QATAR ISLAMIC FINANCE REPORT 2017

EXPANDING HORIZONS

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The financial district, West Bay, Doha.
SOPHIE JAMES / SHUTTERSTOCK.COM

FOREWORD

Dr. Haitham Mohamed Al-Salama

The Qatar Financial Centre (QFC), Thomson Reuters and the Islamic Research and Training Institute (IRTI) are proud to present the Qatar Islamic Finance Report. In this report, the QFC Authority demonstrates its continued commitment to improving the Islamic finance Industry. We also believe that the report will serve as a benchmark for decision-making in the near future for stakeholders in Islamic finance.

Qatar has built one of the world's fastest growing and dynamic economies in the past ten years. With careful government planning and investments in infrastructure, education, social services and other sectors outside hydrocarbons and energy, Qatar is creating a stable and prosperous future for its citizens and workforce. The financial sector is one of the foundations of this new diversified economy, and institutions such as the Qatar Financial Centre are important examples of Qatar's commitment to becoming a financial hub.

The Islamic finance industry is a vital part of Qatar's financial ecosystem, promoting financial inclusion, fostering shared prosperity and supporting economic development. Islamic banks in Qatar have been 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. This report presents analysis, insights, investment opportunities and key challenges in the Islamic finance services industry in Qatar for domestic and foreign investors.

We would like to extend our deepest thanks to all partners and interviewees who have supported this research project, which is designed to benefit the Islamic finance Industry as a whole. We hope the information and analysis in this report will guide you through the opportunities that Qatar presents in Islamic finance.

DR. HAITHAM MOHAMED AL-SALAMA
Chief Economic Advisor,
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EXECUTIVE SUMMARY

Qatar has been one of the fastest growing economies in the world over the last decade, with GDP growth averaging 11.3% between 2006 and 2016. Despite expectations of slowing economic growth in the coming five years, Qatar's economy will remain resilient 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 compound annual growth rate (CAGR) of 11% over the last five years and 6% in 2016 alone. The value of these assets reached QAR 386 billion in 2016, constituting 23% 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 QAR 323 billion in 2016. 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 2% of total Islamic finance assets in 2016. 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 QAR 3.9 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.

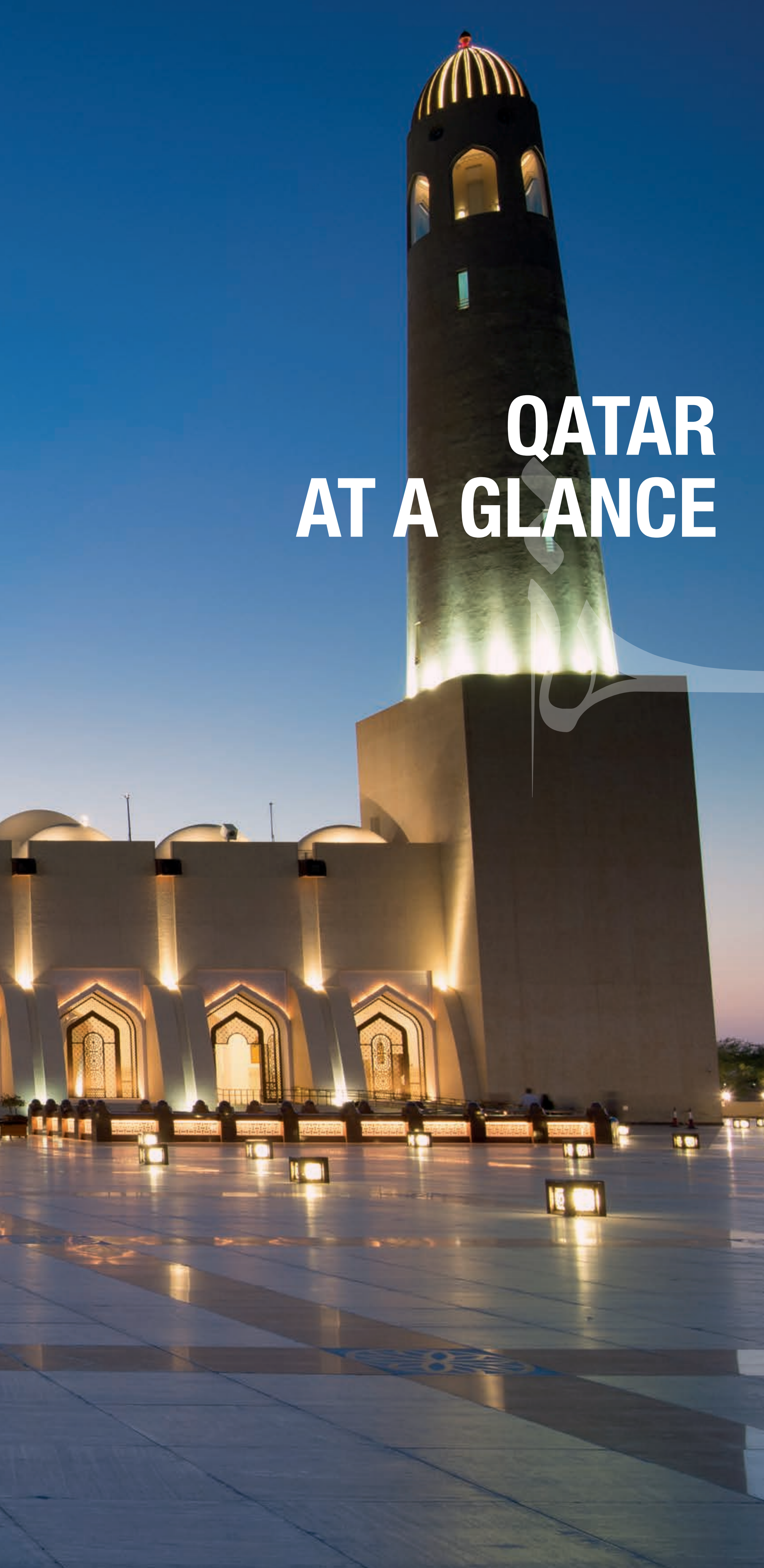
Valued at a mere QAR 2 billion in 2016, the takaful sector in Qatar has underperformed conventional insurance in terms of market penetration as well as growth. The major drawbacks for takaful operators are their small size and the lack of differentiation in their products, compared to the conventional 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 15% of total Islamic finance assets, with a total of QAR 57 billion in outstanding issuances. Sovereign sukuk dominate the market, contributing 87% of issuances, while the corporate segment remains underdeveloped. With 44% 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 new 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 QAR 541 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 QAR 600 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.

Mosque in Katara village, Doha.
FITRIA RAMLI / SHUTTERSTOCK.COM

QATAR AT A GLANCE



COUNTRY OVERVIEW

Located on the east coast of the Arabian Peninsula, Qatar is home to the world's third largest natural gas reserves, boasts one of the top three richest economies and its sovereign wealth fund is one of the ten largest in the world per GDP capita data.

Qatar gained its independence from a British protectorate on 3 September 1971 under the leadership of HH Sheikh Ahmed bin Ali Al-Thani, and it is a constitutional monarchy; the current 2005 constitution recognizes the hereditary rule of the Al-Thani family.

The Qatari government has three branches: executive, legislative and judicial. The Emir, who is the head of state, represents the executive branch and holds the positions of Minister of Defense and Commander-in-Chief of the Armed Forces. As per the constitution, the Council of Ministers assists the Emir in the exercise of his executive authority. This council is established through an Emiri Order proposed by the Prime Minister, who is entrusted with the role of presiding over of the different organs of the state.

The constitution also stipulates the establishment of an advisory council, the Shura Council, which constitutes the legislative authority. This authority "approves the general policy of the government, the budget, and it shall exercise control over the executive authority as specified in this constitution."[1] The Shura Council is composed of thirty members that are elected by direct, general secret ballot, in addition to fifteen other members that are appointed by the Emir from the ministers or any other persons.

One of the most prosperous countries in the world, Qatar has the third largest natural gas reserves in the world. Natural gas reserves in Qatar are expected to last well into the 22nd century, while proven oil reserves should also enable the country to sustain output at current levels for many years.

To reduce the country's dependence on the price-sensitive energy sector, HH Sheikh Hamad bin Khalifa Al-Thani and then Heir Apparent HH Sheikh Tamim bin Hamad Al-Thani launched the National Development Strategy 2011–2016 in April 2011, the first five-year strategy in the implementation of the Qatar National Vision 2030. The strategy created a

1 Al Meezan, "The Permanent Constitution of the State of Qatar 0 / 2004."

blueprint for Qatar to enhance its economic, social, cultural and environmental development in order to help the nation thrive. The strategy even laid foundations for future national strategies to come.

Qatar has been working to diversify its economy into non-energy sectors, including tourism and financial services, with domestic and international investment in different asset classes. This was supported by the accumulated wealth from oil and gas revenues and energy-led growth in previous years. The government has used its budget surpluses to diversify and modernize the economy through increased spending on infrastructure, social programs, healthcare and education. It is also seeking to create a knowledge-based economy with the construction of the Qatar Science and Technology Park, Education City, and Doha Sports City.

Since 2005, the Qatar Investment Authority (QIA), Qatar's sovereign wealth fund, has managed a growing financial portfolio of both domestic and international assets. After the global financial crisis in 2008, the Qatar Investment Authority actively adjusted its investment strategy, diversifying its targets and destinations. As a result, its assets increased from US$85 billion in 2010 to more than US$300 billion by the first half of 2017[2]; making it the fourteenth-largest sovereign wealth fund in the world.[3]

Furthermore, Qatar has very actively transformed itself into a major hub for sports entertainment in the region by hosting major sporting events. For instance, Qatar has hosted the 2006 Asian Games, the 2010 IAAF World Indoor Championships and the 2011 AFC Asian Cup. Notably, in 2010, Qatar was awarded the privilege to host the 2022 FIFA World Cup. The event has required major infrastructure projects, including the construction of new stadiums as well as new roads and transportation facilities.

A GROWING POPULATION DOMINATED BY A FOREIGN LABOR FORCE

According to data from the Ministry of Development Planning and Statistics (MDPS),[4] the population of Qatar including Qatari nationals and foreign residents is estimated at 2.6 million at the end of 2016, up from 614,000 in 2000 and 421,000 in 1990. The population has witnessed its highest increase during the 2000s; it more than quadrupled during the period between 2000 and 2016. The tremendous increase in oil prices between 2003 and 2014 led to a significant increase in infrastructure investments, requiring a simultaneous increase in the immigration of foreign workers.

Qatar is divided into eight municipalities: Doha (the capital), Al Rayyan, Umm Slal, Al Khor, Al Wakrah, Al Daayen, Al Shamal and Al Sheehaniya. Over half of the country's population resides in two municipalities: 40% live in Doha, the smallest of the eight municipalities by land area, while 25% reside in Al Rayyan.

The MDPS Q2 2017 Labor Force Survey reports that men represent 76% of Qatar's overall population. This imbalance is the result of Qatar's foreign labor force, which primarily comprises single men. According to the survey, non-Qatari

2 Qatar Central Bank. (2017, July 10). "The Governor Of Qatar Central Bank: Qatar Has $340 Billion Reserves."
3 Sergie, M. (2017, January 11). "The Tiny Gulf Country With a $335 Billion Global Empire," Bloomberg.
4 Qatar Ministry of Development Planning and Statistics. (2016). Annual Statistics 2016.

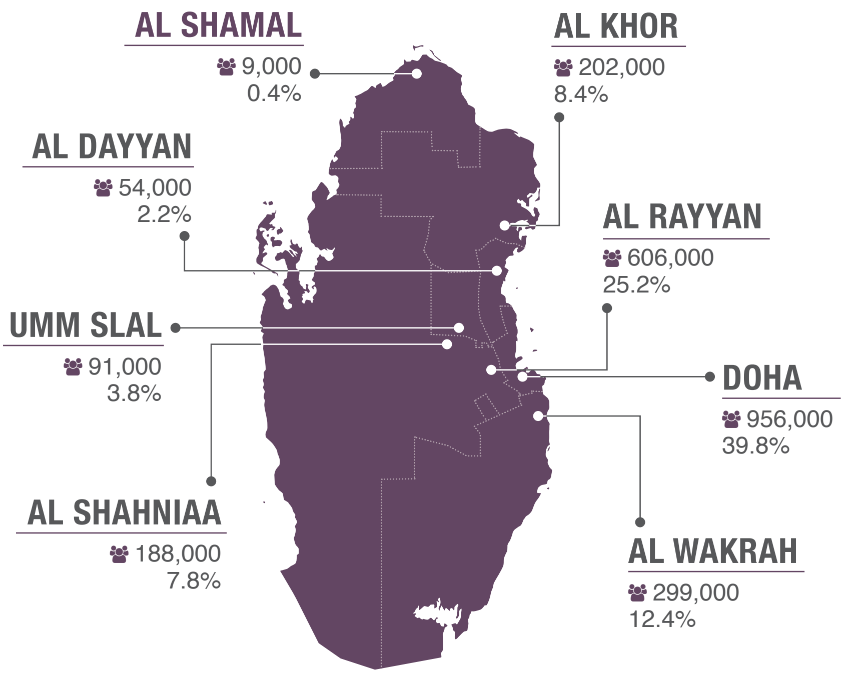
Figure 1 POPULATION OF QATAR 1986-2016

Source: Ministry of Development Planning and Statistics, Thomson Reuters Analysis

men constitute 83% of the employed population in the country.[5]

The main objectives of the Qatar Population Policy include increasing the proportion of Qatari citizens in the population, and reducing the gender imbalance in the total population. However, it is expected that the percentage of expatriates will remain high in the coming years, as Qatar's preparation for the FIFA World Cup 2022 and the need to maintain substantial investments in hydrocarbon resources requires a significant foreign labor force.

Figure 2 QATAR POPULATION BREAKDOWN BY MUNICIPALITY 2015



Source: Ministry of Development Planning and Statistics Population Census 2015

5 Qatar Ministry of Development Planning and Statistics. (2016) "Labor Force Survey: The Second Quarter (April-June) 2017".

QATAR NATIONAL VISION 2030

The Qatar National Vision 2030 was designed to aid the development of a resource-based country that is striving to diversify its economy and to manage its reliance on a foreign labor force. In this context, the Vision hopes to balance five main challenges in Qatar.

- Balancing modernization with the preservation of traditions, while absorbing the social and cultural changes imposed by economic development.
- Establishing sustainable development, so that meeting the needs of current generations does not sacrifice the requirements of future generations. This will be assured in the creation of new sources of renewable wealth that compensate for the depletion of non-renewable resources.
- The the impact of expanding economic activity on society. The economy should adapt the pace of development to achieve a better quality of life for all.
- Managing the reliance of the country on foreign labor force, which includes a large unskilled labor force.
- Achieving a win-win situation, in which Qatar hopes to effect both positive economic development and environmental preservation.

Faced with these challenges, the National Vision rests on four pillars:

- The first pillar, **human development**, aims to transform Qatar's economy toward a knowledge-based economy. This will be achieved by developing world-class education and health systems to provide the environment for the development of skills, and finding the right mix of skills provided by the foreign labor forcew.
- The second pillar stresses the role of family as basis of the society and the need to build a **safe, secure and stable society** in which women will play a major role.
- The third pillar, **economic development**, details efforts to diversify the economy with good management of exhaustible resources and the reinvestment of rents for the benefit of future generations. This will be achieved by investing revenues in world-class infrastructure, building efficient delivery mechanisms for public services, creating a highly skilled and productive labor force, and supporting the development of entrepreneurship and innovation capabilities. Some reports show that Qatar is projected to maintain a high momentum of investment during coming years. This includes US$20 billion investment in roads; US$40 billion in railways; US$4 billion in stadiums; US$8 billion on a deep-water seaport; and about 10,000 hotel rooms to be built in the upcoming years.
- The fourth pillar is dedicated to **environmental planning**. In addition to preserving hydrocarbon resources, the country places among its priorities the preservation of water resources and the prevention of pollution and the degradation of the environment.

These objectives of the Vision will be achieved with the adoption of different strategies covering various periods. The National Development Strategy 2011–2016 was the first that seeks to achieve middle-term National Vision objectives. The Strategy assumed the decreasing contribution of the hydrocarbons sector and an increasing role of other sectors in the economy, buttressed by an increase in their share of investment capital of the non-hydrocarbonsectors. Estimates from the MDPS Qatar Economic Outlook show that the construction sector had the highest growth rate (9.9%) in 2016, compared with manufacturing (7.9%), services (6.7%), electricity and water (7%), mining and quarrying (0.6%) and agriculture (8%).[1]

1 Ministry of Development Planning and Statistics, "Qatar Economic Outlook 2016-2018". June, 2016.

MACROECONOMIC OVERVIEW

MODERATE ECONOMIC GROWTH SINCE 2014

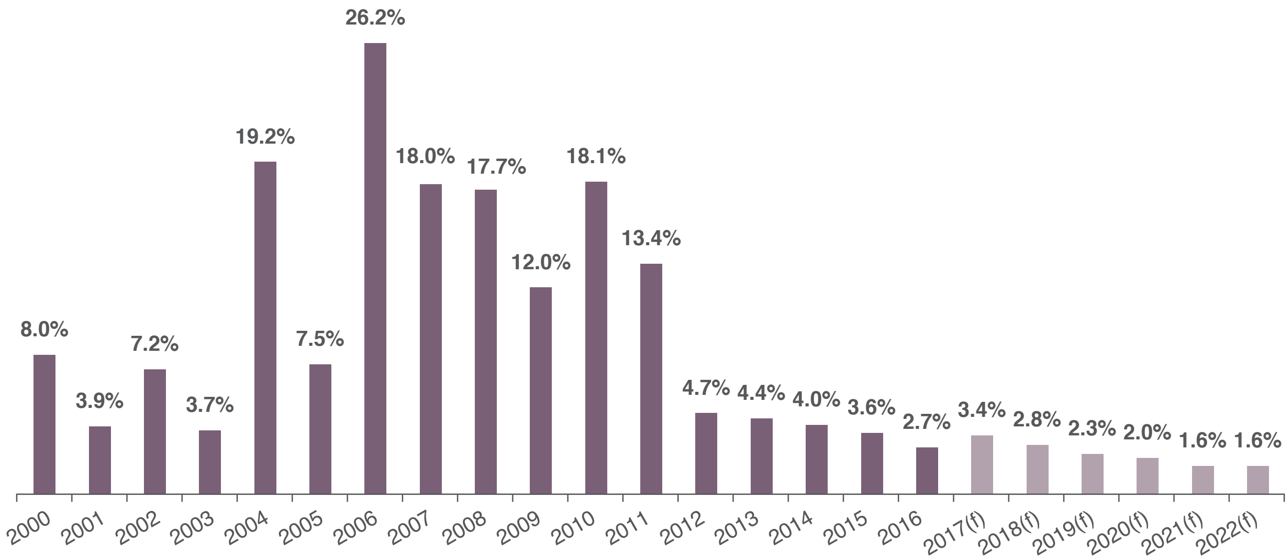
Qatar's economy has been traditionally based on the mining of oil and gas, which has accounted over the two last decades for an average annual value of 80% of exports of goods and services and almost 90% of total fiscal revenues. The hydrocarbon sector fuelled Qatar's economic growth particularly before 2011, when the production of liquefied natural gas reached its peak capacity. Compared to other GCC countries, Qatar achieved significantly higher GDP growth in the period 2000-2010, with an average real GDP growth reaching 13%. Real GDP growth from 2011 to 2016 gradually decelerated to an average of 5%.

More recently, because of slowed world economic growth and low energy prices, real GDP growth in Qatar was 2.7% in 2016. Growth occurred despite hydrocarbon sector GDP declining by 1% following a 0.5% decline in 2015, reflecting the adverse impact of low oil prices but the resilience of other sectors.

As a result, Qatar has followed other GCC countries in implementing cuts to subsidies. In January 2016, it became the fourth Gulf state to increase fuel prices, raising prices of some fuels by as much as 35%. Earlier, the state electricity and water utility company, Kahramaa, lifted the fixed tariff for electricity and water, allowing prices to increase in tandem with rising consumption. Nevertheless, according to the IMF[6], Qatar is relatively well positioned among MENA countries to face the storm of sustained low oil prices, supported by its strong fundamentals.

By diversifying the economy, Qatar has seen enhanced contribution thanks to investments in the infrastructure, tourism, financial services, and petrochemicals sectors. In 2016, non-hydrocarbon sectors contributed almost 71% of

Figure 3 REAL GDP GROWTH (% OF GDP) IN QATAR 2006–2018



Source: International Monetary Fund

6 IMF. (2016). 2016 Article IV Consultation for Qatar — Staff Report, §6

nominal GDP, compared to 41% in 2011. Current growth in real GDP is mainly supported by the non-hydrocarbon sector, which grew by 5.6% in 2016, down from 8% in 2015. The IMF projects that non-hydrocarbon sector growth will moderate to 4.6% in 2017, due to re-routing of trade and continued fiscal consolidation. It is expected to reach 4.8% in the medium-term with the implementation of structural reforms.

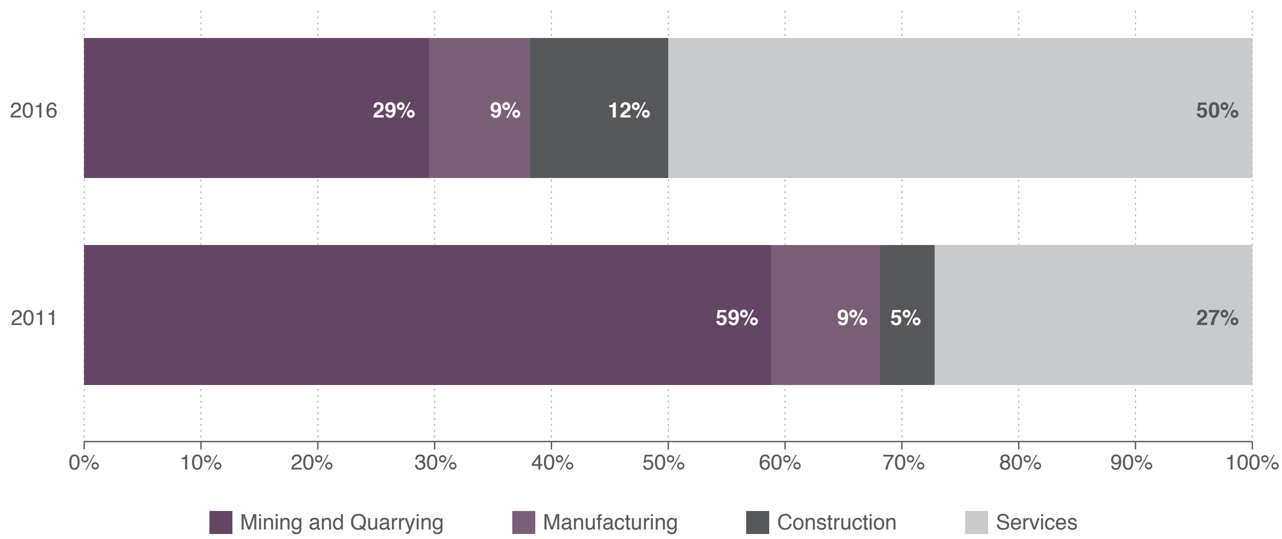
Healthy non-hydrocarbon sector growth was led by strong growth in construction, finance and insurance, transportation and storage, and real estate activities. As a result, the share of non-hydrocarbon sector in real GDP increased marginally to 50.6% from 48.9% a year ago, while that of the hydrocarbon sector decreased to 49.5% in 2016 from 51.1% a year ago. This indicates the diversification process working in a positive manner and to some extent it helped to soften the impact of the oil price volatility to Qatar's economic growth.

INFLATION

Year-on-year Consumer Price Index (CPI) inflation in Qatar fluctuated between 2012 and 2016, peaking at 3.4% in 2014. Inflation stood at 2.7% in 2016, up from 1.8% in 2015, as upward inflationary pressures reflected the increased cost of energy and utilities, education, housing and recreation. Higher fuel costs resulted from higher commodity prices during the year, in addition to the reduction of government fuel subsidies that pushed fuel prices by over 30%. Also during 2016, 55 schools in Qatar announced increases to their fees, which increased the education price index 7%.

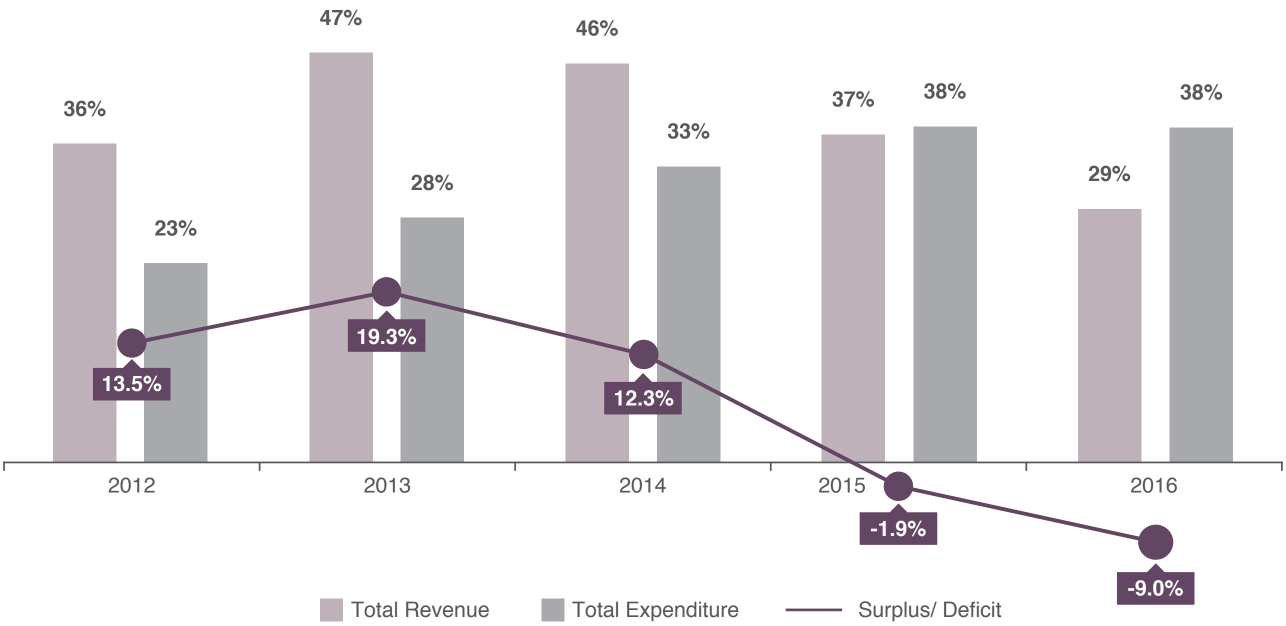
In the aftermath of the recent diplomatic rift, delays from re-routing trade caused higher inflation in transportation (8.9%), food costs (2%) and general operating costs for some sectors. However, inflation remained slow at an annual rate of 0.8% recorded in June 2017. A report from Qatar National Bank (QNB) projects deflation in rents from an oversupply in housing in 2017. Continued low energy prices are expected to persist, with the delayed impact of low oil prices, but inflation induced by subsidy cuts should dissipate in 2017. However, CPI inflation is expected to jump to 3.3% in 2018 with the introduction of a new value added tax (VAT) and projected higher commodity prices. As their impact fades during 2019, inflation is expected to moderate to a level of 2.5%.

Figure 4 SECTOR CONTRIBUTION TO QATAR'S GDP (% OF GDP) 2016



Source: Ministry of Development Planning and Statistics

Figure 5 QATAR'S FISCAL BALANCE (% OF GDP) 2012–2016



Source: Qatar Central Bank

FISCAL BALANCE

Qatar witnessed its first fiscal deficit in 2016 after 15 years in surplus. The country's fiscal balance faced downward pressure resulting from the significant drop in oil prices, which caused a 37% drop in revenues during the year. The government also curtailed spending during the year, reducing expenditures by 15%. Nonetheless, Qatar registered a deficit equal to 9% of GDP.

The fragile oil market recovery and the uncertain capacity of OPEC to monitor oil market volatility have increased pressure on public finance in Qatar. QNB projects a continued decrease of total revenues, which would reach 28% of GDP in 2017 and remain stable until 2019. Expenditures are also projected to be slashed to 29.7% of GDP in 2017. The fiscal balance is expected to return to surplus as expenditures are further reduced to 27.9% in 2018 and 26.7% in 2019. According to the IMF, the fiscal deficit is projected to reduce to 5.9% in 2017 from 8.8% in 2016. Fiscal consolidation and structural reforms are expected to continue with the 2018 state budget.

PUBLIC FINANCE

Qatar's public debt remained around 10% of GDP prior to the global financial crisis, but it increased to around 35% after 2009 and later spiked to 48% in 2016. This occurred as the authorities have taken advantage of reduced rates to fund the 2016 budget deficit, and also to secure early financing for 2017.

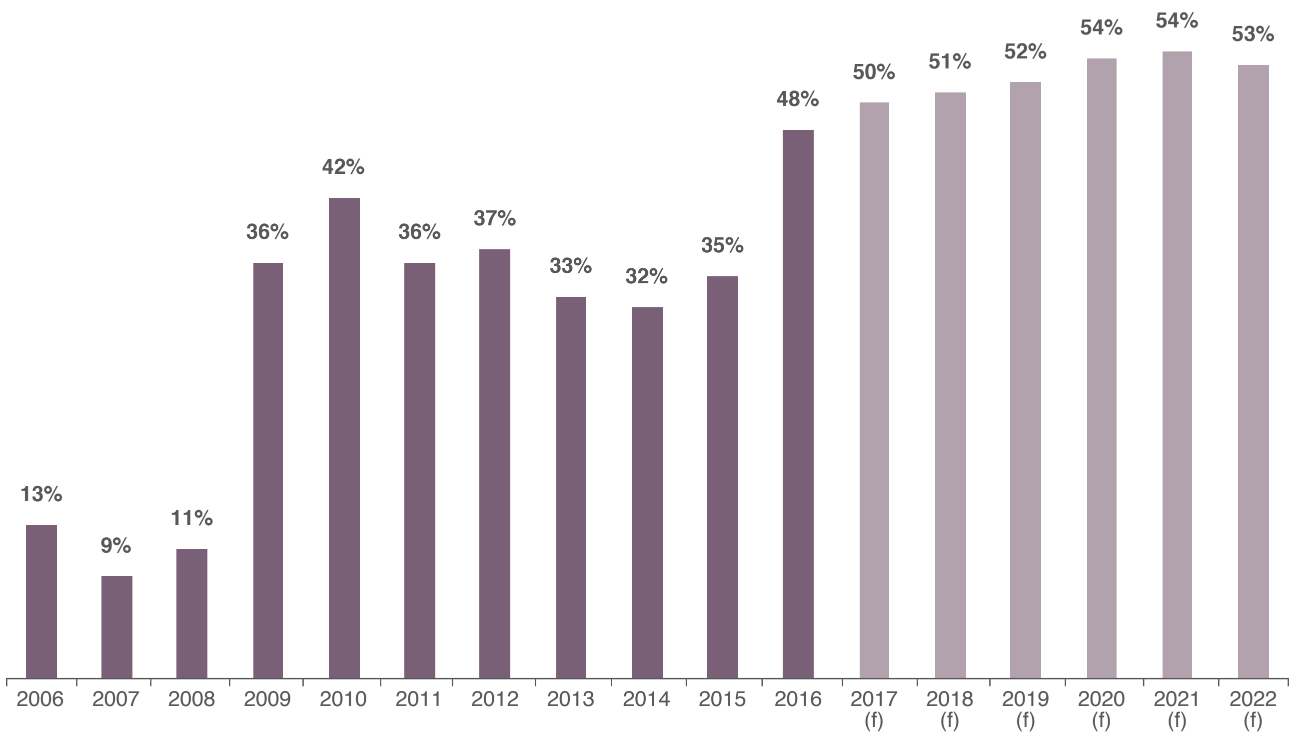
Qatar's debt-to-GDP ratio is relatively high compared to other GCC countries. By the end of 2016, Qatar maintained a high investment grade rating with the three major rating agencies: an AA rating with S&P and Fitch (which downgraded it to AA- in 2017), and an Aa3 rating with Moody's.

