Islamic Finance Seminar

Roma, Italia June 11, 2009

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DIFC Dubai International Financial Centre

Contents

General Characteristics of an Islamic Economic System

- **Individual obligations – man has unique terrestrial role**
- **Property rights – corresponding obligations**
- **Importance of contracts – even public position is a contract regarding behaviour**
- **Work & wealth – not simply a cost, but manner of worship**
- **Invisible & material blessings – follows righteous conduct**
- **Economic justice – emphasis is on moral & just conduct**
- **Competition & co-operation – integration of society vs social disintegration**
- **Role of State – legitimacy derived from enforcing rules / providing infrastructure**
- **Economic development & growth – constantly remembering His omnipresence in all social interactions**
  - **Results in strong work ethic**
  - **Honest business dealing**
  - **Full compliance with terms of contract**
  - **Internalizing of values – results in strong, dynamic & growing economy**

Source: Dr Abbas Mirakhor

Five Pillars of Islamic Finance

- **Ban on interest:** interest must not be charged or paid on any financial transaction, as interest is deemed unlawful by Shari'a.
- **Ban on uncertainty or speculation:** banking & financing contractual terms and conditions should be clear and known to all parties.
- **Ethical Investment & ban on financing certain economic sectors:** financing of industries deemed unlawful by Shari'a-such as weapons, alcohol, pornography and gambling- is forbidden.
- **The profit and loss, risk sharing principle:** parties to a financial transaction must share in the risks and rewards attached to it.
- **The asset-backing principle:** each financial transaction must refer to a tangible, identifiable underlying asset

Islamic Finance- Recent Developments

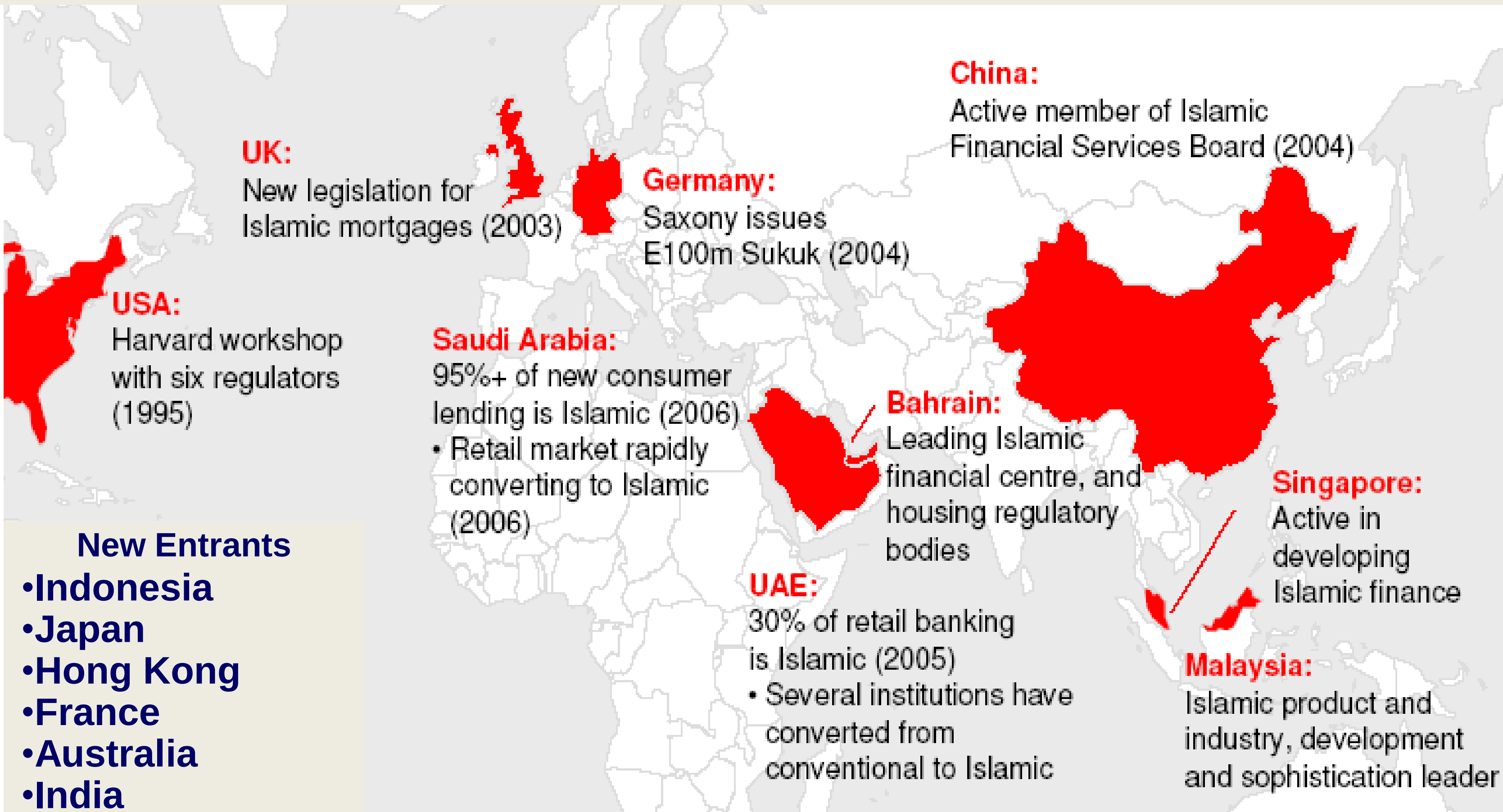
- Islamic Finance continues to be one of the fastest growing segments in the international financial services industry.
  - Number and reach of Islamic Financial Institutions (IFIs) worldwide has risen from one institution in one country in 1975, to more than 300 institutions operating in more than 75 countries
  - IF has grown by about 15% to 20% in each of the past four years.
  - Wide acceptance and recognition of the Sukuk market as a competitive and attractive form of financing. Outstanding Global Sukuk market has now surpassed the US$100 billion mark.
  - Greater innovation and global participation in the development of Islamic finance
  - Financial crisis has increased Non-Islamic world's awareness & interest in Islamic finance given its ethical, risk sharing, relationship based, governance and transparency and "real" activity and asset based characteristics

Islamic Innovation in products & services

1. Islamic real estate investment trusts, or I-REITs offer retail and institutional investors an instrument allowing them to participate in the strong growth prospects of the Gulf
2. Private Equity rapidly growing, based on conservative principles: debt-to-equity ratio should be less than 1/3.
3. Takaful & Re-Takaful
   - There are now more than 60 Takaful companies operating in 23 countries
   - Global conventional average annual premium growth rate stands at about 2.5%. By comparison, in the wider Middle East, the Takaful market segment is growing by 20% a year, while Takaful premiums in the GCC states are increasing by a phenomenal 40% a year.
   - It is estimated that $1.7bn was written in Takaful premiums in 2007 globally, having grown 26% year-on-year between 2004 and 2007.
   - Ernst & Young estimates that the global Takaful market could grow to US$7.7 billion by the end of 2012, from global Takaful contributions at US$3.4 billion in 2007 (2006: US$2.5 billion) Swiss Re Sigma No.5 Report (Feb09)

Geographic Spread of Islamic Finance

Total size estimated between USD 800 billion to USD 1 trillion, growing at 15%-20% per annum



New Entrants

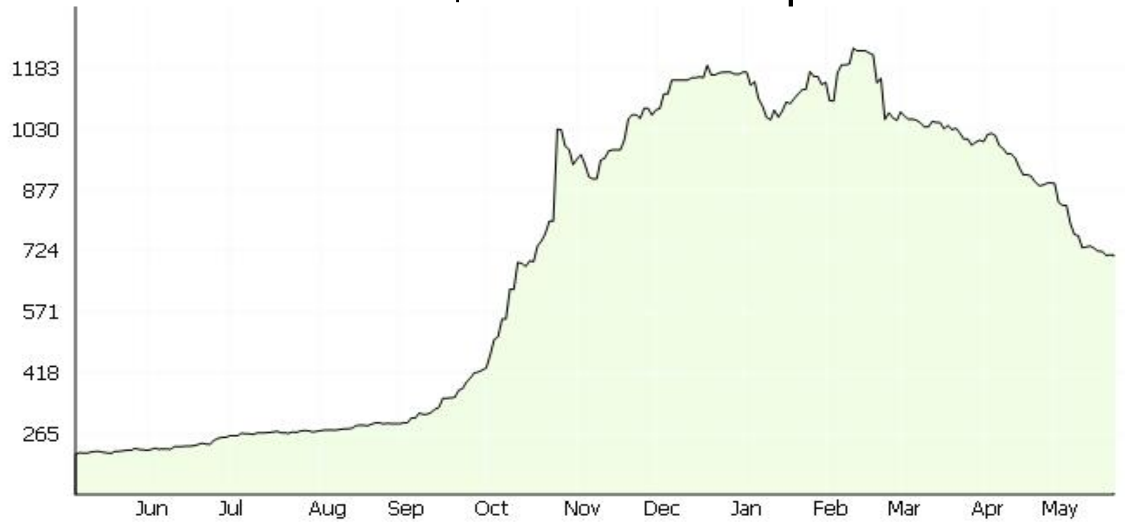
- **Indonesia**
- **Japan**
- **Hong Kong**
- **France**
- **Australia**
- **India**

