, reaching a low of 77% in the first quarter of 2014 before rising to 80% on the back of a surge of deposits into all types of Islamic banking institutions.

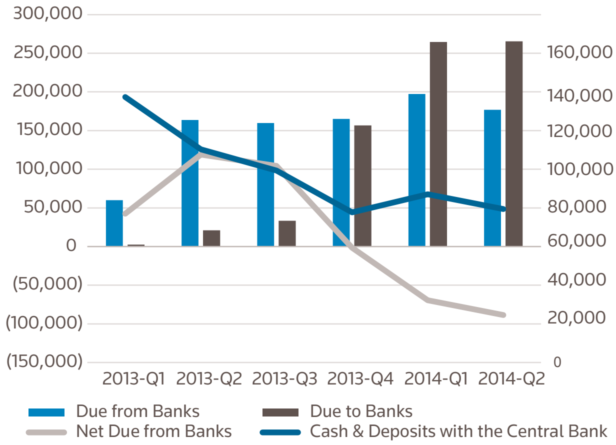
4 *This analysis was written by IFG's Blake Goud and first published in IFG Weekly Issue #96, Sunday, Aug 18, 2014*

Omani Islamic banking balance sheet trends



Source: Bank financial statements and IFG analysis

Liquidity Management Position OMR '000



Source: Bank financial statements, IFG estimates and IFG analysis

Focus on interbank financing markets

The difference between then and now is that there are much more yielding assets on the still-liquid balance sheets which reduces the search-for-yield pressure and is now leading to more of a search for financing sources, particularly at the Islamic windows with relatively limited capital. As a result, they have turned to interbank financing markets leading to a dramatic decline in the slack in the interbank liquidity market.

Before discussing the interbank financing markets, a few notes are in order. First, since most Islamic banking services in Oman don't provide complete balance sheets separate from their conventional banking except in their annual reports, the data presented are estimated based on other available data about total assets, Islamic financing, Islamic deposits and the equity and retained earnings of the Islamic banking subsidiaries which are not presented in exactly the same way (or to the same level of detail) in each bank.

Net interbank position from surplus to deficit

Despite the caveats about the consistency of data across the banks, the trend is clear. During the first three quarters when Islamic banks operated in Oman, the net position in the interbank markets was one of considerable surplus, peaking at the end of June with OMR 142.6 million in net interbank assets. After this date, which coincided with the beginning of the first interbank wakala transactions between Omani banks, the net position became a deficit of OMR 88.6 million, a swing of OMR 231.2 million. Prior to this development, the Central Bank of Oman extended the relaxation of Islamic banks foreign placements of surplus assets for a year to April 2014.

The shift in the liquidity situation and the swing from surplus to deficit is not necessarily cause to celebrate the end of banks needing to look abroad for places to invest their assets for short-term returns. Despite the net interbank asset position shifting from surplus to deficit, Islamic banks in Oman are still much more liquid than their conventional counterparts and it is likely that some of the surplus capital will go outside of Oman seeking higher returns than it could find in Oman. Any continued flow of funds towards non-Omani Islamic banks within the GCC should, all else being equal, raise the interbank rates in Oman closer towards the regional average, although there is limited data to quantify the gap between the two rates.

David Steele / Shutterstock.com

As a result, Islamic windows where financing is growing the fastest relative to the growth in deposits may still have trouble getting interbank funding in the market at an acceptable rate for an acceptable amount. Hence, some Islamic windows which need new external funds for their asset growth will look towards their parent banks, something which the Islamic Banking Regulatory Framework allows. (Islamic Banking Regulatory Framework, Title 9, Section 1.2.10 and 1.2.9. The flow from the parent to the window, however, can only be one way. Conventional parent banks can place funds with Islamic windows using sharia-compliant contracts while the windows and standalone banks cannot place funds with any conventional banks.)

This additional funding will help them continue to grow towards their optimal level of assets for the capital they hold. If this occurs, they should eventually able to shift away from dependence on interbank markets and towards deposits which are typically less expensive and more stable.

That means that the liquidity management system in Oman will remain somewhat idiosyncratic with different players being able to provide financing or receive funding through interbank markets (domestic and foreign). The limited instruments available will not only hinder the development of an Islamic banking sector that can cater to consumers who are more price sensitive but will create more liquidity risk in the Islamic banking sector which ultimately can only be dealt with through the backstop of lender of last resort funding from the central bank.

DEVELOPMENT OF REGULATIONS

Regulatory Framework

The arrival of Islamic banking in Oman added a new dimension to the country's financial services landscape. The Central Bank of Oman has been at the forefront of developing Islamic banking regulations, in collaboration with industry experts in the country.

COVERAGE & TRANSACTIONAL BASE:
The Islamic banking law as published by the Central Bank of Oman applies to domestic Islamic banks, Islamic banking branches of foreign banks, and Islamic banking windows of local conventional banks.

All Islamic financial institutions are authorised to accept and manage deposits and manage restricted and unrestricted investment accounts (RIAs and URIAs). For Islamic banking products, the law grants the approval of financing and investing in most products including mudaraba, musharaka, diminishing musharaka, murabaha, musawama, salam, istisna, ijara and other sharia-compliant contracts with the notable exception of commodity murabaha or tawarruq.

By law, Islamic windows are mandated to allocate a capital of not less than OMR 10 million, in addition to the requirement of the parent licensed bank.

Separation of Islamic and conventional funds and products is mandatory. Islamic windows and foreign banks must operate through separate Islamic banking branches and Islamic banking products and services cannot be offered through conventional branches.

LICENSING & CAPITAL REQUIREMENTS:
Domestic Islamic banks must be listed as joint stock companies on the stock exchange while maintaining a paid-in capital of not less than OMR 100 million.

The branches of foreign banks are regulated based on Omani rules in addition to regulations of the home country to the extent of compliance with Basel III core principles. Foreign banks within the Sultanate are mandated to maintain a paid-in-capital of not less than OMR 20 million, and allocate OMR 10 million over and above the required OMR 20 million to open an Islamic finance branch.

Oman's Oil Minister Mohammad bin Hamad bin Saif al-Rumhi attends during the opening session of the first Gas Exporting Countries Forum (GECF) summit in Doha November 15, 2011. REUTERS/Mohammed Dabbous

EXPERT COMMENTARY

Sohaib Umar

AN OVERVIEW OF THE ISLAMIC BANKING REGULATORY FRAMEWORK IN OMAN

By Sohaib Umar, Central Bank of Bahrain

This contribution was prepared based on the author's previous role with Ernst & Young's Islamic Financial Services team, and as the lead consultant in drafting the Islamic Banking Regulatory Framework in Oman. This contribution does not reflect the views of the Central Bank of Bahrain or its employees.

While Oman's Islamic Banking Regulatory Framework (IBRF) has generally been regarded by other regulators and market players as a comprehensive effort, some criticise it as being too prescriptive. Since a prescriptive regulatory framework does not give much leeway to market participants it is no surprise that banks and financial institutions do not prefer such an approach. They argue that a light-touch framework is better for innovation and market growth.

The global financial crisis of 2007/8 has decisively addressed this issue. It became clear in the aftermath of the crisis that the light-touch regulatory model, which was the preferred choice almost globally before the crisis, was no longer functional.

Regulators around the world intervened heavily in the markets in a manner that was unprecedented. Today, after more than six years, it is a general consensus among central banks that financial markets need to be tightly regulated and monitored in order to ensure smooth functioning.

Perhaps the best demonstration of this changed reality is in the testimony of Alan Greenspan, former Chairman of US Federal Reserve for nearly 20 years between 1987 and 2006. On October 23, 2008 he told the U.S. Congress that in his view the global financial crisis unveiled a flaw of world markets. The Republican Henry Waxman asked Mr. Greenspan: "In other words, you found that your view of the world, your ideology, was not right, it was not working?" to which Mr. Greenspan replied, "That is — precisely. No, that's precisely the reason I was shocked, because I had been going for 40 years or more with very considerable evidence that it was working exceptionally well."[5]

In short, the light-touch regulatory model based on the self-regulation mantra is dead and buried in today's world. There is only one regulatory model that exists today — the prescriptive one. We don't know if the light-touch model will ever come back in fashion or whether the world would forget the lessons of the global financial crisis, but as of now, this does not seem likely.

Having established the effectiveness of a prescriptive regime, the next question is: should Islamic banking be subjected to a more or less prescriptive framework? The answer is rather obvious. Islamic banking is faith-based and relies heavily on the general public's trust on the sharia authenticity of Islamic banks. If there is a reasonable doubt cast on the sharia-compliance of these banks the reputational damage would be severe for the entire Islamic banking industry. Hence, if anything, Islamic banks should be more tightly governed than their conventional counterparts, not less.