Despite its capacity to borrow at low rates, Qatar's borrowing options may become constrained if public debt exceeds 60% of GDP. Despite this, Qatar still has the lowest fiscal deficit among GCC members, as its liquefied natural gas (LNG) exports are locked into long-term fixed-price contracts that ensure high revenues.

Moreover, the Qatar Central Bank's (QCB) and QIA's huge reserves will help Qatar manage the risks associated with its public debt. The recovery of oil prices and further economic diversification, as well as government investment and population growth, will stimulate Qatar domestic demand and consumption, in particular for housing and financial services. A VAT of 5% is expected to take effect in Qatar in 2018, which will come as part of a GCC-wide agreement to

By diversifying the economy, Qatar has seen enhanced contribution thanks to investments in the infrastructure, tourism, financial services, and petrochemicals sectors.

Figure 6 GENERAL GOVERNMENT GROSS DEBT IN QATAR (% OF GDP) 2005–2022



Source: International Monetary Fund

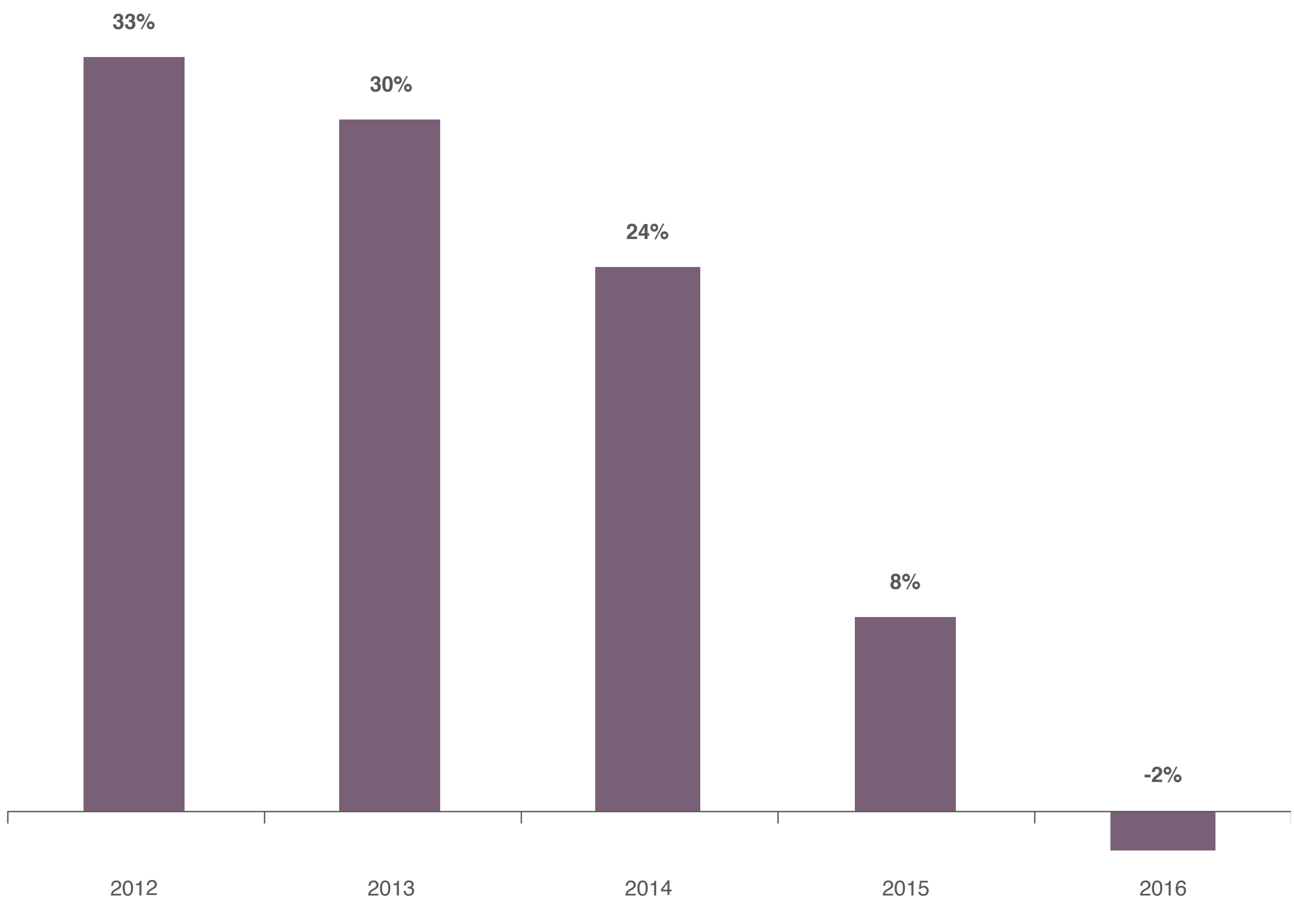
offset budget deficits in the region. The decision to implement VAT will reduce the government's budget deficit, which is forecasted to continue for the next few years in a scenario of sustained low oil prices.

THE EXTERNAL SECTOR

Because of environmental constraints on food production and high demand for infrastructure construction, Qatar is heavily dependent on imported goods. Thanks to its ample oil and gas reserves, however, Qatar is a net exporter of goods and services. In 2015, the total value of imports to Qatar was US$28.5 billion, while exports totaled US$77.3 billion. Hydrocarbon exports (crude oil, LNG, and associated products) accounted for over 85% of this total. According to the MDPS, the largest export markets for Qatar in 2016 were Japan (19%), South Korea (16%), India (13%), China (8%) and the UAE (7%). In the same year, Qatar's top sources of imports were the U.S. (14%), China (10%), Germany (9%), the UAE (9%) and Japan (7%). Qatar's most-imported commodities are machinery and transport equipment, food, and chemicals.

The latest preliminary figures released by the MDPS have shown that the diplomatic rift in the region has not impacted Qatar's foreign trade, despite initial concerns of trade disruption and potential shortages. In August 2017, the foreign merchandise trade balance showed a surplus of QAR 12.6 billion, increasing 5% and 45% compared to July 2017 and August 2016, respectively. The Qatari government was quick to

Figure 7 QATAR'S CURRENT ACCOUNT (% OF GDP) 2012–2016



Source: International Monetary Fund

re-route trade, mainly to Southeast Asian markets, and to establish alternative sources of imports.

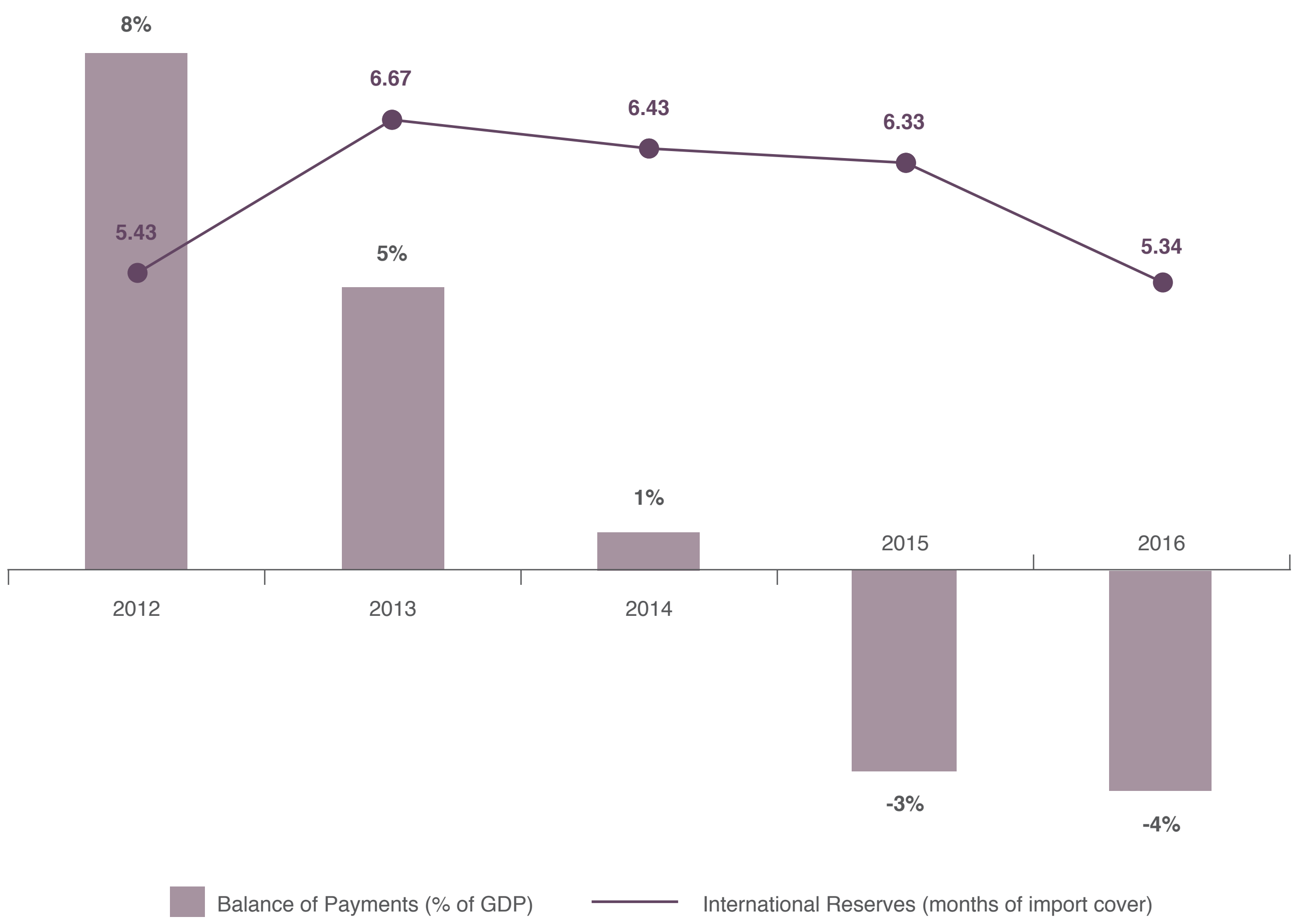
Qatar has a sizable current account surplus and high external debt, but these have trended down starting from 2013 thanks to persistent low oil prices and higher imports of machinery destined for construction projects. The external sector has also been highly affected by this shift, with an estimated deficit in the current account balance of 2.2% in 2016 and an increasing external debt estimated to increase to 131.5% of GDP in 2018. The IMF projects that owing to a contraction in imports the recovery in oil price will take the current account back into surplus, to 3.9% of GDP in 2017.

INTERNATIONAL RESERVES

Qatar's international reserves remained at relatively secure levels, with an average of six months of import cover between 2012 and 2016. In 2016, reserves fell to 5.3 months of import cover, down from 6.3 months in 2015 and 6.4 months in 2014. This resulted from deficits in the overall balance of payments in both years.

Following sanctions imposed on Qatar by neighboring countries, international reserves and foreign currency liquidity recovered in August 2017 to US$29 billion, after a significant drop during the previous two months. Prior to the sanctions, this measure was valued at US$45.8 billion in May 2017. In the second half of 2017, the QCB revised its method of reporting, based on an IMF suggestion to to conform to its Special Data Dissemination Standard.

Figure 8 QATAR'S INTERNATIONAL RESERVES 2012–2016



Source: Qatar Central Bank, International Monetary Fund

SOCIOECONOMIC DEVELOPMENT

With Qatar's endowment of natural resources, its citizens enjoy a high standard of living. The GDP per capita is not only the highest in the Gulf region, but in Purchasing Power Parity (PPP) terms, Qatar has had the highest average GDP per capita in the world in the last decade, according to IMF World Economic Outlook data.[7] Qatar saw an impressive increase in its GDP per capita during the 2000s, even compared to other Gulf countries. World Bank projections also predict moderate GDP growth will continue until 2020, allowing Qatar to stay among the top ten richest countries in the world.

Qatar was ranked 33rd out of 188 countries in the United Nations Development Programme (UNDP) Human Development Index (HDI) in 2015, falling in the 'Very High Human Development' category. Qatar has moved up in the HDI rankings since 2010, when it placed 38 out of 169 countries.

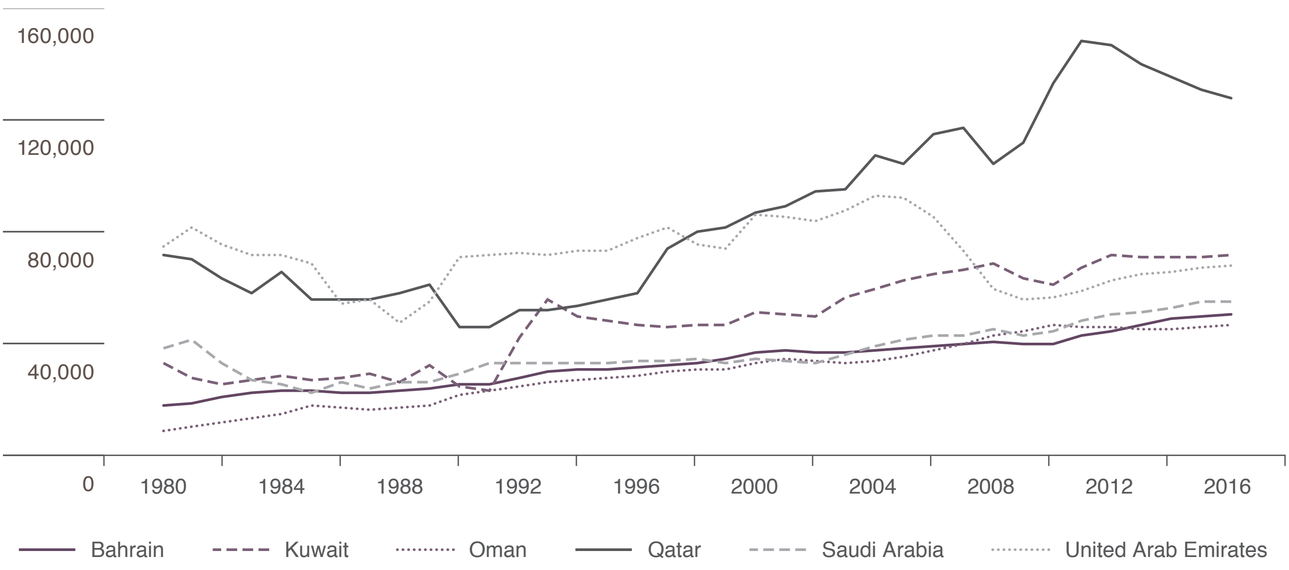
Investment in social sectors has led to important improvements in human capital indicators. In education, the average years of total schooling for Qatar's population was 9.8 years in 2015, up from 7.3 years in 2010. In terms of the quality of education, despite the progress achieved, Qatar's performance is still below the OECD average. The following table gives a comparison between the performance of Qatari students and the average in OECD countries the in The Programme for International Student Assessment (PISA) test in 2015.

The health of the population has also witnessed noticeable improvements during the past few decades. Life expectancy at birth has increased from 76 years in 2010 to 78.3 years. The Qatar National Health Strategy (NHS) 2011–2016 is anchored in the 2030 National Vision. The NHS is based on seven goals ranging from the enhancement of the healthcare system to the development of a highly qualified national workforce.

Table 1 PISA TEST SCORES FOR 2015

	Science Literacy	Mathematics	Reading
Qatar	418	402	402
OECD Average	493	490	493

Figure 9 GDP PER CAPITA (PPP US$) IN THE GCC 1980–2016



Source: International Monetary Fund

7 IMF. (2017). "World Economic Outlook: April 2017."

BUSINESS AND INVESTMENT ENVIRONMENT

EASE OF DOING BUSINESS IN QATAR

Qatar is an open economy with few restrictions to trade or investment. Qatar's political stability, bright prospects for economic development, rich resources, and relatively sophisticated infrastructure make Qatar a good destination for investment. The state has enhanced Qatar's natural attractions with sound laws and regulations for foreign businesses, a high degree of marketization, and a series of preferential policies for foreign investment.

Qatar scored 61 points out of 100 on the 2016 Corruption Perceptions Index and ranked the 31st least corrupt nation out of 175 countries, according to the 2016 Corruption Perceptions Index reported by Transparency International. The Corruption Index in Qatar has averaged 64.86 between 2003 and 2016.

Qatar is ranked 83rd among 190 economies in the ease of doing business according to the latest World Bank annual ratings. The rank of Qatar has declined slightly to 83rd in 2016 from 74th in 2015.

Qatar's sound macroeconomic fundamentals and its strong institutions and high quality of health and education have helped the country remain competitive. In the World Economic Forum 2016-2017 survey, Qatar ranked 18th of 138 countries surveyed and scored well with a 6.7 out of 7 for its macroeconomic environment, 6.3 in health and primary education, and 5.7 in government institutions.

According to the Qatar Ministry of Development and Planning metrics, business confidence decreased to 20.2 in the third quarter of 2016 from 20.4 in the second quarter of 2016, while consumer confidence decreased to 184.3 in the third quarter of 2016 from 185.50 in the second quarter of 2016.

Other economic surveys have highlighted different aspects of Qatar's progress. For example, the country has made steady headway on INSEAD's 2016 Global Innovation Index, ranking first in the Arab world and 50th globally. Qatar is ranked first in the world for two indicators, Ease of Paying Taxes and Tertiary Inbound Mobility of International Students.

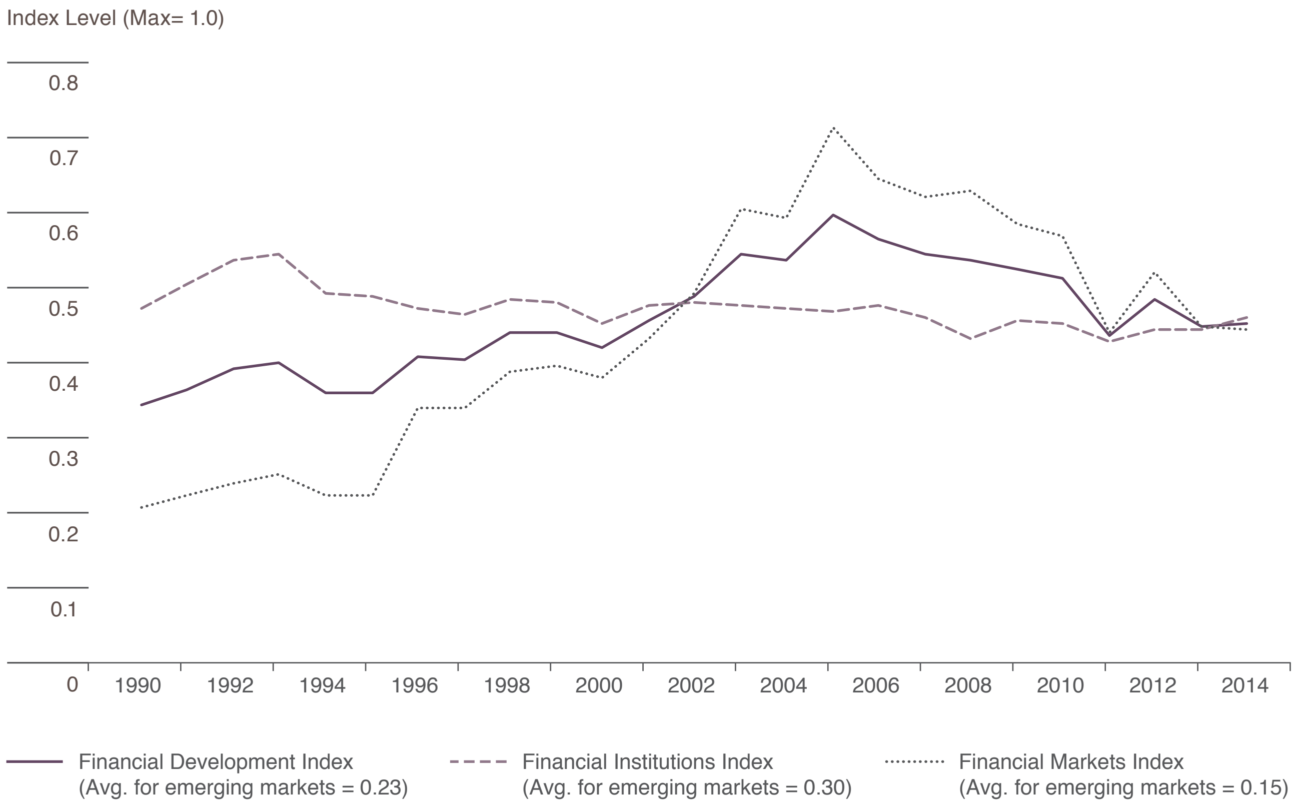
The IMF Financial Development Index (2015) seeks to measure financial sector development. Unlike common measures of financial development, which are generally based on the ratio of private credit or market capitalization to GDP, this index intends to capture more nuanced aspects of financial development. The index includes the different dimensions of the financial system, including its depth and the accessibility and efficiency of financial institutions and financial market. For Qatar, the index shows an important financial development during the period 2000–2016. This result reflects the development of the financial market, with impressive improvements in the three index subcomponents reflecting depth, access and efficiency during the period 2000–2008.

Table 2 QATAR'S PERFORMANCE IN KEY BUSINESS INDICES (2016)

Index	Rank
Corruption Perceptions Index	31 out of 175
Ease of Doing Business (World Bank)	83 out of 190
WEF Global Competitiveness Survey	18 out of 138
INSEAD's 2016 Global Innovation Index	58 out of 128

Qatar's political stability, bright prospects for economic development, rich resources, and relatively sophisticated infrastructure make Qatar a good destination for investment.

Figure 10 QATAR'S PERFORMANCE ACROSS FINANCIAL DEVELOPMENT INDICES



Source: International Monetary Fund

QATAR IN 2017: INITIAL OBSERVATIONS

Despite low energy prices and the economic slowdown, Qatar has proven itself a reliable destination for investment thanks to its political stability, abundant natural resources, and preferential policies and incentives. The country also has comprehensive and ambitious economic development and infrastructure programmers in line with its Vision 2030.

By hosting FIFA 2022 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 is forecasted to reach an annual growth rate of 3.4% in 2017, which would be the highest in the GCC.[8] This is forecasted despite an anticipated plateau in hydrocarbon production in 2017 and 2018, thanks to solid expansion in non-hydrocarbon activities that will sustain overall economic momentum.

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.[9] The United States, Japan and Bahrain are among the top three foreign investors in Qatar, with ExxonMobil the single largest, with a US$21 billion investment. Most GCC governments have established dedicated agencies to promote foreign direct investment (FDI) in their countries, such as the Bahrain Economic Development Board (EDB), the Saudi Arabian General Investment Authority (SAGIA) and Ithraa in Oman. However, Qatar has not yet established an entity mandated with the promotion of FDI.

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 sectors of Qatar's economy provided that they have a Qatari Services agent. The Qatari cabinet approved a draft law in October 2016 that will replace Law No. 13 of 2000. It is not clear whether the new law has already come into effect, nor has a future commencement date been announced.

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.

According to Transparency International's "2015 Global Corruption Perceptions", Qatar is ranked 22nd among the 168 countries in the world, surpassing the UAE to become the cleanest country in the Middle East.

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.

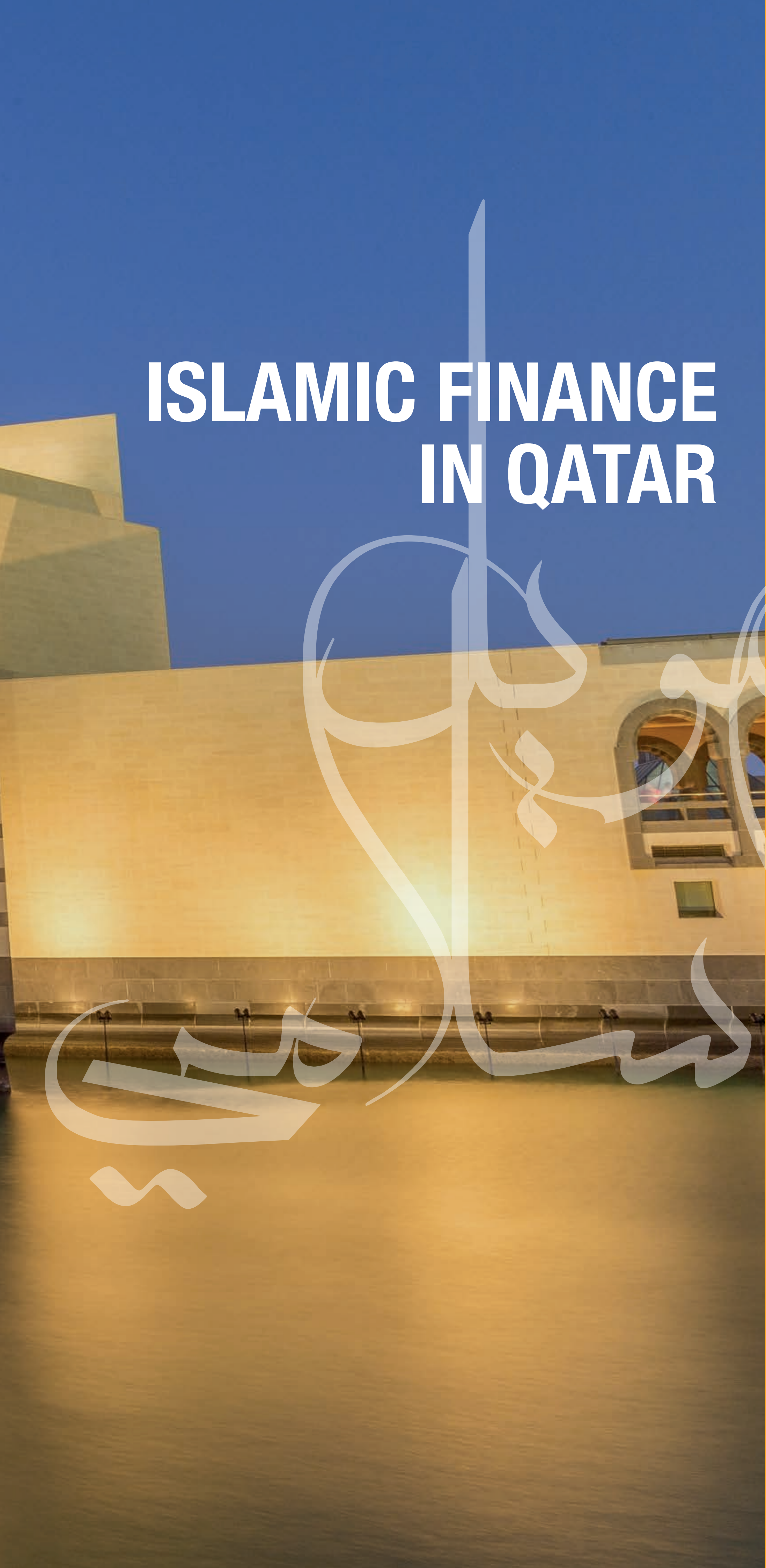
In June 2017, a diplomatic rift emerged between Qatar and Saudi Arabia, Bahrain, the UAE and Egypt, impacting trade and the movement of financial and human capital. This state of affairs remained ongoing at the time of writing this report, and the full extent of its impact could not be assessed.

According to an assessment carried out by the IMF in August 2017, Qatar's economy and financial markets are still in the process of adjusting to the impact of this diplomatic rift. Qatar's government authorities have been quick to respond, stepping up efforts to secure alternative sources of imports and external financing.

8 According to the Ministry of Development Planning and Statistics, despite lower oil prices, real economic growth in 2017 is expected to be 3.8%.
9 The Arab Investment and Export Credit Guarantee Corporation, "Qatar: Inward and Outward FDI."

Museum of Islamic Arts (MIA), Doha.
AHMED ADLY / SHUTTERSTOCK.COM

ISLAMIC FINANCE IN QATAR



QATAR CONVENTIONAL FINANCE AND ISAMIC FINANCE

INDUSTRY LANDSCAPE

BANKING

CONVENTIONAL BANKING		ISLAMIC BANKING
13 Commercial Banks	1 Specialized Bank	4 Commercial Islamic Banks

CONVENTIONAL		ISLAMIC
QAR 949 Bn	TOTAL ASSETS	QAR 323 Bn
QAR 617 Bn	TOTAL CREDIT	QAR 227 Bn
QAR 523 Bn	TOTAL DESPOSITS	QAR 203 Bn

9 QFC Corporate Banks

1 QFC Corporate Islamic Bank

TOTAL QFC ASSETS QAR 29.7 Bn

NON-BANK FINANCIAL INSTITUTIONS

ISLAMIC

3 Finance Companies — TOTAL ASSETS QAR 3.2 Bn

2 Investment Companies — TOTAL ASSETS QAR 645 Mn

CONVENTIONAL	ISLAMIC
7 QFC Conventional Investment Banks and Investment Management	3 QFC Islamic Investment Banks and InvestmentManagement

TOTAL QFC ASSETS QAR 10.5 Bn

INSURANCE

	CONVENTIONAL INSURANCE	TAKAFUL
Operators	8 Insurance Operators	5 Takaful Operators
TOTAL ASSETS	QAR 43 Bn	QAR 2 Bn
GROSS PREMIUMS/ CONTRIBUTIONS	QAR 12 Bn	QAR 668 Mn
QFC Operators	13 QFC Insurance Operators	2 QFC Takaful Operators

TOTAL QFC ASSETS QAR 4.5 Bn

CAPITAL MARKETS (debt securities and asset management)

	CONVENTIONAL	ISLAMIC
DEBT SECURITIES		
Outstanding	42 Bonds Outstanding	36 Sukuk Outstanding
TOTAL VALUE	QAR 268 Bn	QAR 57 Bn
ASSET MANAGEMENT		
TOTAL ASSETS UNDER MANAGEMENT	QAR 395 Bn	QAR 541 Mn

Source: Qatar Central Bank, Qatar Financial Centre Regulatory Authority

FINANCIAL INDUSTRY STRUCTURE AND LANDSCAPE

The current financial system in Qatar comprises banks, insurance operators, investment and financing companies and the capital markets. The financial system's regulatory authorities are the Qatar Central Bank (QCB), Qatar Financial Market Authority (QFMA) and Qatar Financial Centre Regulatory Authority (QFCRA). Each authority serves different objectives, but they work in harmony to create a sound regulatory framework that ensures the strength of Qatar's financial system.