Islamic Finance and the Global Crisis

- IFIs were not insulated from the repercussions of global credit crisis- several contagion channel exist via the real economy and the exposure of counterparties
- While global equities prices fell some 40% in aggregate during 2008 in US Dollar terms, the Islamic World Market Index fell slightly less (38%).
- Over longer, 3, 5 and 10 year investment horizons, Islamic market indices have outperformed conventional investments in advanced countries.
- The Sukuk market has also been hit by the current turmoil. Appetite for Sukuk declined along with international debt issuance, loan syndications and other wholesale debt.
- Total Sukuks outstanding are likely to reach USD 100 billion in 2009, according to Standard & Poor's, and it may go on to grow 35% over the next 2-3 years.
- Islamic financial industry likely to emerge stronger from the crisis. Given its characteristics Islamic finance can help:
  - Curb excessive credit expansion
  - Tangible rather than virtual assets
  - Limit speculative based investing
  - Risk sharing arrangements between borrower and lender

Sukuk Spreads: Contagion & Recovery

GCC US$ Sukuk Index spread



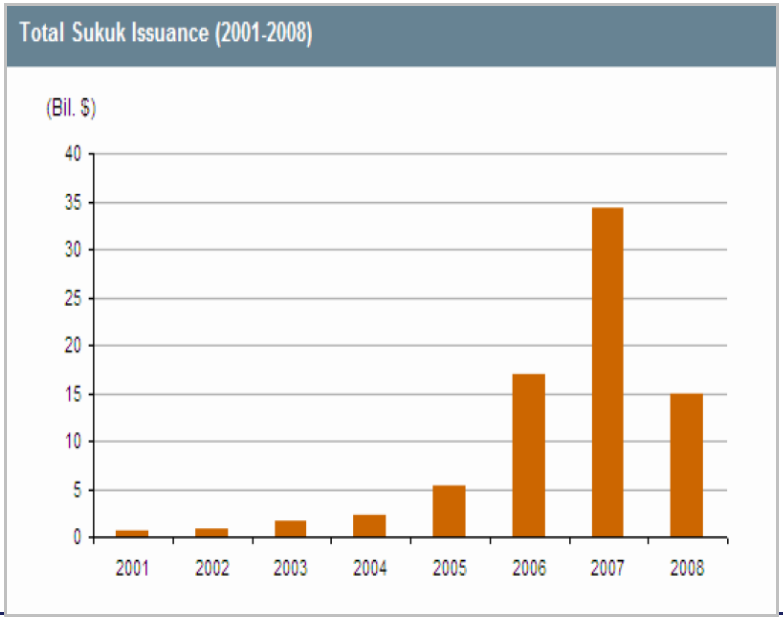
Sovereign US$ Sukuk Index spread

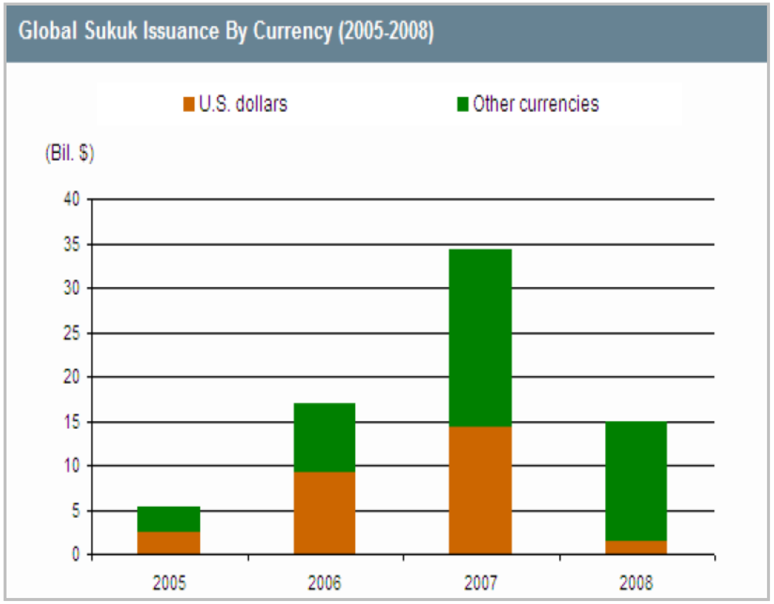
Corporate US$ Sukuk Index spread

Source: DIFX-HSBC Indices; updated June 11, 2009

Sukuk Market: Size and Issuance

- The value of new Sukuk issues in 2008 dropped to $14.9 billion, a decline of some 56% compared with 2007 ($34 billion). Although volumes dropped in 2008, the Sukuk market attracted the same number of issuers.
- Issuance in 1Q09 has picked up with most issues being oversubscribed many times over. Revival of Sukuk market expected in 2H 2009 and 2010, with Sukuk market expected to issue US$27.5 billion in 2009.
- USD no longer the currency of choice. Issuers concentrated on local currency markets, where liquidity was more abundant and appetite for Shari'a-instruments stronger.



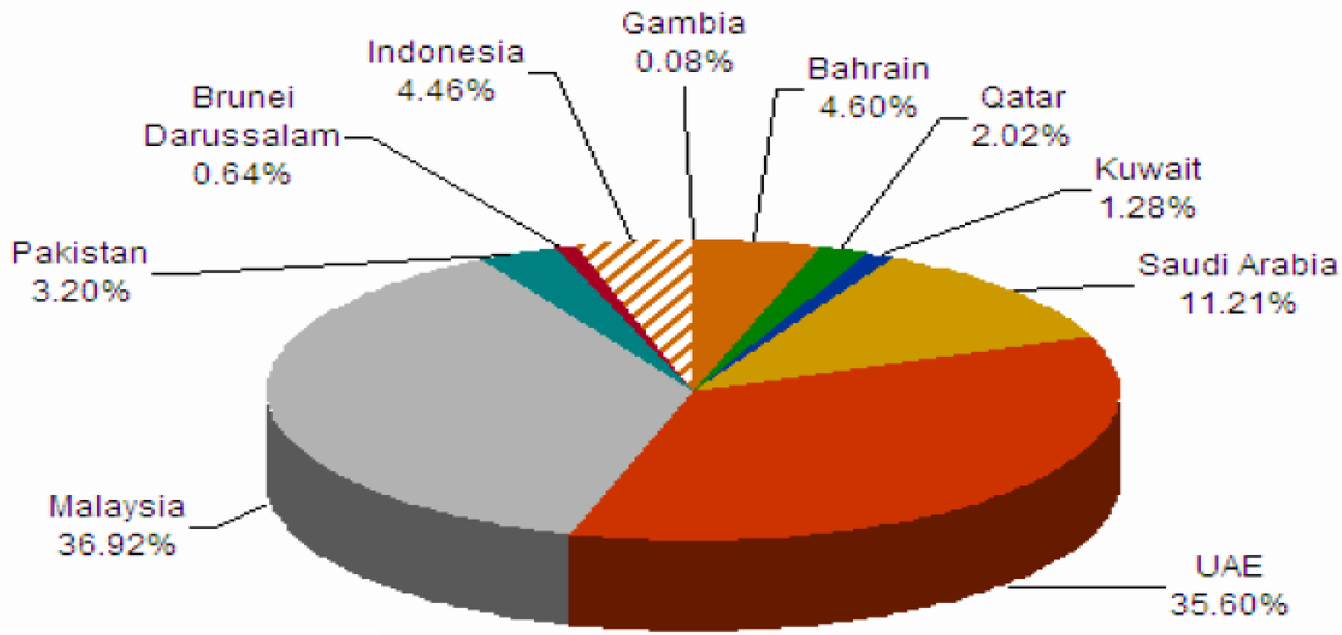


Source: Standard & Poor's

Sukuk Market: Geographical spread

- Issuers from more than 20 countries have expressed interest in issuing Sukuk.
- Conservative estimates of pipeline: in excess of $45 billion.
- Several new sovereigns also expected to enter the market.

Global Sukuk Issuance By Country In 2008



Source: Standard & Poor's

Bond & Sukuk Market in GCC

•In 2008 , the GCC aggregate bond market, which includes both conventional and Sukuk dropped 62.4% comparing with the amount raised in 2007.

•The total number of issuance was 34 conventional Bonds and 42 Sukuk

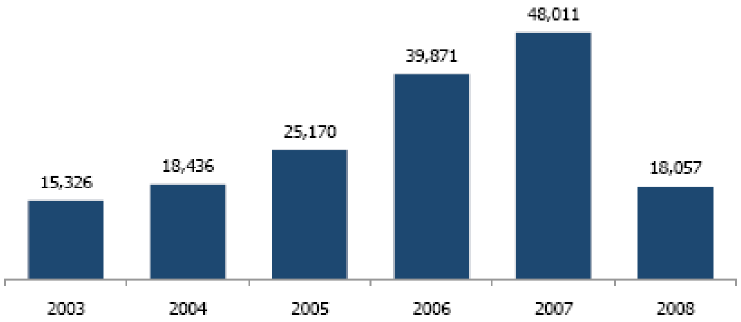
•Share of Sukuks continued to grow in 2008, up 44.80% from 40% in 2007 of total value issued by GCC bond market

•Majority of the listed Bond and Sukuk issues were listed on Nasdaq Dubai. Of the 2008 issuances, 7 were listed on various regional exchanges; 6 Sukuk listed on the NASDAQ Dubai and 1 Sukuk listed on the Saudi Stock Exchange.

