Qatar Islamic Finance Report 2018

Expanding Horizons

مركز قطر للمال
Qatar Financial Centre

Foreword

The Qatar Financial Centre (QFC) is proud to present the Qatar Islamic Finance 2018 Report: Expanding Horizons, which demonstrates the QFC's continued commitment towards providing valuable information and insight into the Shariah-compliant Islamic finance Industry.

Qatar has successfully managed to build one of the world's fastest growing and dynamic economies over the past ten years. With careful government planning and investments in infrastructure, education, social services and other sectors that extend well beyond the hydrocarbons and energy industries, Qatar is creating a stable and prosperous future for its citizens and workforce. This growth trajectory being driven by the implementation of Qatar's 2nd National Development Strategy and the Vision 2030 initative.

The financial sector remains one of the very foundations of this new diversified economy, and institutions such as the Qatar Financial Centre are important examples of Qatar's commitment to becoming a world-class financial hub.

Islamic banks in Qatar have encompassed the largest segment of the Islamic finance market, launching ambitious expansion plans abroad in recent years. Moreover, there are significant opportunities for growth in takaful, asset management and non-bank investment firms, as well as strong demand for increased sukuk issuance. In addition, in 2018 the Qatar Stock Exchange listed the world's largest single-country Islamic exchange-traded fund (ETF) in Qatar.

For the QFC, we see increased importance in not just conventional finance, but also Islamic finance. Furthermore, we see increased opportunity for Islamic finance firms specialising in fintech, asset management and sukuk issuances.

With up to 100% foreign ownership laws in place, a compelling tax environment and ease of business start-up, the QFC is a competitive hub for Islamic finance firms looking to conduct business in Qatar, but also from Qatar into untapped markets in the MENASA region.

For Islamic finance firms, the QFC is committed to ensuring high international regulatory standards through the Qatar Financial Centre Regulatory Authority (QFCRA), which has specific Islamic banking prudent rules in place for QFC Islamic finance firms.

We are confident that this report will serve as a future benchmark and important reference for key stakeholders and decision-making in Islamic finance, and aspire that the information and analysis contained will help guide you through the abundant opportunities that Qatar continues to present in Islamic finance.

Yousuf Mohamed Al-Jaida
Chief Executive Officer

Qatar Financial Centre Authority

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Executive Summary

Qatar has been one of the fastest growing economies in the world over the last decade, with real GDP growth averaging 11% between 2006 and 2017. The IMF projects economic growth to remain stable at an average level of 2.7% in the coming five years as Qatar's economy exhibits its resilience owing to deep foreign reserves. Government plans for economic diversification and infrastructure development in line with the Qatar National Vision 2030 will support continuing growth, by creating more jobs and attracting investment to non-hydrocarbon sectors. These plans are also key to the growth of the financial sector, helping to establish Qatar as a financial and investment hub in the region.

The Islamic finance industry is a vital part of Qatar's financial system, and it has exhibited resilience in the face of less favorable economic conditions. Outpacing the growth of conventional assets, Islamic finance assets have grown at a CAGR of 11% over the last five years and 13% in 2017 alone. The value of these assets reached US$119 billion in 2017, constituting 22% of the financial system's assets. With enhancements to the further evolution of the Islamic finance ecosystem, particularly in its regulatory framework, Qatar has great potential not only to sustain the industry's double-digit growth but also to increase its share of overall financial assets. Stronger collaboration between Islamic banks and other Islamic financial institutions will also help the industry. Partnerships can capitalize on banks' economies of scale and give greater access to funding and other financial institutions' specialized expertise and skills.

The regulatory framework for Islamic finance in Qatar is unique in the region. Islamic and conventional banking and insurance operations have been segregated in an effort to strengthen the Shariah-compliant proposition of full-fledged Islamic financial institutions. However, the approach to Shariah governance at these institutions remains decentralized, overseen by individual institutions' Shariah Supervisory Boards. Efforts to harmonize and enhance financial regulation in Qatar should also involve establishing a centralized Shariah supervisory authority to achieve greater market-wide consistency and credibility in Shariah governance, in line with global best practice.

Islamic banks have been the key driver of Islamic finance growth in recent years, growing by 13% CAGR in the last five years. They hold the largest share of Islamic financial assets, worth US$97 billion in 2017. However, a saturated domestic market and regulatory constraints on consumer lending limit prospects for further fast-paced growth in Islamic banking. As a result, Islamic banks are looking to expand into nascent Islamic finance markets abroad, where they can leverage their market expertise and resources to maintain



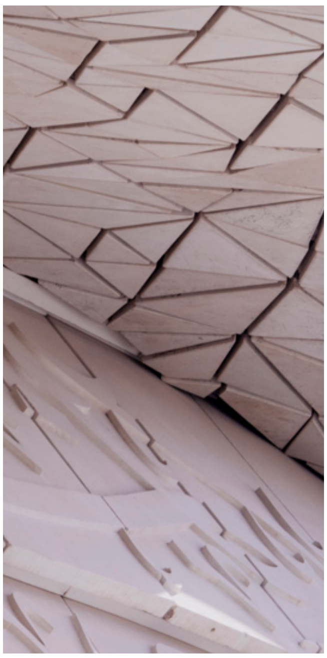
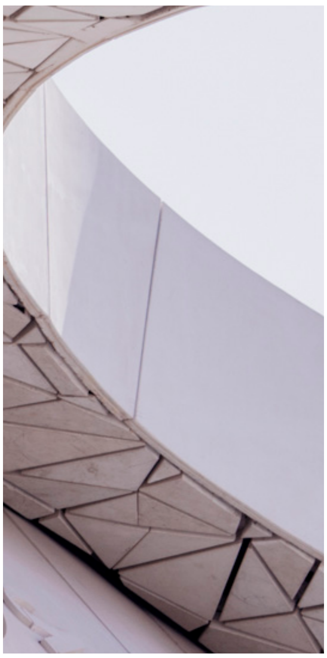

growth. So far, this has been a successful strategy for Qatar's Islamic banks, which have tapped their surplus foreign deposits to meet their liquidity requirements domestically.

Takaful and non-bank financial institutions together accounted for only 1.3% of total Islamic finance assets in 2017. Non-bank financial institutions in Qatar have shown muted growth, limited in both size and number. Assets of the non-bank financial sector were valued at US$1 billion. Caps imposed on consumer loans in Qatar have led non-bank finance companies to shift their focus to growth opportunities in SME lending, building on their competitive advantage in small-ticket financing.

Valued at a mere US$524 million in 2017, the takaful sector in Qatar has underperformed conventional insurance in terms of market penetration as well as growth. The major drawbacks for takaful operators are their small size and the lack of differentiation in their products, compared to the conventional insurers that dominate the insurance market. Enhancing standardization, promoting innovation and increasing consumer awareness should be top priorities in the further development and growth of takaful in Qatar.

Sukuk represent 18% of total Islamic finance assets, with a total of QAR 76 billion in outstanding issuances. Sovereign sukuk dominate the market, contributing 71% of issuances, while the corporate segment remains underdeveloped. With 28% of outstanding sukuk scheduled to mature in 2018, increased issuances will reduce the likelihood investors will reinvest their redeemed capital in other markets or asset classes. This presents an opportunity for more quasi-sovereign and corporate sukuk, which could also develop the issuer and investor bases for the sukuk market. The introduction of further tax incentives should aid this process by attracting foreign corporate issuers to Qatar.

Unlike Qatar's other financial sectors, the Islamic segment in asset management is larger than the conventional segment. Shariah-compliant investment funds make up more than half the asset management sector in Qatar, with US$224 million in assets under management. However, the sector remains relatively undeveloped compared to other Islamic finance sectors; it is currently limited to mutual funds. With over US$165 billion in investable domestic assets, the Qatar Financial Centre (QFC) is in a position to differentiate its investment offerings from other regional financial hubs. A unique proposition focused on alternative investments would likely attract new players to the region to set up in QFC and pursue opportunities in regional markets.