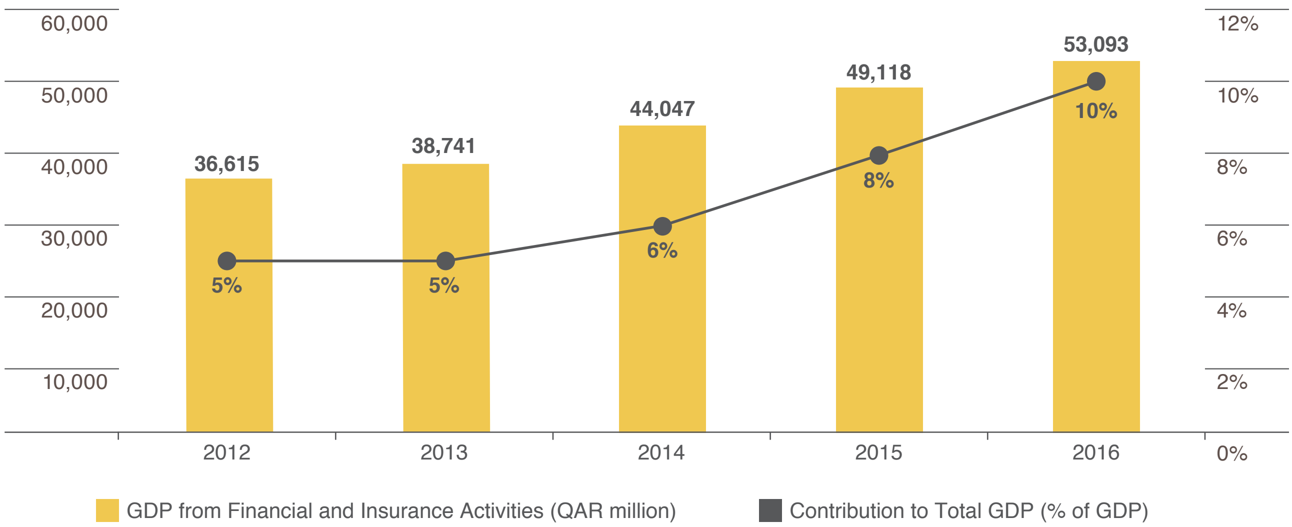
FINANCIAL INSTITUTIONS PLAY A VITAL ROLE IN QATAR

Financial institutions in Qatar directly support the peninsula's economic development and serve the needs of its rapidly expanding population, which increased by 22% to 2.6 million in 2016 from 2.1 million in 2012. Moreover, the GCC regional GDP has grown at a 9% CAGR, from US$378 billion to US$1.25 trillion between 2000 and 2016, according to the World Bank.

The Qatari government's policy of vigorously diversifying economic activity outside the hydrocarbon industry has been an important driver of the development of its banking and financial sector. The government recognizes that having a strong financial sector is critical for creating jobs and attracting investment in more diversified economic activity.

Qatari banks have become a cornerstone of the economy since they were first established in the 1950s, benefitting from expanding domestic and regional growth. The financial services sector is the fourth largest sector in Qatar in terms of its share of GDP. It contributed QAR 53.1 billion in 2016 or 10% of total GDP at current prices, growing from QAR 36.6 billion in 2012. Over the previous five years, it has witnessed double-digit year-on-year growth, peaking in 2014 (13.7%) and 2015 (11.5%), before decelerating to 8.1% in 2016.[1]

Figure 11 FINANCIAL SERVICES CONTRIBUTION TO QATAR'S GDP (2012–2016*)



Source: Ministry of Development Planning and Statistics

* Estimated, at current prices

1 Qatar Ministry of Development Planning and Statistics, Economic Statistics of Qatar, 19th Issue (Q4 2016),

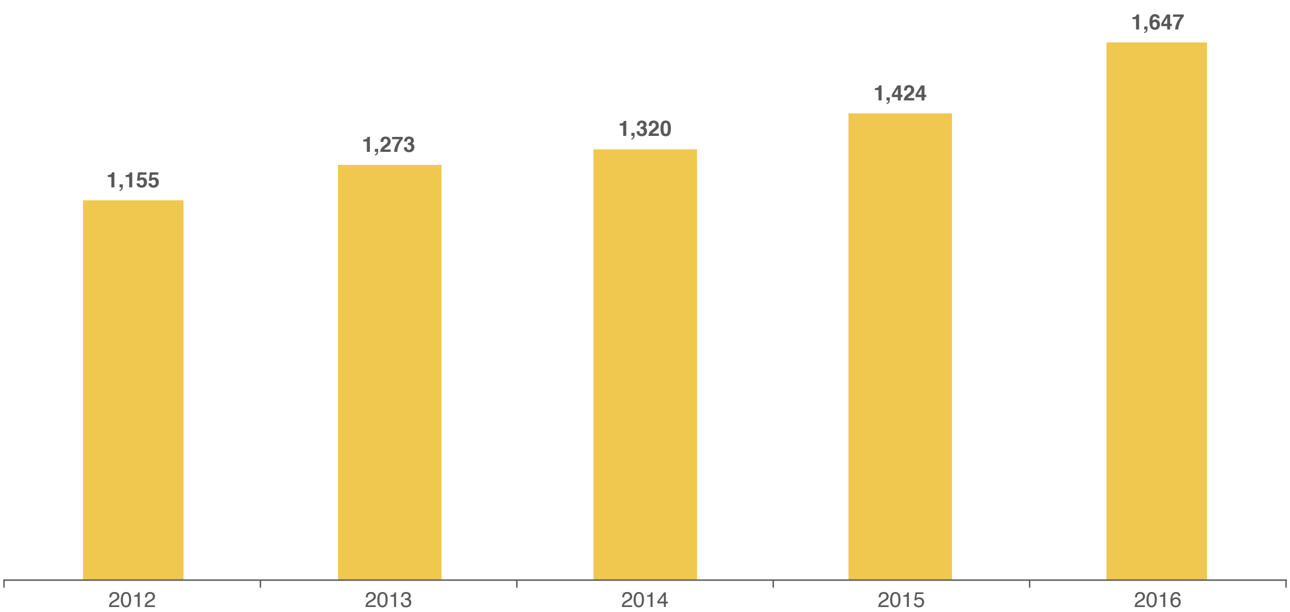
QATAR'S FINANCIAL SYSTEM DOMINATED BY BANKING SECTOR

The Qatari financial system has a dual structure, with one part overseen by the QCB and the other part overseen by the QFCRA. Overall financial system assets in Qatar were valued at QAR 1.69 trillion by the end of 2016. Out of this total, assets of financial institutions overseen by the QCB amount to QAR 1.65 trillion, with conventional financial institutions controlling a 77% share and the Islamic finance industry accounting for the remaining 23%. These assets witnessed double-digit growth of 16% in 2016 and have grown by 42% since 2012.

By sector, banking is the largest in Qatar's financial system, with total assets amounting to QAR 1.27 trillion in 2016 or 77%. This is followed by debt financing through bonds and sukuk, which represents 20% of total assets. The remaining 3% of assets are divided between Qatar's non-bank financial institutions, including insurance, financing and investment companies.

As for the financial institutions overseen by QFCRA, total assets amounted to QAR 44.7 billion in 2016 with corporate banks controlling the lion's share (66%) of the assets in Qatar Financial Centre (QFC) amounting to QAR 29.7 billion. This is followed by investment banks and investment managers amounting to QAR 10.5 billion and insurers and insurance intermediaries amounting to QAR 4.5 billion.

Figure 12 FINANCIAL SYSTEM ASSETS IN QATAR OVERSEEN BY QCB (QAR BILLION) 2012–2016



Source: Thomson Reuters Analysis

Note: Subsequent analysis of Qatar's financial system in this chapter is limited to financial institutions regulated by the QCB, given a breakdown of assets for QFC companies by Shariah-compliance is not available.

FINANCIAL MARKET DEVELOPMENT IN QATAR

Qatar's financial system provides considerable support to the country's economy. According to the World Economic Forum's (WEF) Global Competitiveness Index, Qatar is ranked 21 out of 138 countries globally and the first in the GCC in terms of its financial market development pillar. This pillar measures the sophistication of a country's financial markets, which help enable the transfer of capital for private-sector investment. It considers the development of a combination of different metrics, such as the soundness of the banking system, and the availability of venture capital and other financial products. In high-ranking countries, the financial system also needs to be trustworthy and transparent to protect savers and investors. Qatar's high ranking both globally and regionally is in particular a result of its perceived efficiency metrics, which are weighted 50% in the pillar. The WEF ranks Qatar first in the world in terms of venture capital availability, and second in terms of ease of access to loans, making it one of the most efficient financial markets worldwide. Both metrics indicate the perceived availability of market supply to meet demand for financing.

Qatar still has room for improvement in other metrics of the financial market development pillar, mostly those that constitute the trustworthiness and confidence aspect. The need for ensuring financial system safety and soundness has taken center stage in the wake of the financial crisis in 2007–2008, coupled with the drop in oil prices since 2014 that impacted Qatar and the wider region. In this regard, Qatar's financial regulators are already strengthening their regulatory tools to address the potential vulnerabilities of the financial system and tackle the various risks facing the industry.

8th Pillar: Financial Market Development	Global Ranking
Efficiency	
Financial services meet business needs	18
Affordability of financial services	9
Financing through local equity market	9
Ease of access to loans	2
Venture capital availability	1
Trustworthiness and Confidence	
Soundness of banks	20
Regulation of securities exchanges	11
Legal rights index 0-10 (best)	127

Source: World Economic Forum's Global Competitiveness Report 2016 – 2017

ISLAMIC FINANCE OVERVIEW

ISLAMIC BANKING AND SUKUK FORM 98% OF QATAR'S ISLAMIC FINANCE INDUSTRY

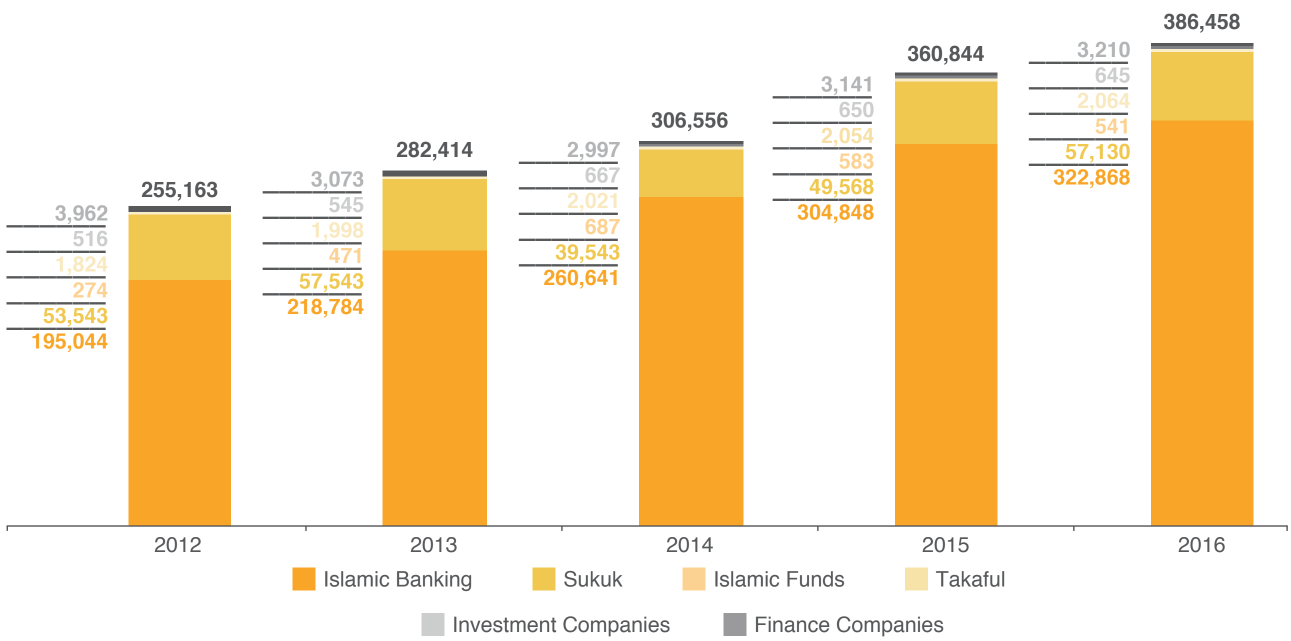
Qatar's Islamic finance industry is considered a vital part of the country's financial system. By the end of 2016, its assets totaled QAR 386.5 billion, constituting 23% of Qatar's total financial system assets under QCB jurisdiction. It has expanded considerably since its establishment in 1982 with both steady government support and spreading retail and corporate banking acceptance and adoption.

In the past five years, the growth of Islamic finance industry assets slightly outpaced that of the overall industry, growing at a CAGR of 11% from 2012 to 2016 while the CAGR for the overall financial system was 9%. This strong performance can be attributed to the relative rates of growth of their respective banking sectors, which constitute most of their assets. As with the overall financial system in Qatar, the Islamic banking sector is the biggest driver of industry asset growth given its 83.5% share of total Islamic finance assets. It grew at a CAGR of 13% between 2012 and 2016, while the overall banking industry grew at 11%. This proves that Shariah-compliant lenders are better positioned to withstand unfavorable economic conditions. Islamic banks benefitted from higher growth in foreign credit, which was a principal driver of impressive performances in the past five years.

Meanwhile, sukuk is the second largest Islamic finance asset class, constituting 14.8% of total Islamic finance assets, while sukuk and bonds together represent a larger 20% share of total financial system assets. The value of sukuk in Qatar has maintained a CAGR of 1.6% from 2012 to 2016, compared to the CAGR of total fixed income of 0.9%.The difference is the result of increased corporate sukuk issuance, amounting to QAR 4.82 billion in 2016, compared to QAR 2 billion in 2015. Prior to this, no corporate sukuk were issued since 2006.

Other players in Qatar's Islamic finance industry include takaful operators, investment and non-bank financing companies, but they contribute a mere 1.7% of assets, along with Islamic funds.

Figure 13 ISLAMIC FINANCE INDUSTRY ASSETS IN QATAR (QAR BILLION) 2012–2016



Source: Thomson Reuters Analysis

1950s and 1960s: Before Independence

The introduction of conventional banking in Qatar occurred 30 years prior to Islamic banking. The development of banking and the financial system in Qatar accelerated in the period following the start of oil exports in 1949 until independence from British rule in 1971. As oil production increased in the 1950s, more banks were founded, while insurance firms started operations in the 1960s. Before independence, there were nine banks and five insurance operators overall in Qatar, but only one of each was local.

Early 1970s: Foundation of Qatar's Financial Industry

Qatar gained political and economic independence from the United Kingdom on September 3, 1971, and joinined the International Monetary Fund (IMF) and the World Bank in 1972. The Qatar Monetary Agency was established in 1973 to function as the nation's central bank. The first oil shock during this year led an increase in government revenues and expenditures, resulting in an increased number of local banks operating in Qatar to address the needs of the government and individuals.

Late 1970s – 1990s: The Emergence of Islamic Finance Regionally and in Qatar

During the 1970s, the concept of Islamic banking emerged in the GCC region. Before Islamic finance existed in the GCC, the conventional banking system was the only option for financing requirements in the region. Government authorities became interested in establishing alternative forms of banking that followed Shariah guidelines on lending. As a result, the authorities passed decrees or legislation authorizing the operation of Islamic banks. The earliest Islamic financial institutions in the GCC were Dubai Islamic Bank in the UAE and the Islamic Development Bank in Saudi Arabia, which began operations in 1975. Kuwait and Bahrain followed the UAE, allowing Islamic banks in 1977 and 1979 respectively.

The oil boom in the 1970s triggered the establishment of Islamic financial institutions in the GCC, when governments discovered the need for more comprehensive modern banking systems to serve their financial needs and to help position themselves as leading trading centers. Early GCC Islamic banks, for example, focused heavily on trade finance using the murabahah contract (mark-up profit) to serve Muslim clientele, despite widespread criticism that murabahah was a proxy for charging interest. Islamic institutions in the GCC developed differently from the first Shariah-compliant institutions in other parts of the world. Egypt's and Pakistan's first Islamic financial institutions focused on Islamic micro-financing and qard hasan, while Malaysia's Tabung Haji focused on serving Hajj pilgrims. GCC Islamic banks were established to serve affluent clients who seek Shariah financing options.

Given the faster pace of economic growth after a second oil price shock in the early 1980s, Qatar introduced Qatar Islamic Bank (QIB) in 1982. QIB was established with a paid up capital of QAR 25 million. In 1989, QIB introduced its 30%-owned subsidiary, Al Jazeera Finance, thus introducing Qatar's first Islamic non-bank finance company.

Qatar's second Islamic bank, Qatar International Islamic Bank (QIIB), was established in a period of economic slowdown and extensive budget revision by the Qatari government following the deterioration of oil prices in 1986. QIIB was the only new bank established until 1993, as many banks struggled as a result of this slowdown.

The QCB replaced the Qatar Monetary Authority in 1993. Since then, it has played a prominent role in monitoring banks and conducting monetary policy. It began monitoring financing and investment companies as well in 1997. During this era, Qatar Islamic Insurance Company (QIIC) opened as Qatar's first takaful operator, joining seven insurers operating during this period, of which three were local.

2000s: Islamic Finance Realizes its Potential

The decade of the 2000s was marked by the Qatar's first sovereign and corporate sukuk issuances. In 2003, Qatar issued its first sovereign sukuk amounting to US$700 million. The Qatar Global Sukuk was used to construct Hamad Medical City in Doha using an ijara structure. Meanwhile, Qatar Real Estate Investment Company was established in the newly founded QFC, and issued Qatar's first corporate sukuk in 2006. This musharaka-structured sukuk funded the construction of housing complexes in Qatar.

The introduction of sukuk in Qatar, along with an increase in the number of Islamic finance institutions including Islamic banks, takaful operators and non-banking financial institutions, showed Qatar's willingness to further develop the industry. Qatar was also expanding globally, as indicated by the establishment of Pakistan's first takaful companies, Pak-Qatar Family and General Takaful, a partnership between QIIC, Fawad Yusuf Securities (Private) Limited, QIIB, and Masraf

Figure 14 THE EVOLUTION OF ISLAMIC FINANCE IN QATAR

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 US$700 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

QATAR'S FINANCIAL INDUSTRY BRIEF HISTORY

FIRST FOREIGN BANK
1950
The Eastern Bank (now Standard Chartered Bank Qatar)

FIRST LOCAL BANK
1956
Ottoman Bank
(International Bank of Qatar)

FIRST MONEY EXCHANGE
1955
Function by a specialized jewelry shop

FIRST INSURANCE OPERATOR
1964
Qatar Insurance Company

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

2017
Establishment of Barwa Bank

CURRENCY

1966
Introduction of Qatari Riyal

REGULATORY AUTHORITIES

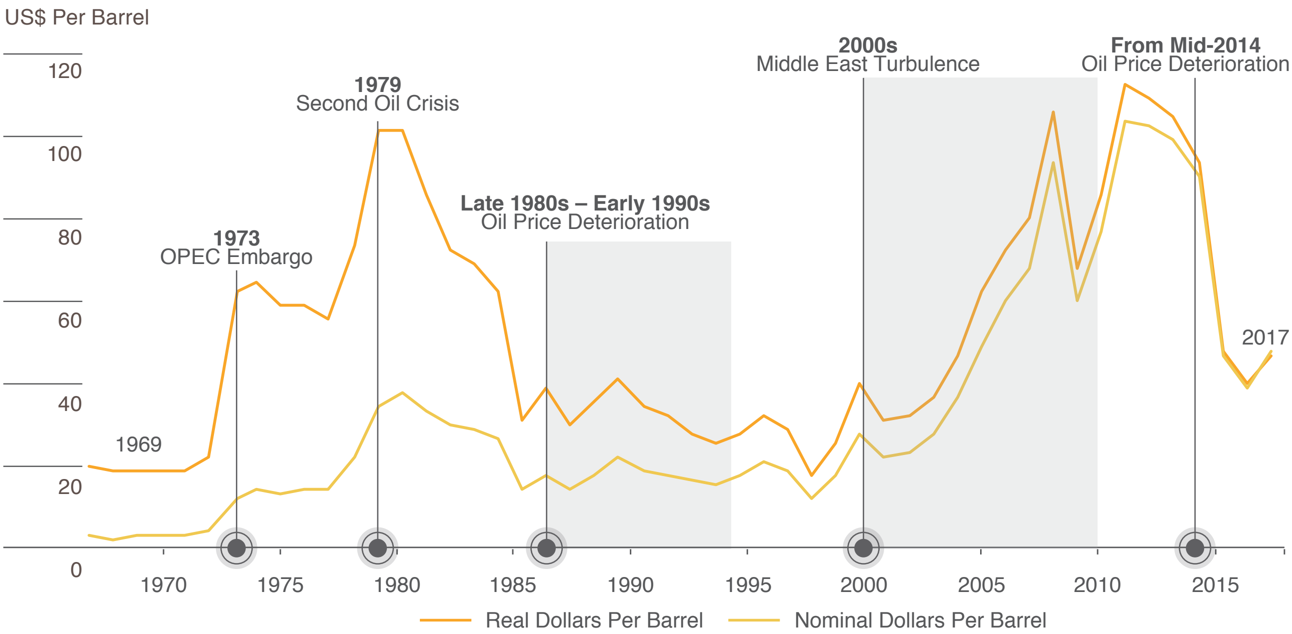
1973
Qatar Monetary Agency (QMA)

1993
Qatar Central Bank
(replacing QMA)

2005
Qatar Financial Centre and
Qatar Financial Centre
Regulatory Authority (QFCRA)

2005
Qatar Financial
Market Authority (QFMA)

Figure 15 THE DEVELOPMENT OF CRUDE OIL PRICES (US$/BARREL)1969–2017



Source: U.S. Energy Information Administration.

Al Rayan. QIB also established a foreign subsidiary, QIB UK.

In addition, Qatar first allowed the operation of Islamic banking divisions or windows at conventional banks in 2005. This regulation increased conventional banks' share of Islamic banking operations, reaching 31% of total Qatari Islamic banking assets in 2010, according to an IMF report.[2]

2010s: Change in the Qatari Islamic Banking Landscape

The popularity of Islamic finance allowed international players such as HSBC to open Islamic windows in the country and to compete with the dominant local operators at the start of the decade. However, HSBC, like the rest of conventional players, had to close down its Islamic operations only a few months later, in the wake of the QCB's decision to ban Islamic windows by the end of 2011. This move was made to ensure the purity of Qatar's Islamic finance operations by preventing Islamic assets and liabilities from mixing with conventional interest-bearing counterparts. As a result, the number of banks offering Islamic products decreased from 12 to 4 in 2012.

In the same year, the QCB sought to strengthen Islamic bank governance and oversight by requiring Islamic banks to have a Shariah supervisory board consisting of at least three members. The members are required to oversee all aspects of an Islamic financial institution's operations ensuring management conducts all business according to Shariah principles.

In recent years, there have been moves by Qatari banks to expand internationally into new Islamic finance markets. Limited deposit growth potential domestically has driven most Qatari banks to look for growth opportunities abroad. The latest is a plan by Qatari Islamic banks such as Masraf Al Rayan and QIIB to find partnerships in new markets in Africa, including Morocco[3] as reported by Reuters. QIIB opened Morocco's first Islamic bank, Umnia Bank, as a joint venture with Moroccan lender Credit Immobilier et Hotelier S.A. (CIH Bank).

The local banking landscape in Qatar could also change considerably with the planned merger of three Qatari banks, Masraf Al Rayan, Barwa Bank and International Bank of Qatar. This would form a new bank operating in line with Islamic banking principles with total assets worth more than QAR 163 billion, becoming Qatar's second largest bank.

2 International Monetary Fund, Qatar 2012 Article IV Consultation, January 2012.
3 Reuters, "UPDATE 1-Morocco to start approving Islamic banks for business to begin in 2017," 30 June 2016.

Minaret and dome of Airport Mosque, Doha.

GCC ISLAMIC FINANCE INDUSTRY PERFORMANCE

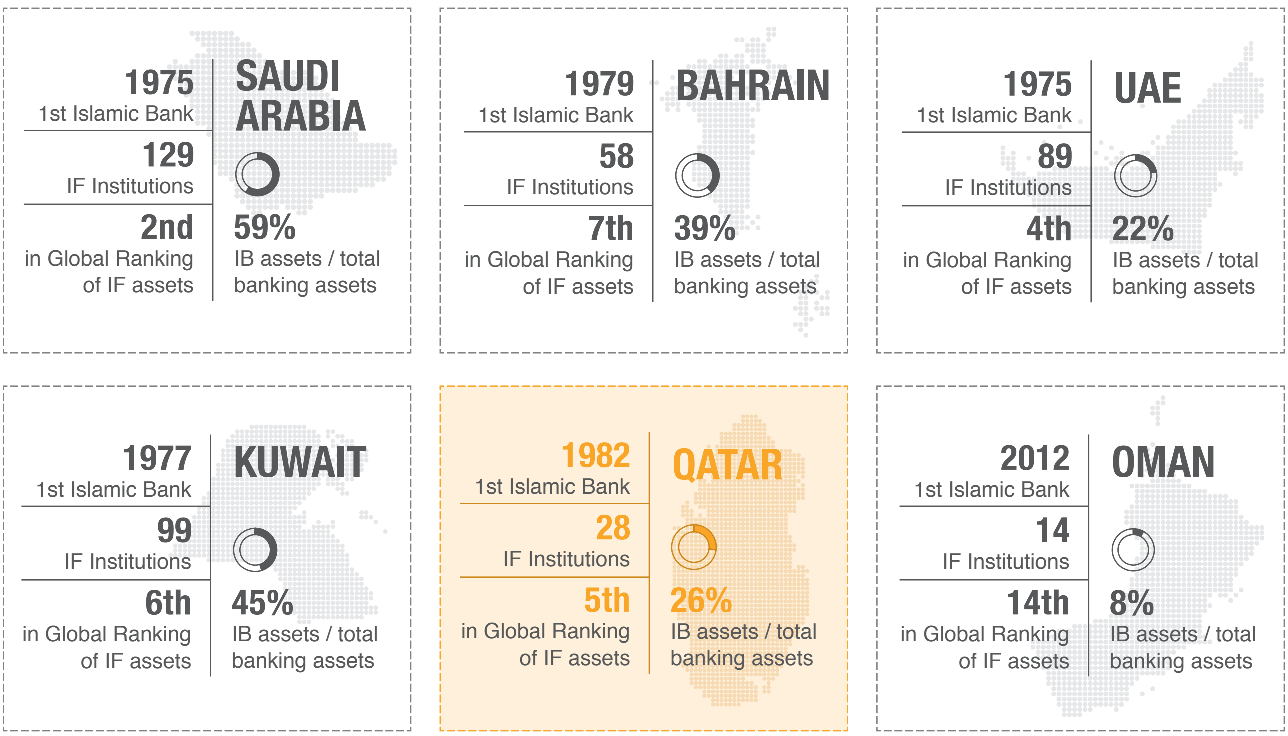
ISLAMIC BANKING PREDOMINATES IN THE GCC'S ISLAMIC FINANCE INDUSTRY

Islamic financial institutions in the GCC account for the largest single-region share, 45%, of total global Islamic finance assets. This share could grow further with the rising demand for alternative sources for financing in the GCC, given ongoing weak oil prices. Qatari institutions hold the third largest volume of Islamic finance assets after Saudi Arabia and the UAE.

As in Qatar, Islamic banking is the main contributor to total Islamic finance assets in the GCC overall (81%) and in each of the GCC states individually. Islamic banks also account for significant shares of total banking assets in each country, except for Oman, which is relatively new in this field, licensing its first Islamic bank only in 2012.

The sukuk market is active as well in the region, but new issuances have fallen recently given governments' and corporations' preference for conventional issues to sukuk in recent years in order to access liquidity from international conventional investors more easily. This is in line with the significant

Figure 16 KEY FIGURES ON ISLAMIC FINANCE IN THE GCC

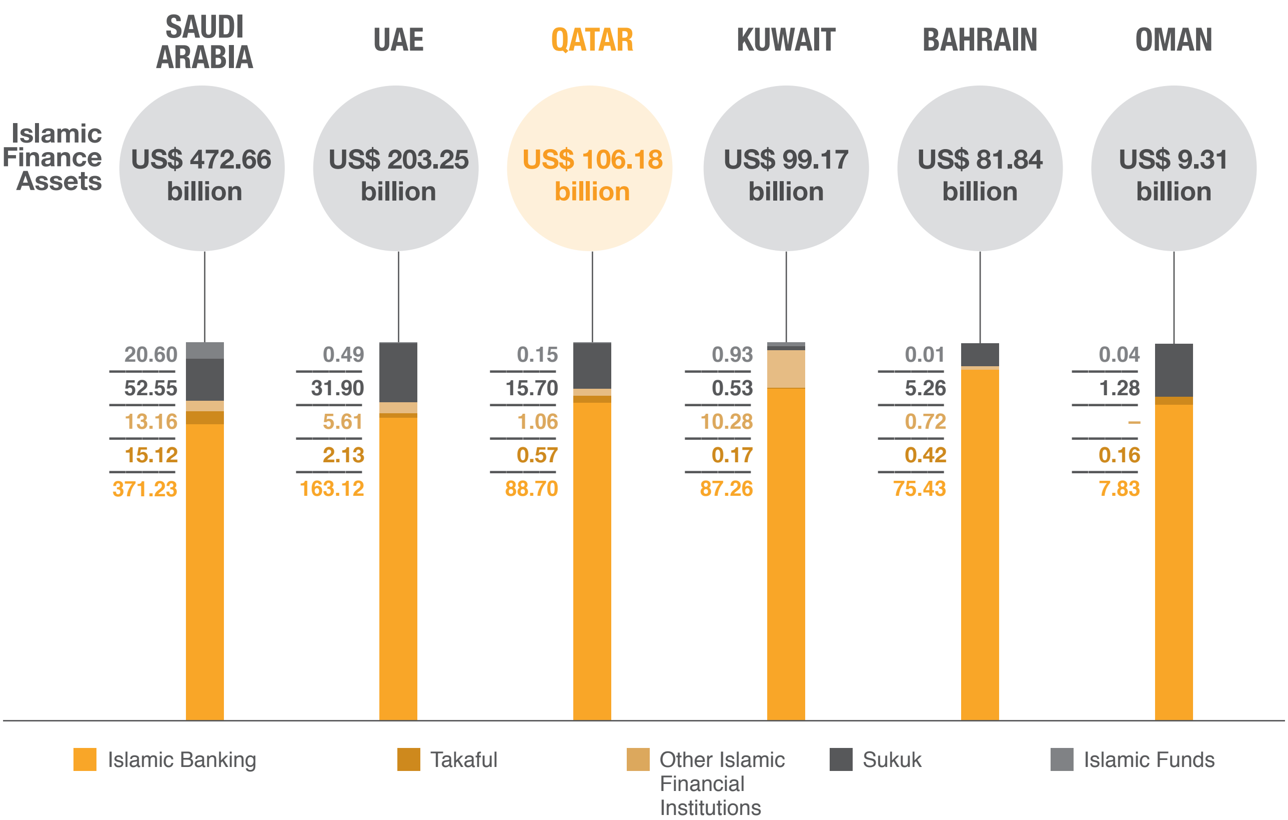


Source: ICD – Thomson Reuters Islamic Finance Development Indicator drop in oil prices in recent years which led to uncertainty and changing financial strategies. Saudi Arabia is the largest sukuk issuer in the GCC, as symbolized by its US$9 billion first international sovereign issuance in 2016. It is followed by the UAE, Qatar and Bahrain, which also raised financing through sovereign sukuk issuances in 2016. Kuwait differs from other GCC members in terms of sukuk's share of its total Islamic finance assets, as it is not as active as other GCC states, while Oman issued its first corporate sukuk in 2013 and first sovereign sukuk in 2015.