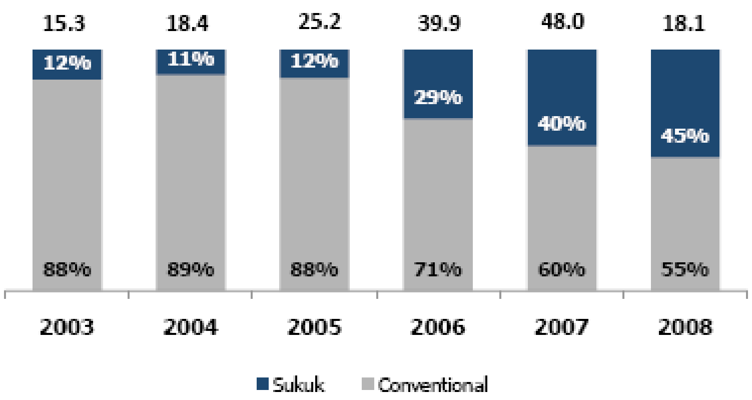
•UAE issuers account for around two-thirds of GCC bond market volumes.

•The HSBC GCC Bond Index was down about 20 per cent in 2008, this compared to a decline of 70 per cent in the DFM, and more than 40 per cent in most other regional and global equity markets.

Total Fixed Income Issuances in the GCC Region (2003-2008 USD Mn)



Total Conventional & Sukuk Issuance in the GCC Region (2003-2008 USD Bn)



•Moody's: Global Sukuk Issuance (January 2009)

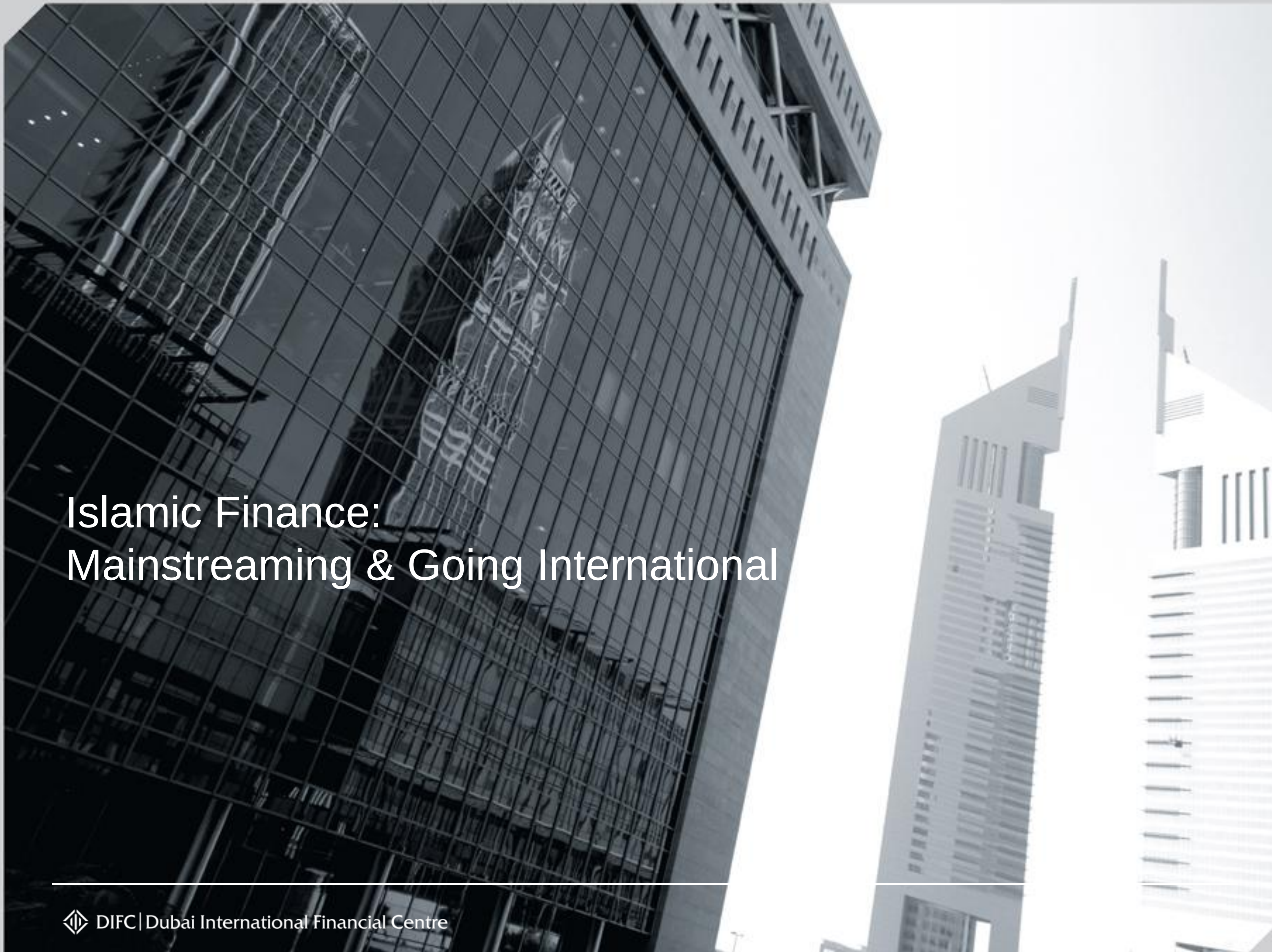
• Kuwait Financial Centre "Markaz" (January 2009)

Islamic Finance:
Some Key Challenges

Key Challenges

Several challenges hindering development of Islamic Finance and its integration into wider international financial system.

- **Convergence of Regulation**
  - Barriers in Cross Border Transactions
- **Lack of Standardization**
  - High transaction costs
  - No clarity in transaction structures
- **Lack of a Level Playing Field between conventional & Islamic**
- **Risk/Liquidity Management**
  - Shortage of liquid instruments
  - Lack of a liquid secondary market
  - Lack of Islamic hedging and risk-management tools
  - Heavy exposure to cyclical assets (real estate and commodities)
- **Shortage of Talent and Scholars.**
- **Lack of Information on markets and instruments**


Islamic Finance:
Mainstreaming & Going International
DIFC | Dubai International Financial Centre

Wider Appeal

- **Current financial crisis has generated international interest in Islamic Finance and its ethical principles**
- **Osservatore Romano (Napoleoni & Segre)**

  "*We believe that IF can contribute to redefine new rules for Western finance […] given that a liquidity crisis is now eminently a confidence crisis. The international banking system needs instruments that would focus on ethics in business […] and help to rebuild the reputation of a capitalist model that has failed.*"

- **Civilta' Cattolica:**

  "*Arab savings have given a substantial contribution to Western Finance. Islamic Finance can make a contribution to the ethical re-foundation of global finance.*"

The Road Ahead I

- Objective should be to mainstream of IF services and products, and the integration of Shari'a compliant securities into international markets, to become an internationally recognised asset class.
- Regulatory streamlining and coordination among regulatory bodies
- Standardization of contracts and harmonization of Shari'a principles resulting in greater clarity and product innovation
- Removing cross border barriers and pushing for products that are globally accepted.
- Interaction and integration of Shari'a Law with other legal regimes such as the common and civil law
- Continued work by institutional infrastructure (IFBS, AAOIFI etc) on developing new regulations and changing existing regulations in response to changes in operating environment brought about by globalization, technological advancements and heightened competition.
- The ultimate objective should be an *Islamic Financial Passport*, an IFP, to facilitate cross-border trade in Islamic Finance Securities (IFSs) and the mutual recognition and establishment of IFIs.

The Road Ahead II

- Promote and encourage the participation of conventional issuers including corporates who could benefit in mobilizing resources using Sukuk as stable income-generating financial instruments.
- Government participation through the regular issuance of sovereign Islamic bonds, in international or domestic currencies, for the funding of government led infrastructure projects.
- Government & Corporate Issuers worldwide should issue Sukuk to tap savings and liquidity available in the GCC countries

Recent Regulatory Reforms

United Kingdom
- Positioning itself as European hub for Islamic finance
- UK Gov't has introduced legislation to promote IF and has made adjustments to stamp duties on income from Islamic products and tax treatment of Islamic mortgages
- Plans for a sovereign issue denominated in GBP In late 2009/2010.
- Gov't looking to legislate to help develop

Singapore
- Developed guidelines for Sukuk and introduced a concessionary tax rate on income derived from Sharia-compliant fund management, lending and insurance.
- Targeting the Islamic wealth management space
- Central bank established program to issue the first-ever Singapore-dollar denominated sovereign Sukuk.
- Issued new regulations to ensure equal tax, regulatory and liquidity treatment of Singapore-dollar Islamic bonds with government securities.