Islamic Finance Landscape

Banking

Conventional		Islamic
13	Number of Commercial Banks	4
1	Number of Specialized Banks	0
277,747	Total Commercial Bank Assets (US$ mn)	96,703
183,242	Total Commercial Bank Credit (US$ mn)	67,033
167,308	Total Commercial Bank Deposits (US$ mn)	58,791
10	Number of QFC Corporate Banks	1

Total QFC Assets (US$ mn)

8,736

Debt Securities

Conventional		Islamic
76	Number of Bonds / Sukuk Outstanding	52
70,055	Value (US$ mn)	20,879

Asset Management

Conventional		Islamic
171	Assets under Management (US$ mn)	224

Insurance

Conventional		Islamic
	Number of Operators	5
13,462	Total Insurance and Takaful Assets (US$ mn)	549
3,571	Total Premiums / Contributions (US$ mn)	176
12	Number of QFC Insurance Operators	3

Total QFC Assets (US$ mn)

852

NBFIs

Conventional		Islamic
0	Number of Finance Companies	3
0	Total Assets (US$ mn)	852
0	Number of Investment Companies	2
0	Total Assets (US$ mn)	179
6	Number of QFC Investment Banks and Investment Management	3

Total QFC Investment Banks and Investment Management AuM (US$ mn)

2,390

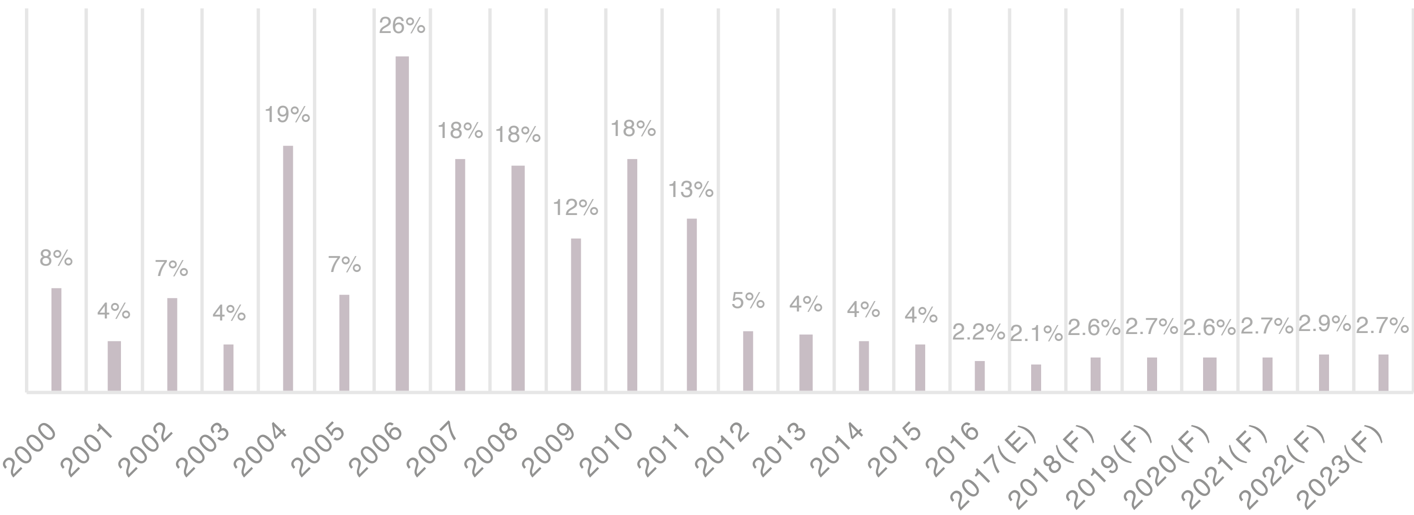
Economic Overview

Qatar has proven itself a reliable destination for investment thanks to its political stability, abundant natural resources, and preferential economic policies and incentives. The country also has comprehensive and ambitious economic development and infrastructure programs in line with its Vision 2030, and the implementation of Qatar's Second National Development Strategy 2018-2022.

By hosting the 2022 FIFA World Cup™, Qatar has made a serious commitment to a considerable project pipeline and key events. This event will help Qatar to enhance the diversification of its economy and to shift away from its heavy reliance on oil and gas.

According to the IMF, Qatar's economic growth is forecasted to reach an annual rate of 2.6% 2018. This is forecasted despite an anticipated plateau in hydrocarbon production, thanks to solid expansion in non-hydrocarbon activities that will sustain overall economic momentum.

Real GDP Growth (% of GDP) in Qatar 2000-2023 (f)



Source: IMF

The Qatari government has introduced a number of laws and regulations to improve its investment environment, attracting foreign capital and technology. From 2003 to May 2015, Qatar attracted foreign investment of US$110 billion in 701 investment projects. The United States and Japan are among the top foreign investors in Qatar, with ExxonMobil the single largest, with a US$21 billion investment.

The Qatar Investment Law provides a number of incentives to foreign investment. Foreign investors may lease land on a long-term basis and can import everything required for establishment, production or expansion of a project. Foreign investors also benefit from the reduced investment capital income tax, equipment import and raw material import tariffs and other tax-free concessions, as well as free capital movement across borders.

In addition, foreign investors can own up to 100% of the total investment in all sector's of Qatar's economy, and up to 49% of companies listed on the Qatar Stock Exchange (QSE). The Qatari cabinet approved a draft law in May 2018 that will replace Law No. 13 of 2000. In addition, the Qatar Financial Centre offers up to 100% foreign ownership and and 100% repatriation of profits, allowing businesses to trade in any currency.

In order to attract international talent, Qatar promulgated the New Labour Law (Law No. 21 of 2015), which entered into force in December 2016.

The labor contract system replaces the original guarantor system and further relaxes restrictions on the entry and exit of foreign workers.

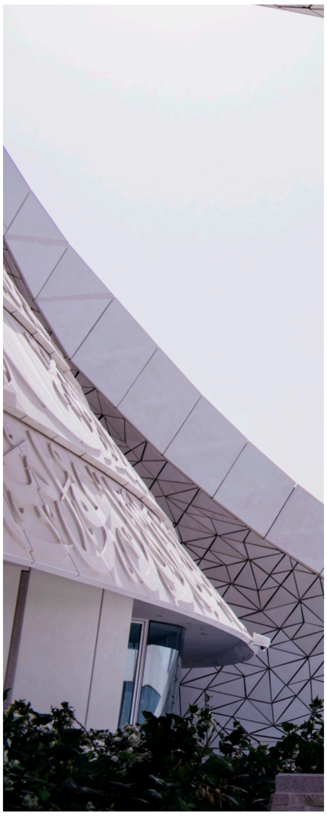
In the first move of its kind in the GCC, the Qatari cabinet approved a draft law allowing permanent residency for some non-Qatari residents in August 2017. Expatriates benefitting from the new law will be able to access free public education and healthcare services, own property, and run businesses without a Qatari partner.

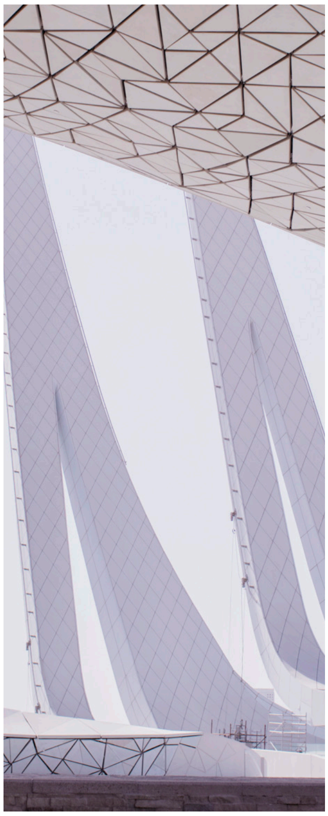
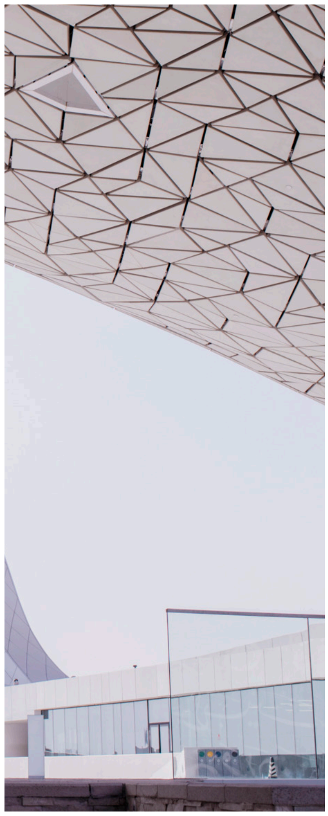
All these measures help stimulate Qatar's high growth. Inflation is kept under control with constant co-ordination between financial and monetary policy to provide support to the business environment and investments in the country. Significant recent regulatory reforms are likely to enhance economic diversification, such as enhancements made to the sovereign tender and procurement process to improve transparency and encourage small business participation.

In June 2017, a diplomatic rift emerged between Qatar and Saudi Arabia, Bahrain, the UAE and Egypt, impacting trade and the movement of financial and human capital. The resulting economic impact proved transitory, from which Qatar emerged with a stable economic outlook thanks to significant fiscal buffers and sound macroeconomic policies.