Meanwhile, non-bank financial institutions hold smaller shares of each country's Islamic finance assets, except in Kuwait. Investment companies are an important part of Kuwait's Islamic finance industry dating back to the early 1990s and witnessing rapid growth in the late 1990s to mid-2000s. Although Islamic investment companies are active in Kuwait, Islamic asset management constitutes a small portion of its total Islamic finance assets, similar to most GCC countries. Saudi Arabia, on the other hand, has the world's largest value of Islamic funds under management, although they account for only 4% of its total Islamic finance assets.

Moreover, Saudi Arabia has the world's largest takaful industry by assets, as its insurance sector is based completely on the cooperative insurance model by law. As for the rest of GCC countries, which have dual conventional and Islamic financial systems, takaful operators are facing increasing competition from conventional insurers that is dragging down their performance. Thus, takaful operators in the region need to compensate for their short track records and focus on corporate business lines rather than retail consumers in order to compete successfully with their conventional counterparts.

Figure 17 GCC ISLAMIC FINANCE LANDSCAPE (FYE 2016)



Source: ICD – Thomson Reuters Islamic Finance Development Report 2017

OPPORTUNITIES AND GROWTH POTENTIAL

ISLAMIC BANKS IN QATAR CAN MEET UNTAPPED CONSUMER POTENTIAL

Qatar enjoyed the highest GDP per capita in the world in 2016,[4] making it one of the wealthiest nations worldwide. Opportunities for conventional or Islamic banks and financial institutions therefore lie in targeting the domestic population, in both the economically active and inactive population segments. The economically active population comprises the employed and unemployed adult population of both Qatari and non-Qatari nationality. The economically inactive population includes students, housewives and retirees.

However, according to IMF data, households that have lines of credit in Qatar represent only one quarter of the employed and economically active population. This is because 95% of the employed category is non-Qataris, such as migrant workers, who comprise the majority of Qatar's population and workforce. They work in craft, retail trade and elementary occupations in sectors such as construction and domestic services with lower average wages and are mostly financially illiterate. Taking this into consideration, financial institutions are not meeting their retail potential, as indicated by the growth of the economically active population outpacing the growth of bank clients in Qatar.

Islamic banks in Qatar can play a role by providing services that facilitate and address the expected increase in consumer spending. According to the latest Qatar Consumer Confidence Index (CCI), one-third of households felt that their financial situation had improved compared to the previous year. Respondents stated this was most commonly the result of increased income. In addition, many expressed their willingness to increase spending on either durable goods or vehicles. Expected growth in spending could lead to increased credit growth which could be for large loan segments such mortgages and auto loans or day-to-day spending through credit cards. Islamic banks can tap into such segments by offering attractive rates for retail products and services and by increasing financial awareness on different Islamic financing options available for retail consumers along with their benefits.

Table 3 QATAR'S POPULATION BY ECONOMIC ACTIVITY

	2012	2013	2014	2015	Q3 2016
Economically Active ('000)	1,347	1,543	1,690	1,957	2,077
Economically Inactive ('000)	209	227	239	251	253

Source: Ministry of Development Planning and Statistics

Table 4 DEPOSITORS AND BORROWERS PER 1,000 ADULTS IN QATAR

	2012	2013	2014	2015
Depositors with Commercial Bank (Per 1,000 Adults)	642	705	711	784
Total Depositors ('000)	1,108	1,262	1,309	1,480
Borrowers from Commercial Bank (Per 1,000 Adults)	234	248	252	262
Total Borrowers ('000)	403	443	463	495
Total Household Borrowers ('000)	386	426	445	476

Source: Financial Access Survey, IMF. Last Updated: 6/1/2017

4 World Bank national accounts and OECD National Accounts data files.

ISLAMIC BANKS AND FINANCIAL INSTITUTIONS CAN TAP CONSUMER DEMAND IN QATAR THROUGH EDUCATION AND AWARENESS

Education and awareness are key building blocks for the successful development of any service industry. Likewise, Islamic finance education and awareness, whether through courses, specialized degrees, public awareness campaigns, roundtables, workshops or other qualifications, are important for the industry's growth in Qatar.

For financial institutions, having in-depth expertise on Islamic commercial transactions law and Islamic finance allows for faster innovation in the industry. Thus, knowledge of conventional banking and financial practices only is not sufficient. According to the Finance Accreditation Agency (FAA) Talent Development Survey 2014, conducted in collaboration with Islamic Finance News (IFN), 57% of respondents who are involved in the human development aspects of the Islamic finance industry believe that the current gaps in the competency of Islamic finance professionals are in Shariah expertise and technical Islamic finance knowledge. 74% believe that professionals who do not possess formal Islamic finance qualifications are less capable of doing their job. In addition, 72% believe that conventional banking professionals cannot manage Islamic finance-related roles without any formal Islamic finance training.

Moreover, attending Islamic finance workshops, studying Islamic finance or reading about the industry's development in newspapers can increase consumer demand for Islamic products. It has been established that leaders in the Islamic finance industry globally, like Malaysia and Bahrain, have dedicated efforts towards Islamic finance education and literacy to ensure the positive development of the industry. According to the ICD — Thomson Reuters Islamic Finance Development Indicator (IFDI), Qatar has nine institutions providing Islamic finance education. Ten colleges and universities provide courses and seminars on Islamic finance in Qatar. Affiliations in Qatar have published 34 research papers on the industry between 2014 and 2016. In addition, there were eight Islamic finance events held in Qatar in 2016. When compared to Bahrain and Malaysia, which are among the most developed IFDI markets, Bahrain has 18 education providers, while Malaysia has 58 providers. In terms of research, Bahrain produced 26 research papers, while Malaysia has the biggest Islamic finance library, totaling 922 published research papers in 2016.

In addition, establishing 'Centers for Excellence' for the Islamic finance industry has proven a major contribution towards the industry's knowledge and awareness in markets such as Pakistan and Malaysia. Among the key contributors towards Qatar's Islamic finance outreach is the Center for Islamic Economics and Finance (CIEF), which is a research centre at Qatar Faculty of Islamic Studies (QFIS) at Hamad Bin Khalifa University, established in 2010. In 2016, the centre held several public events bringing the Islamic finance community together. They included a roundtable event on Shariah governance, which brought together 60 stakeholders from the wider community such as experts, students and practitioners, and a workshop focusing on risk management in Islamic finance. Among the degree programs taught at the university is the Master of Science in Islamic Finance, which will equip students with the required knowledge in the Islamic finance industry.

> *... establishing 'Centers for Excellence' for the Islamic finance industry has proven a major contribution towards the industry's knowledge and awareness...*

West Bay central financial district, Doha.

ISLAMIC FINANCE REGULATION AND INDUSTRY INFRASTRUCTURE

REGULATORY AND SUPERVISORY FRAMEWORK

Qatar's economy and financial sector have developed rapidly over the past decade. The regulatory framework applicable to the banking system in particular has undergone significant changes in this time, reflecting changing market conditions, especially after the financial crisis. They have also led to the growth of the financial system, including an increase in international linkages between Qatari banks and foreign markets.[1] Islamic banking has been the most significant area of growth in the Islamic finance industry globally, as well as in Qatar.

1 IMF. (2016). *2016 Article IV Consultation for Qatar - Staff Report*, §23.

CREATING A FIRM FOUNDATION FOR THE FUTURE OF ISLAMIC FINANCE

Three different regulators oversee the financial sector. The Qatar Central Bank (QCB), the Qatar Financial Centre Regulatory Authority (QFCRA) and the Qatar Financial Market Authority (QFMA). Under the jointly-issued Strategic Plan 2013-2016, the three regulatory agencies are "working together in a coordinated and mutually supportive manner to harmonize Qatar's financial sector policies." Under this plan, the QCB will be the primary regulator, but QFC-based financial institutions that would otherwise be subject to direct oversight will be registered and supervised by the QFCRA, and the regulatory system will be harmonized to avoid duplication of oversight responsibilities. The QFMA supervision of publicly listed financial institutions primarily relates to their listed status and operation in the capital markets, which includes all four Islamic banks. The new five-year Financial Action Strategy 2017-2022 will likely continue to support this harmonization.

All three regulatory bodies have had a regulatory role since they were established. The QCB has been the primary regulator for banks in Qatar since it was established in 1993, taking over this role from its predecessor body, the Qatar Monetary Authority. When the Qatar Financial Centre (QFC) and QFCRA were established in 2005, this regulatory role was split. The QFCRA regulates financial institutions that are based in the QFC, and the regulation of other institutions was divided between QCB for banks and QFMA for securities firms.

The regulatory regime comprising the QCB, QFMA and QFCRA that began in 2005 covered all financial institutions except insurers. Until 2005, all insurers were regulated by the Ministry of Business and Trade under Decree Law No. 1 of 1966. During this time, insurance regulations excluded foreign insurers from insuring property in Qatar. The establishment of the QFC allowed foreign insurers to operate from the QFC. Between 2005 and 2012, the QFCRA regulated QFC-based insurers, while the Ministry of Business and Trade regulated all non-QFC insurers. QCB Law No. 13 of 2012 (QCB Law) brought the regulation of insurers operating outside the QFC to the central bank, culminating in the establishment of its Insurance Division in 2016.[2]

The most important shift in the banking market occurred ahead of the implementation of Basel III regulation, when the QCB mandated the segregation of Islamic and conventional banking in a 2011 directive. Similarly, takaful operators are not permitted to pursue non-takaful business under Section 2.1.7 of the QCB's 2016 Executive Insurance Instructions. In addition, Section 16.3.7 of the instructions advised insurance companies to close any pre-existing takaful windows within two years of the instructions taking effect.

Following the QCB Directive in 2011 and the QCB Law in 2012, the QCB, QFMA and QFCRA, began the harmonization of their regulations under the Strategic Plan 2013-2016. The main purpose of this initiative was to close any gaps that may have allowed unregistered financial services and to eliminate regulatory arbitrage, achieving more consistent regulation of the financial system.

2 Alpen Capital. (2013). *GCC Insurance Industry*.

Qatar Central Bank, Doha. REUTERS/MOHAMMED DABBOUS

CONCENTRATED ISLAMIC BANKING SECTOR AFTER SEGREGATION FROM CONVENTIONAL BANKING

The QCB's approach to Islamic banking was modified in 2011 with a directive prohibiting conventional banks from operating Islamic windows. The directive identified four supervisory challenges related to the operation of Islamic banks alongside conventional banks with Islamic windows. The objective of the directive was to consolidate the Islamic banking industry in Qatar, which is often put forward by industry advocates as necessary for enhancing the competitiveness of Islamic banks. In the directive, the QCB also outlined other macro-prudential issues relating to the transmission of monetary policy. The four major reasons cited for the split of Islamic from conventional banking regulations were:

- Increased complexity leading to different and more challenging risks associated with mudarabah, musharakah, istisna'a and ijarah financing when they are financed with fixed income deposits;
- Difficulty promoting consistent financial reporting for institutions that operate both Islamic and non-Islamic operations;
- Challenges associated with the implementation of Basel III rules, and specifically the differences in treatments under Basel III (for conventional banks) and the Islamic Financial Services Board (IFSB) standards (for Islamic banks); and
- Increased risks to financial stability from the unequal competitive position of Islamic banks, which can only offer Shariah-compliant products, and conventional banks offering Islamic and non-Islamic products.[1]

Under the terms of the directive, conventional banks were given until the end of 2011 to wind down their Islamic windows in an orderly fashion, which proceeded smoothly. Only one Islamic banking window, at the International Bank of Qatar, did not proceed via a wind down. It was instead split, with its retail book sold to Barwa Bank and its corporate book sold to Qatar Islamic Bank.

Although Islamic banks have continued to grow after the directive was implemented, the new policy did not have the effect many expected of accelerating the growth of Islamic banks. According to QCB data, the share of Islamic bank assets rose from 24% in 2012, the first year after the directive, to 25.6% at year-end 2016. This is partially the result of the natural inertia clients have in their banking relationships. On the other hand, this marginal growth in share suggests that some customers may have only temporarily stayed with the conventional banks of Islamic windows, being the most likely new customers for Islamic banks.

The suspension of Islamic windows has led to the continued growth and consolidation of Islamic banking assets at the four remaining Islamic banks. Their current size—and the possible merger of Barwa Bank, Masraf Al Rayan and International Bank of Qatar by year-end—means that Islamic banking could become more concentrated still in the near future.

Increased concentration is often viewed with suspicion because it can mean higher fees for customers if banks exercise their market power. On the other hand, customers can also benefit if the increased efficiencies associated with larger-scale operations lead to better service. The argument for concentration leading to higher fees is less persuasive looking at the Islamic banking sector in isolation because many customers are price sensitive and will switch to a conventional bank if the cost differential widens.[2] An example of this elasticity can be seen in the response to the QCB directive on Islamic windows. If customers had not been price sensitive, they would have moved to full-fledged Islamic banks immediately, which did not occur in actuality.

1 QCB. "Islamic branches of conventional ("commercial") banks," directive issued February 10, 2011.
2 In analysis of data from the World Bank's Global Findex database covering 64 countries which represent 75% of the global Muslim population, most respondents expressed a theoretical preference for Islamic finance and a plurality expressed interest despite higher costs. There exists a nearly as large a number of Muslims for whom costs would lead them to choose a conventional loan over financing from an Islamic bank. See Demurgic-Kunt, Asli, Leora Klapper and Douglas Randall. 2013. The Global Findex Database: Islamic Finance and Financial Inclusion. *Findex Notes No. 12*. Washington, DC: World Bank and the Bill & Melinda Gates Foundation.

Shariah governance is left to each institution provided it follows the general parameters required by QCB Law.

BASEL III IMPROVES RISK AND LIQUIDITY MANAGEMENT AT ISLAMIC BANKS

The primary difference between the treatment of Islamic banks and conventional banks from the perspective of Basel III regulations is in the treatment of restricted and unrestricted investment accounts (RIAs and URIAs, respectively). At Islamic banks, URIAs are combined with the bank's own funds to finance its assets, and they represent most of what a conventional bank holds in deposits. RIAs, on the other hand, are segregated accounts where the assets they fund are held separate from the bank's assets, and which account for the remainder of the bank's deposits.

An 'alpha' coefficient for each type of account reflects the level of displaced commercial risk that banks need to hold capital against. It measures the degree to which banks will not pass on below-market returns or losses through to depositors. Islamic banks generally have low alphas because they bear most of the risk of principal or loss of profit instead of passing the risk onto depositors, who would rely on profit equalization reserves and investment risk reserve accounts that are funded by earlier retained profits. Accordingly, a bank with a higher alpha would have higher outflows in its net stable funding ratio calculation and would require more liquid assets.[3]

For RIAs, where there is a higher defined bearing of risk by RIA holders, the treatment sets alpha at 50%. This reduces the capital required for the risk-weighted assets financed by RIA holders by half.[4] Islamic banks are able to assume that half of the assets funded by RIAs are fully risk bearing and therefore have a 0% capital requirement. This represents an area where Islamic banks may be better off than conventional banks, from a capital optimization perspective. By spinning off the assets funded by RIA deposits into an asset management arrangement, the investors bear full risk and the bank does not have to hold capital against these assets.

The other area of Basel III that raises specific concerns for Islamic banks and regulators in some markets is the application of the Liquidity Coverage Ratio (LCR), which measures the required liquidity that banks must hold to meet deposit withdrawals during economic downturns. Regulators must choose either a standard approach or an Alternative Liquidity Approach (ALA), based on whether there are sufficient high quality liquid assets (HQLAs) in the banking system they regulate. In many markets, the lack of sufficient sovereign sukuk and Shariah-compliant repurchase (repo) facilities with the central bank means there are too few HQLAs to meet banks' needs under the standard approach. The QCB has issued several tenors of sukuk, which are eligible for repurchase agreement transactions with the QCB. They

3 IFSB. (2015). *Guidance Note on Quantitative Measures for Liquidity Risk Management in Institutions Offering Islamic Financial Services (Excluding Islamic Insurance (Takaful) Institutions and Islamic Collective Investment Schemes).* Kuala Lumpur: IFSB, §63

4 QCB. (2014, January 14). "Capital Adequacy Ratio - Basel III Framework and IFSB -15: Revised Capital Adequacy Standard," Circular no. 6/2014.

are also permissible as a Level 1 HQLA, which alleviates the liquidity concerns relative to other markets.

The subsequent application of the IFSB-15 Standard adapts the Basel standards to the specificities of Islamic banks and windows by the Malaysia-based Islamic Financial Services Board (IFSB). This standard was designed to assist standalone Islamic banks in meeting Basel III requirements. The QCB decided to take the supervisory discretion approach outlined in the IFSB Standard rather than the standard treatment and sets the alpha factor at 100%, meaning the bank passes no credit risk through to URIAs for capital adequacy purposes.[5]

Additionally, banks in Qatar are required by the QCB to report their financial statements using the International Financial Reporting Standards (IFRS). Islamic banks are required to report in accordance with the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) accounting standards. The QCB has instructed Islamic banks to use IFRS standards whenever the AAOIFI standards are not available.[6] However, as the new IFRS standard is adopted, this may force Islamic banks to adopt accounting methods that do not reflect the forms of the transactions that have been ruled Shariah-compliant.

SHARIAH GOVERNANCE ENFORCED BY INDIVIDUAL INSTITUTIONS

The harmonized approach implemented following the launch of the strategic plan specifically covers several requirements specific to Islamic finance, primarily related to the Shariah governance process. Unlike some other Islamic finance markets, there is currently no apex Shariah supervisory body at the national level and no announced plans for such an institution. Instead, Shariah governance is left to each institution provided it follows the general parameters required by QCB Law.

NON-QFC REGULATORY BODIES WORK TO LEVEL PLAYING FIELD WITH THE QFC

Outside of banking, there is a similar division in securities regulation, with the QCB acting as the supreme regulator. The regulatory system for local securities firms is handled by the QFMA, which has a single set of net capital rules applicable to all securities firms. These rules spell out the calculation of net capital and outline a single approach to fixed income instruments, including both bonds and sukuk in each category, according to their rating, to determine risk weighting.

There is a single rulebook with the same listing requirements for all issuers, whether Shariah-compliant or not. Any investment firm, whether local or foreign, is able to list on the QSE with the approval of the QFMA. For sukuk, an additional step is required, whereby a sukuk must be approved by the issuer's Shariah Supervisory Board and a fatwa submitted with the listing application. This provides explicit governance control over the Shariah compliance of listed sukuk, but it may add time to the issuance process relative to a conventional bond. There is no specific requirement for issuers to provide the credentials of Shariah board members with the fatwa, but their names and experience must be listed in the offering documents.

INSURANCE REGULATION ALIGNED WITH BANKING FRAMEWORK

The QCB Law moved the insurance sector, including takaful to the jurisdiction of the QCB, where an Insurance Division has been established. Under the new law, the QCB requires more extensive governance requirements and calculation of actuarial risk by insurers than was required under the Ministry of Economy and Commerce. It has taken a phased approach to enforcing full compliance with the requirements. This will ensure consistent regulatory treatment of insurers in each market that is in line with international best practices.

One notable area of stronger regulation is a requirement for brokers to undertake and document a detailed suitability assessment and review program for compliance and potential future dispute resolution.

Specific rules for takaful operators in the QCB rulebook are fragmented, but the QFCRA established a dedicated section applicable for takaful operators in 2006 that has been subsequently updated several times. The rulebook covers specific issues related to takaful, including the establishment of segregated funds for policyholders separate from shareholders and loans made to the policyholder funds by shareholders, for example, when the fund experiences underwriting deficits.

5 QCB. *Op. cit.*
6 Qatar Central Bank. "IFRS 9 Implementation Guidelines in connection with Classification and Measurement of Financial Assets and Liabilities and Derivatives." Doha: Supervision and Control of Financial Institutions Division, QCB.

AT A GLANCE: QATAR CENTRAL BANK AND QATAR FINANCIAL CENTRE REGULATORY AUTHORITY

The regulatory environment for Islamic finance has undergone a comprehensive and systematic change beyond conditions in other markets in the GCC region. Qatar has moved away from a default position for the region, where Islamic finance could coexist with, compete with, and operate alongside conventional finance within single institutions. As a result, Qatar has revamped the regulatory framework dramatically to strengthen the core Shariah proposition of Islamic financial institutions and to better align regulatory oversight.

QCB AND QFCRA BANKING REGULATIONS BUILT ON GLOBAL STANDARDS

The rules governing the Islamic banking sector are mostly consistent between the QCB and the QFCRA. Banking sector regulation rests primarily with the QCB, especially for commercial banks, both Islamic and conventional. QFC-regulated banks are restricted from accepting retail deposits within Qatar. For wholesale banks, QFCRA regulations prohibit banks from operating Islamic windows, aligning regulations with the QCB.

Consistency between the QCB and QFCRA regulations is carefully designed to avoid regulatory arbitrage opportunities and to adhere to the IFSB-15 standard on Islamic banking. It aims to ensure regulations are relevant for Islamic banks while remaining aligned with global banking standards like those issued by the IFSB.

REGULATORY SYSTEM DEVELOPMENT IS STILL UNDERWAY FOR INSURERS

Among the regulated areas of finance in Qatar and in the QFC, insurance contains the greatest differences in regulatory approach. The QFCRA has regulated insurance in the QFC since 2006, while the QCB has only been the insurance regulator for institutions operating within the State of Qatar since the QCB Law shifted regulation from the Ministry of Economy and Commerce. As a result, the state of insurance regulation has been evolving, with new QCB Executive Instructions introduced in 2016.

The main difference in insurance regulation at the QFC is that insurers are subject to a lower minimum base capital requirement compared to QCB-regulated institutions. They are then subject to risk-based capital requirements above the minimum level. QCB-regulated institutions, on the other hand, are subject to higher capital requirements based on a risk-based capital regime. There has been a global shift towards the type of risk-based capital requirements rolled out to insurers by the QCB, which is aligned with International Association of Insurance Supervisors (IAIS) standards.

REGULATORY OVERLAP REMAINS IN SECURITIES OVERSIGHT

Capital markets regulation in the QFC distinguishes between activities that are targeted outside of Qatar and businesses that deal with listed securities on the QSE. The QFCRA primarily deals with private funds and those involved with securities wholly outside of Qatar.

Brokerage and asset management firms involved in activities involving securities listed on the QSE and funds are subject to regulation by the QFMA. Depending on whether they are acting in a principal or agency role, they may also be regulated by the QCB in some cases. In the case of sukuk issuers, a similar distinction exists, whereby the QFCRA may retain its primary role as regulator unless the sukuk is listed on the QSE, whereupon regulatory oversight shifts to the QFMA.

In all of these situations, the regulations being applied are relatively consistent. For example, in sukuk issuance, the primary distinction with a conventional bond is the role of the Shariah board. It is generally allowed for the Shariah board appointed by the issuer to decide whether or not to certify a sukuk as being Shariah


Al-Hitmi Office Building, Doha. ATTILA JANDI / SHUTTERSTOCK.COM

compliant, while the regulatory requirements largely follow IFSB standards relating to additional disclosure of the Shariah scholars' names and the fatwa issued along with the other offering documents.

ENCOURAGING ASSET MANAGEMENT AT QATAR FINANCIAL CENTRE

The QFC's focus has been on growing asset and wealth management.[7] Islamic banks are able to operate from the QFC, although not for their onshore retail banking activities, and all banks are subject to identical segregation rules that prohibit Islamic windows. This makes the QFC appealing for regionally-focused financial institutions operating in Islamic finance in all activities except for retail Islamic banking targeting the Qatari market. There are separate rules for QFC firms carrying out Shariah-compliant commercial and investment banking, asset management, and takaful, respectively providing regulation specific to each area of business such as requirements to conduct proper Shariah governance in product development, review and audit.[8]

QFC, as an onshore financial centre, offers an attractive domicile for regional asset management with fundraising targeting Qatar and other GCC and MENA regional markets. The Collective Investment Scheme (CIS) regulation is modeled on the European Union (EU)'s Undertakings for Collective Investment in Transferable Securities (UCITS) market, which provides a familiar approach to regulation for fund managers already operating in other markets where UCITS is used.

The regulatory approach is separated into collective investment and private placement markets, with the former including all of the retail investment funds as well as many of the institutional funds. Regulations divide collective investment schemes into UCITS funds, which allow sales to all investors (including retail), and institutional funds, which have more flexibility on legal structure but may only be sold to a more limited set of investors.

For example, UCITS funds are only allowed to have 10% leverage. When the CIS rules were originally written, they prohibited UCITS funds from real estate and commodities investment. In 2016, responding to retail investment firm demand, the QFCRA passed amendments to the CIS rulebook to allow retail real estate funds, including Real Estate Investment Trusts (REITs).

Other (non-retail) collective investment schemes are able to invest in less liquid instruments and use higher leverage. However, they must all be open-ended funds. Private placement funds have no restrictions on investments and can be closed-ended. The wide range of fund structures permitted in the QFC, all of which can explicitly be used for Shariah-compliant funds, provides significant flexibility within a globally familiar regulatory framework.[9] The upside for Shariah-compliant fund managers is that QFCRA regulations provide a suitable framework that matches both the fund strategy and investor base without subjecting fund managers to unnecessary regulations.

7 French, D. (2016, June 1). "Qatar Financial Centre sees new law on foreign investment by year end," *Reuters*.
8 Islamic Banking Prudential Rules 2015 cover Islamic banking (commercial and investment banking), Investment Management & Advisory Rules 2014 cover asset management (including a section specifically covering Islamic asset management) and the Insurance Business Rules 2006 cover insurance (including a specific chapter covering takaful).
9 QFCRA. (2011). *A Guide to the QFC: Collective Investment Schemes*. Doha: QFCRA.

MR. MICHAEL RYAN

CEO, Qatar Financial Centre Regulatory Authority (QFCRA)

Mr. Ryan is the Chief Executive Officer of the QFC Regulatory Authority. Mr. Ryan moved to the QFC Regulatory Authority in 2009 from Bank of America Merrill Lynch, where he served in a number of senior management positions in London and Dublin, including Chief Executive Officer of Merrill Lynch International Bank Limited and Country Executive for Bank of America Merrill Lynch in Ireland. Prior to joining Merrill Lynch, Mr. Ryan was Vice President at Credit Suisse Financial Products and an associate with Cadwalader, Wickersham & Taft specializing in banking, securities and corporate law. Mr. Ryan has served on the Irish Prime Minister's advisory committee on financial services and has held a number of senior industry positions, including membership of the Board of Directors of the European Banking Federation. Mr. Ryan is a member of Qatar's Financial Stability and Risk Control Committee. Mr. Ryan is also a member of Qatar's National Anti-Money Laundering and Terrorism Financing Committee and a member of the Board of Directors of the Qatar Financial Markets Authority.

1. The New QCB Law brings together QCB, QFCRA and QFMA to develop an enhanced regulatory framework with a level playing field for all financial institutions operating in Qatar. Could you provide more details about the process of regulatory development in this model? Is QFCRA restricted to developing its regulations only as relevant to QCB?

I think an important starting point is understanding the overall regulatory framework for financial services in Qatar, and from that, understanding the roles of the Qatar Central Bank (QCB), the QFC Regulatory Authority (the Regulatory Authority), and the Qatar Financial Markets Authority (QFMA), and the importance of the relationship between them.

The QCB's regulatory jurisdiction primarily covers banking and, following the new QCB law in 2013, insurance. The QFMA is responsible for capital markets. The firms authorized by the Regulatory Authority also conduct banking, insurance, asset management, and advisory activities in and from the QFC. In contrast to other financial centers, the QFC is onshore, which means that its firms are authorized to do business in the State (of Qatar) and in local currency.

Given that the three regulators have important responsibilities for the overall regulation of financial services in the State (and in the same market), you can appreciate that it is particularly important to ensure that there is good coordination among the regulators and a level of consistency in how we approach our regulatory mandates to avoid market distortions and potential arbitrage.

The current level of coordination really began with the passage of the new QCB law. Article 116 of that law established a new committee, the Financial Stability and Risk Control Committee (FSRCC), with a broad statutory mandate. This mandate extends beyond matters more directly related to financial stability to include improving coordination among financial regulators and finding ways to achieve greater consistency in regulatory policy.

Following the new QCB law, the three regulators remain independent and operate under their respective laws, but the FSRCC plays a vital and active role in ensuring greater coordination and consistency. The committee is comprised of senior representatives from the three organizations, including myself, the Deputy Governor of the QCB and the CEO of the QFMA. The committee is chaired by the Governor of the QCB.

I think there are a number of very good examples of how that has worked in practice. If you look at the

"Having a moderate tax puts the QFC in a better position when it comes to assessments of the regime by international organizations against the principles of tax transparency, fairness, and standards for the automatic exchange of information."

AML/CFT rules adopted by the three regulators, you will see that they are virtually the same. Also, when you compare the Islamic finance and insurance frameworks between the QCB and the Regulatory Authority, you will again find a strong level of consistency. The principles that shape the regulatory framework in Qatar are driven by international standard setters, and the level of coordination we've achieved across the three organizations allows us to pick the same approaches to implementing those principles. That means increased consistency and a greater level of certainty in terms of application and interpretation in the financial services regulations.

2. QFCRA imposes a unique tax regime in the region. Although it initially awarded a tax holiday to its constituents, it currently does not follow a zero-tax policy. Given that many competitors in the region impose no tax, what are the reasons for QFCRA to follow a different approach to taxation?

The QFC was not set up to be a tax haven, and the most important considerations driving the development of the centre have been a desire to ensure that the regime is transparent and meets all applicable international standards. This approach reflects a strong commitment to the long-term development of the QFC and to ensuring that its international reputation is strong. It has become increasingly clear over the last number of years that the quality of the tax regime and tax transparency are really critical to its international reputation and long-term success.

In this post-BEPS era, no taxation at all is actually a challenge rather than an advantage. Having a moderate tax puts the QFC in a better position when it comes to assessments of the regime by international organizations against the principles of tax transparency, fairness, and standards for the automatic exchange of information.

3. QFCRA issued its Islamic Banking Business Prudential Rules in 2015. On what basis have these rules been developed? Do they follow any international standards? How do these rules affect Islamic banks at QFC?