5 http://www.pbs.org/newshour/bb/business-july-dec08-crisishearing_10-23/

It is therefore in the fitness of things that Oman's IBRF places extraordinary emphasis on sharia governance and puts in place a comprehensive framework in this regard. Oman was the last country in the GCC to open up to Islamic banking which gave it the added advantage of learning from other countries' experiences and avoiding their mistakes. It could cherry pick the best practices of the Islamic banking industry from around the globe. Further, Oman added a few unique measures of its own and which were introduced for the first time anywhere in the world.

Two other factors seem to have influenced the shaping of the IBRF. First, Oman does not position itself as an offshore jurisdiction and the primary focus of its regulations is its own population. Second, local Omanis are highly religious, as anecdotal evidence suggests, and therefore cautious in financial dealings when it comes to faith. The Central Bank of Oman is therefore very sensitive about consumer protection and general public perception. Some of the measures taken in the IBRF appear to be a result of these factors.

The following is a summary of the key features of Oman's IBRF concerning sharia governance.

Sharia Supervisory Board (SSB)

- SSB members will be appointed for a maximum of two three-year terms, after which there has to be a 'cooling off' period (of at least one term/three years) before they can be appointed again on the same SSB. This has been proposed in order to enhance the level of independence of SSB members and to avoid any complacency that may set in after being a sharia board member of an institution for too long.

- No sharia scholar can sit on the sharia boards of two competing institutions.

- All fatawa issued by a bank's sharia board have to be disclosed along with their religious reasoning in the annual report (much like how AAOIFI's sharia standards are disclosed). This is meant to enhance transparency and facilitate peer review.

- Remuneration of SSB members, approved by the shareholders, has to be disclosed in the annual report.

- Annual performance assessment of the SSB will be conducted in line with the template provided in IFSB guidelines. Among other matters, it will monitor and document the attendance of SSB members in sharia board meetings.

- The internal sharia reviewer will be a sharia scholar with at least a bachelor's degree in sharia from a recognised institution with specialisation in Fiqh Muamalat. This scholar will be a full time employee of the bank, heading the sharia compliance and sharia audit units, and report to the SSB.

- Independent sharia audit is compulsory (since Oman's announcement, Pakistan has also made it mandatory while Bahrain is contemplating a similar move).

Islamic Windows

- Islamic windows follow a "bank within a bank" model in order to avoid any commingling of funds and to avoid any confusion in the minds of customers. This means that windows should not only operate independently (within the prescribed limits) but should also be seen as distinct from their conventional parent in the eyes of customers and the general public.

- Islamic windows have to separately allocate / set aside capital for Islamic banking operations in an irreversible transaction. These funds are to be deposited with the Central Bank in a special account.

- Windows have to operate through dedicated separate branches — no counters are allowed in conventional branches (in order to avoid brand confusion and maintain independence in customers' minds).

- Business origination can only be from Islamic branches. However, servicing (depositing of a cheque or withdrawal of cash, etc.) can be done by a customer using the conventional branches of parent banks.

- No bank employee can sell both conventional and Islamic products, whether retail or corporate (in order to avoid mis-selling as commonly found in other markets).

- A window can obtain liquidity from its parent in a sharia-compliant structure but cannot pass on liquidity to its parent or a conventional bank under any structure (or it would be a disservice to the Islamic banking customers who trusted their moneys with Islamic banks only to see it being passed on to conventional banks).

Others

- Banks should ensure a robust core banking and IT system which recognises the unique aspects of Islamic contracts. A third party certification of this Islamic module within three years is a must.

- Commodity murabaha / tawarruq is prohibited both on the asset and the liability side (except for rare emergency situations). This is a revolutionary measure taken to protect the sharia authenticity of Oman's Islamic banking sector (the OIC Fiqh Academy prohibited Organised Tawarruq and declared it Haram in its Fatwa issued in April 2009).

- Training of staff including everyone from top management to frontline staff is a must. An annual training program has to be prepared by HR and shared with the Central Bank at the start of each year.

The IBRF was issued on December 18, 2012, and hence 2013 was the first full year of Islamic banking operations in Oman. Given that the prescriptive framework required considerable investment, time and effort from Islamic banking players (separate branches, separate and properly trained employees, limited avenues for liquidity management, etc.) one year may be too short a period to judge the success or otherwise of Islamic banking in Oman. Even so, the early signs are encouraging.

Islamic banking assets — at $2.1 billion as at Dec 31, 2013 — account for 3.5% market share of total banking assets in Oman. Admittedly, not all the assets have been put to good use as yet and gross financing amount is significantly lower at an estimated $1.2 billion, but growing. What is more important is the growth witnessed in 1Q 2014.

If we zoom in on the three largest players in the Omani Islamic banking market — namely Bank Muscat (Meethaq), Ahli Bank (Al Hilal) and Bank Nizwa — which accounted for 84% of total industry gross financing in 2013, we will get a good sense of the industry's performance. The aggregate gross financing at these banks/windows grew 24% quarter on quarter from $ 1 billion to $1.26 billion as of 31 March 2014. This is the highest growth recorded for any quarter so far since the introduction of Islamic banking in Oman. If this trajectory is maintained for the rest of the year, we may see the gross financing amount doubling for the industry by the end of 2014.

If Oman achieves high growth in 2014 and beyond does it necessarily mean that we can declare success? In the opinion of this author success needs to be redefined for Islamic banking. There are two aspects of success when it comes to a faith-based industry. Firstly, the same benchmarks that conventional banking is measured against can be used to assess the performance of Islamic banking (e.g. assets, growth, branches, deposits, etc.). But secondly, and more importantly, Islamic banking needs to be fully sharia-compliant and be seen as such in the perception of customers, the general public and other stakeholders. If this is diluted, it will dent the success of Islamic banks no matter what growth numbers are achieved.

The foundations of Islamic banking have been laid down by the Central Bank of Oman in a solid and well thought out manner, as evidenced by the IBRF. But regulations alone, however well-written, cannot guarantee the success and prosperity of an industry if its leadership is unable or unwilling to commit to a high level of competence, integrity and professionalism.

Going forward, the success or otherwise of Islamic banking in Oman will be determined primarily by the quality of human resources leading the Islamic banks/windows and the extent to which the Central Bank of Oman is able to ensure adherence by the industry to IBRF in letter and spirit through active onsite and offsite supervision.

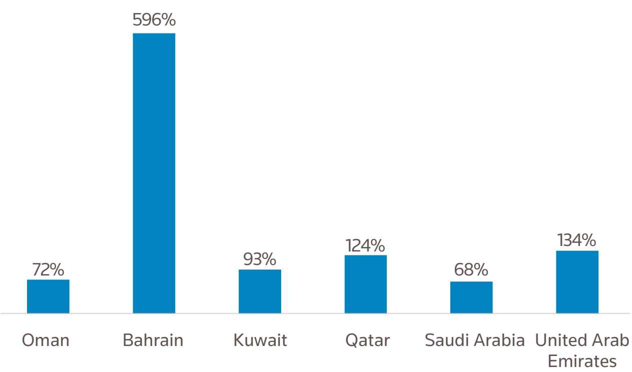
Admittedly, the Islamic banking industry globally has not been able to demonstrate quality leadership equaling or surpassing its conventional peers. Is the leadership in Oman's Islamic banks able and willing to take up this challenge? With ample customer demand, a solid regulatory framework in place, a growing economy and healthy (but not cut-throat) competition, there is no excuse for non-performance. The world is watching.

Sohaib Umar
Advisor, Islamic Financial Services Development
Central Bank of Bahrain

Sohaib Umar works at the Central Bank of Bahrain as Advisor, Islamic Financial Services Development. Prior to joining the CBB, Mr. Umar was part of Ernst & Young's Islamic Financial Services team, and the lead consultant in drafting the Islamic Banking Regulatory Framework in Oman. Mr. Umar has over 20 years of experience in banking and capital markets and has worked in Asia and the Middle East in senior executive roles. At EY he delivered projects related to enterprise risk management, corporate governance, conversion of a conventional bank into Islamic, and business strategy review.

CHALLENGES & OPPORTUNITIES

GCC Banking Penetration in 2013



Data source: World Bank, Central Bank of Oman

Islamic banking in Oman will transform the economy

Given the infancy of Islamic banking in Oman and its low level of penetration compared to other GCC countries, Islamic banks should take advantage of growth opportunities to contribute more to the country's GDP. The financial inclusion index in Oman shows an overall low level of banking penetration. This is the chance for Islamic windows and standalone Islamic banks to contribute more to GDP by introducing new products in line with customer's needs in order to retain existing customers and attract new ones. Oman's banks should invest in mobilising new distribution networks to attract more assets to the banking sector.