France
- Between 6 and 7 million Muslims in France
- Gov't has made changes to the tax code to ensure that Islamic modes of financing do not attract extra tax penalties in comparison with conventional transactions.
- At least 3 Islamic banks are reported to be requesting accreditation to operate in France.

Indonesia
- Highest population of Muslims in South East Asia
- Government has allowed tax concessions for Sukuk and other instruments
- Issued new regulations governing Islamic banks, which include new rules on: minimum reserves; payments clearing; creation of an Islamic inter-bank money market; issuance of Bank Indonesia Wadiah-based promissory notes to provide liquidity to the market.

Hong Kong
- Government changing tax laws to ensure sukuks are treated in the same way as conventional bonds (stamp duty, profits tax and property tax)
- Hong Kong said it plans to issue a sovereign sukuk when market conditions are right.
- Edge in pitching Islamic finance products to China-focused investors

Other
- China, Japan and Thailand announced intention to issue sovereign Sukuk

Source: Team Analysis

Dubai International Financial Centre : Opportunities

DIFC Organisation & Structure

- Over 26 laws & 16 regulations have been enacted establishing the basis for regulatory framework and allowing financial institutions to carry out activity in the DIFC.
- Tailor-made based on the best laws available in leading jurisdictions (e.g. Regulatory Law based on Common Law, Insurance Regulations based on Bermuda Law, Trust Law similar to Singapore and US regulations)

DIFC | Dubai International Financial Centre

- Develop overall strategy and provide direction to the Centre
- Develop laws and regulations governing non-financial services activities
- Promote DIFC and attract licensees to operate in the Centre
- One stop shop service for visas, work permits etc

DFSA Dubai Financial Services Authority

- Sole financial regulator within DIFC, AML co-regulation with UAE Central Bank
- Administrative and civil rule making and enforcement
- Bilateral MOUs with host of jurisdictions
- IOSCO, BOCA Declaration (including multilateral MOU), IFSB, IAIS (Technical Committee) etc

محاكم DIFC COURTS

- An independent court system responsible for administering and enforcing the civil and commercial matters at the Centre
- Based on Common Law- offering institutions and companies the legal clarity and predictability

DIFC- Hierarchy of Laws

Constitutional

UAE Constitution

Federal

UAE Federal Law No.8 of 2004

Federal Decree No.35 of 2004

Cabinet Resolutions

Dubai

Dubai Law No.9 of 2004

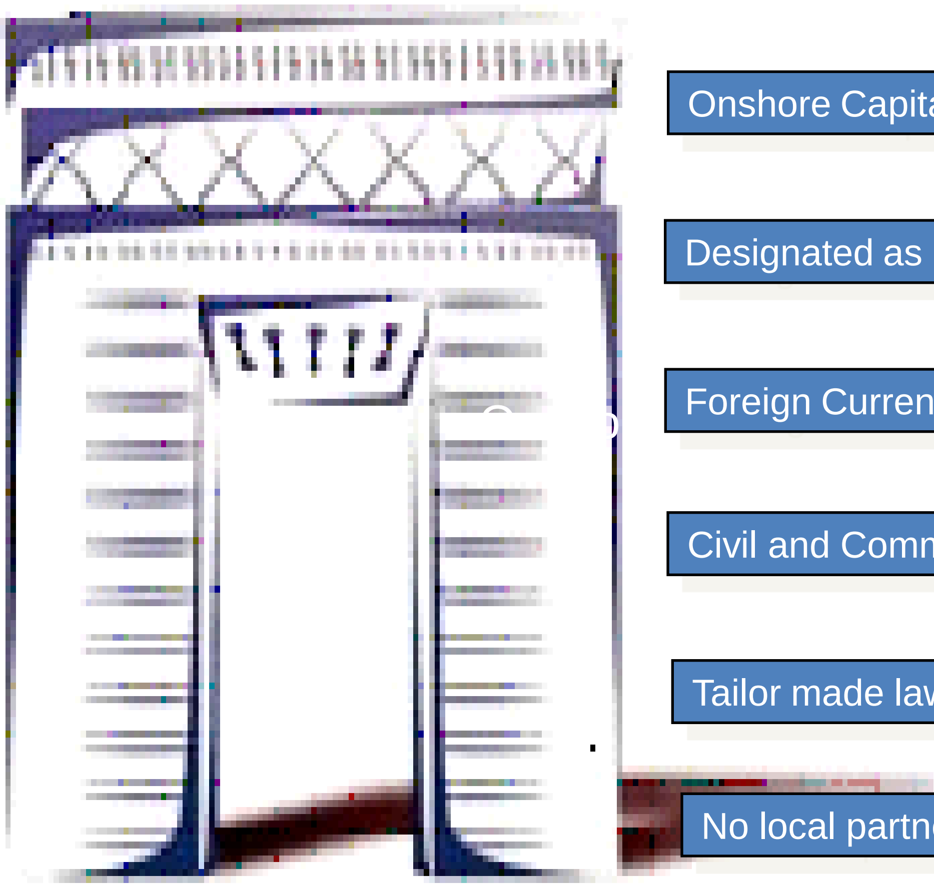
Dubai Law No.12 of 2004

DIFC

DIFC Laws

DIFC Regulations, DIFC Courts and DFSA Rules

Characteristics of the DIFC



- Onshore Capital Market / International Standards
- Designated as a Financial Free Zone
- Foreign Currency Denominated / Zero Tax Rate*
- Civil and Commercial Laws of UAE not applied
- Tailor made laws for the DIFC
- No local partner requirements