As I mentioned previously, the Islamic banking rules are a very good example of the benefits of the coordination brought in under the new QCB law. The Regulatory Authority has a strong commitment to public consultation; the Islamic banking rules went through extensive consultation with the financial services sector to ensure they operated in the most effective and efficient manner. We also coordinated closely with QCB to make sure that the new rules were consistent with its approach. The objective is obviously to create an environment meeting best international practice that allows firms to compete on price and quality of service rather than potential differences in regulation.

4. QFCRA has collaborated with financial regulators from various countries to further enhance its regulatory framework. Have you worked with any of these partners in developing the Islamic Banking Business Prudential Rules for QFC?

Yes. In addition to the public consultation I mentioned, we also coordinated very closely with the Islamic Financial Services Board (IFSB) Secretariat in developing the Islamic banking rules to ensure that they met best international practice. As you are probably aware, the IFSB is the body responsible for establishing international best practice for Islamic finance. The IFSB Secretariat was enormously helpful, and I would like to thank them for their support.

5. Fintech is gaining traction in the region as an important new industry in the development of the financial industry. Is QFCRA considering introducing regulatory guidelines for Fintech companies to help attract such startups to QFC?

Fintech covers a broad landscape so I think it's difficult to distill its impact down to a simple approach. It's clear that some of these technologies will, over time, have a significant disruptive effect on certain areas of financial services. I think that's particularly true when you look at the potential applications of blockchain and artificial intelligence. We have some signals as to how those technologies may impact financial services, but it's early days yet.

Other technologies will bring greater efficiency and enhanced customer service without being inordinately disruptive to the incumbent players. New and better ways to do old processes, if you will. Given the important role that big data plays, I expect we will also see a number of larger data-driven, non-financial organizations enter certain financial services to take advantage of the natural advantage that big data gives them.

All in all, that picture adds up to a pretty challenging landscape for financial services firms and it's important that they understand how Fintech can help them be more competitive and efficient. Importantly, they need to develop a clear line of sight on how new technologies may disrupt their business model in a way that leaves them vulnerable. In a sense, you want Fintech to happen for you and not to you.

The approach we have taken to date has been to work with the firms informally in terms of technology initiatives they are looking to implement, and maintain an open door for discussions with technology firms and startups looking to generate new opportunities.

6. Given QFCRA's efforts to continuously develop its regulatory framework, what are high priorities for regulations currently in the pipeline at QFCRA?

We spent a lot of time over the last several years reviewing the framework to ensure that we meet all of the relevant international standards. In the past few years, there have been many changes in this area. This year, the final piece of our review concludes with the implementation of the new liquidity framework for conventional and Islamic banking firms. The broad aims of the framework are to require firms to actively manage their liquidity risks in both benign and stressed market scenarios by ensuring they are appropriately funded and able to meet their payment obligations on an ongoing basis. ■

A visitor looks at a painting offered for sale, Doha. REUTERS/STRINGER

TAXATION FRAMEWORK

FAVORABLE TAX ENVIRONMENT AT QATAR FINANCIAL CENTRE

Like most GCC countries, one of Qatar's attractions as a business center is its moderate tax environment. The QFC offers firms the opportunity to reach the entire GCC, including Qatar. Companies registered in the QFC are subject to tax only on their Qatar-sourced income at a rate of 10%, with exemptions for dividends and capital gains on qualifying shareholdings. The tax system in Qatar facilitates Islamic finance by virtue of having no personal income tax on individuals and no corporate tax on the share in companies' profits of GCC nationals (who are resident in Qatar), so most common issues that arise in other jurisdictions are not applicable to the local Islamic finance market.

For Islamic finance activity that involves non-GCC nationals or companies that are partially or entirely foreign owned there is a distinct difference between the tax treatment of activity in the QFC and outside of it. This was intended to facilitate foreign investment in Qatar, by making the QFC an onshore financial center that is attractive to business. The tax treatment of transactions conducted outside the QFC differs based on whether the transaction is conventional or Islamic, because the profits paid on Islamic financing are not tax deductible, whereas interest paid on conventional financing are deductable. This occurs because Qatar does not have a special tax regime applicable to Islamic finance.

The QFC, on the other hand, implements a tax regime that adjusts for the difference between conventional and Islamic financial transactions, creating tax neutrality with conventional finance in terms of transaction mechanics. The special rules in the QFC provide a tax adjustment for parties to Islamic finance transactions on any profits paid on Islamic financing, which provides tax neutrality with equivalent conventional financial products.

Financial institutions operating from or in the State of Qatar may therefore lessen their tax complications by registering at the QFC. If they are foreign owned, the profits generated by financial contracts executed in Qatar, and income from securities or real estate, would be taxable for the share owned by non-GCC nationals.

Examples like the preceding show the potential for a significant difference in the tax treatment of some common Islamic finance transactions depending on whether they occur within or outside the QFC. Other transactions are not affected, because they do not generate taxable income in Qatar. For example, if all parties to the transaction are wholly owned by Qatari or GCC nationals and located in Qatar, there is no tax owed.

Moreover, Islamic financial transactions carried out by companies resident in Qatar and involving cross-border income flows may be eligible for the benefits provided for in Qatari double taxation agreements.

The greater predictability of taxes payable by QFC entities and companies doing business with QFC entities supports the growth of activity relative to competing financial centers in the region. Also, in the current context of the OECD's Base Erosion and Profit Shifting (BEPS) project, a moderate tax regime with a high level of certainty provided by the QFC can offer a safer and more sustainable option to companies when comparing the QFC with other financial centers with zero taxation. For these companies, being subject to a moderate and predictable taxation giving access to treaty benefits is far more advantageous than being fully exempt from tax while facing the consequences of using offshore financial centers that are qualified as tax havens.

REGULATORY FLEXIBILITY IN COMMODITY MURABAHAH TAXATION

The two types of transactions that are potentially most affected by the tax regime are financing arrangements for non-GCC owned companies that rely on international commodities markets (e.g. London Metal Exchange (LME) contracts used to effect commodity murabahah transactions) and sukuk, especially those involving tangible assets like real estate located in Qatar.

Consider, for example, the treatment of commodity murabahah financing using LME copper with bullet repayments of principal plus profit on the maturity date.[10] In a conventional transaction, the equivalent loan, even if spread across two tax years, would be accounted with the interest payment deducted across the financing period.

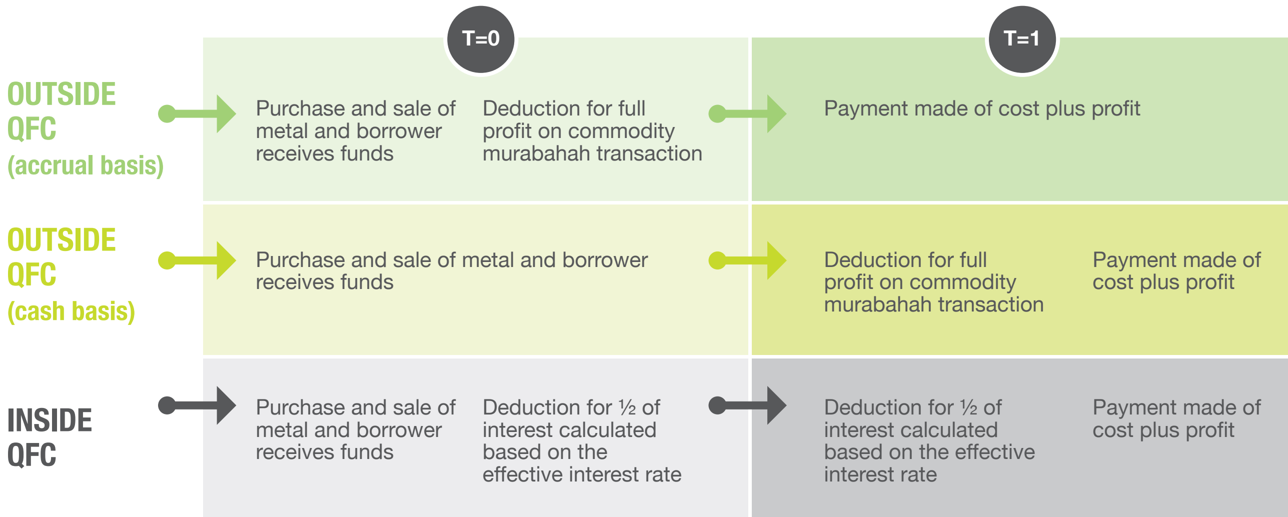
In an Islamic finance transaction outside of the QFC, the full profit paid across the entire tenor of the financing arrangement would be fully deductible in the first year (unless it uses cash accounting in which the full amount would be deducted in the second year). Inside the QFC, accounts are required to follow IFRS, which would equalize the treatment of the profit deduction with a conventional loan.

VAT WILL REQUIRE CHANGES TO RETAIN EQUIVALENCE FOR ISLAMIC FINANCE

The upcoming introduction of a value added tax (VAT) across the GCC region will require changes to ensure the level playing field between Islamic and conventional finance continues to exist, both for the local market and involving cross-border transactions. For example, interest charges may not be considered a 'taxable supply' and so VAT paid on the purchases made by financial institutions would not be recoverable.

Therefore, in transactions where a financial institution buys an asset that it then sells to the customer, the financial institution may not be allowed to recover the VAT due on its purchase. Where the financial institution cannot recover the VAT due, it becomes an added cost to the customer. This creates an uneven playing field by charging VAT on finance costs in an Islamic finance transaction that would be excluded on interest costs in a conventional transaction.[11] In Muslim-majority countries, the tax law is often changed such that transactions designed to be Shariah compliant allow for full VAT recovery. In non-Muslim majority countries, it is more common for the tax neutrality to be achieved by exempting transactions of the form used in Islamic finance without mentioning Shariah, but nonetheless carefully detailing the form used to achieve it.[12]

Figure 18 TAX TREATMENTS FOR COMMODITY MURABAHAH



10 This example and the following example of an ijarah sukuk are based on the examples used by Amin, M., Gueydi, S., and Choudhury, H. (2013). *Cross border taxation of Islamic finance in the MENA region: Phase One*.
11 Amin, M. (2016, June 6). "How Should VAT Systems Treat Islamic Finance Transactions?" Blog post on MohammedAmin.com,
12 Amin, Mohammed et. al. (2013).

West Bay skyline at night, Doha.

QFC TAX REGULATIONS ON SUKUK ISSUANCES ATTRACTIVE TO GLOBAL INVESTORS

For issuers using onshore Special Purpose Vehicles (SPVs) in Qatar, the tax treatment of sukuk can differ from a conventional bond. Consequently, the QFC introduced a tax structure for sukuk using QFC-domiciled SPVs that equalizes the tax treatment for sukuk with conventional bonds. These tax differences occur in some transactions when the structure of a financial transaction is altered to meet Shariah requirements. Compared to a bond, a sukuk must be structured with reference to an asset. For example, the originator (the company ultimately receiving finance) can sell a building it owns to an SPV. The SPV issues sukuk to finance the purchase and subsequently leases the building back to the originator.

The originator promises that at the end of a stipulated period of time corresponding to the tenor of the sukuk, they will purchase the asset back at the original sale price. This provides the cash to the SPV to redeem the sukuk it issues. The economic outcome is the same in terms of creating a tradable financial receivable evidenced either by a bond or a sukuk but the tax treatment diverges because the form of the transaction differs from its intended economic outcome.

For example, in the case illustrated using an onshore SPV in the State of Qatar, there could be capital gains taxes incurred if the building were sold to the SPV at a price higher than its book value. There could also be tax payable on the pre-distribution profits if the SPV is not treated as a pass-through entity. Investors could see profit payments made by the SPV treated as dividends subject to withholding instead of being treated as favorably as interest payments in a conventional bond. Finally, there may be an adverse tax consequence for the originator if it is not eligible to depreciate the value of the building during the period when it is owned by the SPV.

In general, there are two ways that these tax issues are dealt with that roughly correspond to the treatment of sukuk implemented in the UK and Malaysia. The UK being a secular government is loath to create a separate tax system for sukuk and does not reference sukuk at all. The tax treatment for sukuk is made equivalent to bonds by describing the common structures used in sukuk and specifically modifying them to create an equivalent tax outcome to a conventional bond.

For Muslim-majority countries or those with explicitly defined regulations covering Islamic finance, tax changes are usually easier. Instead of defining what a sukuk transaction is without referring to Islam or Shariah specifically, as in the UK model, the tax law can reference specific Islamic structures. Once the sukuk structures are incorporated into Islamic finance regulations, tax laws can simply reference the Islamic finance transaction types and grant them equivalent treatment in terms of interest or profit payments, allowance for depreciation of the underlying asset and avoidance of capital gains income as would occur if the sukuk were instead a conventional bond.

Within Qatar, a transaction that can be structured through the QFC already provides tax equality if the asset is not located in Qatar and if the investors are all Qatari nationals. However, if the asset used to structure the sukuk is located in Qatar, it may create capital gains tax liability when the asset is sold to the SPV. In this case, tax neutrality is fully ensured in the QFC. Foreign investors are supposed to report their profit and pay tax on the distributions made by the SPV, although the SPV would have no obligation to withhold this tax amount.

Sukuk issued using an onshore SPV outside of the QFC would have greater likelihood of triggering tax liabilities, including liabilities from rental income, because the profit payments to sukuk holders would not be tax deductible. The originator would therefore owe tax on the non-deductible profit payments unless the onshore SPV was 100% owned by Qatari or GCC nationals. A sukuk issued by a QFC registered SPV that does not involve a tangible asset located in Qatar is likely to be accorded the same tax treatment as a conventional bond. As a result of QFC's onshore status, the favorable tax treatment for sukuk using QFC registered SPVs will likely hold true whether the investors are foreign or based in Qatar.

SHARIAH ECOSYSTEM OVERVIEW AND OVERSIGHT

DECENTRALIZED SHARIAH GOVERNANCE IN QATAR FACES CURRENT TRENDS TOWARDS CENTRALIZATION

In the absence of an apex Shariah authority, each Islamic financial institution in Qatar regardless of their regulator is required to have a Shariah Supervisory Board (SSB) composed of at least three members, appointed by the financial institution. SSB members are required to supervise all the activities of the institutions to ensure they comply with Shariah principles and to approve the products, services and agreements it uses.[13] The current framework takes a laissez faire approach, which has traditionally been used in Islamic finance. However, it is subject to governance concerns that have caused it to lose favor in recent years.[14]

This bottom-up approach leads to inconsistency and the lack of a market-wide consensus. When different institutions apply different minimum standards for Shariah compliance, it inhibits trading and financing between these institutions and it causes confusion for customers about differing Shariah compliance conditions at different institutions. A centralized approach, which has become the global best practice, alleviates these concerns by centrally determining the minimum standards that are in place market-wide, providing clarity to financial institutions and their customers.[15]

Many jurisdictions in the region have chosen to follow Malaysia's model for Shariah governance, which includes an apex Shariah board (Malaysia has two, one for banks and one for securities markets). Malaysia's Shariah Advisory Council (SAC) at Bank Negara Malaysia (BNM) is the highest Shariah authority for Islamic finance in the country. Under BNM, the SAC governs the Shariah activities of Islamic financial institutions including Islamic banks and takaful operators. It also reviews all Islamic banking and takaful products to ensure they are Shariah-compliant.

The advantage of centralized Shariah boards is that they provide consistency across the market. They also act as a common source for Shariah interpretation if disputes arise between financial institutions, or between customers and their financial institutions, about the Shariah-compliance of transactions. In many cases, this will not result in enforcement by the central Shariah board itself, but rather through the legal system which will adjudicate Shariah conflicts with expert testimony from the central Shariah board.

Qatar has set different rules on Shariah oversight for banks and for other financial institutions, particularly regarding the composition of the Shariah boards where it follows the AAOIFI requirement that a Shariah board be composed of at least three scholars. However, many Islamic finance professionals currently consider this standard to be the bare minimum for Shariah governance.

The decentralized approach also caused governance concerns stemming from perceptions of conflicts of interest, and increased the appeal of national Shariah boards. A number of Shariah scholars sit on many boards, often at competing institutions, which has raised concerns about how these scholars handle their proprietary information. To date, there have been no legal cases over conflicts of interest by Shariah boards. However, there remains a perception that Shariah scholars may be influenced in favor of financial institutions whose Shariah compliance they review.

Islamic financial institutions have sharply reduced the transparency of their rulings, although no major scandals have resulted from these governance risks. Most of the perceived risks associated with a decentralized Shariah review system can be addressed through

13 Al Tamimi and Co. (2013). "Qatar's new central bank law: Key developments in banking regulation."
14 Vizcaino, B. and Lee, L. (2017, July 17). "Amid Dana debacle, Islamic finance seeks safeguards against illegality claims," *Reuters*.
15 Shah, H. (2015, March). "Central Shar□□ah Board In Central Banks: A Comparative Study Of Pakistan and Brunei Darussalam". 10th International Conference on Islamic Economics and Finance, Doha, Volume 10; Chapra, U. and Ahmed, H. (2002). "Corporate Governance in Islamic Financial Institutions". Islamic Development Bank.

Qatar University campus, Doha.GIMAS / SHUTTERSTOCK.COM

greater adoption of national Shariah boards, and the development of selection criteria and training requirements for Shariah scholars in national regulation.

Like potential conflicts of interest, these requirements have not been set in response to any specific problem in the industry but instead as a preemptive move to increase consumer confidence. Shariah oversight of financial institutions is a highly technical task, which requires specialized knowledge of fiqh al-muamalat and a specialized understanding of Arabic. It also requires an understanding of modern business and finance, conventional financial legal and regulatory systems and a working knowledge of business English.

ISLAMIC FINANCE REGULATORY TRENDS

A FOCUS ON TRANSPARENCY, CENTRALIZATION AND CODIFYING INTERPRETATIONS

One area where the regulatory system in Qatar and the QFC could be improved to align more closely with regional and global practices is its Shariah governance system. By enhancing Shariah governance and considering introducing a centralized Shariah oversight authority, Qatar could increase its appeal as a regional hub. However, the challenge with tailoring apex Shariah bodies to allow for regional and global institutions is in managing different interpretations of fiqh.

Although many major contracts in Islamic finance are supported by a consensus of Shariah scholars, there remain more difficult technical issues relating to specific contractual terms and financial product structures. For example in a wakalah bil istithmar sukuk, AAOFI rules require 30% tangible assets while the Islamic Fiqh Academy rulings require 51% tangible assets. These differences do not pose risks to the industry's reputation, but they affect investment decisions at Islamic financial institutions, which would benefit from requiring greater disclosure about which standards are followed in a particular transaction.

In addition to the much more challenging task of managing Shariah interpretation, there are several Shariah governance issues that would benefit from more specific rules, which are being applied in other markets. For example, Oman has adopted fit and proper criteria for Shariah scholars and limited the number of boards in each sector that a Shariah scholar can sit on simultaneously.

BANKS FACE ACCELERATING CHANGES FROM BASEL III AND IFRS 9

The implementation of Basel III has created several challenges for Islamic finance that require new market infrastructure. For certain contracts, like sovereign sukuk, these are being put into place. Other upcoming changes, such as excluding longer-tenor wholesale deposits from the definition of stable funding, will challenge banks in Qatar where deposit growth has not kept pace with asset growth. The Net Stable Funding Ratio (NSFR) requirement concerns the ability of a bank to withstand systemic risk.

The stable funding requirement is based on the assumed rate at which funding sources can be relied upon as being stable during a crisis. Qatar's bank balance sheets have been stretched by rapid economic growth, followed by a drop in oil prices in the medium term and swelling loan to deposit ratios across the banking system. This means they are more dependent on funding sources that are not included with a discount in the NSFR. Because Islamic banks have a smaller pool of qualifying liquid assets, they would be more likely to be affected by any heightened liquid asset requirement.

In response, the IMF has recommended that the government postpone a loan-to-deposit cap on banks in Qatar that is scheduled to come into place at the end of 2017, noting that "if liquidity conditions become tighter for cyclical reasons, consideration should be given to suspending or postponing the implementation of the new loan-to-deposit ratio requirement."[16] The government has stated that it is considering taking a measure that would extend the compliance period until the end of 2018. Such a move is particularly important for Islamic banks.[17] Although they have more conservative balance sheets and higher liquidity, they are not immune to the overall changes in the banking market, and they have fewer liquidity management instruments to manage their balance sheets and liquidity needs. For example, they cannot use conventional repo facilities with the central bank and there is no widely accepted Shariah compliant two- or tri-party repo facility that would otherwise allow

16 IMF, op cit.
17 Staff writer. (2016, June 16). "Qatar Central Bank 'may miss 100% loan-to-deposit' deadline," *Arabian Business*.

them to access liquidity to support their longer-term assets.

In addition to Basel III rules, there are significant changes coming to accounting rules covering financial instruments with the introduction of IFRS 9. The new regulations impact how financial assets are presented in financial statements, including requiring financial institutions to book expected losses in advance. The new standard would adversely affect Islamic banks more severely than conventional banks. The way their financial instruments are structured to meet Shariah guidelines creates a wider gap between the accounting treatment and economic substance. For instance, using sale contracts such as commodity murabahah to create financing arrangements would potentially be re-characterized as trading activity and not a financial transaction.[18]

In addition to sales-based contracts, IFRS 9 would also potentially impact leasing (ijarah) transactions and sukuk. These types of structures are designed to deliver economic returns similar to those of conventional financial instruments, but they are modified so that they do not deliver guaranteed principal plus interest payments. This puts them at odds with the requirements under IFRS 9 to book expected losses in advance. Therefore, accounting for them in the way outlined under IFRS 9 could create unfavorable treatments that could alter their profitability, credit ratings and other factors that affect their competitive position.[19] At present, AAOIFI is working to achieve agreement on how to mitigate the unintended consequence of IFRS 9 for Islamic finance.

BEYOND SHARIAH COMPLIANCE, ISLAMIC FINANCE PROFESSIONALS SEEK SUSTAINABILITY

As the Islamic banking sector makes its way past the uncertainty created by the closing of Islamic banking windows and begins to consolidate, it will have to differentiate itself from conventional banking. In particular, Qatar would benefit by differentiating its Islamic banking industry from its regional counterparts. In order to boost its Islamic finance profile regionally, Qatar can leverage the government's efforts to promote environmental sustainability within its financial sector, namely by discouraging economic activity that generates short-term profits at the expense of long-term benefits for all future generations.

The overlap between sustainability efforts at non-financial corporations and within Islamic finance more widely has seen little development. One exception is Malaysia, which has announced an ambitious strategy for the development of the wealth and fund management industry. The strategy incorporates environmental, social and governance (ESG) criteria alongside Shariah-compliance as complementary areas of focus.[20] Efforts by the QSE to encourage greater ESG data disclosure with a 'comply or explain' voluntary approach would provide the tools required for sustainability to be integrated with Islamic finance.

The QSE has joined the United Nations Sustainable Stock Exchange Initiative (SSE Initiative), which covers listed company disclosures of ESG data. The QSE has also launched a regional body, the Middle East Sustainable Investment Forum, to advance sustainable investment in the region.[21] Sustainability is important to Islamic finance because it seeks to achieve the Islamic principle of humankind's responsible stewardship of the earth's resources. From a business perspective, better environmental practices by companies have been linked to a positive financial impact on operational and equity performance and reduced credit risks.[22]

The opportunity afforded Qatar by its leadership on sustainability issues in the region can take place both domestically and regionally. Within Qatar, banks can encourage more green building construction by offering more favorable terms for new construction meeting green building standards, reflecting the better operational and risk profiles such projects deliver. Regionally, Qatar can build upon the experience of its listed companies in addressing sustainability reporting to attract investors who require their portfolio managers to consider environmental, social and governance factors.

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18 Vizcaino, B. (2016, Nov. 28). "Accounting meets religion in challenge for Islamic banks," *Reuters.*
19 *Ibid.*
20 Securities Commission Malaysia. 2017. *Islamic Funds and Wealth Management Blueprint*.
21 Pothering, J. (2017, March 21). "Qatar Stock Exchange brings sustainable investment forum to the Middle East," *Impact Alpha*.
22 Clark, G., Feiner, A., and Viehs, M. (2015). *From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance*, Oxford: Arabesque Partners and University of Oxford; Reznick, M and Viehs, M. (2017). *Pricing ESG Risk in Credit Markets*. Hermes Credit and Hermes EOS Research Paper.

PROF. DATUK RIFAAT ABDEL KARIM

Leader and Authority in the Islamic Financial Services Industry

Professor Datuk Abdel Karim has an international reputation as a leader and authority in the Islamic financial services industry (IFSI) at both the professional and the academic levels He has played a pioneering role in the development of Islamic finance, serving as the CEO of the IILM from 2012 to 2016. He has also served as Inaugural Secretary-General of the IFSB between 2003 and 2011, and AOOIFI prior to that from 1991.

His leadership in the setting of accounting, auditing, governance, Shari'ah and regulatory standards has been instrumental in establishing the position of the IFSI in the mainstream of global financial services. He has been particularly involved in developing high quality short-term sukuk to facilitate liquidity management for Islamic financial institutions.

1. In what key areas must Qatar develop to position itself as an Islamic finance hub?

Qatar should establish an international court for Islamic finance, building on ongoing efforts such as the annual Qatar Law Forum. The court would issue fatawa (rulings) on matters of Shariah compliance, but only when presented with an issue such as a dispute between contracting parties or an action against a putative transgressor (with regard to Shariah compliance) brought by an interested party such as the financial regulator. It would not issue a fatwa in other circumstances, as is the case with AAOIFI or OIC Fiqh Academy. It would also provide a tribunal for determining the rights and obligations of contracting parties, apart from issues of Shariah compliance. To operate, there would need to be a number of countries or jurisdictions signing up to accept its authority and treating it as a superior court.

Through this initiative, the country can build on the international aspects of existing laws as well as develop Islamic finance law, which will attract more Shariah scholars to Qatar. Developing Islamic finance law will also make Qatar more attractive for foreign sukuk issuers and will provide a legal framework to guide Shariah scholars in the country.

2. In 2011, the Qatar Central Bank (QCB) instituted a ban on operating Islamic banking windows in Qatar. In hindsight, how has this decision supported full-fledged Islamic banks and affected competition overall in the segment?

I think this was a very wise decision from a risk management perspective. For example, if you have both conventional and Islamic banking operations under single management, you cannot be completely certain that Shariah-compliant funds are segregated from those that are non-compliant.

Another issue is perception. If banks continued to operate on the dual model, how would Shariah-compliant investors accept ownership of shares in these banks? This takes us back to the issue of certainty around funds from the conventional side not mixing with those from the Islamic operation. If banks wished to continue with this model, then it would be best for the Islamic side of their businesses to be separate legal entities, which is the practice in Malaysia.

3. Would the establishment of apex Shariah supervisory body at a national level add value to the Islamic finance industry in Qatar?

Relying solely on individual Shariah supervisory boards comes with its own set of problems, mainly non-standardization stemming from inconsistent interpretations of Shariah. Qatar needs to establish a an overarching Shariah supervisory board governing Islamic financial institutions operating under the QCB and the QFCRA jurisdictions. Having a centralized Shariah board will help harmonize Shariah rulings across all Islamic financial institutions in Qatar. It would also provide customers and investors with some degree of certainty, which would also make Qatar more attractive to overseas Shariah-compliant investors. Furthermore, centralizing Shariah governance of Qatar's Islamic financial institutions would give them more creditability in the sukuk market, and avoiding cases where Shariah risk arises like the recent case with Dana Gas sukuk.

4. What are your recommendations for the development of Shariah compliance standards and regulations for Islamic finance in Qatar?

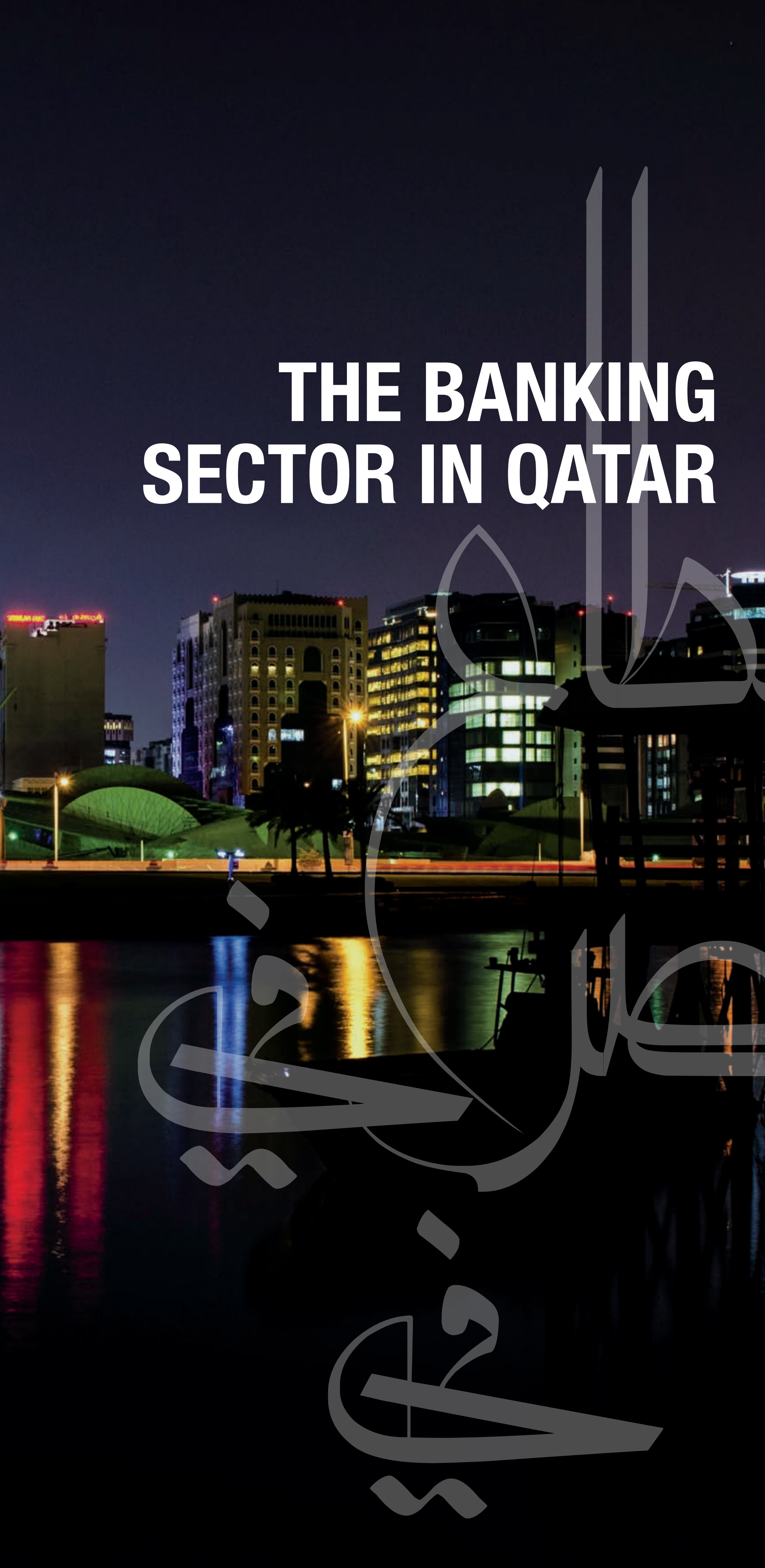
Conventional financial rules do not always apply in Islamic finance, leaving some areas specific to Islamic finance unaddressed. International organizations such as AAOIFI in Bahrain and IFSB in Malaysia have been developed not only to address these gaps, but primarily to adapt global financial standards to be implemented at Islamic financial institutions.