Seven key recommendations to ensure organic growth of Islamic finance in Oman

Thomson Reuters, in partnership with Meethaq, held a seminar in March 2014 to assess the state of Oman's Islamic banking sector and map the way forward for the sustainable development of the industry. The seminar was attended by finance professionals as well as representatives from Oman's central bank, Capital Market Authority and Ministry of Finance. Three sessions were convened that concluded with the following recommendations to promote organic growth of Islamic finance in the Sultanate.

- Islamic banks should jointly fund training for staff of Islamic banks and Islamic banking services
- The CBO should develop a 5-year strategic plan for Islamic finance in Oman
- Islamic banks should develop a committee to engage with the CBO on regulatory issues
- Government of Oman should develop regular issuance of sukuk to develop market & fund deficit
- CBO /Government of Oman should develop short-term sukuk for liquidity management
- CBO /CMA should finalise sukuk rules
- CBO should consider whether tawarruq could be allowed under IBRF with restrictions on use to inter-bank liquidity management & with oversight relating to use of proceeds

Click here to read the Meethaq and Thomson Reuters Islamic finance 2014 whitepaper[6]

6 *Meethaq and Thomson Reuters Islamic Finance 2014 white paper URL http://www.zawya.com/story/Islamic_Finance_Gateway_Developing_a_Sustainable_Islamic_Banking_Industry_in_Oman_230314-pdf_130514115635*

Exclusive Interview with Dr.Jamil Jaroudi, Chief Executive Officer, Bank Nizwa

(Interview conducted on May 20, 2014)

How would you describe the current state of Islamic finance in Oman?

Islamic finance formally launched in Oman with the opening of Bank Nizwa in January 2013. It is a new concept in Oman and after 15 months Islamic finance is still in the early stages of development. There has been a very positive response from the public as can be seen from the number of accounts that have been opened. Also, the Islamic banking industry is well positioned with two full-fledged Islamic banks and six conventional banks with Islamic banking windows; in addition there are now two takaful companies, with a possible third coming soon. I think this bodes well for the industry and I am optimistic that with the level of involvement from the regulators and the market players knowledge and awareness will spread and customers will see the benefits of undertaking their financial transactions in a sharia-compliant way.

What do you think the Islamic banking share of Oman's total banking sector will be in the coming three to five years?

Various estimates have been made by different experts. While forecasting the future is fraught with issues, I can, with confidence, say that Islamic banking will prosper in Oman as it is currently growing in other parts of the world, both in Muslim and non-Muslim countries. I think it would be a fairly safe assumption that in the next three to five years, Islamic banking assets would be around 20% of total banking assets in Oman.

How do you evaluate the legal framework that governs Islamic banking? And where do you see gaps (if any) in the framework?

I think the Central Bank of Oman (CBO) has done an excellent job with the very comprehensive regulations which were issued in December 2012, the Islamic Banking Regulatory Framework (IBRF). All the major areas have been covered in the IBRF and the CBO maintains active dialogue with the industry to see where changes might be needed to further align the regulations to facilitate the functioning of Islamic banks. Having said this, if there is one thing which I think needs attention, it is to ensure that there is a level playing field for all banks — large or small, Islamic and conventional — so that each bank can grow its service and attention to customers.

Given that all major players in the banking sector have opened or will open Islamic windows, do you consider this a threat to the newly established full-fledged Islamic banks?

No. I welcome a full and active market place. However, we need to ensure that the windows and the full-fledged Islamic banks have a level playing field.

How would you assess the Omani sukuk market in the medium-term? Is the bank planning to issue sukuk?

Bank Nizwa was the co-lead arranger of the first Omani sukuk issuance at the end of 2013, and awareness is certainly building with all the talk of a sovereign sukuk this year. Corporates will be encouraged to explore this as a viable and extremely suitable means of raising finance. In addition to a commercial banking license, Bank Nizwa also has an Investment Banking license. We *are currently working with a number of corporates to study if issuing sukuk would be an option for them. However, with regards to Bank Nizwa issuing a sukuk of its own, we currently do not plan to do so, as we are awaiting full deployment of our capital and growth of business.*

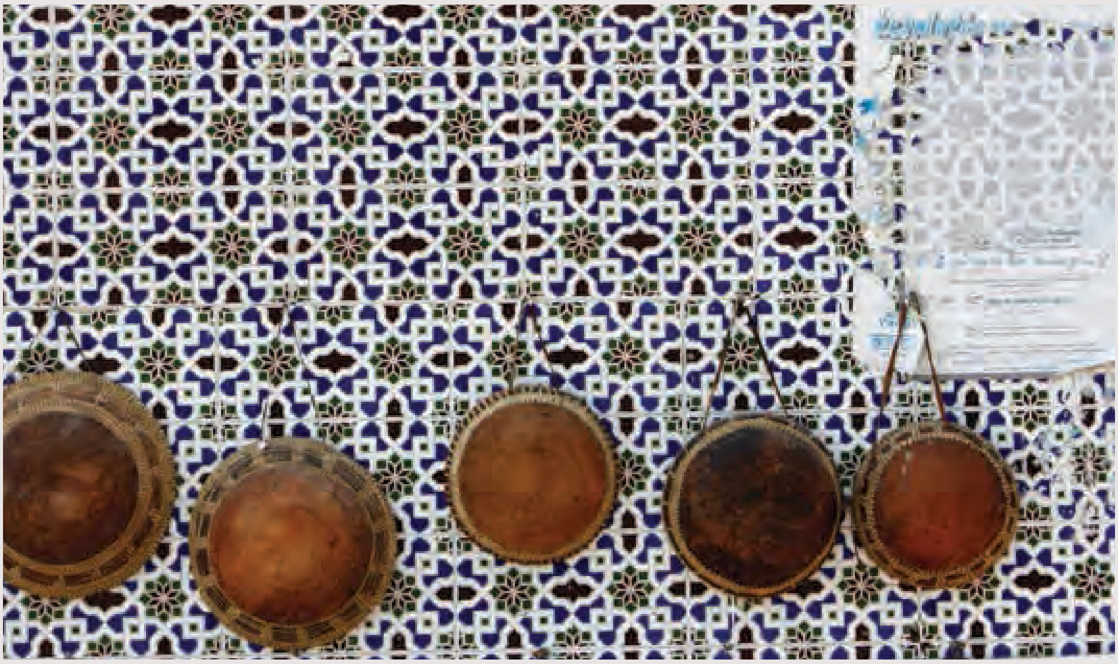
With the growing attention to the Islamic banking sector in Oman, what is the bank's strategy to expand in the market?

Bank Nizwa was established with the vision of being the 'Islamic Bank of choice for the people of Oman'. As such the bank's strategy is to be a 'universal bank' providing sharia-compliant services to all sectors of the economy — ranging from individuals, small businesses, large corporates, government-owned entities, and the government. All this requires both a wide distribution network and products and services. We are diligently working on all of these. We currently have a network of seven branches with more to come and a full-range of products for individuals and commercial entities.

How do you evaluate public awareness of Islamic banking in Oman? And what are the actions that your bank is taking to increase public awareness?

As the first Islamic bank in the Sultanate of Oman, one of our key initiatives is to raise awareness. Since our inception, we have participated in various events to raise public awareness of Islamic finance. We have participated in various forums and conferences locally and regionally (as representatives of Oman and Bank Nizwa) to promote and share our knowledge on the subject. We have visited colleges and universities and conducted seminars on Islamic finance for students. We recently agreed to conduct a workshop for the Ministry of Education's Islamic studies teachers to inject knowledge of Islamic finance to final year students in schools.

Our team also took to the roads of Oman with "road shows" which brought us closer to our customers, communities and individuals in different parts of Oman. We visited all the major shopping malls, supermarkets, and traditional souks in the smaller towns.



REUTERS/Ahmed Jadallah

We represented not only Bank Nizwa and explained our offerings but also showed a new way of banking to the people of Oman.

In addition, we are proud to have recently launched our Islamic Finance Knowledge Forum, which is hosted by our bank and which will convene on an annual basis. The Forum will bring international speakers to Oman to highlight issues, challenges, and benefits of Islamic finance.

We take every opportunity to promote Islamic finance. We would like to believe that we are ambassadors for Islamic finance, so be it via the printed press, interviews with local publications, radio or TV interviews or our social media channels we are constantly trying to spread and increase knowledge of Islamic finance.

Dr. Jamil Jaroudi
Chief Executive Officer
Bank Nizwa

Dr. Jaroudi was appointed as the first CEO of Oman's first Islamic bank, Bank Nizwa, in April 2012. He started his career in the 1970s as a consultant with Booz Allen & Hamilton in the UAE and the Kingdom Of Saudi Arabia, after which he held various senior executive roles with Al Mawarid Group, Saudi Arabia. In 1996 he co-established the Middle East Capital Group in Lebanon, the region's first merchant bank with a pan-Arab focus. Dr Jaroudi then held senior positions with DMI Trust, Islamic Investment Company of the Gulf and Shamil Bank, and was involved in the establishment of Arab Finance House in Lebanon and most recently Elaf Bank in Bahrain, where he was CEO. Dr. Jaroudi holds an MBA from Columbia University, USA, and a PhD in Finance from Kellogg School, Northwestern University, USA. Among other activities for NGOs and charitable organisations, he is a Board member of the Beirut Islamic University, a member of the Board of Trustees of the Lebanese American University Institute of Family Businesses and a member of the Governing Council of INCEIF, the Global University of Islamic Finance in Malaysia. He was recently invited to join the Global Islamic Financial Investment Group with the objective to develop Islamic finance in London.