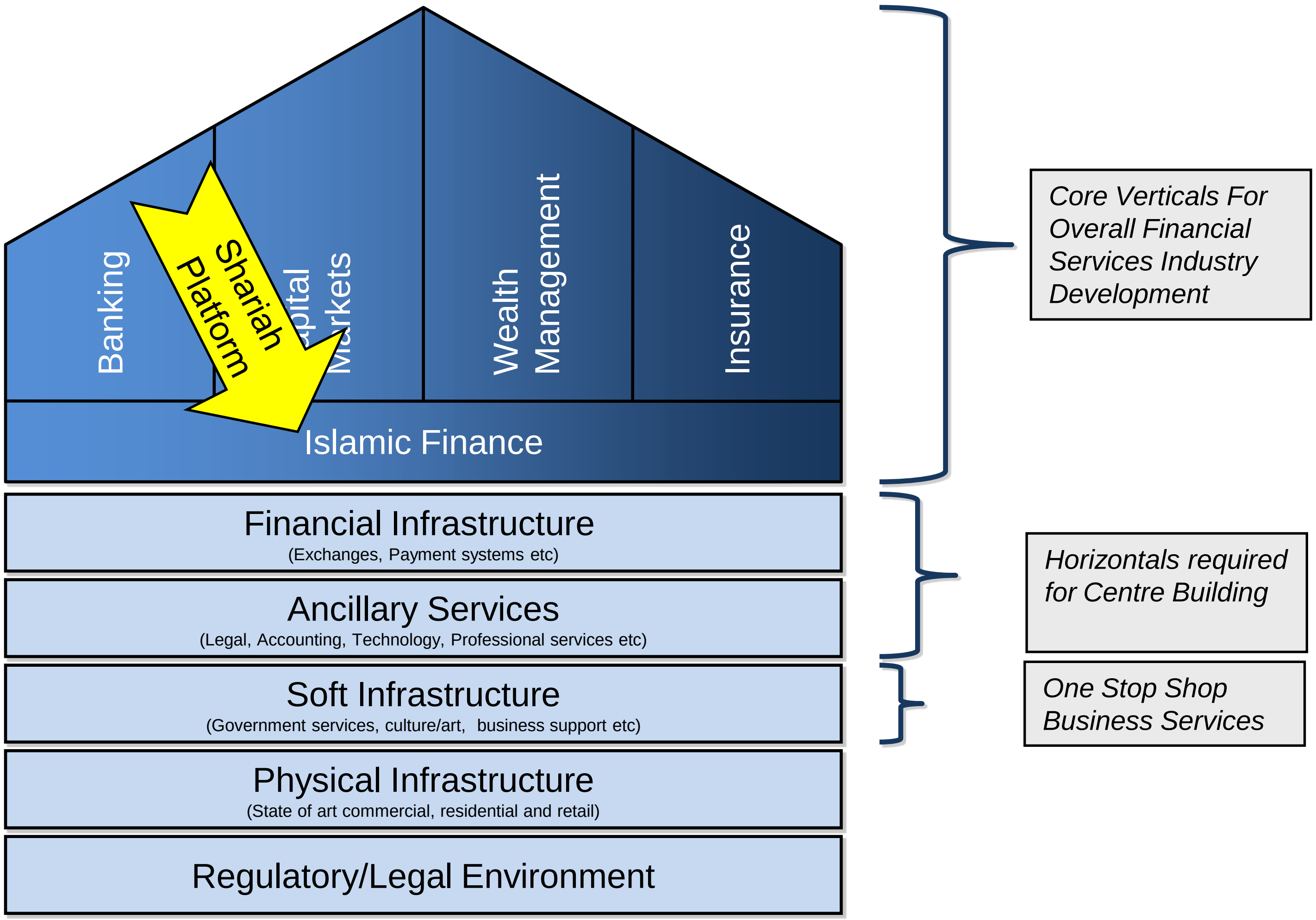
DIFC Legal & Regulatory Infrastructure

DIFC Law No.	Law/Regulation	Administrative Authority DIFCA	DFSA	DJA
No. 1 of 2004	Regulatory Law		✓	
No. 2 of 2004	Companies Law	✓		
No. 4 of 2004	Law Relating to the Application of DIFC Laws	✓		
No. 5 of 2004	Limited Liability Partnership Law	✓		
No. 6 of 2004	Contract Law	✓		
No. 7 of 2004	Insolvency Law	✓		
No. 10 of 2004	Courts Law			✓
No. 11 of 2004	General Partnership Law	✓		
No. 12 of 2004	Markets Law		✓	
No. 13 of 2004	Law Regulating Islamic Financial Business		✓	
No. 4 of 2005	Employment Law	✓		
No. 5 of 2005	Law of Obligations	✓		
No. 6 of 2005	Implied Terms in Contracts and Unfair Terms Law	✓		
No. 7 of 2005	Law of Damages and Remedies	✓		
No. 8 of 2005	Law of Security	✓		
No. 9 of 2005	Personal Property Law	✓		
No. 10 of 2005	Law on the Application of Civil and Commercial Laws	✓		
No. 11 of 2005	Trust Law		✓	
No. 1 of 2006	Collective Investment Law		✓	
No. 3 of 2006	Companies Law	✓		
No. 4 of 2006	Limited Partnership Law	✓		
No. 5 of 2006	Investment Trust Law		✓	
No. 1 of 2007	Date Protection Law	✓		
No. 4 of 2007	Real Property Law	✓		
No. 5 of 2007	Strata Title Law	✓		
No. 1 of 2008	Arbitration Law	✓		

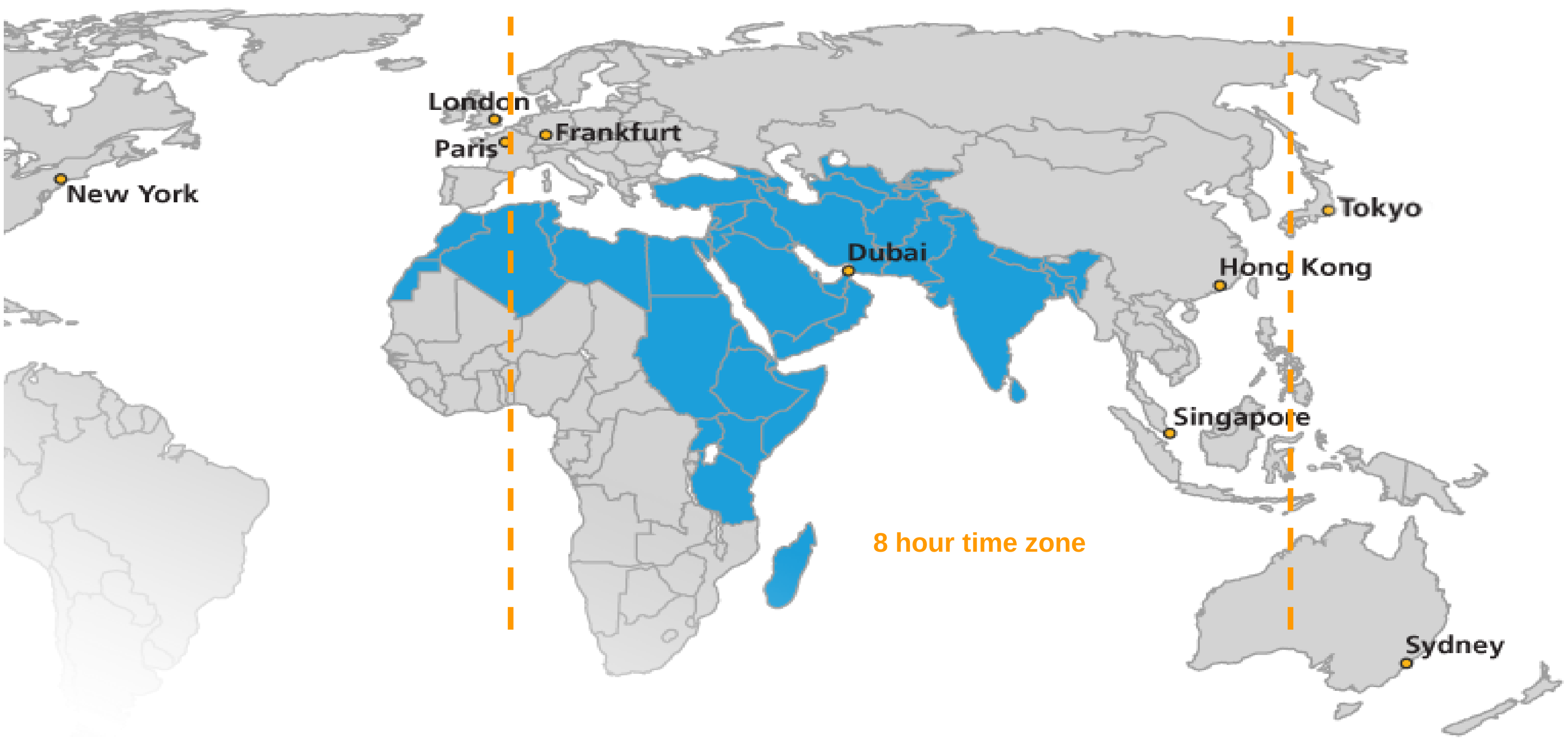
DIFC Regulations

1. Non Financial Anti Money Laundering/Anti Terrorist Financing (AML/CFT) Regulations
2. Real Property Regulations
3. Strata Title Regulations
4. Data Protection Regulations
5. Limited Partnership Regulations
6. Security Regulations
7. Dematerialized Investments Regulations
8. DIFC Insolvency Regulations
9. Preferential Creditor Regulations
10. Companies Regulations
11. Single Family Office Regulations
12. General Partnership Regulations
13. Limited Liability Partnership Regulations
14. DIFCA Operating Regulations
15. Special Purpose Company Regulation
16. Special Purpose Company Fee Regulation

DIFC: Ecosystem – Supports the 360º Development of the fixed Income Market



DIFC – Time Zone Advantage



Dubai is 4 hours ahead of Greenwich Mean time (GMT)

5pm Dubai = 9am New York	1pm Dubai = 9am London	9am Dubai = 1pm Hong Kong

DIFC - Value Proposition

Clear & Transparent Legislation

DFSA: World Class Regulations

Window to a wealth of opportunities

A dedicated financial services cluster

Borse Dubai/Nasdaq Dubai: Liquid & Transparent International Exchange

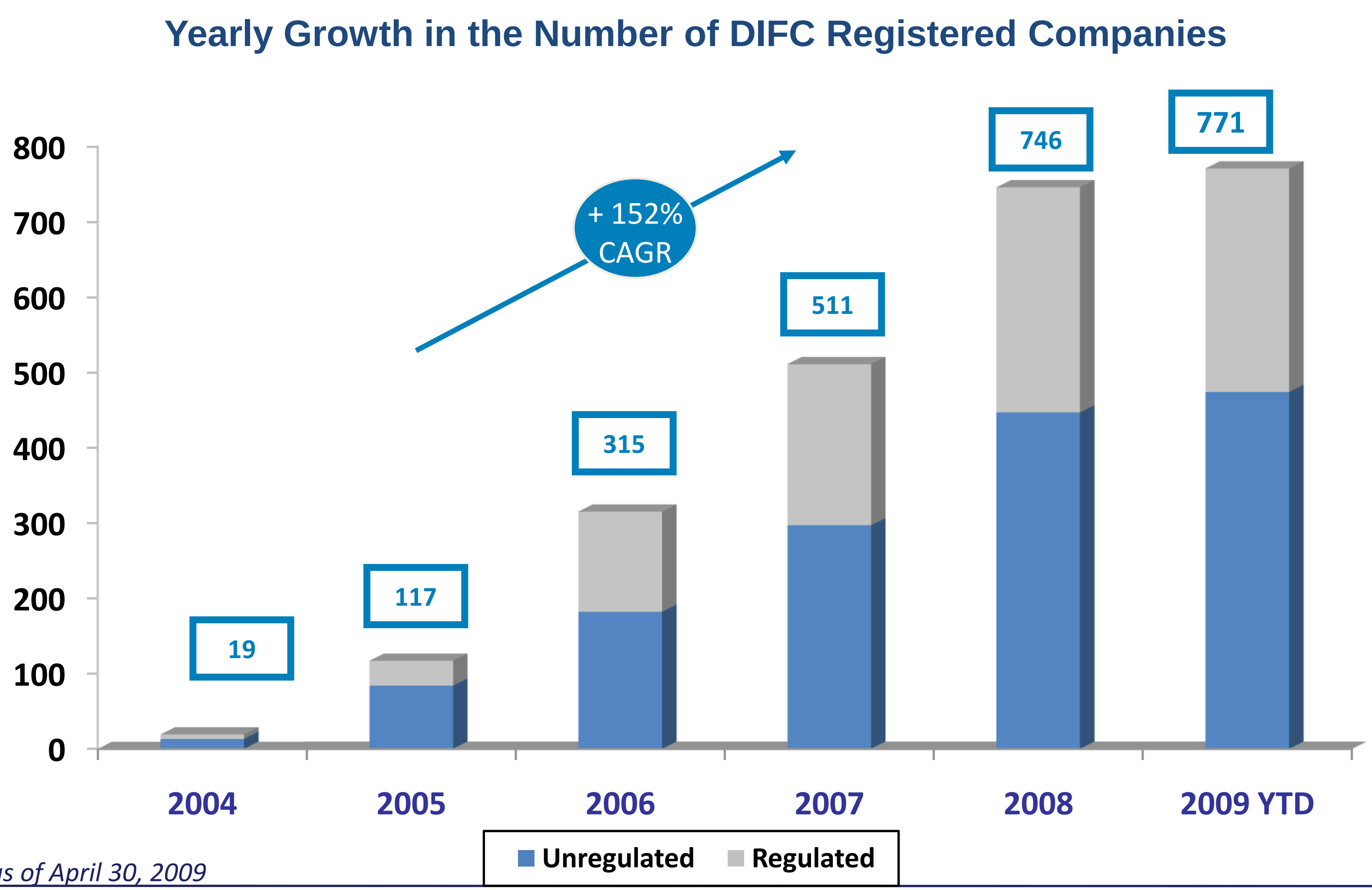
Hawkamah Institute for Corporate Governance