According to an assessment carried out by the IMF in August 2018, Qatar's economy and financial markets have been resilient to the impact of this diplomatic rift. In 2018, the three major credit rating agencies revised Qatar's sovereign ratings upwards to 'Stable', based on expectations that the country can withstand the impact of the diplomatic rift for a longer period of time than initially anticipated.

Qatar's government authorities have been quick to respond, stepping up efforts to secure alternative sources of imports and external financing. The Qatar Central Bank (QCB) and Qatar Investment Authority (QIA) have supported the domestic banking sector by injecting liquidity in the banking system through public sector deposits, offsetting a sharp decline in foreign deposits. This in turn led to increased commercial bank credit to the government, thus funding and narrowing the fiscal deficit to 6% of GDP in 2017 from 9% in 2016. A balanced budget in 2018 and a 2.9% fiscal surplus are anticipated.



Islamic Finance History

- **1982** – Establishment of Qatar's first Islamic bank and first Islamic financial institution, Qatar Islamic Bank (QIB)
- **1989** – Establishment of Qatar's first non-bank financing company, Al Jazeera Finance
- **1991** – Establishment of Qatar International Islamic Bank (QIIB)
- **1994** – Establishment of Qatar Islamic Insurance Company (QIIC) as Qatar's first takaful operator
- **2003** – Issuance of first Qatari sovereign sukuk, worth US700$ million
- **2005** – Authorization of Islamic windows in Qatar's banking system by QCB

  Introduction of Islamic Finance Rules by QFCRA
- **2006** – Establishment of Masraf Al Rayan

  Issuance of Qatar's first corporate sukuk by the Qatar Real Estate Investment Company

  Establishment of Pak-Qatar Family and General Takaful operators in Pakistan, backed by Qatari financial institutions
- **2007** – Establishment of Al Rayan Investment as QFC's first Shariah-compliant investment manager

  Establishment of QInvest, QFC's first authorized Shariah-compliant investment bank
- **2008** – Authorization of Qatar First Bank by QFC

  Establishment of QIB-UK, an international subsidiary of QIB
- **2009** – Establishment of Barwa Bank
- **2010** – Holding of %31 of Islamic banking assets in Qatar by Islamic windows at conventional banks, according to IMF

  Establishment of HSBC Amanah in Qatar

  Conversion of Al Khaleej Insurance and Reinsurance to Al Khaleej Takaful, Qatar's second takaful operator
- **2011** – Regulation by QCB disallowing of the operation of Islamic windows by conventional financial institutions
- **2012** – Introduction of Law No 13 of 2012 by QCB calling for the establishment of Shariah boards for Islamic financial institutions

  "Decline in number of banks offering Islamic products from 12 to 4, following QCB decision to disallow Islamic banking windows"
- **2013** – Establishment of Qatar's first Shariah-compliant equity index, QE Al Rayan Islamic index
- **2014** – Acquisition of controlling stake of Islamic Bank of Britain (IBB) by Masraf Al Rayan

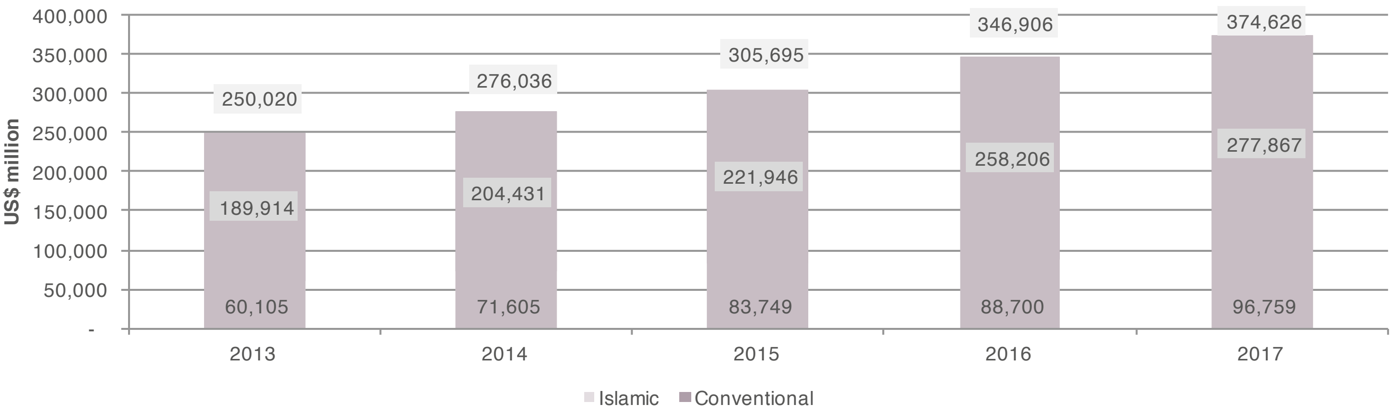
  Partnership between Qatar and Kenya to develop Kenya's Islamic finance industry
- **2016** – Approval of establishment of joint-venture Islamic bank between QIIB and Credit Immobilier et Hotelier (CIH) by the Moroccan central bank
- **2018** – Launch of Qatar's first Shariah-compliant ETF, Al Rayan Qatar ETF, and the world's largest single country Shariah-compliant ETF

Islamic Banking Overview

Banking growth resilient in economic slowdown driven by Islamic banking.

The banking system holds the largest share of total Islamic finance assets in Qatar. Islamic banking assets were valued at US$97 billion by the end of 2017, 81% of total Islamic finance assets. Collectively, Qatar's four Islamic banks posted 9.1% year-on-year growth in assets during the year, resuming its medium-term trend of outpacing conventional banking asset growth. This demonstrates the robustness and resilience of Qatar's Islamic banking sector to economic and political uncertainty. Growth in conventional banking assets registered a substantial drop from 16.3% in 2016 to 7.6% in 2017. The increase in Islamic banking growth translated to an increase in Islamic banking penetration reaching 43% of real GDP in 2017, up from 4% the previous year.

Commercial Banking Assets in Qatar 2013-2017



Source: Qatar Central Bank

- Prohibition of operating Islamic banking windows
- Imposing of limitations on personal financing
- Implementation of Basel III capital adequacy requirements
- Capping of loan-to-deposit ratios for banks, potentially delayed

Qatari Islamic banks bring expertise to new markets for Islamic finance.

Both Islamic and conventional banks in Qatar are having difficulty finding less competitive yet still profitable market segments domestically. With the market for personal financing seeing growth constrained by lending and financing cost limits, Islamic banks looking to expand domestically will have to focus on growth where their Shariah-compliance is not as much of an important differentiator, such as in the corporate finance market. As a result, many banks have looked abroad to find better growth prospects.

Qatar's Islamic banks are pursuing such strategic opportunities, seeking to operate in international markets such as Morocco and the UK. This opens new markets with significant untapped demand for Islamic finance and provides funding cost diversification to the parent Islamic bank in Qatar.

Fintech development could make Islamic banks more competitive.

Another opportunity for Islamic banks in Qatar to better compete with non-bank financial institutions will be by innovating with Fintech. Investment in Fintech has grown rapidly in previous years and this investment is beginning to translate into greater adoption, although most banks are still proceeding cautiously.