INSURANCE OVERVIEW AND RECENT ACTIVITY

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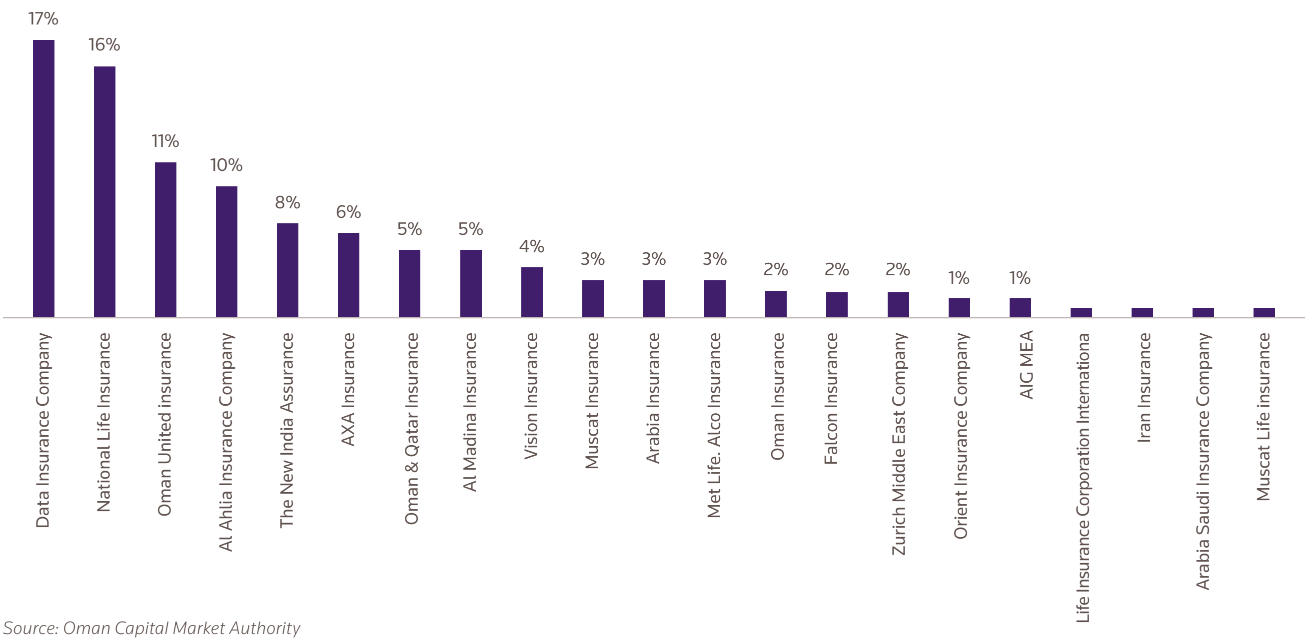
REUTERS/Ahmed Jadallah

INSURANCE SECTOR KEY INDICATORS

The responsibilities of the insurance sector were transferred from the Ministry of Commerce and Industry to the Capital Market Authority (CMA) in 2004 in order to develop and restructure the legislative and regulatory framework of the sector.

According to the CMA, Oman has 21 insurers, many of which are smaller companies. A small pool of larger insurers is seen as a more sustainable path for sector development. Existing firms have thus far been reluctant to merge their operations, and raising capital requirements is a proven method for encouraging consolidation worldwide — as long as the increase is large enough to make it difficult for smaller players to meet the new threshold. In late 2013, two companies — Falcon Insurance and Vision Insurance — started negotiations for a potential merger but talks have come to naught. Once the current round of capital hikes is completed, the regulator plans to seek approval for another boost, to OMR 15 million ($39 million), which would come in the next few years.

Insurance sector market share (GWP 2013)



Source: Oman Capital Market Authority

Top five insurance companies

National companies have the biggest share in the insurance market in the Sultanate. Among the top five, there are four national companies which together represent 53% of the total direct insurance premiums. Dhofar Insurance Company is in first place. Its share of total direct premiums is OMR 62.4 million or 17.2%, followed by National Life & General Insurance Company with 15.4% and Oman United Insurance Company with 11%, according to 2013 year-end data.

The CMA Annual Statistical Report for the insurance sector in the Sultanate indicates a steady growth of the total value of insurance premiums during 2013. Total direct premiums rose 10.44% in the said year as compared to 2012, an increase of OMR 34.39 million, from OMR 329.6 million to OMR 364 million.

The report also shows that retention rates in direct premiums rose 41% reaching OMR 195.5 million compared to 52% or OMR 173 million in the previous year, calculated after the insurance companies carried out reinsurance operations with reinsurance companies in the local and foreign markets.

Vehicle insurance was the highest in retention rates amounting to 87%. In relation to operation results of insurance companies, the CMA report indicates a 21% rise in the value of premiums earned in 2013 compared to 2012. An earned premium is an insurance premium paid to the company for the period ended since the inception of the insurance policy by the end of 2013. The volume of net compensations paid to policyholders by the companies uncovered by reinsurance agreements was OMR 105 million.

The report shows national insurance companies` investments reached OMR 277 million in 2013 in contrast to OMR 261.6 million in 2012. Of these, investments in Oman were about 95%, while the foreign companies` investments inside and outside the Sultanate were OMR 170 million in the same year as compared to OMR 150 million at the end of 2012.

TYPE	GWP 2013 IN OMR	GWP 2012 IN OMR	% CHANGE
Motor	148,151,194	135,773,587	9.12%
Life	33,676,003	40,496,881	-16.84%
Medical	63,155,934	45,650,667	38.35%
Engineering	23,892,508	22,773,216	4.91%
Liability	10,623,899	9,452,777	12.39%
Property	51,834,250	42,732,808	21.30%
Marine	12,703,102	12,174,242	4.34%
Others	20,018,096	20,601,247	-2.83%
Total	364,054,986	329,655,425	10.44%

Source: Oman Capital Market Authority — Insurance 2013 Report.

REUTERS/Martin Dokoupil

Takaful opportunities and outlook in Oman

Based on a Royal decree allowing Islamic banks in the Sultanate and the accompanying financial instruments supporting their operations, the CMA in cooperation with international experts prepared a draft law to govern takaful in the Sultanate. The draft law was discussed with the Board of Directors and upon its approval the work in the insurance market will be updated accordingly. CMA also granted preliminary approval for the establishment of three takaful companies in the Sultanate. CMA has not yet, however, published the final regulations on takaful; the draft is expected to be finalised by the end of 2014. The laws will be introduced as part of a general update on the existing regulation for insurance.

The basic requirements for licensing and regulating takaful products within the Sultanate are for the takaful company to be publicly listed and for its capital to not be less than OMR 10 million.

Three takaful companies to enter the market hoping to gain an edge in Oman's crowded insurance sector

In October 21, 2013 Oman's first takaful company was born after Al Madina converted itself from a conventional insurer to a takaful company through an IPO with a paid up capital of OMR 16.67 million divided into 166,670 shares, and offered approximately 66.67 million shares for public subscription.

Established in 2006, Al Madina has accumulated a 5% share of the insurance market. It has converted its existing conventional insurance clients to takaful policies. Interestingly, after a customer education campaign, it did not experience client exits or other problems.

Al Madina now hopes that its switch to takaful will attract more clients who may have shunned conventional financial products for religious reasons. This could also prove significant in a market where the top seven firms, out of 21 account for as much as 70% of total gross written premiums.

Apart from Al Madina, two other companies are also setting up new takaful businesses — Takaful Oman Insurance and Oman United Insurance.

Takaful Oman Insurance, which started operations in June 2014, first offered 40% of its shares to the public towards the end of 2013 but has faced a setback in meeting some regulatory procedures and obtaining the licence approval from the CMA to carry out its takaful business.

Takaful Oman Insurance projects a 4% share of the overall insurance market within five years of starting operations, according to its IPO prospectus.

The third potential takaful operator, Oman United Insurance, obtained board approval to incorporate a takaful company in February 2013 and planned its IPO for the first quarter of 2014 but has not yet provided further details of its plans.

REUTERS/Ahmed Jadallah

EXPERT COMMENTARY

Khalid Yousaf

INSURANCE REGULATORY FRAMEWORK AND ITS IMPACT ON TAKAFUL SECTOR GROWTH

By Khalid Yousaf, KPMG

Insurance penetration (the ratio of gross written premiums to GDP) for Oman stands at less than 1%, well below the global average (7%) and that of the Gulf region (1.2%).