Qatar is a member of both AAOIFI, concerned with accounting and auditing standards, and IFSB, for supervisory and operational standards. The QCB can share its regulation setting role with these institutions, mandating Islamic banks and other Islamic financial institutions to follow AAOIFI standards overall (in line with the current practice in the region), and IFSB standards where appropriate. ■

> "Qatar should establish an international court for Islamic finance, building on ongoing efforts such as the annual Qatar Law Forum."

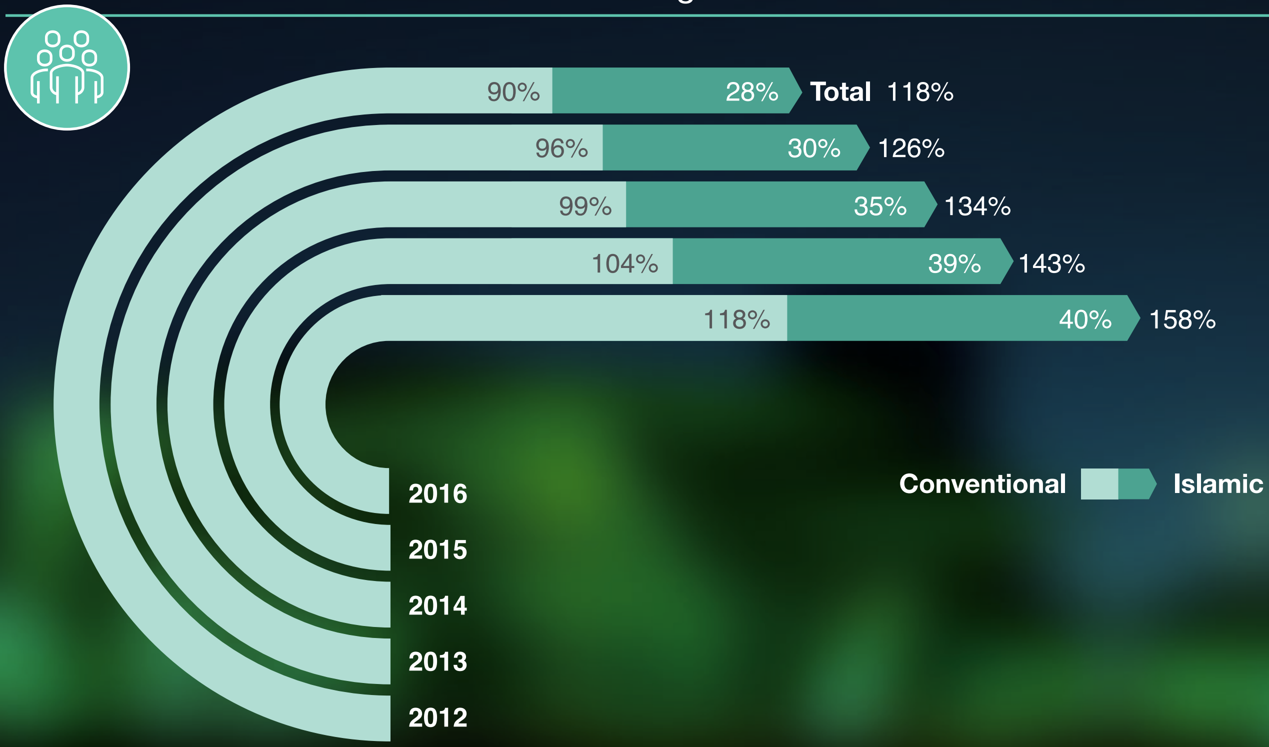
National Museum of Qatar, Doha.COLOUR WORLD / SHUTTERSTOCK.COM

THE BANKING SECTOR IN QATAR

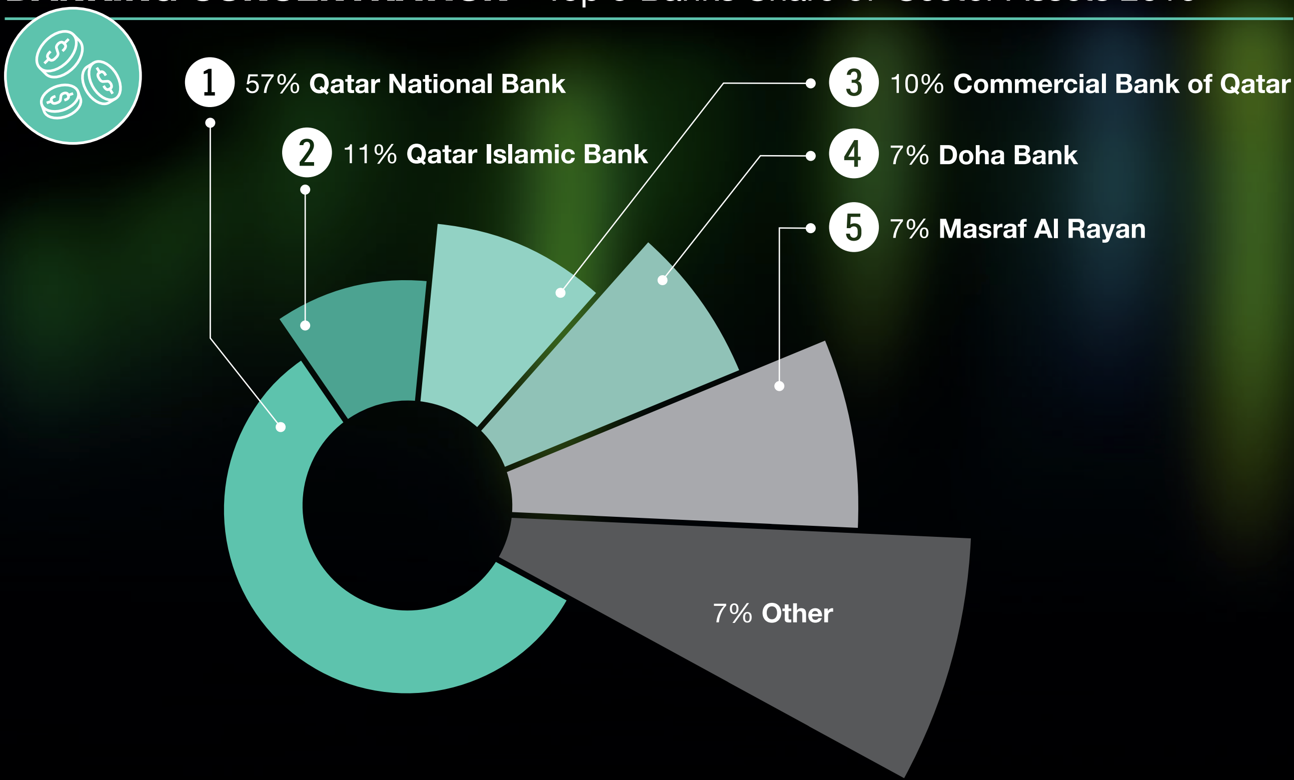


BANKING SECTOR IN QATAR

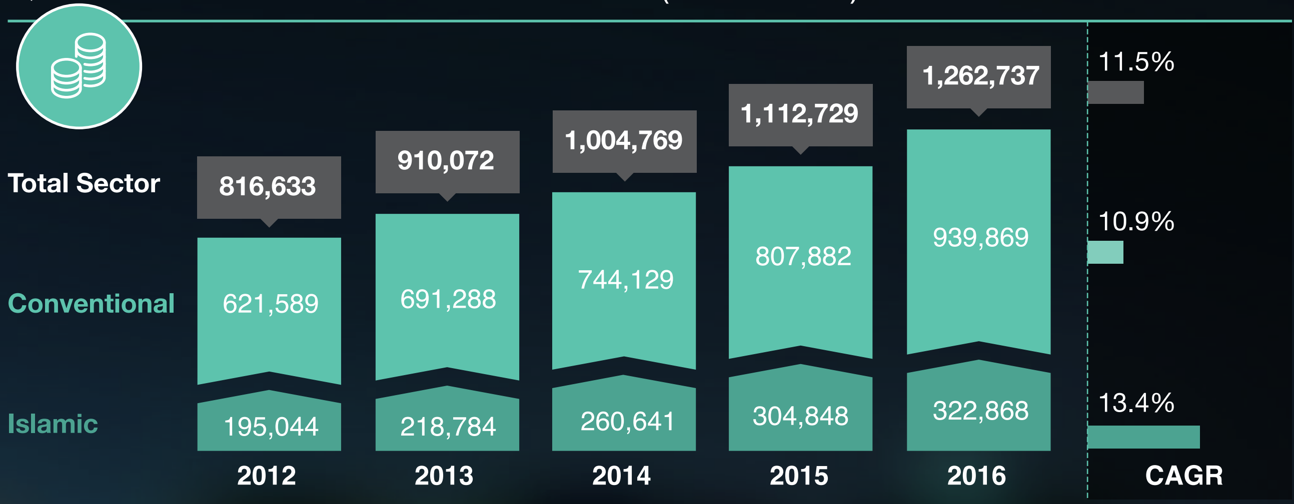
BANKING PENETRATION Total Banking Assets to GDP



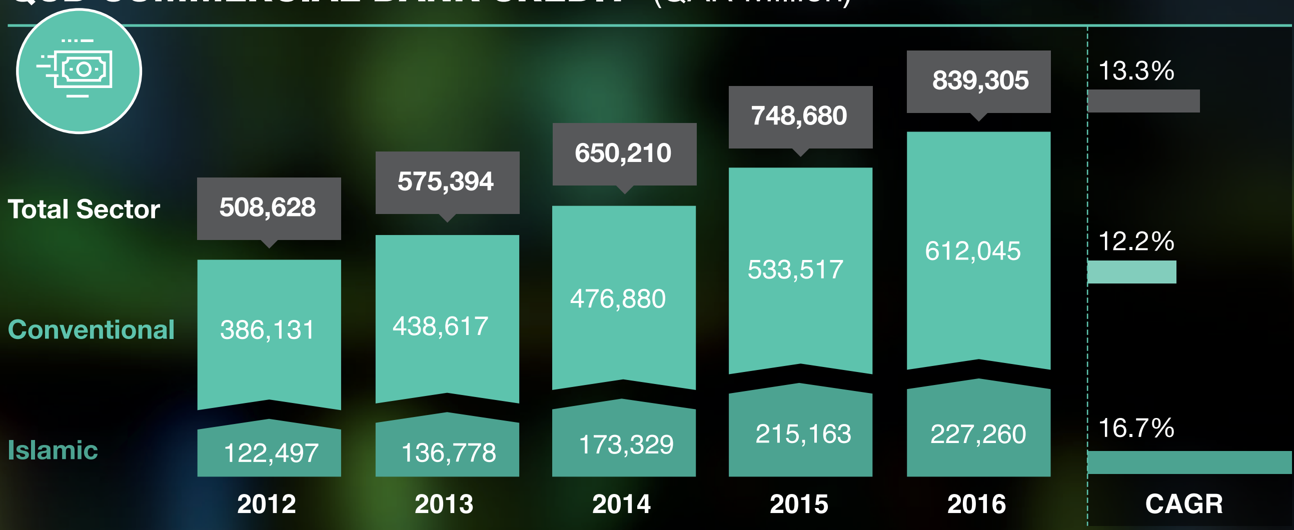
BANKING CONCENTRATION Top 5 Banks Share of Sector Assets 2016



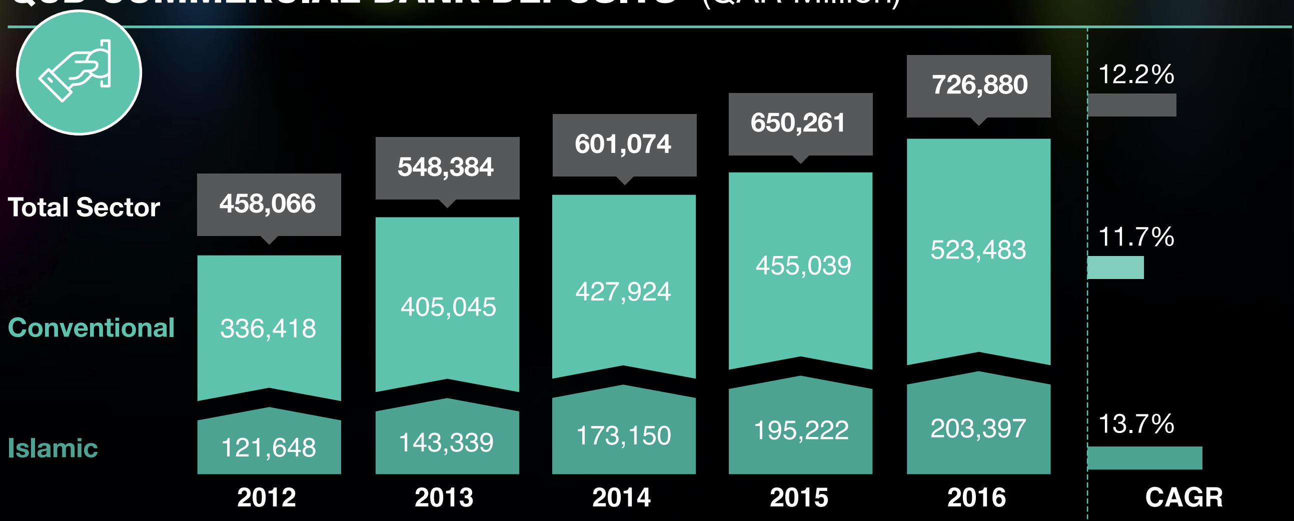
QCB COMMERCIAL BANK ASSETS (QAR Million)



QCB COMMERCIAL BANK CREDIT (QAR Million)



QCB COMMERCIAL BANK DEPOSITS (QAR Million)



Source: Qatar Central Bank

BANKING SECTOR LANDSCAPE AND PROFILE

The prolonged decline in oil prices since 2014 has led to slower economic growth in Qatar. Real GDP growth fell below 3% in 2016 and Qatar witnessed its first fiscal deficit in 15 years. Despite the challenging economic environment, Qatar's banking sector has continued to register positive double-digit growth. It is the fastest growing banking sector in the GCC, with a CAGR of 11.5% between 2012 and 2016 and total assets exceeding QAR 1 trillion in 2016. During this period, the other GCC countries registered an average CAGR of 6.3%, with the highest growth coming from Oman (9.6%) and the UAE (8.6%).

Overall growth in the Islamic banking segment outpaced that of conventional banks, proving that Shariah-compliant lenders are better positioned to withstand unfavorable economic conditions. Islamic banks benefitted from higher growth in foreign credit, which was a principal driver of the segment's impressive performance in the past five years. It is likely that Islamic banks will continue this growth trajectory in the short term as they increase their focus on foreign operations and leverage them to maintain their domestic liquidity, while growth in public sector deposits continues to slow. The IMF revealed in its August 2017 assessment of recent economic developments that foreign liabilities (mainly non-resident deposits) of Qatar's banks plummeted, as neighbouring countries began to withdraw their deposits following the ongoing diplomatic rift. IMF officials concluded that the swift coordinated reaction from key Qatari government agencies helped maintain the soundness, asset quality and strong capitalization of the banking sector.

INCREASED ISLAMIC BANKING PENETRATION DRIVEN BY HIGH ASSET GROWTH

Qatar's banking sector grew at a faster pace than its GDP between 2012 and 2016. As a result, it experienced continued growth in banking penetration (ratio of banking assets to GDP), a measurement of the development of the banking sector in a country. Penetration grew 40 percentage points from 118% in 2012 to 158% in 2016. During 2016 alone, banking penetration saw a significant increase of 15%, which was primarily driven by accelerated growth in conventional banking assets after a slower pace in previous years.

Between 2012 and 2015, Islamic banking penetration also grew at a healthy rate, outpacing conventional banking. However, this growth slowed considerably during 2016 resulting from stunted growth of Islamic banking assets during the year. Islamic banking penetration reached 40% of GDP in 2016, compared to 28% in 2012.

Despite a challenging economic environment, the continued increase in banking penetration reflects reduced correlation between banking assets and energy prices. Growth in public sector credit slowed down significantly in 2014 and 2015 only to recover in 2016 as the government increased its infrastructure spending leading up to the FIFA World Cup 2022. During this time, credit to the private sector grew significantly, taking a 10% share of domestic credit from the public sector. Alongside even faster growth in cross-border credit (or credit outside Qatar), this has driven the growth of commercial banking assets in the past few years. The resilience of the banking sector in adverse economic conditions can be attributed to the Qatari government's efforts to diversify its economy into the non-energy sector through the Qatar National Vision 2030.

The rise in banking penetration is likely to continue increasing in the short term as infrastructure projects continue at full speed in the lead up to the World Cup 2022, in addition to the ongoing influx of foreign labor into the country. However, in the medium term, these rates will probably stabilize as the market saturates and most projects are completed. Islamic banking penetration will follow a similar growth trajectory to the entire banking sector. However, it will most likely remain at a relatively low level given its overall share of sector assets.

After seeing double digit growth between 2012 and 2015, the growth of Islamic banking assets moderated in 2016. Islamic banks are expected to maintain this moderate level of growth in the short-to-medium term, but unlikely to exceed that of conventional banking assets. A recent proposed merger between Masraf Al Rayan, Barwa Bank and International Bank of Qatar (IBQ) will contribute to the growth of Islamic banking penetration. Once the merger is

The two largest Islamic banks, QIB and Masraf Al Rayan, together account for 18% of banking sector assets, the majority of the 26% share Islamic banks hold of total bank assets.

approved, Islamic banking assets will see a marginal increase in the short term due to the addition of the assets of IBQ. The merger will create a more cost effective Islamic bank with a solid and diversified portfolio, leveraging Masraf Al Rayan's government and public sector lending portfolio, Barwa's retail and corporate books and IBQ's niche private banking business. Islamic banks' share has remained stable over the last five years, despite outpacing conventional counterparts in terms of asset growth. This can partly be attributed to relatively small size of the Islamic banking segment, but also due to these banks competing with themselves in terms of pricing rather than also competing with conventional banks through product differentiation.

MOST BANKS OPERATE OUTSIDE QFC; ISLAMIC BANKING SEGMENT REMAINS RELATIVELY SMALL

Both domestic and foreign commercial banks in Qatar operate under two regulatory jurisdictions: banks under Qatar Central Bank (QCB) jurisdiction and banks operating inside the Qatar Financial Centre (QFC). At the end of 2016, the banking sector regulated by the QCB comprised 17 commercial banks – 13 conventional and 4 Islamic banks. Of these banks, 10 are Qatari banks and the remaining seven are foreign owned. Banks operating outside the QFC dominate the banking sector. They are the only banking institutions serving the retail segment, which is not open to banks inside the QFC. The banking sector is led by five national banks in terms of asset size: Qatar National Bank (QNB), Qatar Islamic Bank (QIB), Commercial Bank of Qatar (CBQ), Masraf Al Rayan and Doha Bank.

Islamic banking emerged in Qatar in 1982 with the establishment of Qatar Islamic Bank (QIB), which is currently the largest Islamic bank in the country. By the end of 2016, QIB held 43% of Islamic banking assets and 11% of overall banking sector assets. The three other full-fledged Islamic banks operating under the QCB are Masraf Al Rayan, Barwa Bank and Qatar International Islamic Bank (QIIB).

There are currently no Islamic banking windows operating in Qatar following a 2011 directive from the QCB imposing a ban on conventional banks from providing Islamic banking services. This move has resulted in a more concentrated sector, with the current Islamic banks absorbing much of the business lost from the windows.

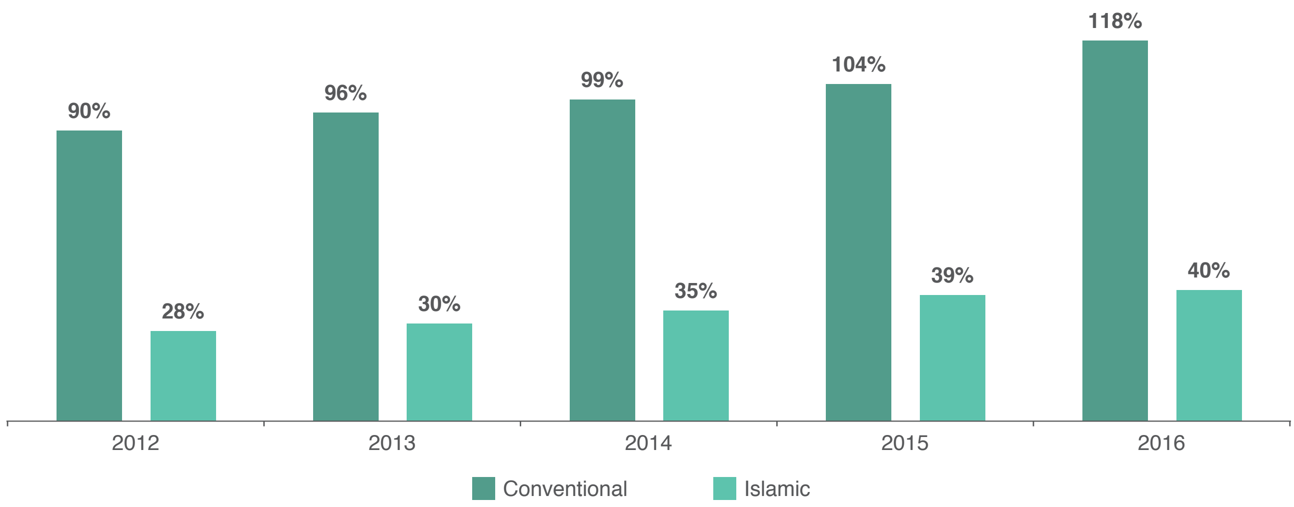
QFC banks operate solely in corporate financial services, with a single Islamic bank

Alongside the banks operating under the QCB, there are 10 banks operating within the QFC. All 10 banks are foreign entities, split between three LLCs and seven bank branches, with total assets at the end of 2016 reaching QAR 29.7 billion, equivalent to a mere 2.4% of the sector assets outside the QFC. All these banks operate in the corporate market only, as they are not permitted to pursue retail banking activities from inside QFC. Of these banks, there is only one full-fledged Islamic institution, the QFC branch of Abu Dhabi Islamic Bank.

Five local players dominate highly concentrated sector

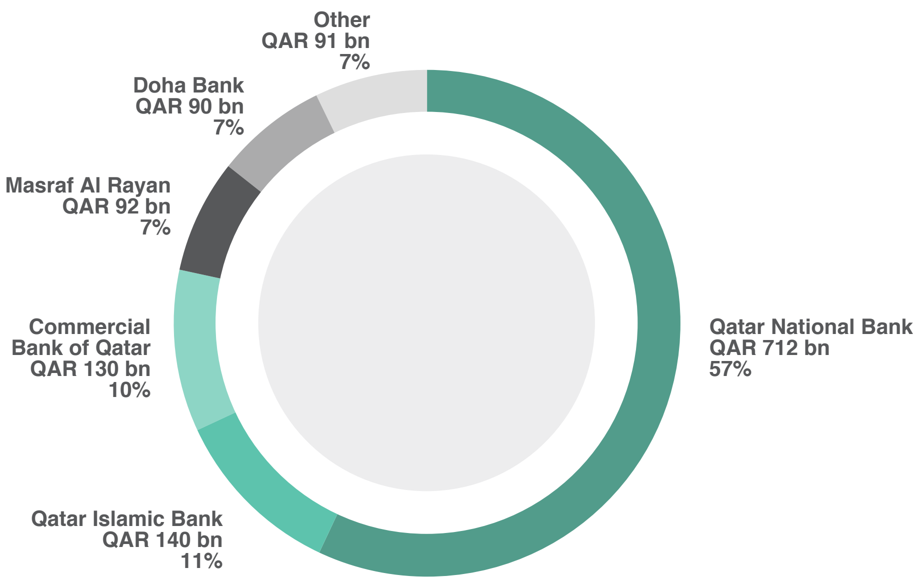
The banking sector in Qatar is highly concentrated, with the largest five banks controlling 93% of total banking assets. QNB is the largest player, holding 57% of banking assets in Qatar in 2016, up from 45% in 2012. The two largest Islamic banks, QIB and Masraf Al Rayan, together account for 18% of banking sector assets, the majority of the 26% share Islamic banks hold of total bank assets.

Figure 19 BANKING PENETRATION IN QATAR (QCB BANKING ASSETS AS % OF GDP) 2012–2016



Source: Qatar Central Bank, Thomson Reuters Analysis

Figure 20 SHARE OF QATAR'S TOP FIVE BANKS OF QCB BANKING ASSETS IN 2016



Source: Annual Reports, Thomson Reuters Analysis

Fanar Islamic Cultural Center, Doha. FITRIA RAMLI / SHUTTERSTOCK.COM

PROPOSED MERGER MAY INCREASE CONCENTRATION OF ISLAMIC BANKING

In recent years, given an increased regulatory focus on the liquidity and financial stability of banks, there has been a wave of bank consolidation in emerging markets. With the enforcement of more prudent regulatory requirements including the Basel III standards, smaller banks that previously operated with high risks began to struggle to comply with these new requirements. Consolidation soon emerged as a solution for such banks, wherein a group of smaller banks would merge to form a single bank that could comfortably operate while complying. Moreover, larger and more stable banks backed by strong liquidity have been able to acquire smaller banks to expand their asset bases and operations.

Bank consolidation is emerging as a trend in Islamic banking, with the recent merger of Al Salam Bank and BMI Bank in Bahrain in 2014, and the merger of Burj Bank into Al Baraka Bank's subsidiary in Pakistan in 2016. In December 2016, a three-way bank merger was announced between Masraf Al Rayan (as lead), Barwa Bank, and International Bank of Qatar (a conventional player). Merger talks are underway, with the result to be announced later in 2017. If the merger is approved, the three banks will form an Islamic bank with assets totaling QAR 163 billion (based on 2016 values), replacing QIB as the largest Shariah-compliant lender in Qatar. It will command a share of 47% of Islamic banking assets, with QIB's share declining slightly to 40%.

In an overbanked market with a large number of banks and high banking penetration levels, consolidation is a cost effective way to restructure the banking system and can help in improving its financial stability by eliminating institutions that are perceived as inefficient and without adequate liquidity and strong asset bases.[1] The UAE and Bahrain, for example, are considered overbanked markets in the GCC, with banking assets at 215% and 587% of GDP in 2016, respectively. Both these markets have already begun to see M&A activity in their banking sectors as slow economic growth exudes liquidity pressures on banks.

Given both relatively high banking penetration, as well its largest five banks controlling over 90% of banking assets, Qatar is arguably also an overbanked market. Within the context of the wider banking sector, the proposed merger is a step towards consolidation. Looking further into the Islamic banking segment, it is highly concentrated, with only four banks, two of which control over 70% of Islamic banking assets. With this merger, the segment will become even more concentrated, with only three players and the largest two controlling 87% of assets. The risks inherent in such a move include reduced competitiveness in the market, leading to increased pricing power for the larger players.

Table 5 GCC BANKING PENETRATION LEVELS (% OF GDP) 2012–2016

Country	2012	2013	2014	2015	2016
Bahrain	685%	670%	633%	621%	587%
UAE	177%	192%	202%	209%	215%
Qatar	118%	126%	134%	143%	158%
Kuwait	119%	130%	139%	144%	145%
Oman	86%	91%	100%	112%	108%
Saudi Arabia	76%	80%	87%	87%	87%

Source: GCC Central Banks

1 Abdullah, B. and Santoso, W. (2001), "The Indonesian Banking Industry: Competition, Consolidation and Systemic Stability," in *The Banking Industry in the Emerging Market Economies. (Bank for International Settlements),* 80-92.

SECTOR SIZE, GROWTH AND PERFORMANCE

BANKING GROWTH RESILIENT IN ECONOMIC SLOWDOWN, DRIVEN BY ISLAMIC BANKING

By the end of 2016, Qatar's banking sector assets reached almost QAR 1.3 trillion, with a CAGR of 11.5% between 2012 and 2016. Despite a prolonged period of low oil prices and lackluster economic performance, the banking sector maintained relatively stable double-digit growth between 2012 and 2016, growing by 14% in 2016 alone. Asset growth in the banking sector marginally slowed down in 2014 and 2015 as oil prices plummeted, held back by a larger drop in conventional banking assets during the same period. Growth in overall banking assets picked up in 2016 as conventional asset growth recovered. This has been attributed to the government's sovereign reserves, mainly in foreign currencies. These fiscal buffers have cushioned the impact of the recent economic slowdown, ensuring continued government spending on major infrastructure in the short-term. The QCB has capacity to introduce additional liquidity into the financial system, and one of the ways it can do this is through introducing foreign currency from its reserves through managing the portfolios of the Qatar Investment Authority (QIA) and public sector enterprises.[1]

The share of Islamic banking assets system-wide has remained relatively stable over the past five years, growing by only 2% from 24% in 2012 to 26% in 2016. Unlike other sectors in Qatar's financial industry, the growth in banking assets during this period was primarily driven by strong growth in the Islamic segment. Islamic banking assets grew at a CAGR of 13% between 2012 and 2016. Islamic banking asset growth was driven by increased domestic credit through Islamic financing, which grew higher than conventional loans at 22% in 2014 and 18% in 2015. However, the delayed impact of lower oil prices was seen in the reduced growth of Islamic banking assets in 2015, where it slightly dropped to 17% and subsequently dropped substantially to 6% in 2016. This growth pattern reflects in the growth in credit through Islamic finance. It is significant to note that the growth trajectory for Islamic banking assets generally seems to react to economic conditions at a slower pace than conventional banking assets.[2] This is likely the result of government deposits and credit making up a smaller share of Islamic banks' portfolios compared to conventional counterparts.