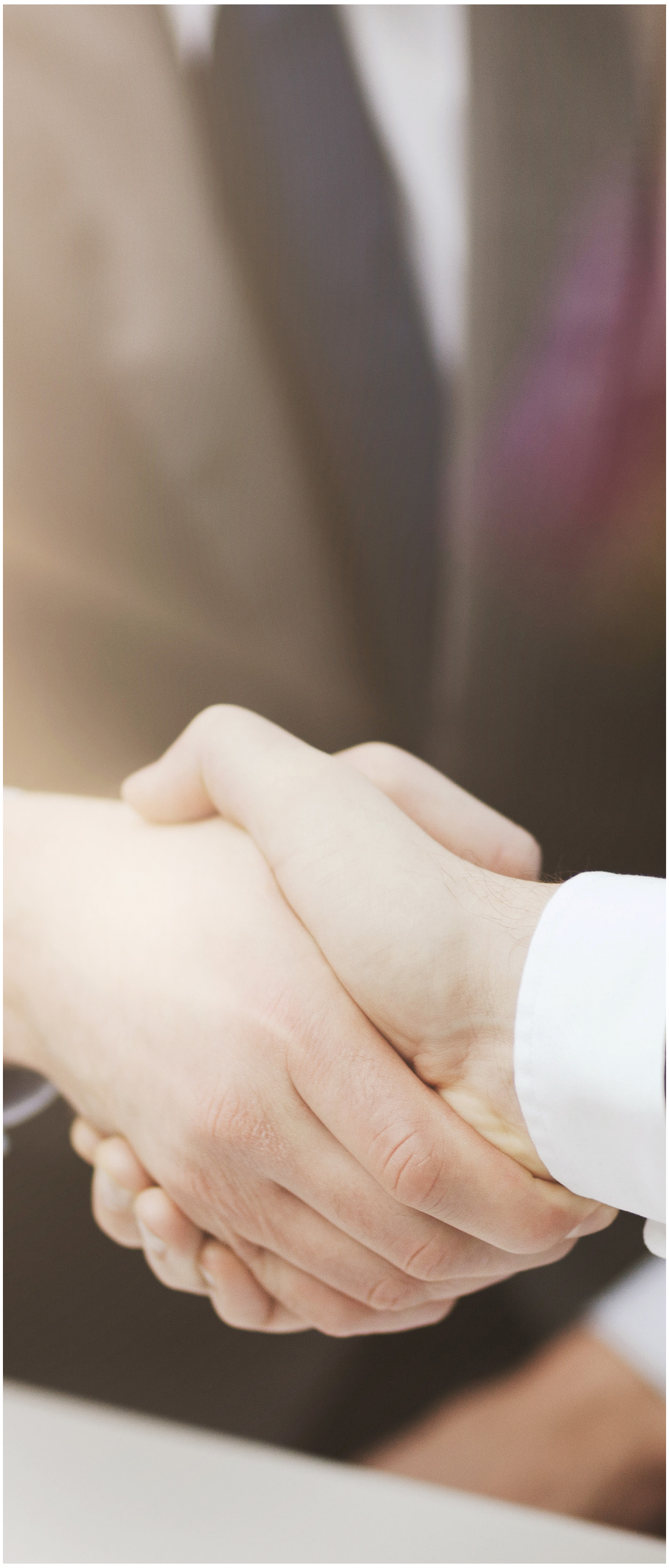
Successful deployment of a blockchain-based Fintech solution by Islamic banks would greatly expand the number of SMEs that could be financed. SME lending had been previously challenging for Islamic banks due to high administrative costs. Increasing the efficiency of the financing application and review process would allow Islamic banks to take advantage of their economies to scale. The Commercial Bank of Qatar undertook the first trial of a blockchain- based transaction for money transfer with other banks outside of Qatar, indicating an interest within the banking sector.

The most effective approaches to the regulation of Fintech involve a proactive approach that encourages development within the existing regulatory system. Many financial regulators have followed the lead of the Financial Conduct Authority (FCA) in the UK by setting up regulatory 'sandboxes'. A regulatory sandbox is a temporary regulatory environment that applies, on a case-by-case basis, only the regulations that are needed for consumer protection and to meet global requirements. In exchange for lighter regulations, Fintech startups agree to limit the types of business they will engage in, as well as the number and type of their customers.




Islamic Banking Retail Consumer Survey

Our exclusive retail banking consumer survey highlights a number of growth and investment opportunities for the Islamic banking sector in Qatar.



Customer Awareness

A significant gap exists between perceived and actual retail consumer knowledge and awareness of Islamic finance and banking. Only 1% exhibited excellent understanding of Islamic finance, although 79% believed they had at least some understanding.

Social media can be leveraged to promote knowledge and awareness to consumers. 49% preferred social media to all other channels for learning about Islamic finance and banking concepts.

Customer Experience and Satisfaction

Customers still do most of their banking offline. Over 50% of respondents prefer to carry out banking transactions over the counter.

Professional qualifications for bank staff necessary to improve customer service.

Developing customer-facing technology is key to differentiation and growth. Only 15% of respondents were 'very satisfied' with their bank's current technology.

Customer Product Preference

Product offering and customer service a priority for customers. The most important criterion, cited by 24% of respondents, for choosing a bank was product offerings.

Customers can be swayed to switch banks with product differentiation. 58% ranked limited product offerings as the most important reason to switch banks.

Basic banking products still in use, insurance the most demanded addition. 83% said they would like their banks to also provide insurance products.

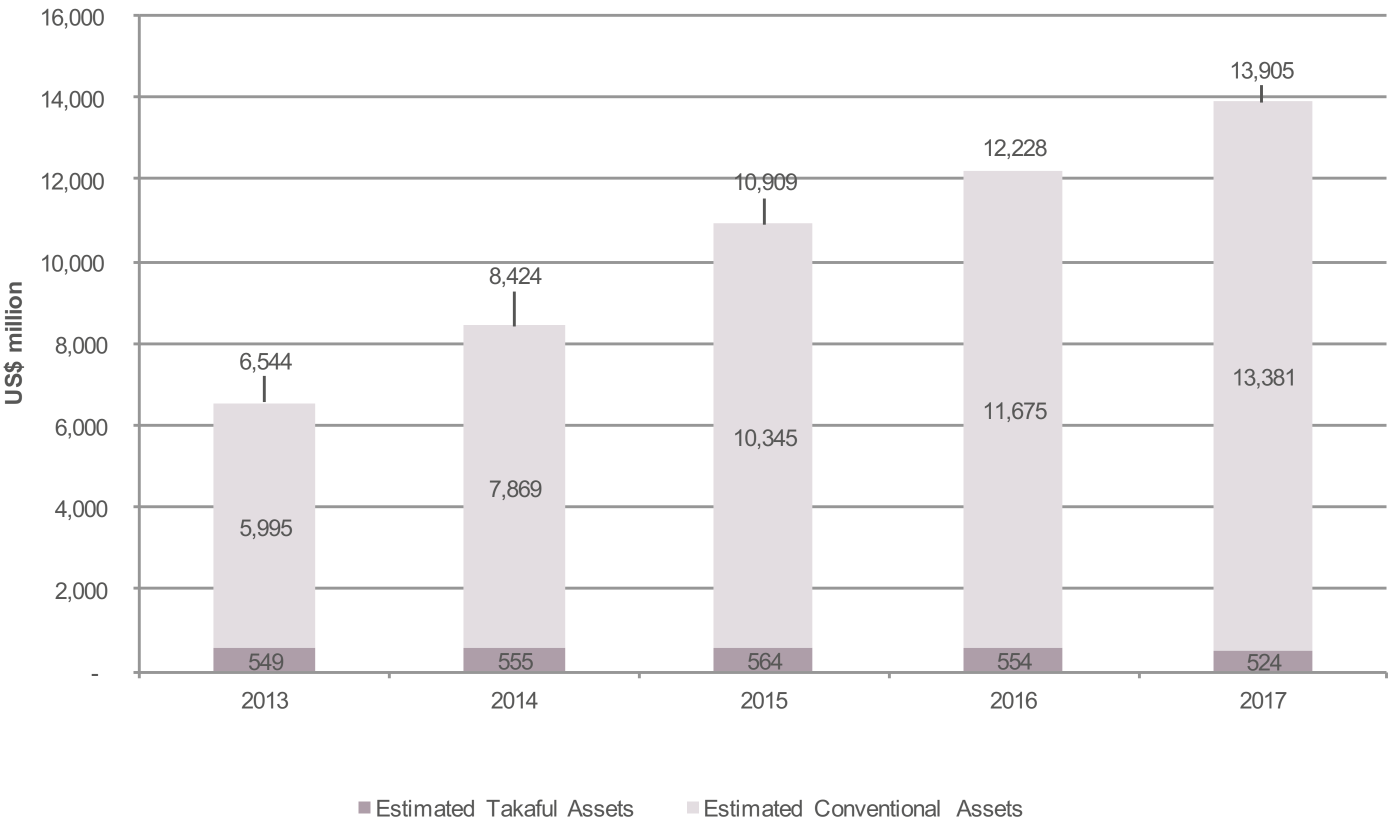
Takaful And Other Non-Bank Islamic Financial Institutions

Takaful

There is a paucity of data on Qatar's insurance and takaful sectors. Consequently, figures included below are estimated values for the insurance sector operating under the QCB jurisdiction based on a sample of the largest insurers that control 95% of sector assets.

By the end of 2017, Qatar's takaful assets reached an estimated US$524 million, after a five-year CAGR of -1%. Assets continued to decline by 5% in 2017 alone, down from US$554 million in 2016—a reduced rate compared to previous years.