The Muslim population worldwide represents nearly 25% of total global population yet accounts for only a small proportion of global insurance premiums, indicating under penetration of insurance and presenting opportunity for growth. This growth opportunity in the takaful sector is further substantiated by the fact that the global Muslim population accounts for the highest proportion of young adults in the world, indicating a higher need for insurance and takaful protection against risks.

Oman's insurance sector is highly competitive with 21 licensed insurance companies, one reinsurance company and 29 insurance brokers. The top eight companies held a combined market share of 78% at the end of 2013. Dhofar Insurance is the largest player with OMR 62.4 million ($162 million) in gross written premiums (GWP) and the company commands 17.5% of market share.

Market competition is expected to further intensify as three licenses have been issued to Oman's first takaful companies: Al Madina, Takaful Oman and Oman United Insurance. Al Madina has already completed its IPO and is listed as the first takaful operator in Oman. For consumers, this increased supply may result in more competitive premium levels, better quality of service and more innovative products entering the market.

While licenses have already been issued, Oman's takaful regulations, which were made public by regulator the Capital Market Authority (CMA), have not actually been officially approved. CMA has issued a draft takaful law under which these licenses have been granted and the rules and regulations are expected to be finalised only in due course.

In general on a comparative basis, Oman's conventional insurance companies have more options to invest than their takaful counterparts. Based on CMA guidelines, a takaful company needs to have major investment in instruments with short-term maturity. The company should also hold a minimum of 30% of its investment portfolio in cash/short term mudaraba (bank deposits)/ sovereign sukuk. Moreover, the company should not invest more than 30% of its investments in equities, mutual funds and shares of unlisted companies. Further, the maximum investment the company can make is 20% in real estate and 30% in corporate sukuk. Where these investment restrictions lower the risk profile, they can put a takaful company at a disadvantage relative to its conventional peers.

Risks facing takaful sector

There are risks attached to the future financial performance of takaful operators in Oman. While the draft takaful law is pending approval, takaful operators face potential risks that could impact their overall business growth in the absence of a clear legal and regulatory framework. Currently, licensed takaful companies follow the draft takaful rules and regulations. If there are no changes to the final version of takaful rules and regulations, the companies would have operated safely within the legal and regulatory framework until the publication of the final version. If however, the final version incorporates changes based on feedback from the industry and public, these companies may be required to amend their policies already issued and investments made for compliance with the final version. Draft takaful rules and regulations comply with Takaful Standards issued by the Accounting & Auditing Organization for Islamic Financial Institutions (AAOIFI). They are also in line with takaful rules and regulations practised in other Islamic jurisdictions such as Bahrain and Qatar. The mitigating factor for takaful operators must be that the Capital Market Authority feels that the draft takaful rules and regulations will be finalised without significant changes. This was also the case with the Islamic Banking Regulatory Framework (IBRF) draft regulations issued by the Central Bank of Oman, which were finalised without any significant changes.

Oman is a small market and the presence of 21 licensed operators creates surplus capacity resulting in intense competition, lower premium rates and impacting profitability of all companies. Market consolidation therefore, is a natural and expected move. CMA has addressed this situation by raising the minimum capital requirement for takaful companies to OMR 10 million. Higher minimum capital requirements would force consolidation and raise the capacity of the serious companies.

Draft takaful law and regulations

CMA issued three separate documents during 2012 in draft form, inviting public and industry comments:

1. Ministerial Order on Regulations for implementing the Takaful Undertakings Law

2. Takaful Companies Bill of 2012

3. Draft Takaful Undertakings Law 2012

These documents divide takaful business into two categories:

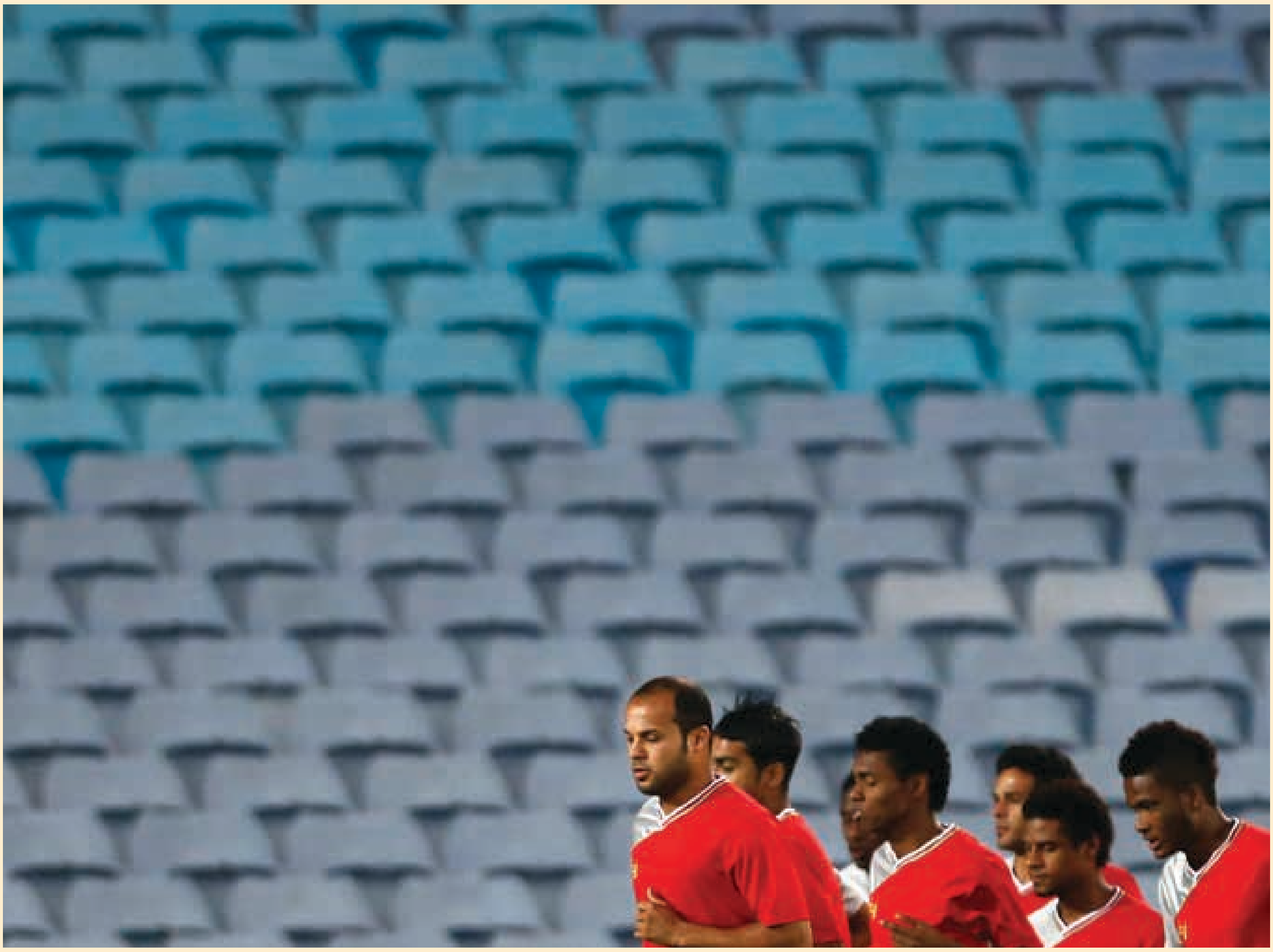
- **Family Takaful** comprising of Life and annuities on human life; linked long-term contracts; permanent medical takaful contracts; participatory insurance plans; pensions funds management; non-life takaful contracts with coverage exceeding one year and other categories approved by the Executive President.

- **General Takaful** comprising of accident takaful; injury caused by an accident; death caused by an accident; industrial injuries; disease-related disability; terrain vehicle takaful; marine, air & transport takaful; fires & property damages takaful; liability takaful; credit & guarantee takaful contracts; other forms like business interruptions, unanticipated expenses, legal costs, away-from-home losses and other categories approved by the Executive President.

Responsibilities of Takaful companies

The draft takaful regulations require takaful companies to be publicly listed firms. Their objective of operating a takaful business should be in accordance with the provisions of sharia. To comply with sharia principles, takaful companies must form a sharia board comprising of a minimum of three members. Each member of the sharia board ought to have specialised knowledge of Islamic law for transacting (Fiqh al mu'amalat) as well as knowledge of modern finance, banking, economics and other requirements as specified by the CMA.

The takaful company shall have two types of actuaries, i.e. an independent actuary approved by CMA, and an internal actuary who will be approved by the authority.



