

# GROWTH OF ISLAMIC FINANCIAL AND CAPITAL MARKETS

---

Dean Peloso  
York University  
Toronto, Canada

**The Third Annual Conference of  
Islamic Economics & Islamic Finance**

**Venue:** Chestnut Conference Center  
**Date:** October 29<sup>th</sup>, 2016

Organized by: [ECO-ENA, Inc.](#), Canada

# Growth of Islamic Finance

- Growth of Islamic Finance (IF) has been remarkable
- Predictions suggest a market of U.S. \$3 trillion by 2018
  - Recent Gulf financings with commitment for Sukuk product
- Starting from almost zero-base in the early 1970's
- Breadth of institutions, products (debt, equity, funds, derivatives, ETF's, REIT's) and global geographic participation (Gulf, Asia, Europe, North America)
- Question: Has the growth in Shari'ah compliant financing also embraced the Islamic ideal of promoting the larger public good (equity, fairness, practicality and social justice)?

# Focus on Shari'ah Compliant Product

- Product innovation and product engineering have been responsible for much this successful IF growth
- Shari'ah compliant products largely mirror conventional finance product structures (debt, equity, derivatives) via historic Islamic contract structures or combinations thereof that draw their legitimacy from the Quran
  - Equity – Mudarabah, Musharakah
  - Debt – Murabahah, Istisna, Ijarah, etc.
- Shari'ah law is meant to promote a way of life
- Question: If the products are the same or if there is emphasis on debt-like products will Islamic ideals be realized?

# Sukuk Domination

- Largest, fastest growing and most dominant product
- Growth is justified
  - Low risk
  - Consistent returns
  - Tax advantaged
- Sukuk represents an ownership interest and is valued on the underlying asset
- Some product engineering may have rendered differences to be semantic
  - Returns fixed (interest-like)
  - Certainty of principal return
- Riba prohibited for a reason ... and so IF needs to move in a different direction

# Lessons From the Financial Crisis

- Clear indications that a debt-based economy leads to instability
  - Easy money, predatory lending, high leverage, uncontrolled growth of credit, complex financial structures, risk/responsibility transfer ...
  - Financing that far exceeded the needs of the real economy
  - Not Shari'ah compliant behaviour ... Debt, Riba, Maysir and Gharar
- Even post-crisis its clear that problems persist
  - Negative interest rates and low productivity are indications of a world economy that remains unstable and out of balance.
- Arguably ... Islamic finance is an answer ... a way to move forward
- Also consistent with the sentiment within the Muslim community (Dusuki)

# Equities - Shari'ah Compliance

- Equity investments involve partnership and risk sharing
- Consistent with Mudarabah and Musharakah contracts
- For equities to be Shari'ah compliant you must accept:
  - Principal–agent relationship
  - Transfer of ownership in secondary markets
  - Uneven dividend yields and loss realization based on share purchase price
  - Going concern assumption
  - Majority vs. consensus decision making
- Greater equity valuation and pricing sophistication is required, one that encompasses the principles of Islamic Finance, to prevent Gharar and Maysir
- Fiqh Academy has approved both modern equities and the secondary markets they trade on

# Role for Exchanges in Promoting Islamic Equity Financing

- Exchanges have played an important role in the growth of western economies
- Important for
  - Financial intermediation
  - Financing growth
  - Providing Visibility to Companies
  - Liquidity to Shareholders
  - Currency for M&A activity
  - Incenting employees
- Potential for a much greater role in Islamic economies
- Not all equities are Shari'ah compliant
  - Conventional finance companies
  - Alcohol producers, vendors
  - Etc.