Estimated Insurance Assets in Qatar 2013-2017



Source: Annual Reports, Thomson Reuters Analysis

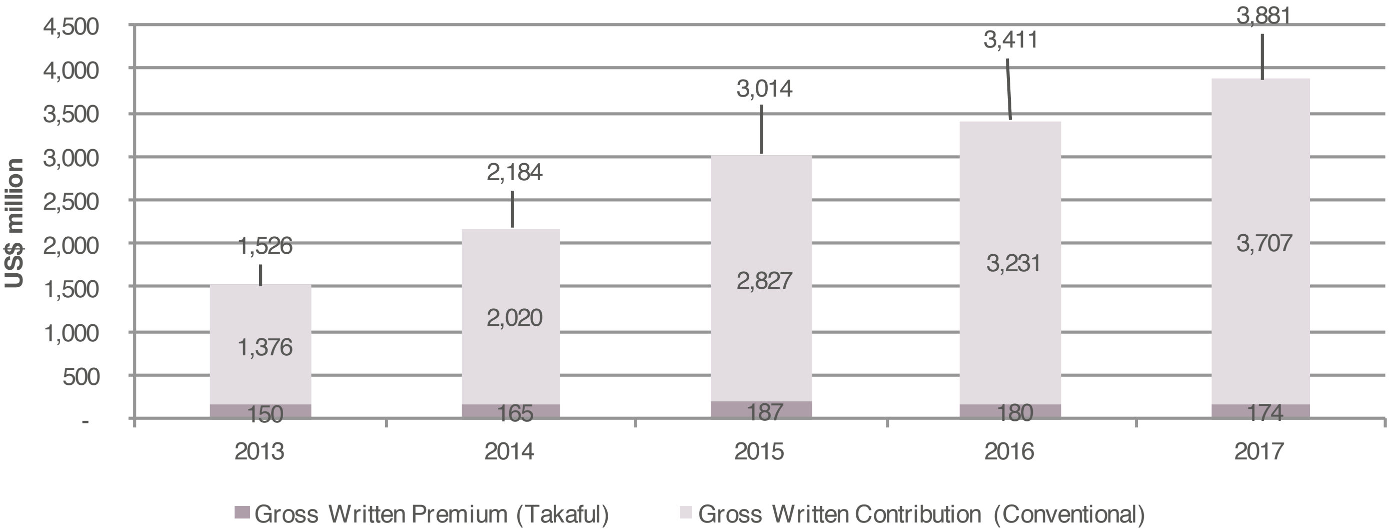
Sector growth has capitalized on infrastructure development as part of the country's preparations for the 2022 FIFA World Cup Qatar™ and ongoing investment in non-hydrocarbon sectors. Insurance growth is likely to remain at double digit levels at least until 2022, when a number of ongoing infrastructure projects will be completed in time for the FIFA World Cup. In the longer-run, growth should continue to slow down to moderate at the single-digit level.

The expansion of the takaful industry has continued to underperform the wider insurance sector, and it is expected to continue underperforming in coming years. Market experts attribute this poor performance in new contributions to the lack of genuine differentiation by takaful operators between their offerings and their conventional counterparts, with only competitive pricing as the main selling point. Conventional insurance assets maintained double-digit growth, achieving a 5-year CAGR of 22%.

Although gross takaful contributions have also witnessed double-digit growth since 2013, they have not kept the pace of conventional premiums. Gross contributions grew by 10% in 2014 and 13% in 2015. However, in 2017 total takaful contributions fell by 3%.

Insurance penetration in Qatar remains low. The penetration rate for the wider insurance sector reached 1.74% of real GDP form 0.77% in 2013, although takaful penetration has remained flat at 0.08% during this period. Two factors contribute to Qatar's low insurance penetration rate: the country's insurance base remains small in terms of asset size and revenues, while real GDP growth has been particularly high in the past decade.

Estimated Gross Premiums/ Contributions in Qatar 2013-2017



Source: Annual Reports, Thomson Reuters Analysis

Regulatory Developments

- Overhaul of QCB insurance regulation, following global best practice
- Prohibition of operating takaful windows
- Additional focus on insurance intermediaries
- Enhanced regulatory framework required needed to boost life takaful

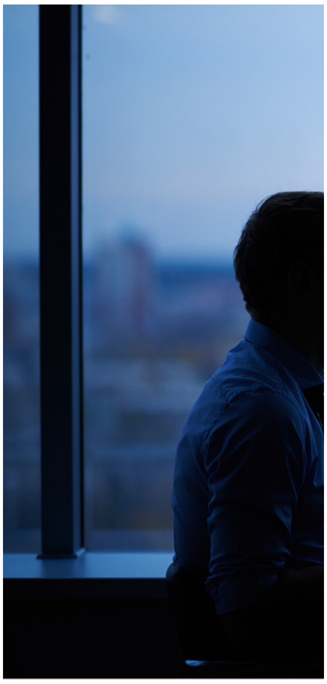
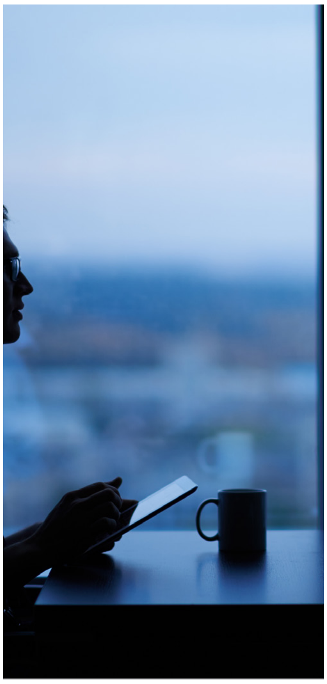
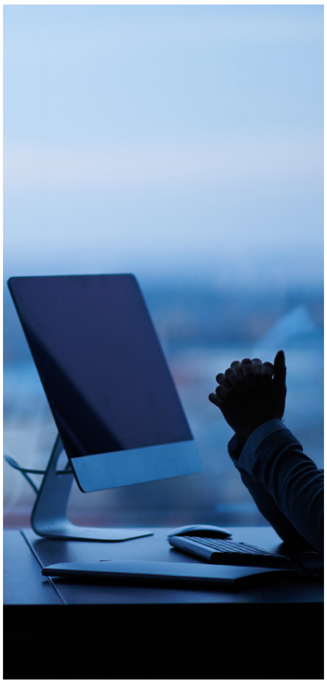
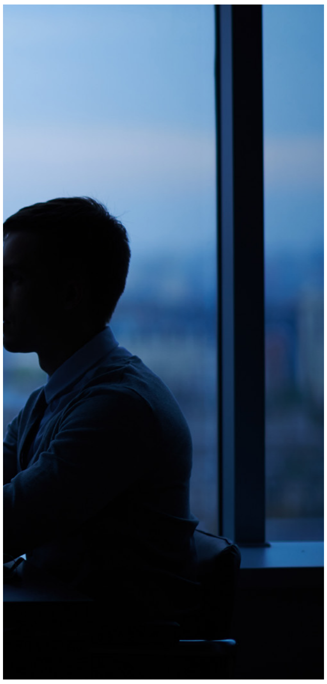
The insurance and takaful industry in Qatar is highly concentrated on the non-life business both because of perceptions about the permissibility of life insurance, and predominance of large infrastructure projects over a relatively small population. The largest five domestic firms have a first right of refusal on government projects, which provides significant barriers to entry for foreign firms. In addition, although local firms have historically ceded a significant share of their overall risk to global reinsurers, this business has shrunk over time as conventional insurers have retained more risk; takaful operators still cede around half of their gross premiums to reinsurers.

Insurance sector would benefit from technology to lower costs.

Outside of the non-life corporate market, insurance products in the health and auto sectors will become more commoditised and will increasingly benefit from the infusion of technology. This means a bigger focus on digital systems for claims management, but also exposure to new competition from Insurtech companies.

Takaful faces the challenge of growing its small and stagnant share of the overall market, where they offer products that lack the differentiation that conventional insurers often have developed. Although increasing distribution strategies through bancatakaful can help leverage banks' larger scale and client bases, it may not be enough to overcome the underlying challenges facing takaful operators. For example, it is unclear whether the lack of differentiation reflects Shariah compliance challenges or is merely due to lack of experience by management.