DIFC Courts: Independent Judicial System

DIFC Education Strategy: Access to Talent

DIFC Resource Centre: Business Support Services

The Momentum



Data as of April 30, 2009

Islamic Finance at the DIFC

Islamic Banking in the DIFC

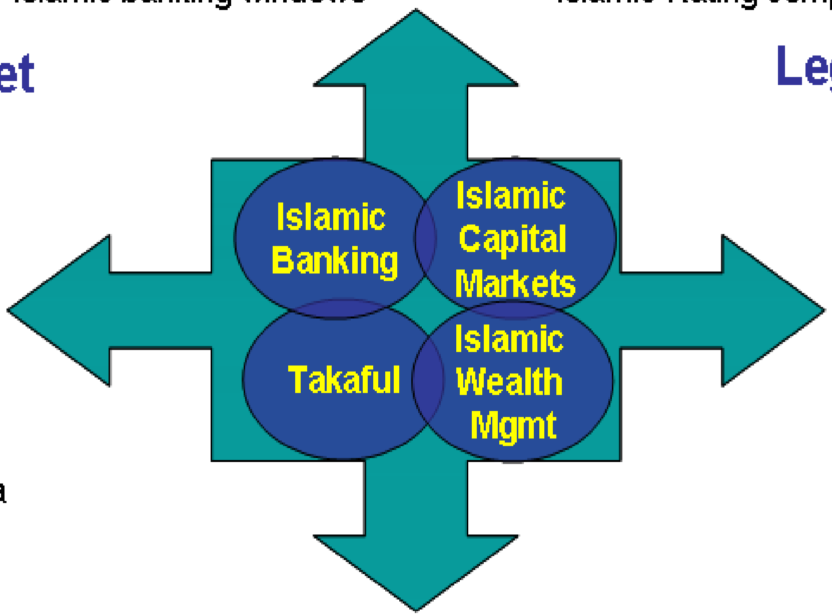
DIFC's Enabling Infrastructure

Institutional Development

- Domestic & foreign Islamic banks
- Islamic banking windows
- Waqf Trust Services
- Islamic Rating companies

Product & Market Development

- Comprehensive product range in banking, Takaful & financial markets
- Global Sukuk listing platform, sovereign & corporate
- Commodity Murabaha Exchange
- Islamic Hedge Funds Platform



Legal, Shari'a & Reg. Framework

- Comprehensive regulatory and legislative framework
- Dispute resolution
- Arbitration centre
- Favourable tax structure
- DIFC Shari'a Center
- International best practices

Knowledge & Education

- Education Centre
- International conferences
- Islamic Finance Portal
- Business Intelligence Centre

Islamic Finance at the DIFC I

- A sophisticated framework of laws, regulations and controls relating to Islamic Financial business
- Appropriate degree of flexibility built into regime, allowing financial institutions to carry out a number of activities conducive to the cross-sectoral nature of Islamic finance, as well as the flexibility of the establishment of either Islamic windows and Islamic financial institutions.
- Regulation ensures conformity to international standards such as risk and capital adequacy as set out by Basel, while adhering to Islamic finance industry guidelines and applications as set out by AAOIFI.
- An international base for providers of Islamic financial products, including Sukuk, that meet the needs of both institutional and individual investors.
- Regulatory regime for Islamic Funds, Investment Trusts and Real Estate Investment Trusts (REITs)
- The structuring of Islamic finance transactions such as Murabaha and Ijara under DIFC's clear & transparent legislation leaves no room for uncertainty and misinterpretation, giving Islamic financial institutions the level of comfort.

Islamic Finance at the DIFC II

- **Facilitating establishment of educational programs, workshops, training on Islamic finance using the DIFC platform.**
- **A new domicile for the registration of Islamic collective investment schemes, reflecting an increasing investor preference for Shari'a-compliant investment products originating and managed in the region.**
- **An electronic platform for the primary listing and secondary trading of sophisticated Islamic financial instruments, such as Sukuk.**
- **DFSA is working with regional and international regulatory bodies and entering into cooperation and information sharing arrangements with other regulators and counterparties.**
- **DIFC has established the Hawkamah Institute for Corporate Governance which provides assistance to Islamic finance institutions on enhancing their corporate governance arrangements and structures.**

The Result: an enabling and conducive environment supportive of the future development of the Islamic Financial sector

Islamic Finance Milestones at DIFC

Jul 2006	Islamic International Rating Agency (IIRA) established a presence at the DIFC.
Mar 2007	World's first new Executive MBA specialized in Islamic Finance and Energy delivered in DIFC by Cass Business School
Mar 2007	DFSA signs MoU with Bank Negara Malaysia in order to facilitate and remove regulatory barriers for Islamic finance transactions between the DIFC and Malaysia.
Mar 2007	DIFC establishes Islamic Finance Advisory Council to promote the development of Islamic Finance.
Jun 2007	DIFC Investments issues a US$1.25 billion Sukuk, the largest rated and the largest Straight Sukuk to come out of the region.

Islamic Finance Milestones at DIFC

Apr 2008	DFSA signs MoU with the Securities and Futures Commission of Hong Kong ("SFC") to promote and develop Islamic capital markets, and facilitate the distribution of Islamic funds in the DIFC and Hong Kong.
Apr 2008	DIFC becomes associate member of the Islamic Financial Services Board (IFSB)
May 2008	DIFC signed an MoU with the Hong Kong Monetary Authority (HKMA) aimed at fostering co-operation in the development of Shari'a-compliant financial products and the financial infrastructures between the two jurisdictions.
Nov 2008	Launch of the first standardized Commodity Murabaha Contracts (Master Agreement for Treasury Placement) in association with IIFM

NASDAQ Dubai- largest global exchange for Sukuk

PCFC Development FZCO
US $ 3,500,000,000
Trust certificates Due 2008
January 26, 2006

Aabar Sukuk Ltd
US $ 460,000,000
Trust certificates Due 2010
June 30, 2006

TID Global Sukuk Ltd
US $ 150,000,000
Trust certificates Due 2011
October 16, 2006

Nakheel Development Ltd
US $ 3,520,000,000
Trust certificates Due 2009
December 14, 2006

DIB Sukuk Company Ltd
US $ 750,000,000
Trust certificates Due 2012
March 26, 2007

DAAR International Sukuk Ltd
US $ 600,000,000
Trust certificates Due 2010
May 28, 2007

IIG Funding Ltd
US $ 200,000,000
Trust certificates Due 2012
June 14, 2007

Dubai Sukuk Centre Ltd
US $ 1,250,000,000
Trust certificates Due 2012
June 18, 2007

DP World Sukuk Ltd
US $ 1,500,000,000
Trust certificates Due 2012
July 3, 2007

Cherating Capital Ltd
US $ 850,000,000
Trust certificates Due 2012
July 6, 2007

Dar Al Arkan International Sukuk Ltd
US $ 1,000,000,000
Trust certificates Due 2010
July 23, 2007

Ras Al Khaimah Investment Authority
US $ 325,000,000
Trust certificates Due 2012
December 9, 2007

JAFZ Sukuk Ltd
US $ 2,040,000,000
Trust certificates Due 2012
December 9, 2007

Nakheel Development 2 Ltd
US $ 750,000,000
Trust certificates Due 2011
17 January, 2008