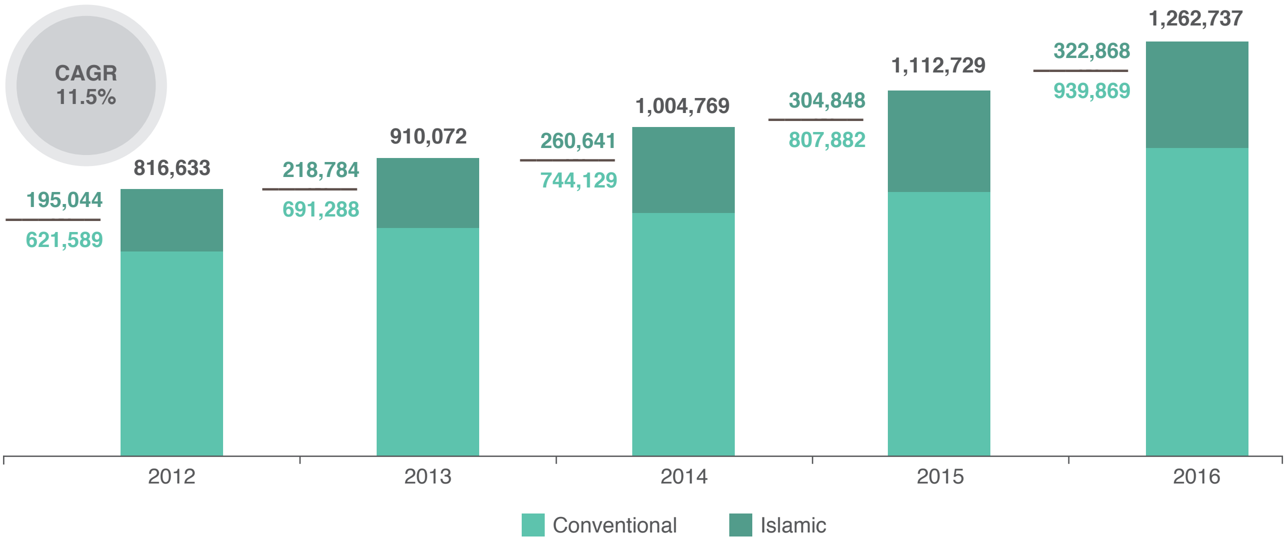
Banking growth fuelled by increasing share of foreign assets

The growth in Qatar's banking assets stemmed in large part from lending activities outside of Qatar. "Credit Outside Qatar" grew at a CAGR of 32% between 2012 and 2016. 66% of foreign lending is split between the GCC (35%) and Europe (31%) in 2016. This growth increased the share of foreign assets at banks from 16% in 2012 to 22% in 2016, while the share for domestic assets declined. With increased competitiveness in the banking sector, the larger banks began to look for growth opportunities in overseas markets in recent years. And as the economic slowdown ensued, followed by a drawdown of government deposits with banks, Qatari banks sought expansion and funding opportunities in their foreign operations. In 2016, 60% of banks' total earning foreign assets were based in Europe (31.4%) and the GCC (28.6%).

Growth in Islamic banking assets was also driven by the lending activities of Islamic banks abroad. "Credit Outside Qatar" at Islamic banks grew at a CAGR of 45% from 2012 to 2016, which drove the share of foreign assets to 13% in 2016, up from 9% in 2012. This also reduced the share of domestic assets by 3% during the same period. The significant slowdown in Islamic banks' asset growth during 2016 can be traced back to a decline in credit, investments and other assets held abroad. This significantly slowed down the growth of

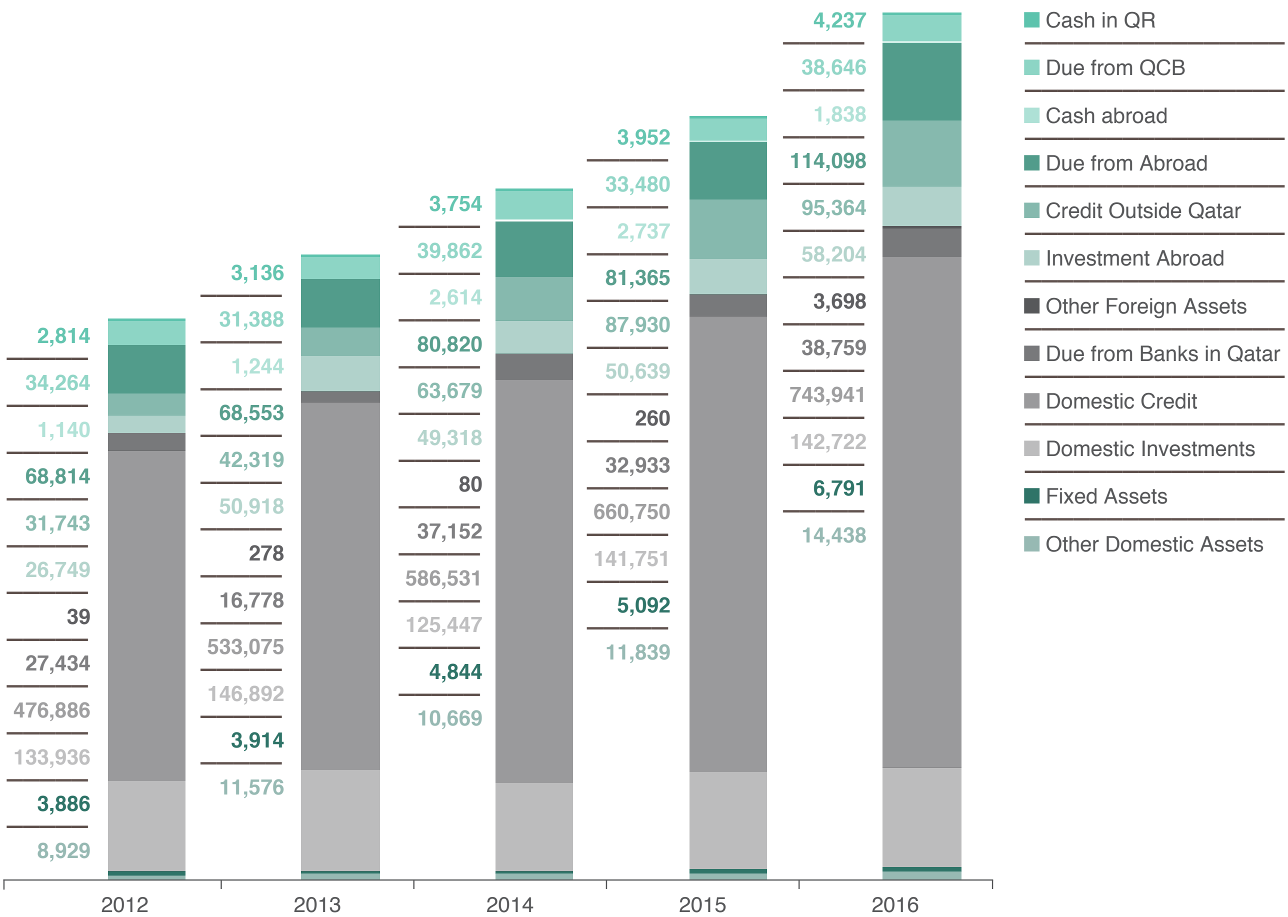
1 "Qatar," IMF Country Report 17/88, April 2017.
2 In an examination of the correlation between average quarterly oil prices, GDP growth rates and quarterly growth rates for Islamic and conventional banking assets, Islamic banking growth showed the strongest correlation with economic variables one period later than conventional banking growth.

Figure 21 QCB COMMERCIAL BANK ASSETS (QAR MILLION) 2012–2016



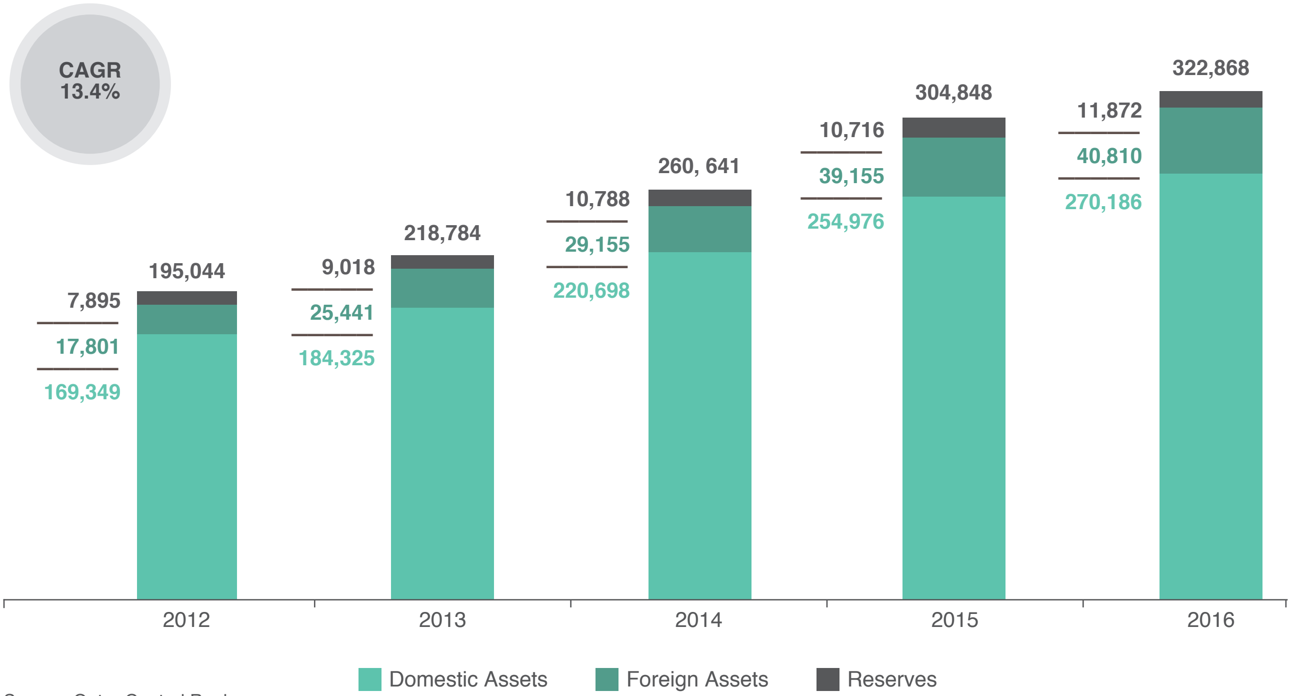
Source: Qatar Central Bank

Figure 22 BREAKDOWN OF QCB COMMERCIAL BANK ASSETS (QAR MILLION) 2012–2016



Source: Qatar Central Bank

Figure 23 BREAKDOWN OF ISLAMIC BANK ASSETS (QAR MILLION) 2012–2016



Source: Qatar Central Bank

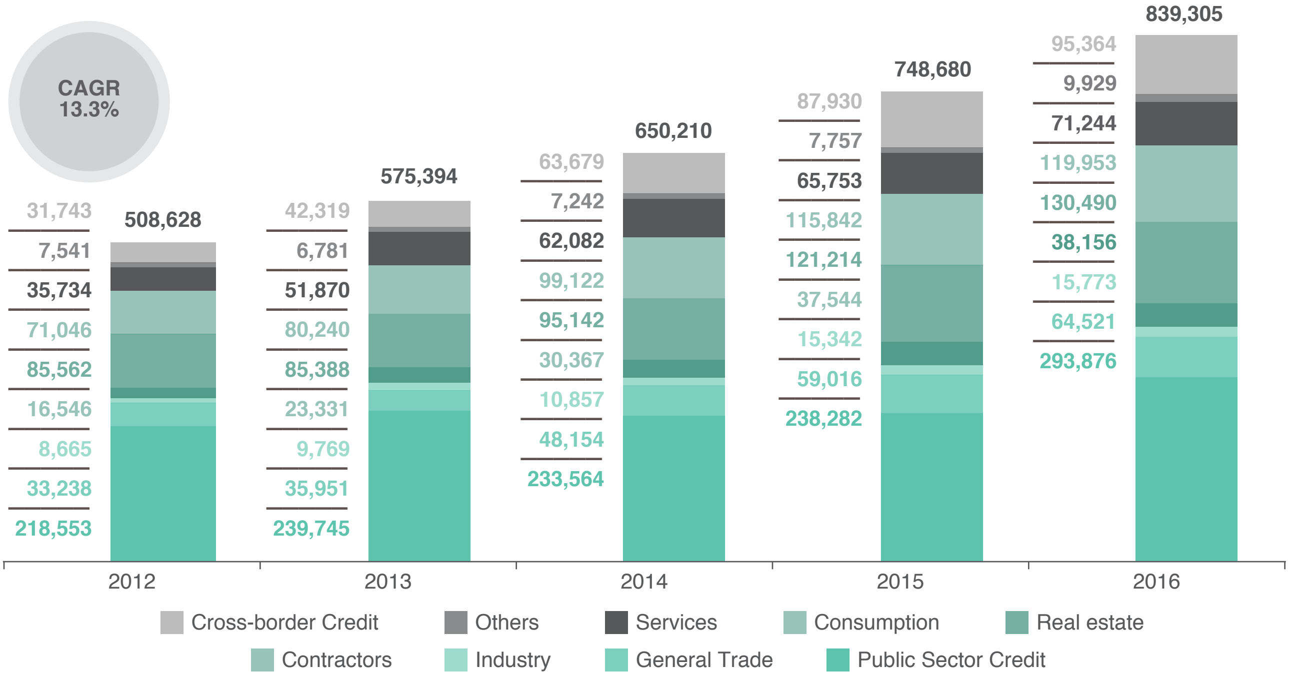
foreign assets from 34% in 2015 to 4% in 2016, dragging down Islamic banking asset growth. As a result of tougher liquidity conditions in the local banking system, some banks have tapped their foreign operations to meet their liquidity needs in Qatar.

OVERSEAS AND PRIVATE SECTOR LENDING BOOSTS CREDIT GROWTH

At the end of 2016, total credit extended by commercial banks in Qatar reached QAR 839 billion. This has followed a similar growth trajectory to overall banking assets with a CAGR of 13% from 2012 to 2016. Reflecting assets overall, the growth in credit has been driven by growth in cross-border credit, which tripled in value during this period. The construction sector was another driver of private sector credit growth, with lending to the contractors more than doubling during the same period. Islamic banks led conventional banks in the rate of growth for these segments during 2014 and 2015, and maintained growth over 20% during these two years compared to a slowdown in the growth of conventional banking credit. Islamic banking cross-border credit grew at substantially high levels between 2012 and 2016, with a CAGR of 45%. Credit in this segment grew by 53% in 2013, 64% in 2014 and 90% in 2015. However, it fell by 7% in 2016 in line with banks withdrawing liquidity from their foreign operations and redirecting it to their operations in Qatar.

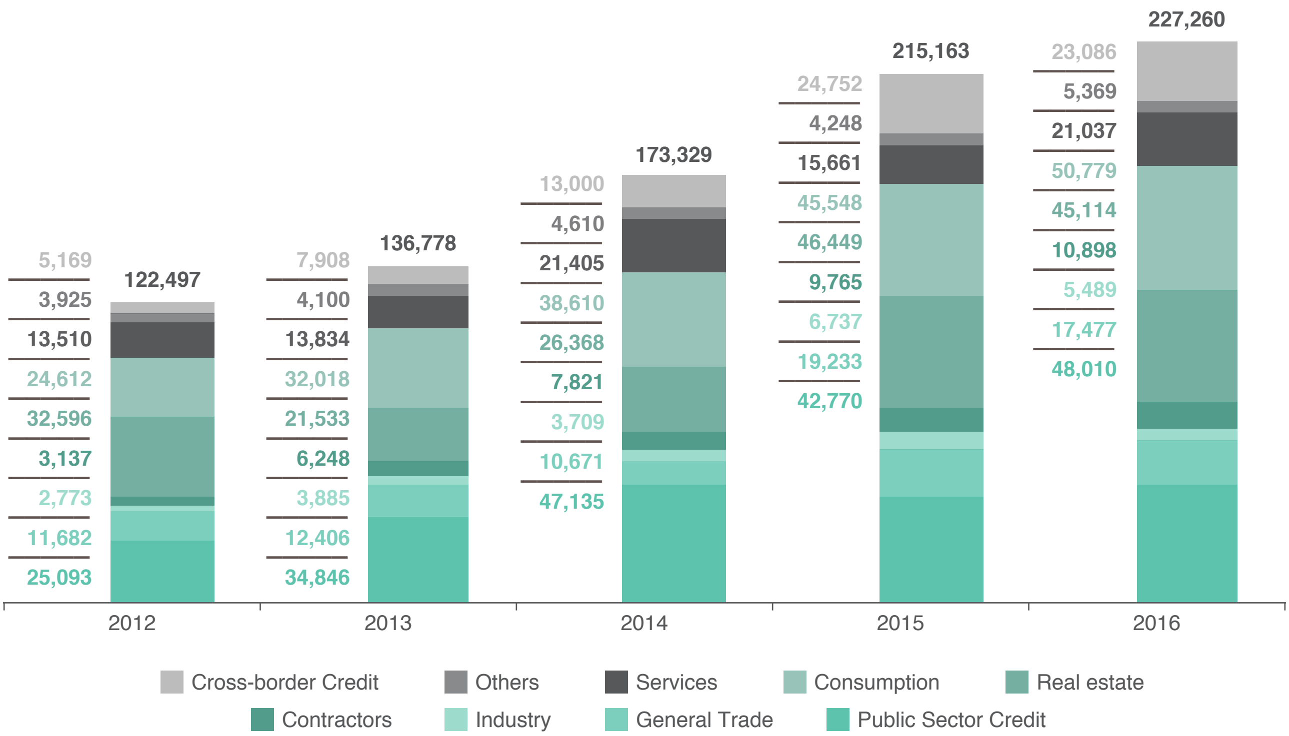
Credit to the public sector, usually a key driver of credit growth, saw decelerating growth in 2014 and 2015 as a result of lower demand in light of the significant drop in energy prices. Consequently, the public sector's share of total credit fell from 43% in 2012 to 35% in 2016. In 2016, particularly at conventional banks, credit to the public sector began to recover, growing by 23% overall. Sustained infrastructure spending, despite expectations of continued fiscal deficits, will further boost demand for credit from the public sector. Strong demand growth in this segment will stand to benefit conventional banks the most, given that they extend almost five times the value of credit provided by Islamic banks to the sector. In other terms, public sector lending represents 40% of conventional credit, but only 21% of Islamic credit.

Figure 24 BREAKDOWN OF QCB COMMERCIAL BANK CREDIT (QAR MILLION) 2012–2016



Source: Qatar Central Bank

Figure 25 BREAKDOWN OF QCB ISLAMIC BANK CREDIT (QAR MILLION) 2012–2016



Source: Qatar Central Bank

In efforts to address the increasing gap between domestic credit and deposits, banks in Qatar have resorted to financing their operations with external sources of funding ...

SLOWING DEPOSIT GROWTH BUOYED BY NON-RESIDENT DEPOSITS

Deposits in the banking sector continued to grow between 2012 and 2016, but at a slower pace than credit growth. Growth reached almost 20% in 2013. However, it dropped to 10% in 2014 and fell further to 8% in 2015. The main cause for this was the decline in the value of public sector deposits, which fell by 11% in 2016 alone. In particular, public sector deposits with conventional banks fell by 21% in 2016. This decline began in 2014, when oil prices plummeted, placing downward pressure on government revenues. As a result, the government resorted to drawing down some of its deposits to address its funding and liquidity needs. Public sector deposits as a share of total deposits fell from 33% in 2012 to 26% 2016.

The private sector's share of total deposits has remained relatively stable, although it has slightly dropped, with a 6% decline between 2012 and 2016 at Islamic banks. Domestic deposits, both in the public and private sectors, lost ground to non-resident deposits. This category grew significantly at a CAGR of 46% between 2012 and 2016, boosting its share of total deposits from 9% to 25% during the same period. Non-resident deposits at Islamic banks saw much higher growth than at conventional banks; growing 503% during this period, compared to 326% at conventional banks, with their share of total Islamic deposits increasing from 4% to 16%.

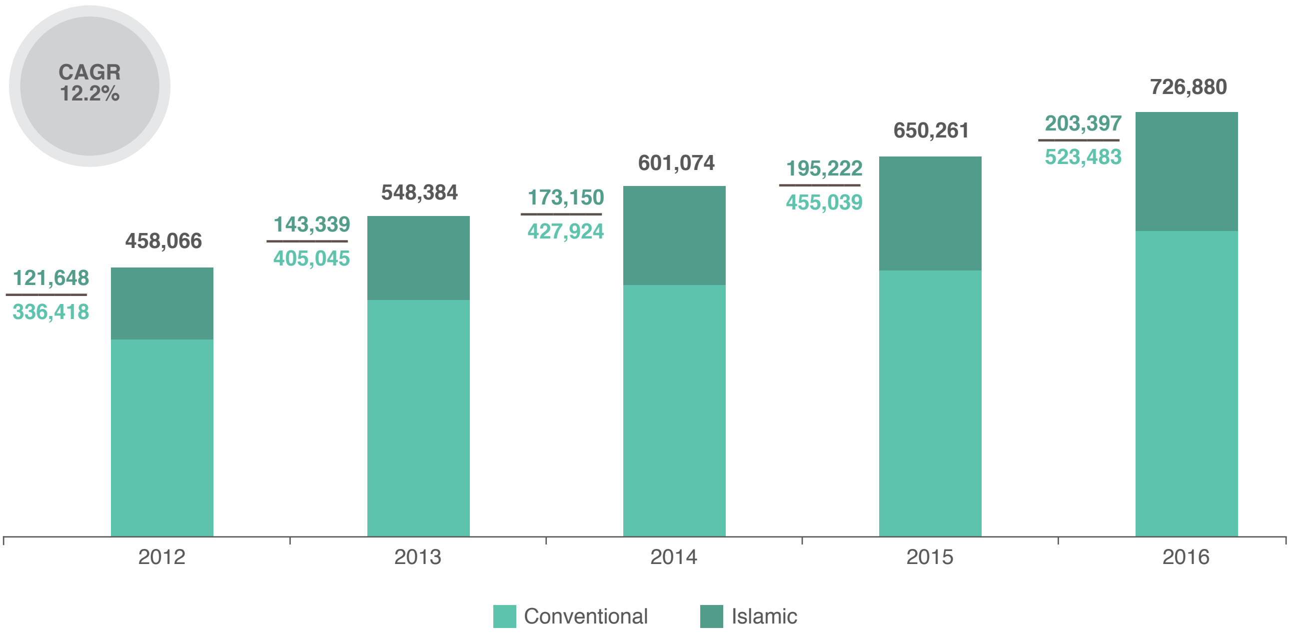
EXPANDING CREDIT-DEPOSIT GAP INCREASING PRESSURE ON BANK LIQUIDITY

Overall banking credit grew at a faster pace than deposits between 2012 and 2016, widening the credit-deposit gap. An implication of this widening gap is that banks have less liquidity to support their lending activities. However, this issue is specific to the banks' domestic operations. The credit-deposit gap for foreign accounts has actually closed in recent years, with foreign deposits exceeding credit extended abroad. This reverse in the gap has resulted from slower growth in cross-border credit in 2016, while non-resident deposits more than doubled in the same year.

Although the reversed foreign credit-deposit gap has managed to somewhat balance the domestic credit-deposit gap, the overall gap remains wide. However, an excess of foreign deposits over credit has given banks a more favorable liquidity position in their overseas operations, leading them to tap into this excess liquidity for their domestic liquidity needs.

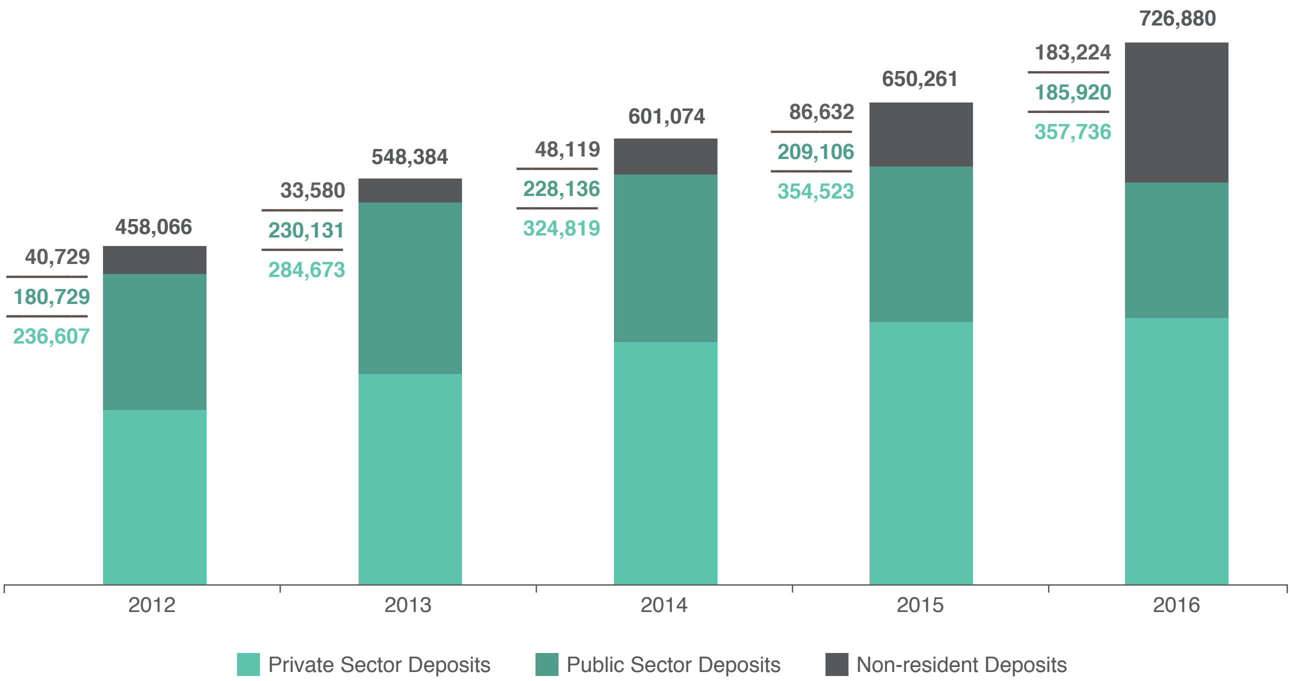
In efforts to address the increasing gap between domestic credit and deposits, banks in Qatar have resorted to financing their operations with external sources of funding from outside Qatar, which include their foreign branches and subsidiaries. For the overall

Figure 26 QCB COMMERCIAL BANK DEPOSITS (QAR MILLION) 2012–2016



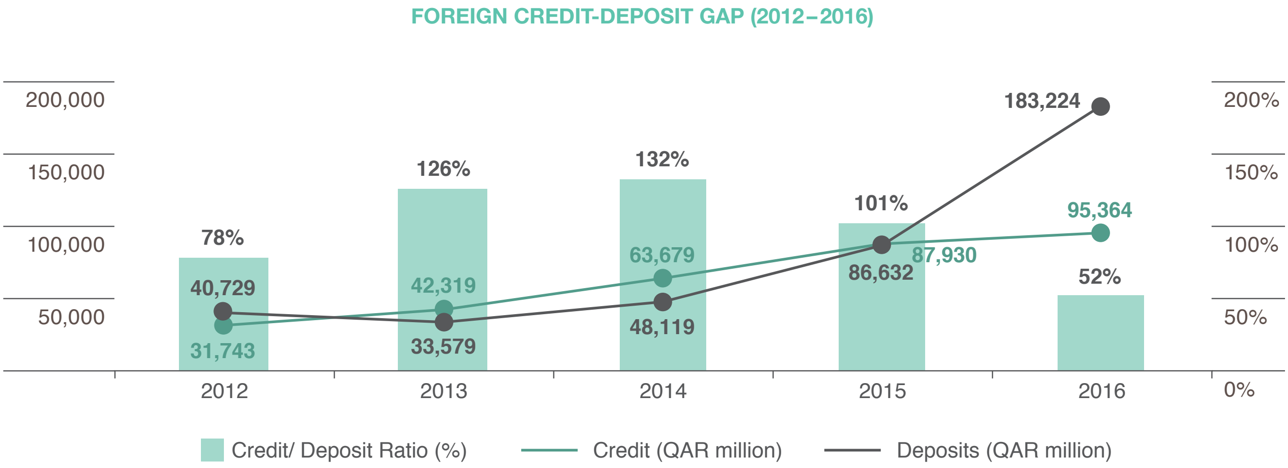
Source: Qatar Central Bank

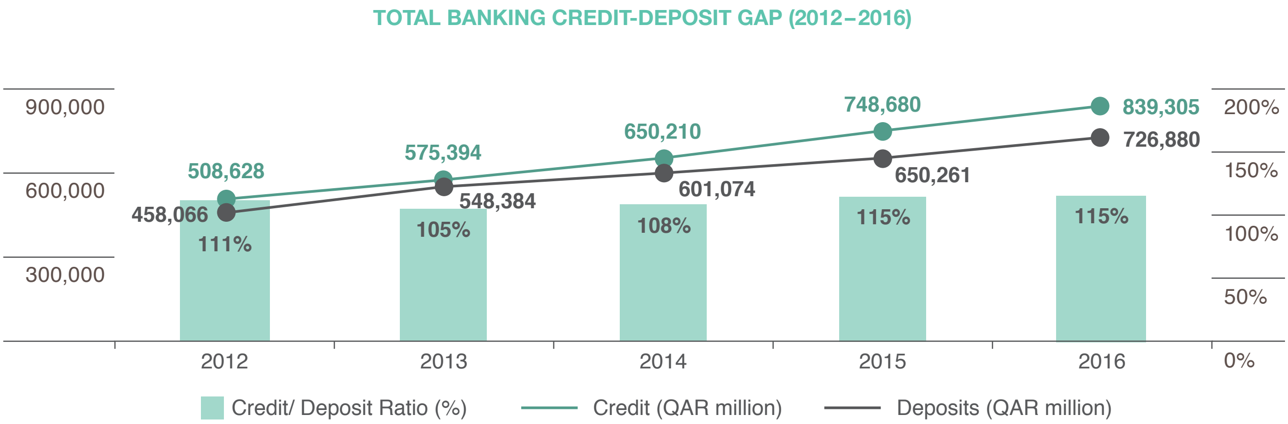
Figure 27 BREAKDOWN OF QCB COMMERCIAL BANK DEPOSITS (QAR MILLION) 2012–2016



Source: Qatar Central Bank

Figure 28 TOTAL AND FOREIGN BANKING CREDIT-DEPOSIT GAPS 2012-2016





Source: Qatar Central Bank, Thomson Reuters Analysis

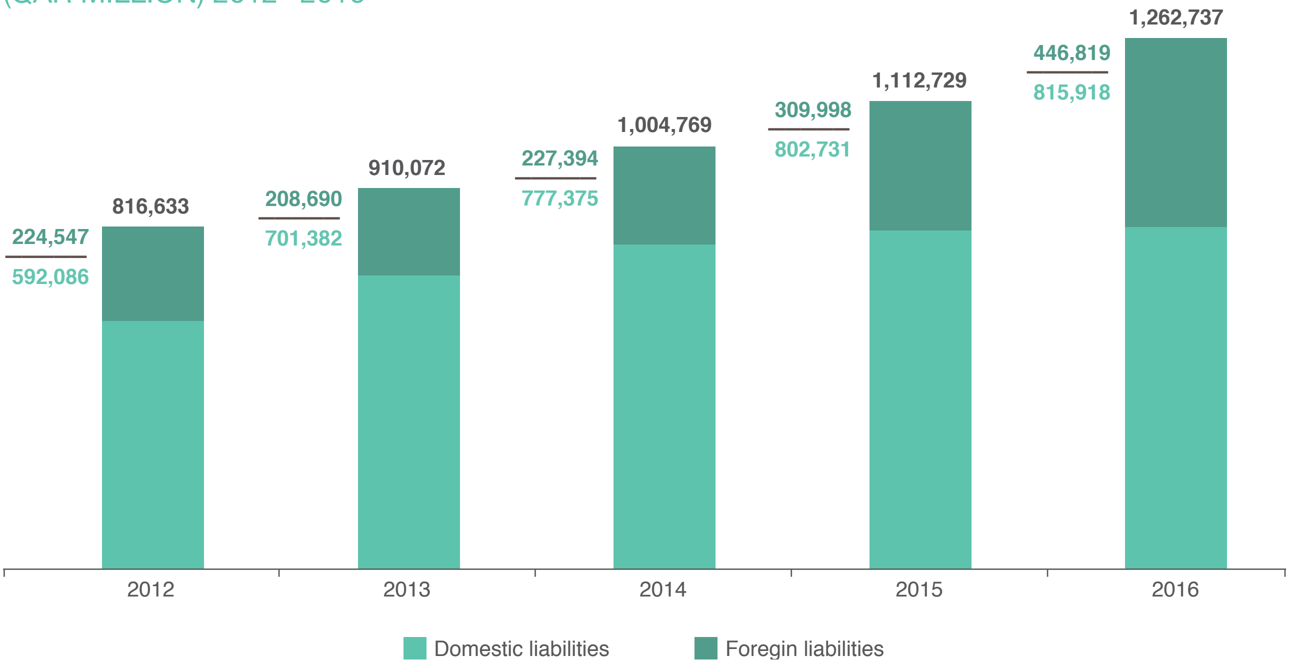
banking sector, the foreign share of total liabilities increased by 8% between 2012 and 2016 and was mainly concentrated in borrowing from foreign banks, including their own banking subsidiaries. Similarly Islamic banks' foreign liabilities increased as a share of total liabilities by 7% during the same period, with the majority of liabilities coming from non-resident deposits and a significant percentage from borrowing from their foreign subsidiaries and other foreign banks.