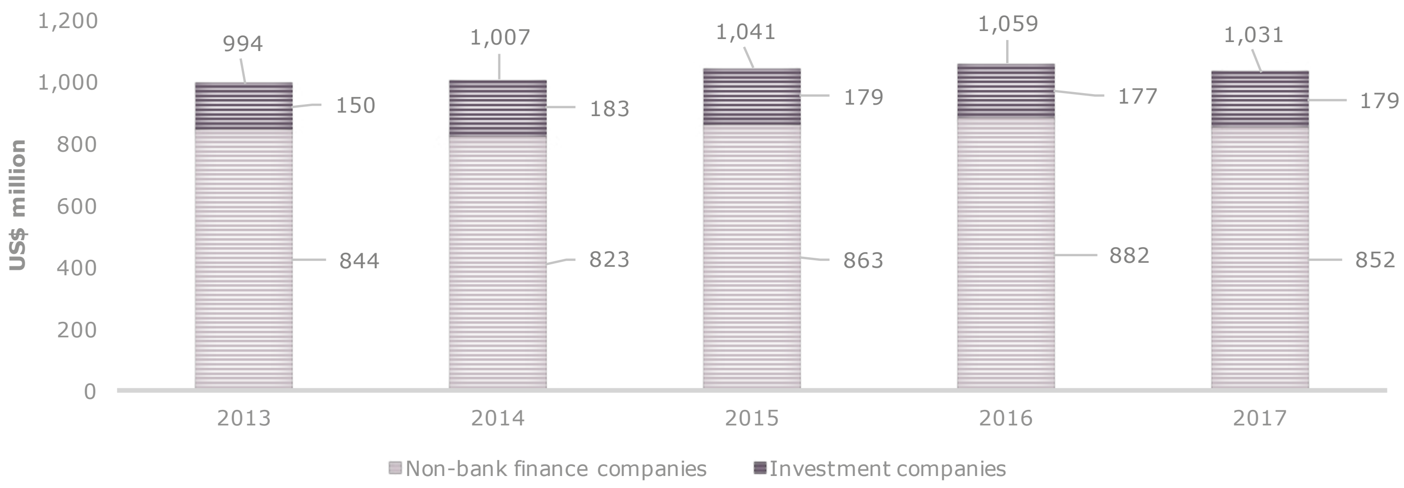
The infusion of technology into low-margin businesses could be a challenge for takaful operators. The lack of agreement among Shariah scholars about the appropriate takaful business model remains a headwind for faster growth in this segment. If this can be addressed, there will still be significant consumer education needed. However, if that is undertaken, the underlying preference for takaful versus insurance in the family/life segment is likely to be stronger than in the banking sector, providing a more defencible market for successful takaful operators, which is important given the existing market structure.

Other Non-Bank Islamic Financial Institutions

Qatar's non-bank financial sector, operating under the QCB, comprises a limited number of companies that are all Shariah-compliant. The number of these institutions has remained unchanged since 2012, indicating limited growth and development of the sector. Non-bank finance companies ended 2017 with an asset base worth US$1.03 billion, down from US$1.06 billion in 2016.

Other Non-bank Financial Institution Assets in Qatar 2013-2017



Source: Qatar Central Bank

Total assets of investment companies at the end of 2017 were valued at US$179 million, up from US$177 million in 2016. Over the longer term, the growth of their total assets has been healthy. Investment companies' asset base has grown 20% from US$150 million in 2013, mainly driven by the growth of financial investments and liquid assets.

Regulatory Developments

- Consumer lending restrictions reshaping non-bank finance companies' business model
- Master plan required for developing Islamic non-bank financial institutions

The rules introduced to curb the growth of personal lending have forced a shift by non-bank finance companies away from this segment and towards SME lending. Changes in the banking market are also pushing many banks, especially Islamic banks, towards a greater focus on SME financing, which puts pressure on non-bank financial institutions' growth in this segment. However, non-bank finance companies have a structural advantage in targeting smaller-ticket financing. This may provide them with a competitive advantage, although demand for financing in this segment may decline in the short run with the recent rise in the cost of funding and slower economic growth.

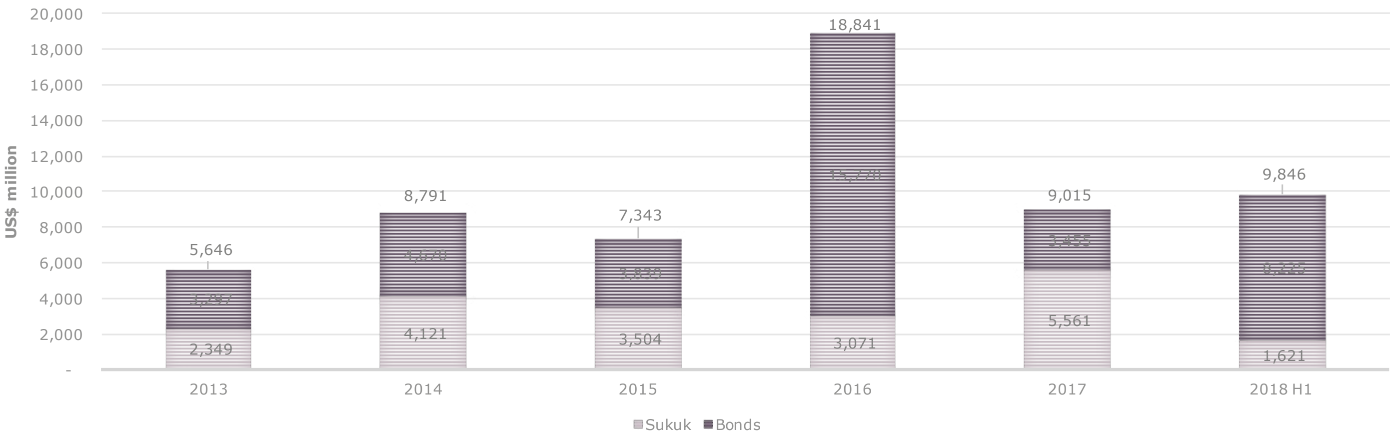
Lower costs from Fintech can offset rising funding costs.

In order to overcome these obstacles, non-bank financial institutions should explore the opportunities that Fintech provides. In order to develop this area of the market, regulators should follow developments already occurring elsewhere, where regulatory "sandboxes" are providing a live-testing ground for Fintech companies.

Sukuk Overview

Historically, Qatar has issued both bonds and sukuks to finance projects and budget deficits, although its reliance on bonds has traditionally been greater. Sukuk represented 18% of Qatar's total Islamic finance assets in 2017, with total outstanding issuances amounting to US$21 billion. The government has been the backbone of the sukuk market in Qatar, representing 73% of issuances between 2013 and the first half of 2018, by value. The cumulative value of sovereign sukuk issuances during this period reached US$14 billion. Sukuk issued by the Qatari government mainly funds budget deficits and provides working capital.

Bonds and Sukuk Issuances in Qatar 2013-2017



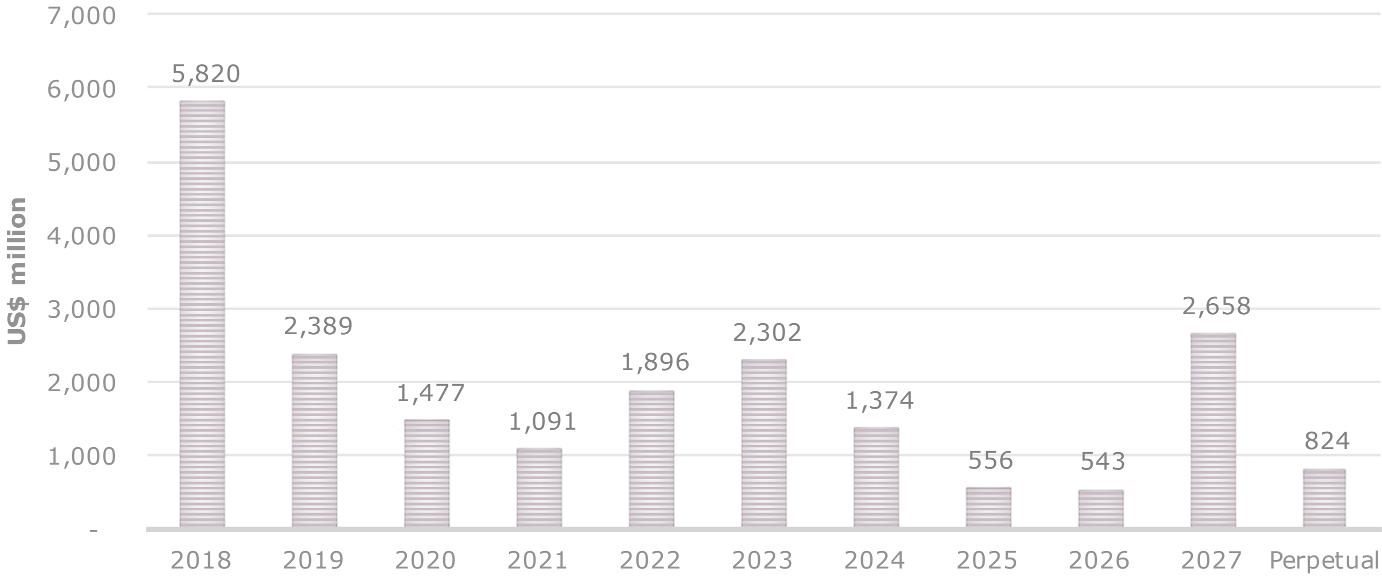
Source: Thomson Reuters

Qatar Sukuk Highlights

Sukuk was first issued in 2003 by the Qatari government	**75%** 75% of Qatar sukuks were issued using ijarah structure	**71%** Between 2013-2018 H1, 73% of Qatar sukuk were issued by the government	The largest sukuk issued in Qatar to date was issued by the government in 2011 raising US$9 billion	US$6 billion worth of sukuk will mature by 2018, accounting for 28% of the value of sukuk outstanding at the end of 2017

A relatively large proportion of outstanding sukuk is maturing in 2018, the market will see its future unfold in the coming year depending on the profile of new issuers. The least favorable outcome for Qatar's sukuk market would be if most of the capital redeemed through the end of 2018 is reinvested elsewhere in sukuk in other markets or into other asset classes.