REUTERS/Daniel Munoz

All takaful companies are required to maintain a solvency margin that fulfills the minimum capital requirements or risk-adjusted capital requirement as set in the regulations and calculated on the participants/policyholders' fund. Any deficit in the participants' funds shall be financed by the shareholders' fund. Dividends distribution restrictions apply if the company's capital falls below the minimum capital requirements.

Takaful companies shall prepare and keep all financial records in accordance with AAOIFI accounting standards. While developing the policy, takaful undertakings shall consider all relevant AAOIFI standards including AAOIFI accounting Standard 13 (Disclosure of Bases for Determining and Allocating Surplus or Deficit in Islamic Insurance Companies).

Takaful companies must undertake an internal sharia review in accordance with AAOIFI Governance Standards for Islamic Financial Institutions No.3 (GSIFI) and ensure that this review is undertaken by persons who are competent and sufficiently independent to assess sharia-compliance.

External auditors shall perform audit in accordance with the requirements of AAOIFI standards or other international financial standards approved by the Executive President.

Takaful companies shall also submit to the CMA an annual report issued by the company's sharia board in compliance with the requirement of Islamic Financial Institutions' Governance Standard 1 issued by AAOIFI.

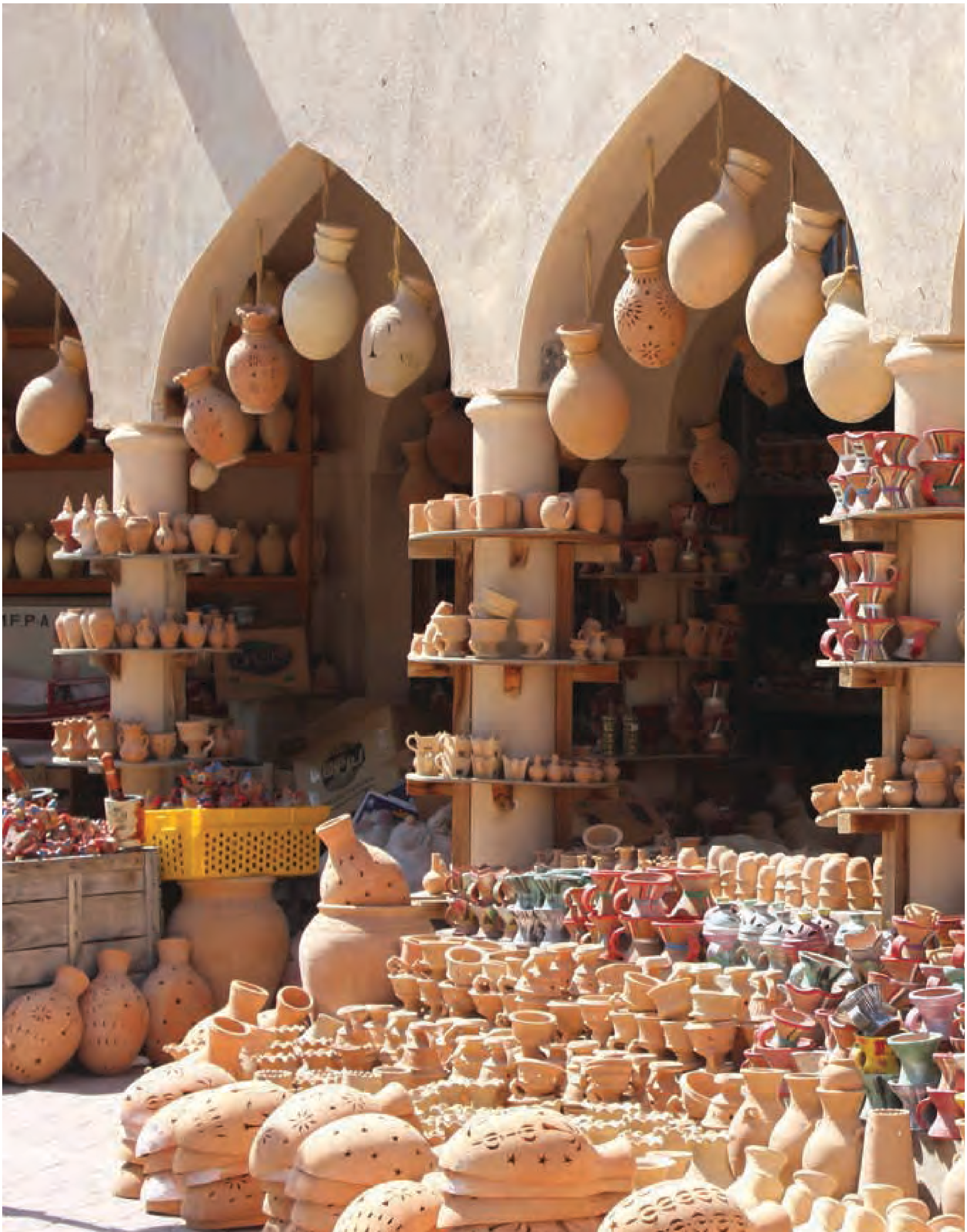
Looking ahead

Al Madina previously operated as a conventional insurance company and has obtained the license to convert its operations into a takaful company. Being the first mover in the market, it has the advantage to capture sharia-compliant insurance business generated by Islamic banks and windows in Oman.

As the Islamic banking market grows in Oman, more players are likely to enter the market to seek market share. The addition of new takaful companies will clearly create excess capacity. New entrants may face similar scenarios of tough competition, slow growth and the need to educate the market and consumers about the differentiating features takaful has to offer, as the new Islamic banks and windows are currently going through in Oman. For any new takaful license applicant therefore, it may make better sense to convert an existing conventional insurance business into takaful operations for better sustainability.

Khalid Yousaf
Director, Islamic Finance Advisory Services
KPMG — Oman

Khalid Yousaf is Director, Islamic Finance Advisory Services at KPMG. Khalid is a senior banking executive with three decades of experience in corporate banking, SME sector and Islamic banking. Khalid has extensive experience within the world's leading banking groups. He worked at Citibank and Bank of America in the UK, Turkey, USA, Belgium, Greece and Pakistan, where his roles included Country Operations Officer and Vice President. His areas of banking expertise span Operations, IT, Treasury Management, Risk Management, Financial Control and B2B e-Business Solutions. In addition, he has held a number of key business development roles in both the Islamic and conventional sectors. He holds an MBA in Finance and a BSc. in Physics.



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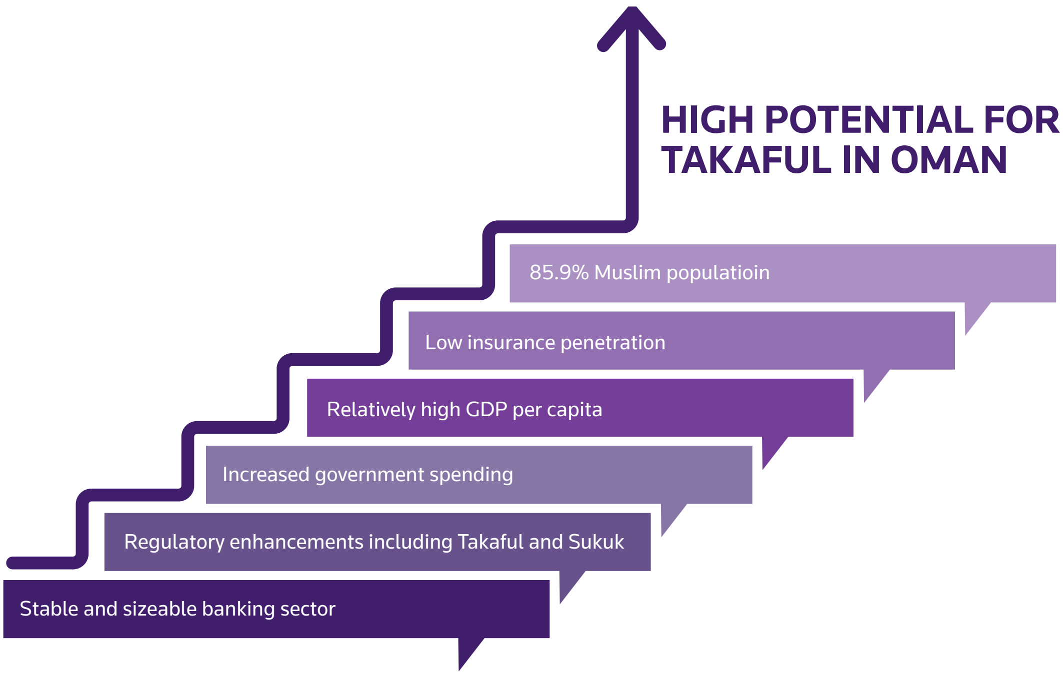
Critical characteristics that position Oman as a potential key player in the global takaful industry



a) Solidifying the market likely to boost penetration

The new insurance law which will update existing legislations are expected to most significantly affect the minimum requirement for paid-up capital that could trigger consolidation in the sector. A new rule also mandates that any new licensee must sell shares on the Muscat Securities Market (MSM), the Omani bourse. These will give a competitive edge to the takaful and insurance sector. The CMA is considering an increase to the minimum capital requirements for insurance operators, both life and non-life insurance, to OMR 10 million each. As of this writing, Insurance operators need to have minimum paid-in capital of OMR 5 million. Given that Oman may see more firms applying for takaful licenses, regulators see the urgency to solidify the capital base in order to prevent financial disruption in the already crowded insurance market. As such, the possibility of increasing minimum paid-in capital is likely to see players pull out of the market, or lead to mergers. This will also ease the pressure on prices and the intensified competition that is likely to foster an organic growth of the conventional and Islamic insurance market.

b) Compulsory listing to diversify capital pool and encourage disclosure

The CMA, the sector's regulator, wants to see more insurers publicly traded on the MSM. Insurers have in the past been reluctant to list because they have not had the need for additional capital. They have also been reluctant to share equity and take on the burden of disclosure that comes with a listing. There are currently few incentives to list in most economic sectors in the country, a situation that mirrors the region as a whole.