NASDAQ Dubai is the largest exchange in the world for Sukuk listings by value

Total Sukuk Value of USD 16.45 billion

Areas for Cooperation with the Italian Banking & Financial Sector

Framework for Cooperation

- Global economic & financial geography is changing. Need for establishing and strengthening of links and channels for communication, transactions, trade, investment and mutually beneficial cooperation.
- The DIFC and Italian Banking and Financial Industry have an opportunity to develop institutional and working relationships between each other.
- Development of the Islamic Finance Sector in Italy:
  1. Advise on development of legal and regulatory framework governing Islamic financial institutions in Italy
  2. DIFC can assist Italy in joining the ranks of countries –including the UK, France, Singapore and Japan- by removing tax, legal and regulatory barriers to Islamic finance.
  3. Address standardization and harmonization of laws
  4. Facilitate dialogue among Shari’a Boards
  5. Exchange of information and best practice
  6. Promote training, professional and educational programs
  7. Facilitate issuance of Government of Italy Sukuk
  8. Facilitate issuance of Shari’a compliant securities by Italian banks & companies, including funds and Sukuk

Annex: Shari'a & Conventional Banking Equivalence

I. Financing Products (arranged in order of importance)

Islamic Banking Products	Conventional Banking Products
Murabaha • A Murabaha transaction involves the purchase and resale (generally on installments) of an asset at cost plus an agreed profit margin. • The bank may retain a security interest in the asset being sold to the customer under a Murabaha. • The bank may not charge interest on late payments of installments. Nonetheless, penalty may be levied on late payments provided that the bank spends the penalty proceeds on charitable causes. • A special form of Murabaha, known as **International Murabaha**, is used by Islamic banks as the Shari'a-compliant alternative to placement of interbank deposits. The asset used in this case is generally one of the commodities traded on the London Metal Exchange. To take deposits from other banks, a bank uses **Reverse Murabaha.** • International Murabaha is a variation of a special form of Murabaha known as Tawarruq Murabaha, which is a transaction the sole purpose of which is for a bank to make cash available to its customer. This is accomplished by the bank purchasing a commodity spot, and reselling it to the customer on a deferred payment basis, then helping the customer to sell the same commodity spot for immediate cash. • Twarruq Murabaha is the mechanism underlying the Islamic credit cards that have been recently issued by some Islamic banks. The proceeds generated by the Tawarruq Murabaha are credited to a special purpose account in the name of the credit card holder which acts as the cover account for his credit card transactions (therefore it is called the "covered card"). • To simulate financing at a variable rate, a Murabaha transaction is structured to be rolled over at a predetermined frequency whereby each rollover Murabaha is priced at market rates. This structure is also used to simulate conventional bank overdrafts. • Tawarruq Murabaha and Revolving Murabaha have been the subject of increasing criticism by Shari'a scholars. Accordingly, many Islamic banks are restructuring the transactions that use these Murabahas as the vehicle to use Ijara instead. • Murabaha has also been used to finance real estate (residential, commercial, etc.). Although Ijara (at a variable profit rate) is the more popular vehicle for this.	Personal/Commercial Loans • A Murabaha is generally used as the Shari'a-compliant counterpart to conventional loans extended to customers for personal or commercial purposes. However, the differences between Murabaha and loans are: (i) A conventional bank generally disburses loans to its customers without becoming a party to the transaction involving the asset being financed (other than having a security interest in the asset); (ii) A conventional bank charges interest at fixed/variable rate as opposed to a profit margin, and it charges penalty and interest on late payments; (iii) Conventional banks transacting in the interbank market do not have to go through a commodity to place or take money in the form of bank-to-bank deposits. Instead, money is placed or taken at predetermined interest rates.

I. Financing Products

Ijara	**Leasing**
• Ijara involves the purchase of an asset by the bank then letting it to a lessee under either an operating or a capital lease ("Ijara Muntahia Bittamleek"). • Under an Ijara Muntahia Bittamleek, the asset is transferred to the lessee at the end of the lease term in consideration for i) a token price, ii) market value of the asset or iii) payment of the last lease installment. The property may also be gifted to the lessee by the lessor at the end of the lease term. • Risk of loss throughout the Ijara term must rest with the lessor under either Ijara type (but, of course, this is covered by insurance). • Insurance and major maintenance must be borne by the lessor under either Ijara type, but could be passed to the lessee through the lease payments. • If the Ijara assets were to be securitized, the beneficiaries must have ownership of the asset itself or its usufruct and not only the lease payments (i.e. one can not simply securitize only the receivables). • Ijara could be used as a vehicle to provide the customer with cash by simply buying an asset from the customer spot, then letting the same asset to the customer under an Ijara Muntahia Bittamleek that has a term of more than 12 months (to avoid a Shari'a prohibition against wash sale). • Ijara is the preferred vehicle for issuing Islamic bonds ("Sukuk"). The party wishing to avail itself of Sukuk financing simply sells assets to a special purpose vehicle that funds the transaction through issuing participation certificates to investors evidencing undivided interest in the assets and income thereon. The SPV then lets the assets back to the seller or to a third party to generate rental income. • Ijara Muntahia Bittamleek is the primary vehicle for real estate finance of all types (residential, commercial, retail properties, etc.). One of the primary reasons for this is the ability of the lessor to charge variable rent that could be indexed to a market benchmark (e.g. LIBOR).	• Conventional banks are generally limited to capital (or finance) leases. • In a capital lease, the risk of loss is ordinarily passed to the lessee. • In a capital lease, insurance and major maintenance are borne by the lessee. • Securitization could involve only the lease payments (i.e. only the receivables and not the underlying assets). • Conventional bonds do not necessarily have to be backed by specific assets. • Conventional mortgage finance involves a loan supported by a mortgage over the property as opposed to Ijara where the bank owns the property throughout the term of the financing.
Istisna • Istisna is a contract for financing the construction of capital assets. The bank must enter into two separate and distinct contracts, one with the customer who wishes to avail construction financing (the "**Istisna Contract**") and one with the builder or contractor (the "**Parallel Istisna Contract**"). An important Shari'a constraint here is that the outcome of the Istisna Contract may not be made explicitly dependent upon the outcome of the Parallel Istisna Contract (i.e. no pass-through). • Once the asset is constructed, the Istisna may turn into an Ijara Muntahia Bittamleek or a Murabaha.	**Construction Loans** • In a typical construction loan, the bank extends funds against some sort of security or mortgage, and does not get involved in contractual arrangements with the builder or contractor. • The construction loan is generally in the form of a bridge loan with interest payable during the construction period.

I. Financing Products

• A combination of Istisna and Forward Ijara (**Ijara Mawsufa' Fi Al Zima**) is used for construction financing to allow servicing the facility during the construction period and before the asset is completed. The Forward Ijara provides for a current lease of a specified asset under construction (the subject of the Istisna) and calls for advance rental payments that the bank receives during the construction period.	
<u>Asset-side Mudaraba</u> • In a Mudaraba, the bank is known as Rubulmal (owner of capital) and the customer is known as Mudarib (entrepreneur). The bank and the Mudarib share the enterprise profits in a predetermined manner. However, losses are borne only by the bank (being the contributor of all of the enterprise's capital). • Mudaraba could be used to simulate conventional bank overdraft. Here, the customer has the right to draw funds from the bank up to a certain limit under a Mudaraba agreement. The funds are invested by the customer in his business activities with the bank promising to waive any profits distributable to it in excess of a given rate. • Mudaraba could also be used as the vehicle for asset management whereby the bank entrusts the Mudarib with funds to manage in accordance with set guidelines.	**<u>Commercial/Corporate Loans and Asset Management</u>** • A conventional bank does not ordinarily partner with its customers. • The conventional arrangement that comes closest to a Mudaraba is where a bank hires an asset manager to manage an investment portfolio under a contract whereby the manager is entitled to a share of the profits to the extent the calculated returns exceed a certain rate or benchmark (i.e. incentive fee).
<u>Musharaka</u> • In a Musharaka, the bank becomes a partner in a certain economic activity with its customer(s). Both the bank and the customer(s) contribute capital to the business enterprise. • The bank takes direct ownership/business risk and shares in the profits or losses. • Profits generated by the business enterprise are allocated pro-rata among partners (or in any manner they see fit). • Losses can only be shared in proportion to each partner's share in capital (this is a Shari'a constraint). • A special form of Musharaka known as **Diminishing Musharaka** is used to finance real estate and other capital assets. Here, the bank's share in the Musharaka declines overtime through amortizing payments by the customer-partner who promises, at the outset, to buy out the bank's equity gradually over time. • Musharaka is not a widely used form of doing business in Islamic banking, primarily due to the higher degree of risk associated with it.	**<u>Commercial/Corporate Loans</u>** • A conventional bank does not ordinarily partner with its customers. • The bank would generally act only as lender to the business enterprise. • The lending rate (i.e. interest) is generally pre-determined and is fixed or floating (i.e. there are no profit sharing arrangements). • Business losses are the sole responsibility of the borrower.