Maturity Profile For Sukuk Outstanding In Qatar 2017



Source: Thomson Reuters

However, this unfavorable outcome seems to be averted as the QCB ramped up its sukuk issuances by nearly US$3 billion in 2017, driving 80% year-on-year growth in total sukuk issuances. Although this would contribute to market stability, it would not necessarily develop the market further because it would represent just a rollover of existing issued sukuk and not new supplies.

Corporate sukuk issuances, by number, have been on the rise in 2016 and 2017. This was primarily driven by QIB issuances tapping foreign capital markets for funding. Nonetheless, the value of corporate sukuk issued remained flat in the last five years.

Changes to tax rules can increase sukuk issuance.

One important reason why sukuk issuances by corporations have been limited is the tax treatment of sukuk transactions. In particular, sukuk issuances by Qatari companies with foreign partners from outside the GCC are subject to corporate tax on the share owned by non-GCC nationals. This issue will make sukuk a less appealing opportunity relative to conventional bonds. The tax may be restructured in a way that is tax-neutral for the sukuk investors, using a SPV domiciled in the QFC.

Use of incentives can build momentum in sukuk market.

Malaysia, for example, has encouraged sukuk issuances by providing an exemption for the expenses associated with sukuk issuance. This would include costs such as legal and banking fees for structuring the transaction, tax advice and Shariah board review. In Qatar's case the form of the added tax incentive would have to be developed taking into consideration the local tax laws in country.

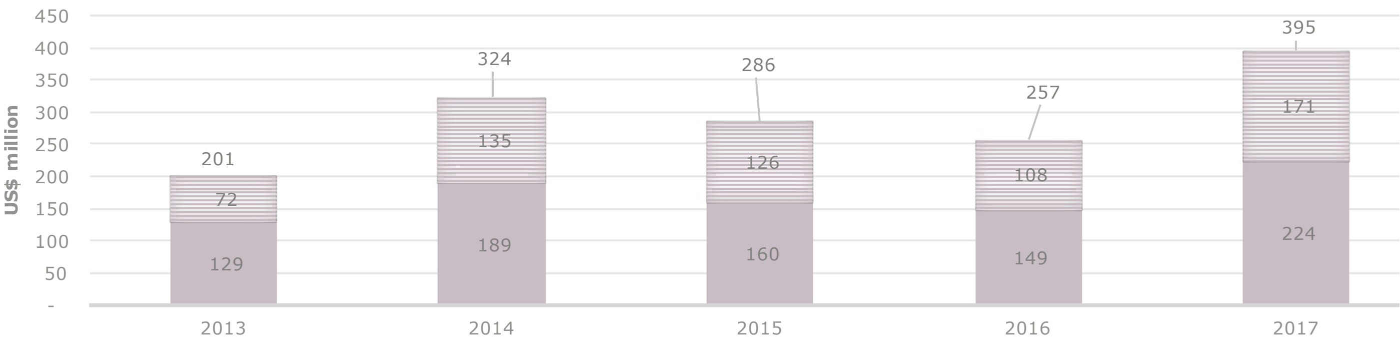
These initiatives would be focused on offering tangible benefits such as lower cost for sukuk issuance for prospective issuers in Qatar who may have preferred bank financing as an easier and faster source of financing. There are reasons for optimism in the further development of the sukuk market in Qatar starting with the government's active posture with regards to sukuk issuance. The QCB has issued sukuk with tenors including 3, 5, 7, 8, and 10 years, which provides a good benchmark yield curve for other issuers to set prices. With the possible refinancing activity of existing government sukuk providing an updated benchmark curve, it may be an apt time for the launch of incentives to support further corporate issuances.

Asset Management Overview

The asset management sector in Qatar remains limited in the field of mutual funds, which account for just US$224 million in assets under management. Notably, the sector has been more developed in Shariah-compliant funds, which represent just over 50% of total fund assets. Opportunities in Qatar's fund and asset wealth exist, despite the currently limited development of the fund industry.

In March 2018, Masraf Al Rayan launched Qatar's first Shariah-compliant ETF – Al Rayan Qatar ETF – with initial assets worth US$120 million. This is the world's largest single country ETF and second largest Islamic fund. The ETF tracks the performance of the QE Al Rayan Islamic Price Index of Shariah-compliant stocks trading on the QSE. Also listed on the QSE, the fund targets foreign investors from the US, Europe and Asia.

Qatar Mutual Funds AuM 2013-2017



Source: Thomson Reuters

Asset management has a US$35 billion opportunity.

The gap between Qatari-domiciled investments in mutual funds and total wealth suggests that increasing legal stability is important for investor confidence. This may make the QFC the ideal area to promote the local asset management sector because of the legal framework in place.

Domestic private wealth is estimated at US$35 billion, with 290 ultra-high net worth individuals with more than US$30 million in investable assets. These individuals are being targeted by the QFCRA through special licences granted for foundations and investment clubs, in the former case giving legal personhood to the foundation and in the latter, allowing for groups of up to 15 individuals to invest together without requiring licencing.

Alternative investments add diversification opportunities.

In addition to building the capabilities within the QFC, it will be important to provide a unique range of investments, such as alternative investments like infrastructure funds that will differentiate the QFC from other regional and global financial centers. In order to attract international firms, one deciding factor may be the openness that allows firms in the QFC to manage funds targeting other GCC countries as well as funds specific to the local markets.

The challenge for investment managers in Qatar and the MENA region in developing alternative investments is that the region's economy and investment landscape is relatively undiversified. While real estate is heavily represented in the available investment universe, venture capital and private equity investments remain limited. These types of market niches are the focus of a lot of financial centers in emerging markets, and Qatar will need to take a unique approach to stand out from the crowd as a home to fund and asset managers, including in alternative investments.

Sustainability could act as key differentiator for Qatar's regional ambitions.

The area of sustainable finance may be key for Qatar's ambitions. On the local level, Qatar is leading the region in increasing pressure on listed companies to report their environmental, social and governance (ESG) data.

As Asia becomes a more important market for responsible investment, there will be an increasing demand for additional investment, particularly to finance projects designed to support the Paris Climate Agreements. If Qatar is able to build sufficient capacity in its financial sector, it will have an edge over other regional financial centers. Adding Islamic financial capabilities to this trend would provide a complementary focus connecting sustainability with Islam's mandate for humankind's responsibility for good stewardship of the earth.

Islamic Finance Roadmap

Improve shariah governance

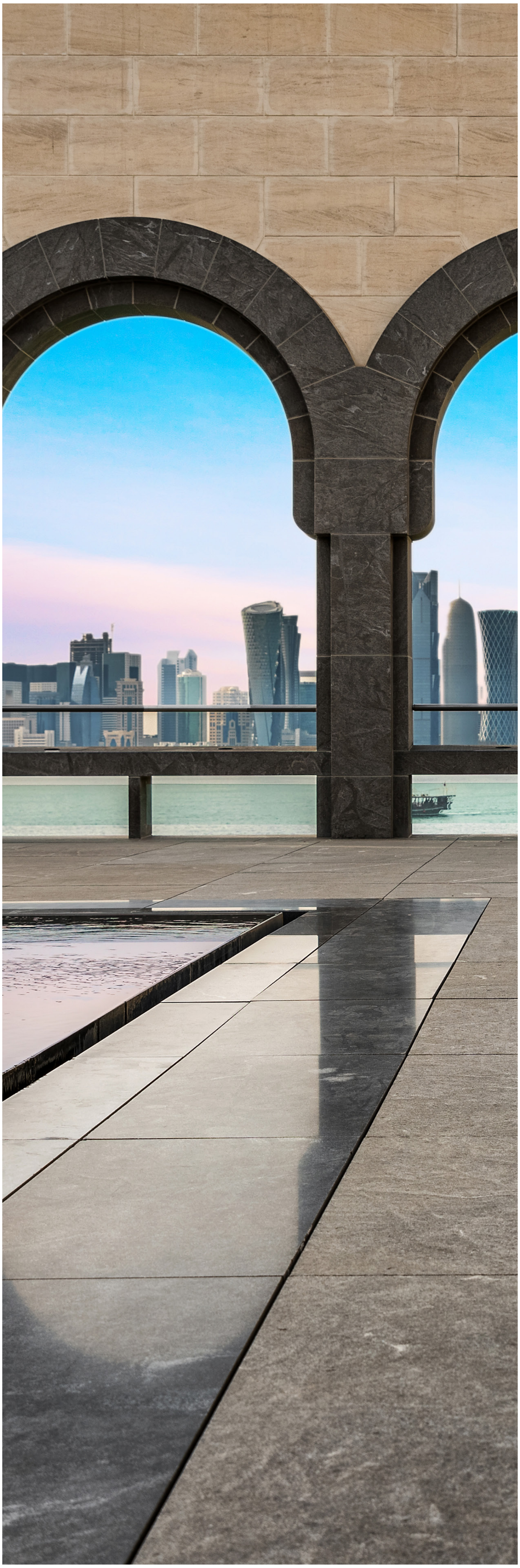
Provide centralised guidance on fit and proper criteria for Shariah scholars.