As of end 2013, there were three insurers on the MSM, namely Dhofar Insurance, Oman United Insurance and Al Madina Takaful. The authorities hope to develop the bourse by adding more equities, and have had growing success in recent years encouraging companies to list. The new insurance law will formalise a practice that has been in place for several years in the financial services sector — making licensing conditional on listing.

Existing insurers may also choose to take up the IPO option as they work to comply with other changes in the sector. Those that struggle to meet the new capital requirements of OMR 26 million are the prime candidates. The future of the sector is very much based on the opportunities of further consolidation, which includes foreign firms with a larger capital base purchasing local insurers.

c) Potential for retakaful success in Oman

Oman Reinsurance Company, the first and only Omani company engaged in reinsurance activities and operations was established in 2009. Apart from insurance services, its aim is to increase the proportion of insurance premiums which are retained in the local economy and to reduce the leakage of these premiums outside Oman's borders. The limited number of reinsurance companies in Oman provides opportunities for retakaful companies, particularly to serve the needs of the three new takaful operators.

REUTERS/Randolph Caguintuan

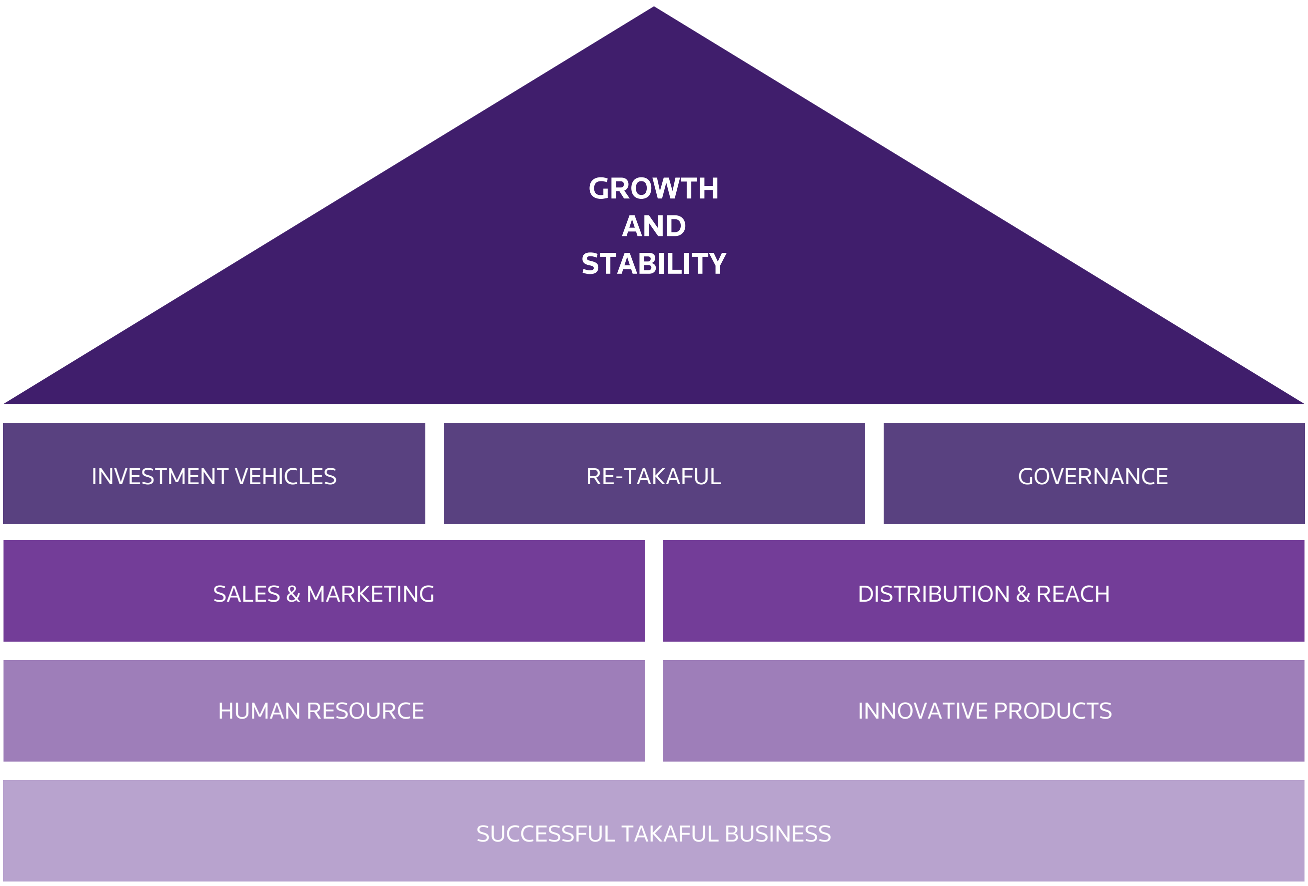
Key takaful business requirements and considerations to capture untapped demand

1. Takaful in Oman likely to grow faster through Bancatakaful

Bancatakaful, or selling takaful products through banks, can provide a successful route for takaful operators in Oman to tap potential customers. Takaful operators in Oman will certainly be facing challenges with distribution and scarcity of surplus and will need to expand their market share in the overcrowded market. They will be looking to increase their footprint and market share in existing sector segments but most importantly they must penetrate new segments where there is less intense competition. Takaful operators in Oman must identify new methods of distribution that will allow them to penetrate new segments with lower acquisitions costs and expenses.

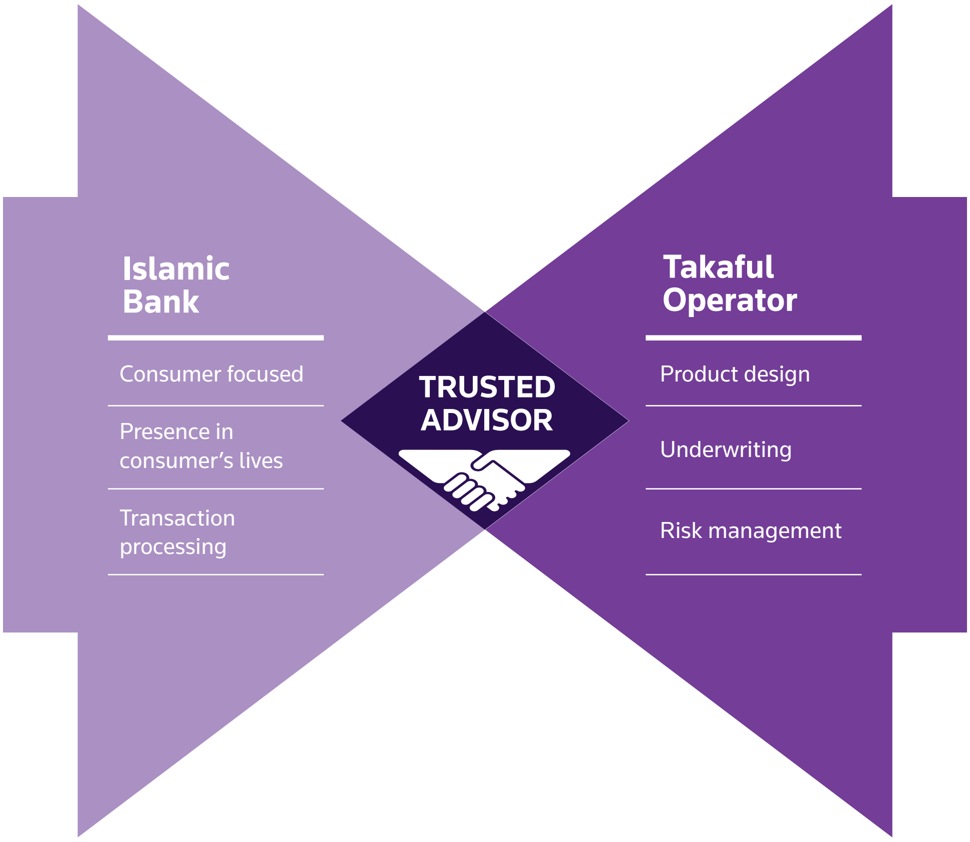
2. Trained and competent workforce is essential

The takaful operator in Oman needs to have a dedicated workforce in all responsible functions. Of primary importance is a dedicated and well-trained sales force required to promote and distribute takaful in the country. The market in Oman is likely to hire more generalist players with background in conventional insurance products. As such, takaful operators must ensure their staff gain access to constantly updated and practical training programmes on takaful.