II. Deposit Products

Liability-side Mudaraba • Typically, an Islamic bank takes deposits from its customers either in the form of **Qard** (i.e. non-interest bearing loan) or Mudaraba. Current account deposits are taken as Qards, while savings and term deposits (known as "Investment Deposits") are taken under a Mudaraba agreement designating the customer as Rubulmal and the bank as Mudarib. The bank is fully indebted to the customer for the Qard, but the customer bears the risk of loss with respect to Investment Deposit Accounts. • A term deposit may take the form of either "Restricted Investment Account" or "Unrestricted Investment Account", with the former being invested by the bank in a specific investment vehicle in a separate account (i.e. not commingled with other customers' deposits) while the latter becomes part of the common pool in which both depositors and shareholders' funds are commingled and invested collectively as the bank sees fit. • Subject to certain adjustments and exclusions, the bank's periodic net profit is allocated between shareholders on one side and Savings and Unrestricted Investment Deposit Account holders on the other (current accounts are excluded and Restricted Investment Accounts get their profits credited directly outside the common pool) based on their respective weighted average balances. However, in practice, most Islamic banks distribute to depositors a share of the profit calculated at a rate that is very close to the conventional market rates and reserve the difference for future use or take the difference from the reserve.	**Deposits** • Conventional bank depositors are creditors and the bank is a debtor. • A conventional bank pays its interest-bearing accounts a predetermined interest rate.
Wakala • In a Wakala, the bank may act as agent ("Wakil") or principal ("Muwakil"). When the bank is entrusted with customer funds for investment, the bank as a Wakil acts in a fiduciary capacity. On the other hand, the bank may entrust another party with funds for investment. • Wakala is being increasingly used by some Islamic banks to accept deposits from institutional customers or to place funds with other banks (i.e. interbank). This is primarily because i) under a Wakala, the profit rate that the funds would earn could be determined in advance with a high level of certainty and ii) the Wakala agreement is much simpler than the International Murabaha agreement (for placing with other banks) or the Mudaraba (for taking deposits from customers).	**Fiduciary Arrangements** • Conventional banks act as fiduciaries under a variety of arrangements. They also occasionally entrust others with funds for management in a fiduciary capacity (e.g., asset managers). • Conventional bank s place and take deposits at predetermined interest rates.

III. Investment and Derivative products and Waqf (trust) - arranged in terms of frequency of use

Product Description	Conventional Banking Products
<u>Equity Investments</u> • Equity funds come with different objectives (e.g., growth, income, small cap, large cap, etc.) and different scope (e.g., global equities, US equities, local equities, private equities, Takaful (Islamic insurance), healthcare, etc.). Also, equity funds may take the full equity investment risk or may be structured as capital protected funds. • Many Islamic equity investments today are screened for Shari'a compliance using the criteria of the Dow Jones Islamic Market index. These criteria deal with the nature of business which the company undertakes, its total indebtedness, total receivables and its level of income from prohibited assets. Screened equities that are eligible for investment from a Shari'a standpoint are, of course, further screened to ensure that they meet the investment objectives and guidelines of the investor. • Prohibited income that would inevitably be produced by some of the Shari'a screened stocks must be cleansed by the investor by spending it on charitable causes.	• Other than Shari'a screening and the cleansing of prohibited income, there are no major differences between investing in equity conventionally vs. investing in compliance with Shari'a.
<u>Shari'a Alternatives to Money Market Funds</u> • Funds for short-term liquidity and cash management (these are more or less the equivalent of the conventional money market funds). Most of these funds invest in International Murabahas although some of them use Ijara as the basis.	• See comments under Murabaha and Ijara in the Financing Products table above.
<u>Income Producing Investments</u> • Ijara (leasing) funds are the equivalent of conventional fixed income funds. These funds generally invest in capital assets that are let to end-user lessees. These include vehicles, computers, construction cranes, agricultural equipment, earthmoving machines, cars, trucks, special purpose factory equipment, etc. • Real estate funds are also a subclass of the Ijara funds. Also, Ijara is the preferred vehicle for issuing Sukuk or Islamic bonds (see description of Sukuk under Ijara in the table for Financing Products above).	**<u>Fixed Income Investments</u>** • Conventional fixed income funds and bonds pay interest at fixed or floating rates, as opposed to the rental income distributed by Ijara funds and Sukuk.
<u>Bai Al Salam</u> • Bai Al Salam is the Shari'a counterpart to a forward contract. Under a Salam contract, a party could sell a specified commodity that he does not own at the time of sale. However, as opposed to a conventional forward contract, the seller receives the full amount of the sales proceeds from the buyer at the time of sale.	**<u>Forward Contracts</u>** • In a forward contract the buyer (with the possible exception of a small margin deposit and mark to market adjustments) does not have to pay the full amount of the underlying until delivery takes place. • Forward contracts are used to buy and sell foreign currencies and precious metals at future dates.

III. Investment and Derivative products and Waqf (trust) - arranged in terms of frequency of use

• The seller may enter into a "Parallel Salam" contract simultaneous with the sale under the Salam contract for the purpose of acquiring the assets being sold (i.e. matched purchase and sale). • Salam may not be used for the sale of foreign currencies or precious metals as these must be paid for spot. Currencies and precious metals have many restrictions placed on their sales and exchanges as they are considered as means of payment (i.e. money) that could not be bought or sold on a deferred payment and/or deferred delivery basis, since the purchase or sale of money for deferred payment or delivery is Shari'a objectionable as it is deemed a form of paying or receiving interest.	
Bai Al Arboun • Bai Al Arboun is the Shari'a counterpart of call options. A Arboun contract provides for one party paying a down payment (Arboun) to another in return for the right to purchase a particular underlying(s) at an agreed upon price at a future date. If the holder of the right does not exercise it, his Arboun is forfeited. If he exercises his right, the Arboun is considered part of the purchase price.	**Options** • In a conventional option, the premium paid by the option buyer is considered the price of the option as opposed to a down payment on the price of the underlying. Therefore, even if an option is exercised, the premium would not be taken into consideration in determining the purchase price to be paid by the option holder.
Profit Rate Swaps • Shari'a-compliant Profit Rate Swaps (PRS) have been developed by simulating the two legs of a conventional IRS using International Murabaha. The fixed rate leg is simulated by a term International Murabaha contract, while the floating rate leg is simulated by a revolving International Murabaha contract. • Although few PRS transactions have been executed so far, the rules of entering and unwinding the swap are still being hammered out in order to bring them to full compliance with Shari'a requirements. In this regard, there are some ongoing attempts by international law firms to rewrite the ISDA rules specifically for Islamic banking. • It should also be noted here that some Islamic banks have succeeded in simulating Credit Default Swaps through a structure involving a Murabaha with zero profits (called "**Bai Al Tawlia**") extended to a special purpose vehicle, where the proceeds of the Murabaha remains credited to an account for the SPV with the bank and where the account used as margin for a bank guarantee issued by the bank benefiting a third party to whom the SPV sells protection. Similar structures, more or less, are used to invest in CDOs and CLNs.	**Interest Rate Swaps** • Interest Rate Swaps (IRS) involve the payment by one party (A) of a fixed rate to another party (B) and the simultaneous payment by party (B) of a floating rate to party (A), or vise versa. • Interest Rate Swaps are governed by the International Swap Dealers Association (ISDA) rules.

III. Investment and Derivative products and Waqf (trust) - arranged in terms of frequency of use

Waqf	Trust
• A Waqf involves the transfer of assets by a grantor (Wakif) to a trustee (Mutawalli) who administers these assets for the benefit of others. • The Mutawalli may not sell the Waqf assets without the permission of the Shari'a court. • A Waqf may continue to exist indefinitely. • A Waqf may not be revoked. • A Wakif may not have beneficiary interest in the Waqf once created. • Some assets may not be eligible for transfer to a Waqf. • Waqf assets must be invested in a Shari'a-compliant manner.	• In a conventional trust, the trustee owns the assets and may dispose of them as he deems appropriate. • Trust assets must vest in the ultimate beneficiaries within a certain time period. • A trust may be revocable or irrevocable. • A grantor may be a beneficiary of the trust he grants.

IV. Takaful (Islamic Insurance)

Takaful	Conventional Insurance
• A Takaful operator collects premiums from policyholders in the form of donation (Tabarru) to a common pool of funds intended for the mutual protection of all policyholders. • The Takaful operator manages the Takaful pool pursuant to a Mudaraba or a Wakal contract (i.e. the operator becomes a Mudarib or a Wakil – see definition of Mudaraba and Wakala in the Deposit Products table above). • Investment income is shared by the operator (Mudarib/Wakil) and policyholders (Rubulmal/Muwakil) as specified in the Mudaraba/Wakala contract. Furthermore, the operator may be compensated from the Takaful pool surplus in the form of a management fee or in the form of reimbursement of actual expenses. • Investment of the Takaful pool surplus funds may only be done in compliance with Shari'a (see Investment and Derivative Products and Waqf table above). • There are two major types of Takaful, i) Family Takaful which is the equivalent of conventional life insurance and ii) General Lines Takaful which is the equivalent of non-life insurance.	• There are two types of conventional insurance companies, i) stock insurance companies and ii) mutual insurance companies. Stock insurance companies are purely "for profit" and, accordingly, their aim is to maximize shareholders' wealth. Mutual insurance companies are more in the nature of cooperatives in the sense that they aim to serve the policyholders interest.

Thank You

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