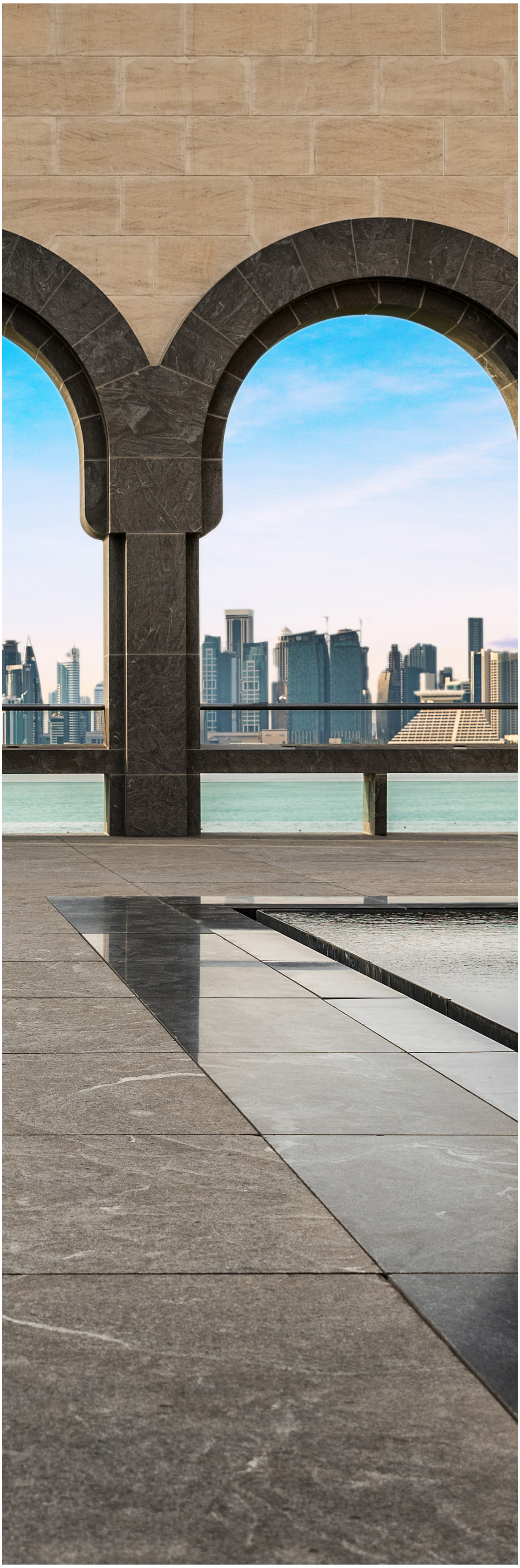
National Shariah boards provide some level of market-wide consistency in the implementation of Islamic finance criteria at institutions. The centralisation of authority on Shariah compliance oversight in national boards does not mean that they are the sole source of Shariah oversight in these jurisdictions, and individual institutions still maintain their own Shariah boards.

Reform interbank liquidity management

Study leakages from Islamic banks through interbank finance.

Qatar has ensured the authenticity of Shariah-compliant bank assets with regulatory requirements separating Islamic and conventional banks entirely. In order to ensure this segregation remains effective, there should be a review to determine the feasibility for the central bank to limit flows from Islamic banks to conventional banks in interbank markets resulting from liquidity management operations using murabahah. The concern around leakage occurs when Islamic banks place funds through murabahah inter-bank placements with conventional banks. Although these placements generate Shariah- compliant income, they also promote the greater use of interest-based finance, which is contrary to the broader objectives of Islamic banks.





Develop human resources by tackling specific skill gaps

Evaluate how to support Fintech startups with 'sand-box' regulation.

Fintech offers a way to reduce costs and make Islamic banks more competitive with their larger conventional counterparts. The establishment of a dedicated department at the regulator that could create an experimental 'sandbox' regulatory regime for Fintech enterprises would be valuable not only for banks, but also for non-bank financial institutions, asset and fund management companies and insurers.

Consider lifting lending limits and interest rate caps for Fintech startups.

The development of Fintech, much of which is currently dedicated to serving the personal lending market, may see a slower pace because of personal lending limits and financing cost or interest rate caps in Qatar. It may be desirable, as part of the regulatory sandbox, to allow temporary exemptions and relaxed size limits for Fintech companies from these limits and caps.

Encourage collaboration between banks, non-bank financial institutions and Fintech.

Banks, which have greater access to stable funding, and non-bank financial institutions, which have more experience underwriting smaller loans for SMEs, can more effectively support SMEs by working together than in competition. Fintech will help this collaboration work by providing greater transparency between the institutions, lower costs and an increased ability to do ex-post Shariah audits to ensure that procedures approved by each institution's Shariah board were followed.

Enhance differentiation in asset management

Promote sustainable investment initiatives.

The asset management sector offers the greatest opportunity for Qatar, but it also requires the most detailed and differentiated plan for attracting asset managers to build capacity in the sector. One approach that leverages the work already done by the QSE and the work begun by the Middle East Sustainable Investment Forum is to increase the connection between an Islamic asset management proposition with a sustainable or ESG-focused proposition.

Develop a responsible finance regulatory framework to attract regional managers.

Expanding Qatar's regional leadership in sustainable investment will require effort both in the public equity market as well as in the real estate sector, with the development of a regulatory framework and promotion of green bonds and sukuk, and in private equity and other alternative investments. This could also open up a larger market than just the GCC or MENA regions, as responsible investment grows across Asia in support of the Paris Climate Agreement and the Sustainable Development Goals.

Strengthen the unique proposition in takaful

Develop the single business model and consumer awareness for takaful.

It is imperative to develop a domestic takaful industry around a single business model and then to build consumer awareness of the differences between family takaful and life insurance. Takaful operators in other lines, particularly health and motor takaful where margins are lower, should be connected with innovative Insurtech startups that are able to reduce costs for takaful operators. As the family takaful sector develops, it should also adopt the responsible investment approach recommended for the asset management sector because of the long-term strategy needed for policyholder funds and the importance of ESG in identifying medium- to long-term risks.

Improve public awareness of Islamic finance

Launch an Islamic finance awareness campaign focusing on financial literacy.

Awareness of Islamic finance among the Qatar public is wide but not deep. Although almost half of people surveyed in this report indicated they had a 'good' or 'excellent' understanding of Islamic finance, many were not able to correctly distinguish true and false statements about Islamic finance, reflecting common misunderstandings. The lack of a complete, even if limited, understanding of the principles and practices guiding Islamic finance can translate into missed opportunities for Islamic banks to increase their customer base.

In order to improve public knowledge of Islamic finance, a public awareness campaign could make significant progress. The most effective strategy would foremost focus on financial literacy and also highlight some of the differences between conventional finance and Islamic finance beyond the use or prohibition of interest-based contracts.

Develop human resources by tackling specific skill gaps

Introduce testing programs for Islamic bank staff.

Although the maturity level of the Islamic finance industry has grown over recent years, it has not been accompanied in equal measure by the development of professional skills. Our banking survey found that just under a half of Islamic bank customers reported satisfaction with staff knowledge at their banks.

The most common knowledge gap among staff is in understanding the suitability of particular products and services for each customer. An approach that could yield improvement in this area would be the development of testing programs for Islamic bank employees. Such testing could ensure they are competent not only in general Islamic finance knowledge, but also in the appropriate suitability guidelines that should guide their interactions with customers.

When introducing this type of program, it would be important to engage with universities and training providers to assess what is currently covered in Islamic finance curricula and identify areas where students and trainees have weaknesses.

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