BANCATAKAFUL CORE COMPETENCIES

The key area of overlap between bank and insurer key competencies is the desire to be a "trusted advisor" to the end consumer. Both banks and insurers in Oman enjoy a high degree of trust and respect with the public, but they approach the role of the trusted advisor differently.



Source: Adrian R. Pask, Bancassurance - Society of Actuaries 2003

WHY WILL BANCATAKAFUL WORK IN OMAN? A WIN-WIN FOR BOTH BANKS AND INSURERS

Bancatakaful will prove to be profitable to both the takaful operator and the bank but only if the following requirements are met:

Distribution economies of scale

Distribution economies of scale occur because:

- The customer has a deeper relationship with the financial institution
- The customer makes larger purchases
- Sales need less effort to complete

Bancatakaful leverages on a deeper relationship between customers and the bank. Closer bank-customer relationships will lead to customers feeling more at ease purchasing more products and services. As a result of increased trust, subsequent sales will be either larger or easier to complete.

Value added benefits to the customer

The value added benefits to the customers occur when they can see rewards and merits from having multiple sets of products from a single financial institution. This leads to efficiency and convenience to both customer and the single financial institution. Value added benefits include combined billing for all products, integrated monthly statements for all products/services displaying a complete financial picture, and time savings from only using one point of contact for all financial matters.

Organizational economies of scale

Organisational economies of scale are the potential reduction of costs from integrating banking and insurance operations. The cost required to train staff and set up technical systems, among other costs, is likely to be reduced with bancatakaful.

Exclusive Interview with Mohammad Haris, Head of Islamic Banking, Bank Sohar — Sohar Islamic

(Interview conducted on April 24, 2014)

What share do you think Islamic windows will attain out of the total Islamic banking share?

In countries where Islamic banks and Islamic windows operate side by side, standalone Islamic banks typically hold majority share of the Islamic banking industry. However, in the case of Oman, Islamic windows seem to be faring better in attracting business as compared to full-fledged Islamic banks. The primary reasons are that the Central Bank of Oman regulations have set strict sharia governance conditions for Islamic windows including: complete segregation of funds; sharia supervisory board, sharia audit and compliance unit, separate financial statements, independent Islamic branches and dedicated staff for all business functions. This has created comfort in the minds of the public in terms of the sharia credibility of Islamic windows.

Many clients who wish to use Islamic products are already banking with conventional banks and if their needs are met by the Islamic window of the same bank, they prefer to stay with it. Hence Islamic windows are receiving some leads/referrals from their parent bank. In the next few years, the same trend is likely to continue until the full-fledged banks are able to strengthen their brand, foothold and to somehow differentiate their offering from Islamic windows.

Where do you expect the major demand for Islamic banking in Oman to come from, retail or corporate, and why?

During 2013 Islamic banking institutions rolled out a broad range of products and services for the retail and business (corporate and SME) segments of the market. Almost all players are offering current accounts, savings accounts, term deposits, debit cards, home financing, and automobile financing in the retail segment. Similarly, several corporate financing products covering working capital financing, asset purchase financing, import financing, and project financing are being offered by most players.

In addition to all these products, a few players have also launched construction products, Islamic credit cards, financing for travel costs, and for household items.

In any new Islamic finance market, the first movers to Islamic banking are typically individuals followed by small businesses, while large businesses are the last ones to try out Islamic products. The Islamic banks have not been able to capitalise on the retail segment as tighter debt burden ratios (and other requirements) were imposed on retail loans, coincidently at the same time Islamic banks entered the market, resulting in slow growth in the retail segment. Hence, Islamic banks are unable to deploy sizable liquidity in this segment. The demand will likely come from retail customers keen to convert existing conventional loans with Islamic banks enticing them with much finer rates, from the SME segment and from infrastructure projects in private sectors. The government would also need to play its role in facilitating Islamic banks to finance large projects in the public sector.

Where do you see the Islamic banking share of Oman's total banking sector in the coming three to five years?

At the end of 2013, there were 29 Islamic branches operating in Oman. This number *is expected to double in 2014 as Islamic banks further expand their reach. In terms of market share, there were a few studies done in 2011 and 2012 which predicted that Islamic banking in Oman will reach 10% of the entire banking industry in three to five years. The industry numbers at the end of 2013 based on available estimates are:*

	ACHIEVED ISLAMIC % SHARE
Net Worth	11.1%
Loans & Advances/Financing	2.83%
Customer Deposits	1.4%

It must be noted that two Islamic windows had inherited Islamic finance portfolios built over the last few years, before the issuance of Islamic banking regulations in December 2012. Hence, exclusion of this portfolio will allow us to reach a more realistic estimate of the Islamic banking industry's share achieved in 2013:

	ESTIMATED ISLAMIC % SHARE
Net Worth	11.1%
Loans & Advances/Financing	1.67%
Customer Deposits	1.4%

Considering these estimates, progress for the Islamic banking industry is certainly promising. Going forward, the market for Islamic banking products is expected to grow with increased awareness and education. However, it is quite difficult to say what share it will likely reach in the next three to five years.

What is the main challenge that faces the Islamic banking sector in Oman?

The Omani banking industry was highly competitive and liquid even before the entry of Islamic banks in early 2013. All Islamic banks and windows entered the market in 2013 with fresh capital of approximately OMR 400 million ($1 billion). In addition, these Islamic banks have mobilised deposits. This liquidity cannot be readily deployed into corporate/retail assets in an already highly competitive industry. Majority of Islamic banks are net lenders. The biggest challenge they face is that they are not allowed to lend to the conventional industry, as stipulated by the Central Bank of Oman. In this situation, most of the players are: 1) aggressively going after retail/corporate assets thereby bringing the financing rates down even further, and 2) placing funds in offshore Islamic banks within limits prescribed by CBO.

How do you evaluate public awareness about Islamic banking in Oman?

Similar to other countries where Islamic finance was introduced in the past, the initial reaction of the general public in Oman has been, to an extent, sceptical. They react with scepticism when they find out that the cost for Islamic home financing is more or less the same as for a conventional housing loan. However, as a result of several conferences and seminars held in the country since 2011, the awareness level is improving fast. The ICD — Thomson Reuters Islamic Finance Development Report 2013 ranked Oman at the top of the table in terms of awareness efforts in the form of various Islamic finance conferences and seminars. The market for Islamic banking products is expected to grow with increased awareness and education.

Mohammad Haris
Head of Islamic Banking
Bank Sohar — Sohar Islamic

Mr. Mohammad Haris heads Sohar Islamic, the Islamic window of Bank Sohar in Oman. He successfully set up the window from scratch and has rolled out products for retail and corporate segments through four independent Islamic branches. He previously worked as Deputy General Manager at Gulf African Bank, the first sharia-compliant bank in Kenya where he headed Corporate Banking, Structured Finance and Product Development functions. Mr. Haris's experience spans over 23 years in diverse service industries and his career has taken him from USA to Pakistan and from the Gulf to East Africa. He is regarded as one of the pioneers of Islamic banking in Pakistan and Kenya having played key roles in establishing the first Islamic banks in the two countries. Prior to joining GAB, he worked as Head of Corporate Banking, Product development and Investment Banking at Meezan Bank — the first and largest Islamic bank in Pakistan. He holds an MBA and Master of Engineering degrees from Florida Institute of Technology and Virginia Tech, USA, respectively.

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The goals and motivations of this report follow in the same vein as the previous country reports — to serve the needs of the Islamic finance industry and to provide financial institutions, governmental bodies and associations, customers and other stakeholders with high quality intelligence and insights into the Islamic finance opportunity in Oman in order to help all parties make informed decisions. This report reflects the efforts of a broad and diverse group of experts.

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Sincerely,
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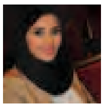

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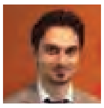

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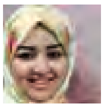

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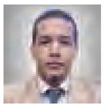

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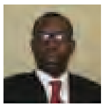

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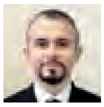

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