# Comparison of TSX and Bursa Malaysia

- Paper compared the Original Listing requirements of the two exchanges to understand the potential for BM to further the growth of Islamic equity financings
  - Further effort could be expended on the Continued Listing requirements of both exchanges as well as their rules around corporate transactions
- Chose Malaysia for its relatively well developed financial markets
- Also looked at the Shari'ah compliant indices for both exchanges

# Bursa Malaysia

- Operates under the oversight of the Malaysia Securities Commission (SC)
- Over 800 senior and about 100 junior listed companies
- Broad range of enterprises – finance, hotel, industrial, mining, plantation, REIT's, etc.
- SC sets out listing requirements and along with BM control access to the exchange
- Listing criteria are standard and include quantitative (profit, capitalization, public spread) and qualitative (sponsors, management, etc.)
- Act (CMSA) does not mention Shari'ah compliance
- Shari'ah Advisory Committee (SAC) does rule on which listed entities are Shari'ah compliant

# Listing on the TSX

- Operates under the oversight of the Ontario Securities Commission (OSC)
- Over 3300 senior and junior listed companies
- Broad range of enterprises – mining, finance, technology, biotechnology, communications, utilities, industrial, oil & gas, ETF's, REIT's, etc.
- Listing criteria are standard and include quantitative (profit, capitalization, public spread) and qualitative (sponsors, management, etc.)
- Difference – listing requirements are much deeper and offer categories for companies at different stages and profiles
  - List without earnings, revenue, cash flow or tangible assets

# Early Stage Listings – some criteria

- Audited and verified cash flow projections
- Adequate working capital to complete work programs
- Successful prior operating history
- Sophisticated Board and management with history of commercialization
- Commercial contracts
- Relationships/affiliations with large players/majors if necessary
- Sales contracts contingent on delivery
- Verification that products, services or properties are at an advanced stage

# TSX Mining

- Listing possible for both producers and explorers
- Property of merit
- Produce an official document – CSA 43-101 Report
- Verification by “qualified person” (geologist, mining engineer)
- Sufficient capital to advance the property to the next stage
- Minimum proven and probable reserves of sufficient economic grade and continuity for commercialization
- Must retain 50% ownership of the property
- Additional capital to support general and administrative activities
- Contingency fund

# Impact of Mining Listing Requirements

- TSX responsible for 50% of mining financings globally in 2015
  - Diversified by commodity (gold, copper, etc.) and by stage of development
  - Majority of the mining projects are undertaken outside of Canada
- Listing requirements have resulted in amassing large sophisticated financing capital pools
- Even deeper pool of sophisticated talent
  - Mining engineers
  - Geologists
  - Lawyers
  - Accountants
  - Financial and market analysts
  - Commodity experts
  - Etc.
- This same approach is needed for Islamic Financing
- BM or others could take the lead

# Impact of Mining Listing Requirements

- TSX responsible for half of mining financings globally in 2015
- More than 50% of ALL mining companies are listed on TSX
  - Diversified by commodity (gold, copper, etc.) and by stage of development
  - Vast majority of the mining projects are undertaken outside of Canada
- Listing requirements have resulted in amassing large sophisticated financing capital pools
- Even deeper pool of sophisticated talent
  - Mining engineers
  - Geologists
  - Lawyers
  - Accountants
  - Financial and market analysts
  - Commodity experts
  - Etc.
- A similar focus and approach is needed for Islamic Financing
- BM or others could take the lead

# Opportunities for Shari'ah Compliant Equity Financing

- Specific research and focus is required to assist Shari'ah compliant companies to come to market
  - Understand types of entities
  - Stages of development
  - Risks and mitigations
  - Policy approach including tax
- Consider opportunities for microfinance
  - Fintech
  - Crowd-funding
- Macro approaches to establishing large equity pools (i.e. Pensions) to support large infrastructure projects
  - Solar or wind power
  - Telecommunications networks
  - Pipelines
- Consider expansion of REIT's and the Income Trust Model
- Expansion of Indices to reflect the Shari'ah based specialization
- This will be another 40 – 50 year journey ... and the end result will be to bring Islamic Finance closer to the Shari'ah ideal

# Thank You

- Questions?