MARGINAL DECLINE IN PROFITABILITY DESPITE STRONG ASSET GROWTH

Despite double-digit growth in commercial banking assets, both conventional and Islamic banks saw a decrease in profitability between 2012 and 2016. Return on average assets (ROAA) declined marginally during this period, ending 2016 at 1.7%. This indicates the relative resilience of Qatar's banks in the face of low energy prices and the economic slowdown, which placed liquidity pressures on the domestic banking sector. This level of performance can be attributed to the growth in cross-border lending. By the end of 2016, net interest income accounted for a 73% share of net revenues as a result of increased lending by banks.

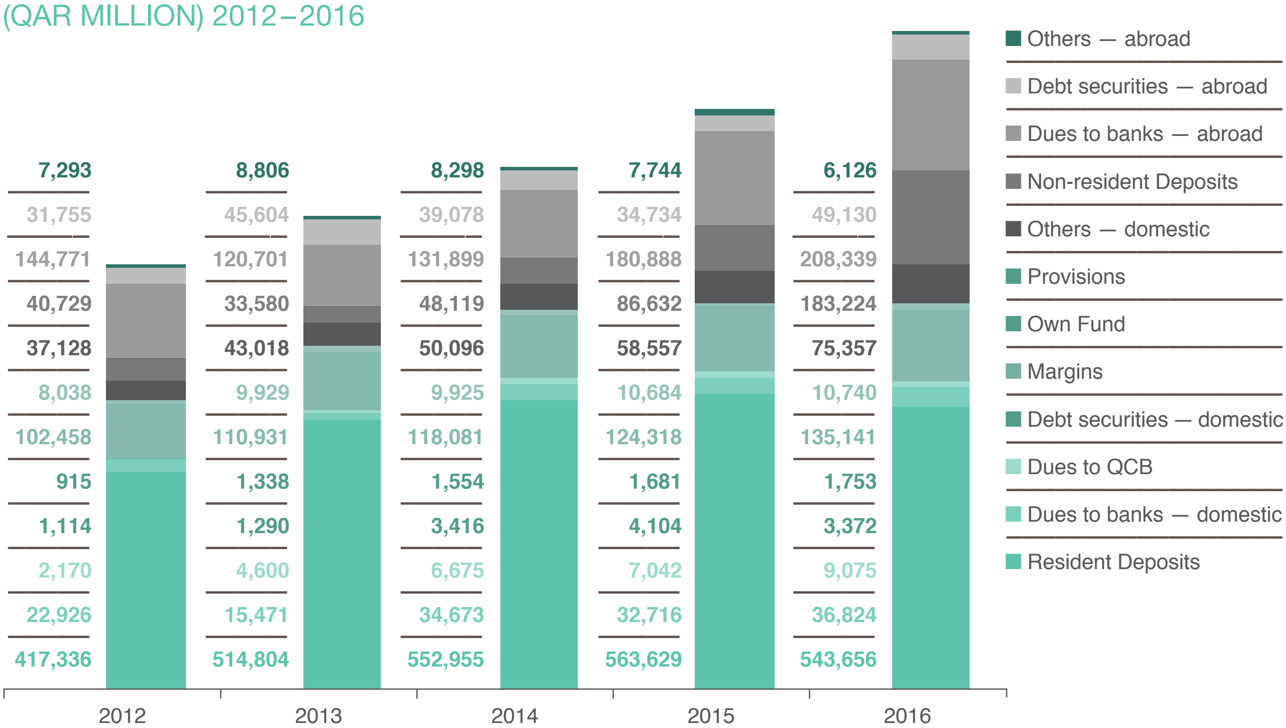
At conventional banks, net income has grown at a similar pace to assets, resulting in a stable ROAA between 2012 and 2016. However, as growth in conventional assets picked up in 2016, growth in net income continued to slow resulting

Figure 29 DOMESTIC AND FOREIGN LIABILITIRES OF QCB COMMERCIAL BANKS (QAR MILLION) 2012–2016



Source: Qatar Central Bank

Figure 30 BREAKDOWN OF QCB COMMERCIAL BANK LIABILITIES (QAR MILLION) 2012–2016



Source: Qatar Central Bank

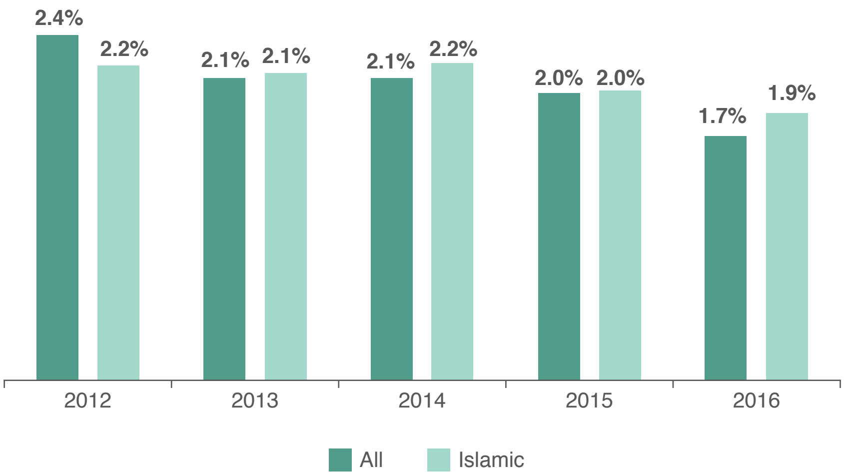
in marginally lower profitability on average assets during 2016. ROAA for Islamic banks increased in 2014, reflecting higher growth in net income compared to their assets. However, slower growth in net income compared to assets in 2015 and 2016 led to a commensurate drop in the profitability of Islamic banks.

ISLAMIC BANKS MAINTAIN STRONGER POSITION IN OPERATIONAL EFFICIENCY

The overall banking sector in Qatar has seen a decline in operating efficiency between 2013 and 2016. The estimated cost-to-income ratio for the overall sector has gradually increased from 20% in 2012 to 30% in 2016. However, it remains at a healthy level due to banks' conservative provisioning policies. The ratio saw a 4% increase in 2016 alone, due to a sharp increase in the cost-to-income ratio for QNB from 21.5% to 30.4%, which can partly be attributed to QNB's US$ 3 billion acquisition of Finansbank in Turkey during the year. The estimated cost-to-income ratio for Islamic banks, on the other hand, are relatively lower compared to their conventional counterparts. QIB, the country's largest Islamic bank, recorded a cost-to-income ratio of 29.8% and Masraf Al Rayan a ratio of 18.09%, making it one of the most efficient banks in the region. Islamic banks manage to keep their operational costs low as they do not participate in volatile market based activities.

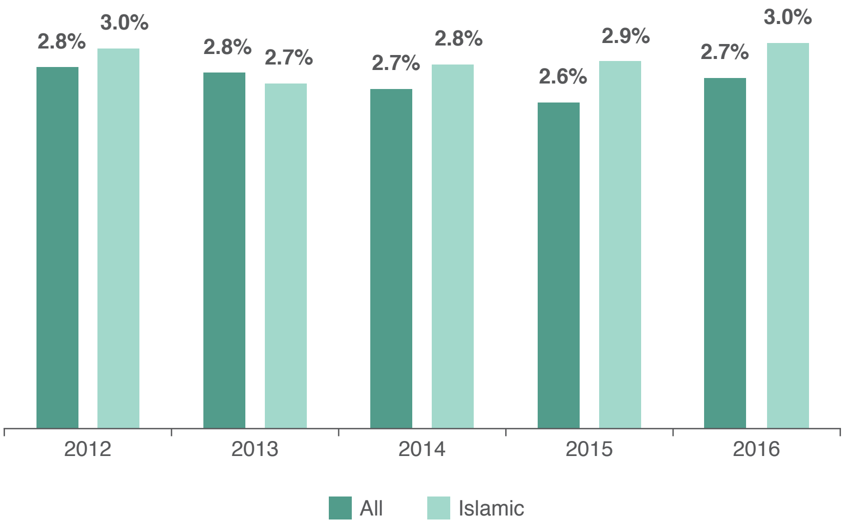
Net interest margin (NIM) has remained relatively stable between 2012 and 2016, with a marginal decrease of 1% for the overall sector. Despite double-digit credit growth seen during this period, prevailing low interest rates placed

Figure 31 RETURN ON AVERAGE ASSETS FOR QCB COMMERCIAL BANKS IN QATAR 2012–2016



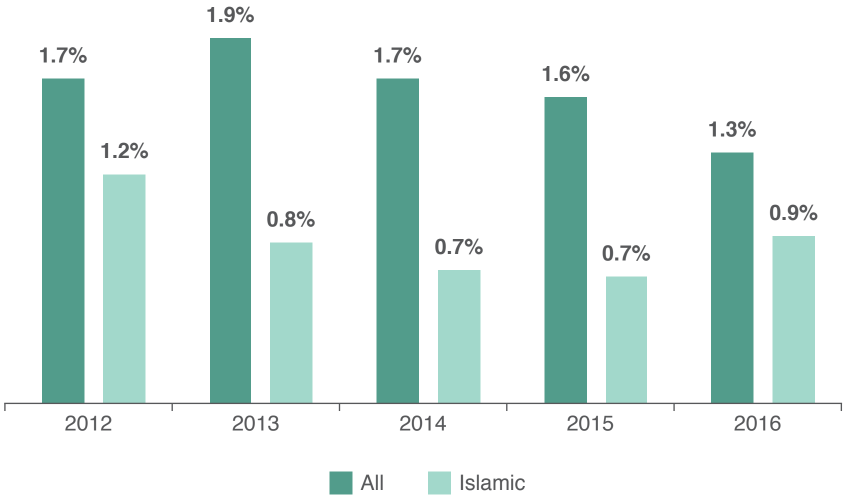
Source: Qatar Central Bank, Thomson Reuters Analysis

Figure 32 QCB COMMERCIAL BANKS' NET INTEREST MARGIN (NIM) 2012–2016



*Based on a sample of Qatar's largest five banks accounting for 93% of banking assets.
Source: Annual Reports, Thomson Reuters Analysis

Figure 33 QCB COMMERCIAL BANKS' NON-PERFORMING LOANS/FINANCING (% OF TOTAL LOANS/FINANCING)



Source: Qatar Central Bank, Thomson Reuters Analysis

Table 6 QCB COMMERCIAL BAKS' NPL RATIO BY SECTOR 2014–2016

Sector	2014	2015	2016
Public sector	0.0%	0.0%	0.0%
Private sector	2.6%	2.2%	2.1%
Corporations	1.2%	1.9%	1.7%
Individuals (Retail)	4.6%	2.7%	2.8%
Cross-border	3.1%	2.6%	1.7%

Source: Qatar Central Bank

downward pressure on banks' NIM. At Islamic banks, on the other hand, NIM remained stable between 2012 and 2016. This is a sign of lower competitiveness in the Islamic banking segment.[3]

IMPROVED NON-PERFORMING LOAN/FINANCING RATIO WITH INCREASED BUSINESS PRUDENCE

The quality of credit in the overall banking sector improved as the ratio of non-performing loans (NPLs) to total loans declined from a ratio of 1.7% in 2012, NPLs accounted for only 1.3% by the end of 2016. This trend indicates Qatari banks are better managing credit risk during this period. This can be attributed to increased prudence in lending activities, in addition to improved management of asset quality by banks with the onset of the implementation of Basel III requirements in 2013. NPL ratios for Islamic banks remained stable during the same period. Islamic banks collectively ended 2013 with non-performing financing (NPF) accounting for a mere 0.8% of total financing, which increased marginally to 0.9% in 2016, likely the result of increased defaults on personal financing.

During 2016, NPLs reduced across all major economic sectors with the exception of retail (credit to individuals). Credit to individuals marginally increased by 0.1% in 2016 and accounted for the largest share of total NPLs, increasing from 42% in 2015 to 46% in 2016. On the other hand, NPLs from the cross-border segment reduced the most from an NPL ratio of 3% in 2015 to 2% in 2016.

The ratio of NPL provisions to total NPLs for the overall banking sector has seen a marginal decrease from 81% in 2013 to 80% in 2016, affirming the conservative provisioning policies of banks in Qatar. NPL provisions for Islamic banks increased from 78% in 2013 to 81% in 2016. It is worth noting that the level of provisions at Islamic banks reached higher levels during 2014 and 2015, in line with expectations for increased defaults as oil prices fell significantly during this period.

3 François Boutin-Dufresne, Santiago Peña, Oral Williams and Tomasz A. Zawisza (2013), "Benchmarking Banking Sector Efficiency Across Regional Blocks in Sub-Saharan Africa: What Room for Policy?" IMF Working Paper.

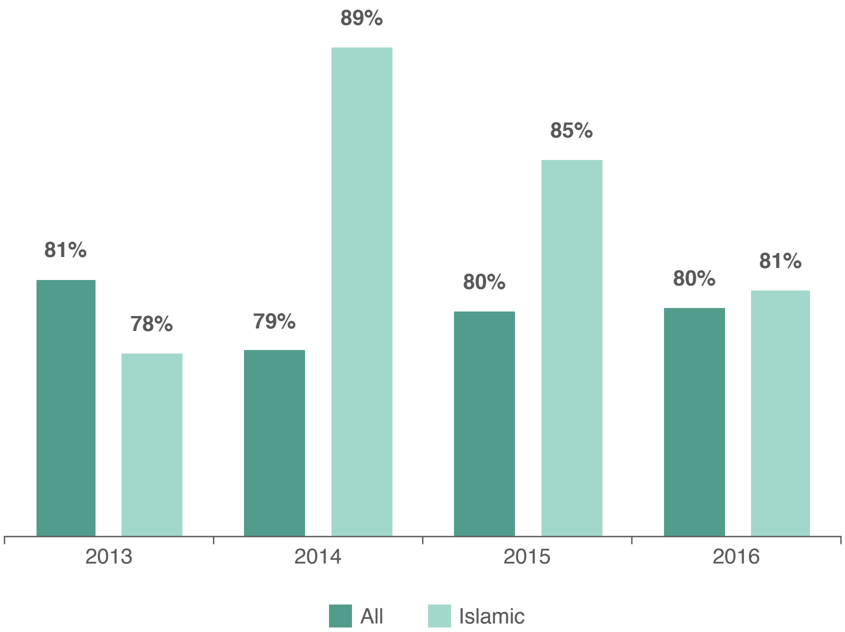
STABLE CAPITAL ADEQUACY RATIO, LED BY ISLAMIC BANKS

Banks in Qatar have been required to comply with Basel III capital adequacy requirements since 2014. Their aggregate Tier 1 Capital Adequacy Ratio (CAR), the proportion of Tier 1 capital to total risk-weighted assets, remained stable at a healthy level above the QCB's required 8% to comply with Basel III standards. The overall banking sector in Qatar enjoys a comfortable position in terms of capital adequacy, maintaining a level of just above 15% between 2013 and 2016. The fact that banks in Qatar exceeded the required level of Tier 1 capital is an indication that liquidity in the banking sector remains strong, despite the strain of lower deposit growth. Islamic banks have maintained a CAR slightly above that of the sector during this period, fluctuating around 16% but ending 2016 at 16.8%.

Although the Tier 1 CAR for the banking sector is much higher than the regulatory requirement, Qatari banks have continued their efforts to enhance their capital base, mainly Tier 1 capital, to remain in a comfortable position relative to Basel III standards. Two Islamic banks recently issued Basel III Tier 1 sukuk in efforts to build up their capital. In 2015, QIB issued QAR 5 billion in Tier 1 sukuk, followed by QIIB's QAR 1 billion issuance in 2016. Conventional banks also adopted this approach with Doha Bank issuing QAR 2 billion through a capital-boosting bond in 2015, and CBQ issuing QAR 1 billion in 2016. The largest issuance raising QAR 10 billion in Tier 1 capital came from QNB, the GCC's largest lender by assets, in 2016.

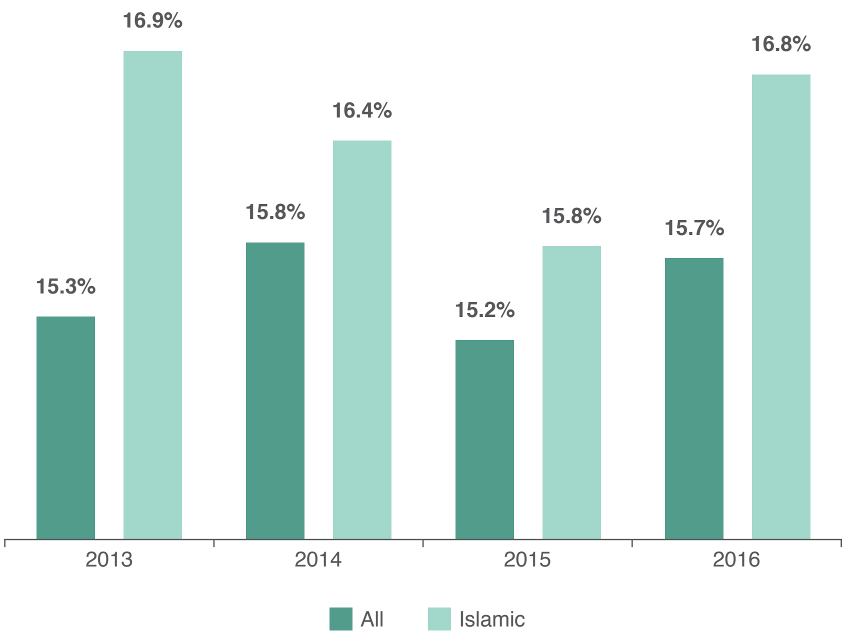
Liquidity ratios for Qatar's banks have also come under some

Figure 34 QCB COMMERCIAL BANKS' NON-PERFORMING LOAN/FINANCING PROVISIONS 2013–2016



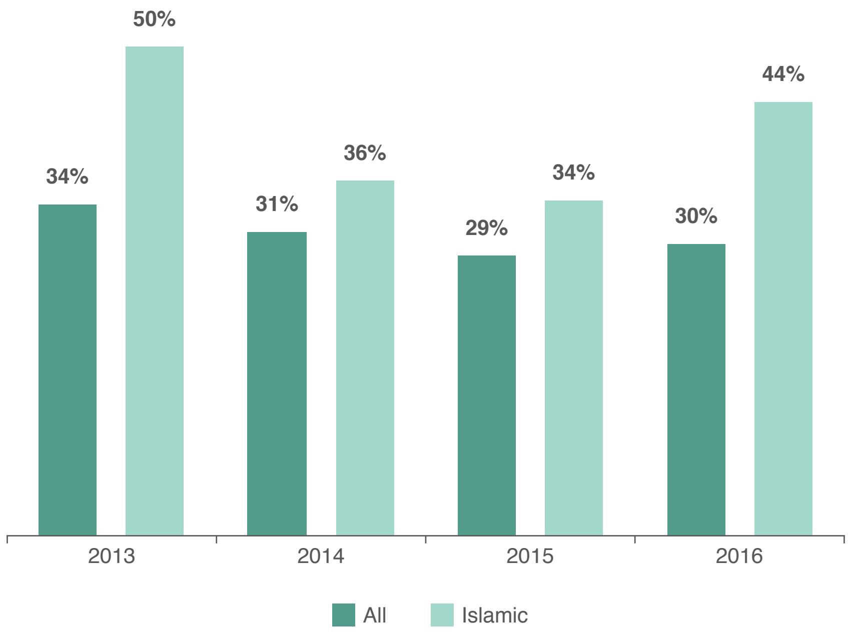
Source: Qatar Central Bank, Annual Reports, Thomson Reuters Analysis

Figure 35 TIER 1 CAPITAL ADEQUACY RATIO FOR COMMERCIAL BANKS IN QATAR (REGULATORY TIER I CAPITAL/TOTAL RISK WEIGHTED ASSETS) 2013–2016



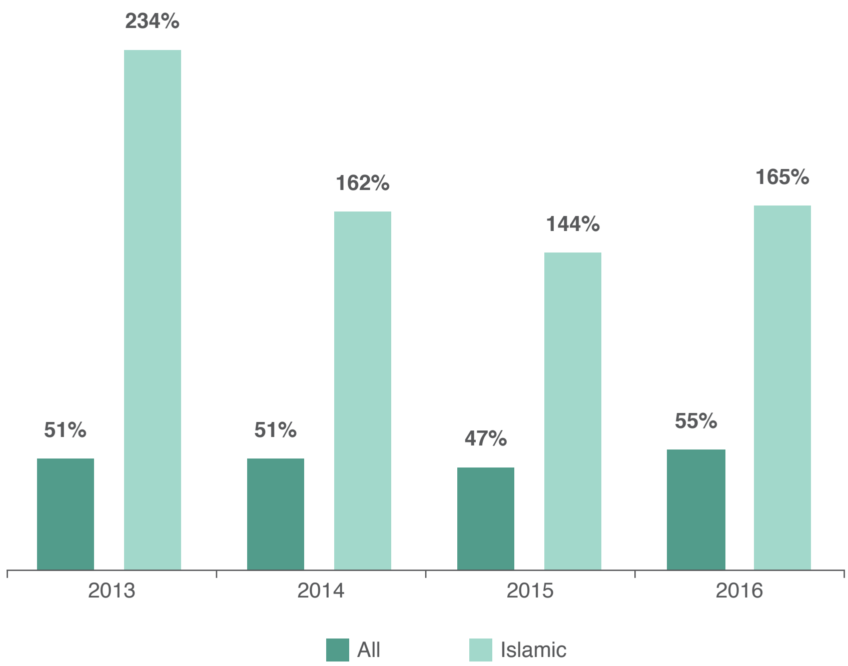
Source: Qatar Central Bank, Thomson Reuters Analysis

Figure 36 QCB COMMERCIAL BANKS' LIQUID ASSETS (% OF TOTAL ASSETS) 2013–2016



Source: Qatar Central Bank, Thomson Reuters Analysis

Figure 37 QCB COMMERCIAL BANKS' LIQUIDITY COVERAGE (LIQUID ASSETS/LIQUID LIABILITIES) 2013–2016



Source: Qatar Central Bank, Annual Reports, Thomson Reuters Analysis

pressure as a result of slower economic growth and fiscal deficits resulting from the sharp decline in oil prices. For the overall banking sector, the ratio of liquid to total assets declined marginally between 2013 and 2016.

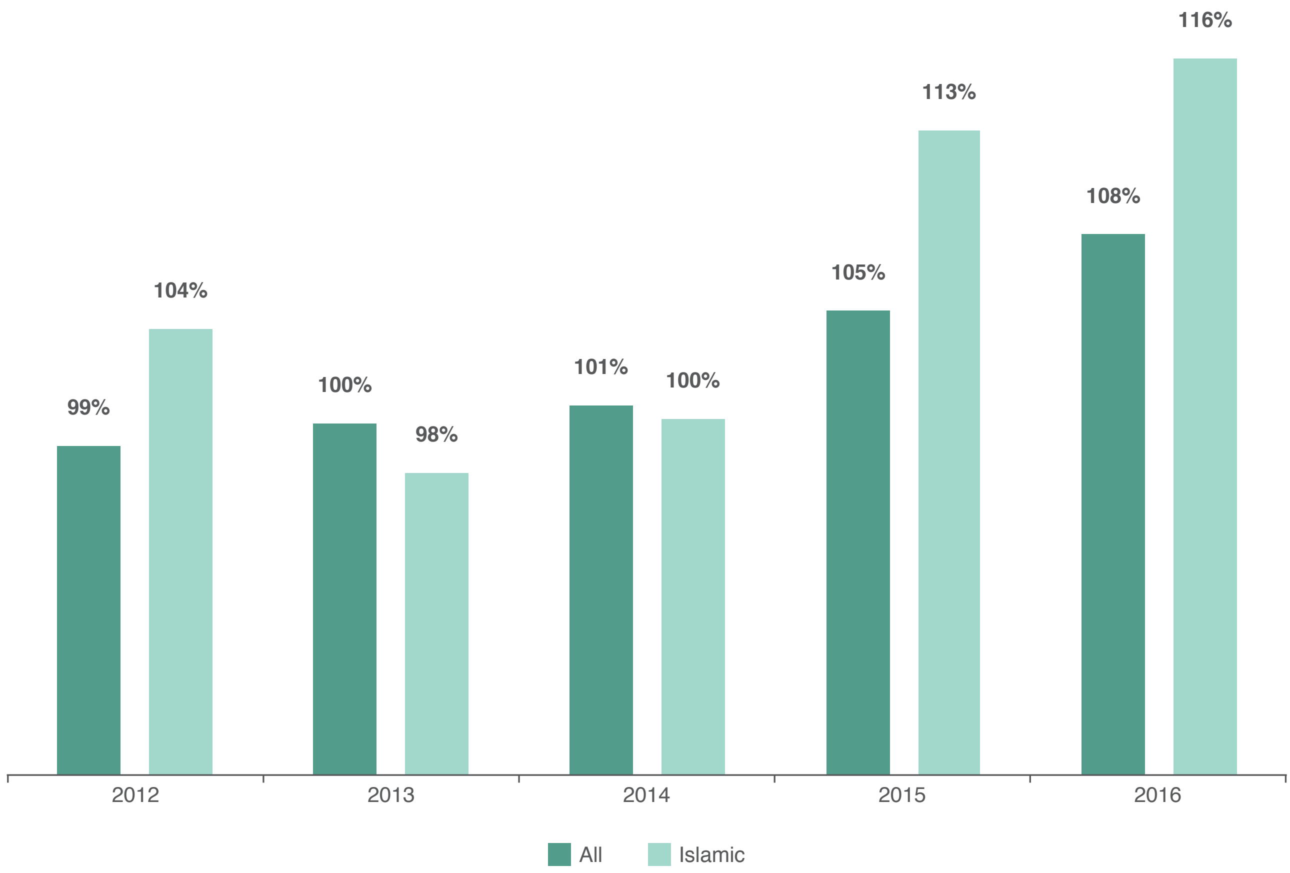
Despite an overall drop between 2013 and 2016, Islamic banks are in a more favorable position compared to the rest of the sector in terms of liquidity, with their ratio of liquid to total assets at 44% by the end of 2016. In terms of liquidity coverage, the ratio of liquid assets to liquid liabilities for Islamic banks is substantially higher than the overall sector.

BANKS TURN TO EXTERNAL FUNDING WITH RISING LOAN/FINANCING-TO-DEPOSIT RATIOS

Banks in Qatar saw a notable increase in loan-to-deposit ratios between 2013 and 2016, which exacerbated existing liquidity pressures from declining government deposits. The estimated loan-to-deposit ratio for the overall banking sector increased from 99% to 108% during this period. The estimated financing to deposit ratio for Islamic banks is higher than that for the overall sector and has also increased more substantially during the same period, supported by higher proportions of liquid assets.

As the gap between their loans and customer deposits widened, banks began to seek funding through external sources, tapping liquidity in global markets. The main target markets for funding were Europe, where the European Central Bank's bond buying program significantly boosted liquidity, and some Asian markets that have maintained robust liquidity. On the other hand, banks in Qatar managed to garner interest

Figure 38 QCB COMMERCIAL BANKS' LOAN/FINANCING-TO-DEPOSIT RATIOS 2012–2016



*Based on a sample of Qatar's largest five banks accounting for 93% of banking assets.
Source: Annual Reports, Thomson Reuters Analysis

from foreign investors through the country's resilience to plummeting oil prices. These banks continue to tap overseas markets, mainly Asia, for funding as the ongoing diplomatic rift in the region has shown no signs of abating at the time of writing this report. Most of the external funding to banks was US dollar-denominated short-term debt, which was largely used to finance QAR-denominated long-term projects.

The overall banking sector saw gross external funding more than double from QAR 200 billion in 2013 to QAR 441 billion in 2016. The share of non-resident deposits rose from 17% of total external funding in 2013 to 42% in 2016. External funding for Islamic banks almost doubled from QAR 15.4 billion in 2013 to QAR 29 billion in 2016 and during this period, the share of non-resident deposits jumped from 19% to 53%.

However, this recent surge in external funding makes Qatar's banks more vulnerable to a shift in foreign investor sentiment or reduced global liquidity in the medium term. With interest rates expected to increase across Europe by the end of 2018, it is more likely that investors in these markets will reinvest the short term funding provided to Qatari banks in local debt securities. Qatar's banks will also see an increased cost of external funding as interest rates begin to rise.

Mosque in the old town, Doha. ATTILA JANDI / SHUTTERSTOCK.COM

MR. BASSEL GAMAL

Group CEO, Qatar Islamic Bank (QIB)

Mr. Gamal has held the position of QIB's Group CEO since February 2013. He has over 25 years of experience in the banking and finance industry and is currently the Chairman of QIB-UK and a Board Member of Qinvest. He began his career at Commercial International Bank (Chase National Bank) in Egypt, in 1990, where he worked for more than a decade. In 2001, he joined Ahli United Bank Group in Bahrain, where he held many positions, culminating in Senior Deputy Group CEO – Banking Group, in charge of various businesses including Corporate Banking, Retail Banking, Treasury and Investment, Private Banking and Wealth Management, and Financial Institutions, spanning eight countries. He chaired and was a member of a number of committees including: the Credit and Investment Committee, Operational Risk Committee, Special Assets Committee and Group Management Committee. At the Ahli United Bank Group, he also served on the board of many of AUB's affiliated banks. He was Ahli Bank's Deputy CEO in Qatar from 2004 until 2006, at which point he became the CEO until early 2009.

1. In recent years, the growth of Islamic banking assets in Qatar has outpaced conventional banking assets. In your opinion, what were the key factors contributing to this growth, given that other Islamic finance sectors have underperformed their conventional counterparts?

The Islamic banking industry in Qatar and around the world is relatively young, and QIB was the first Islamic bank to operate in the country, starting in 1982. In the early years, most Shariah-compliant banks were mainly leveraging a "positional advantage", vis-a-vis conventional banks, with certain segments in personal banking. This is due to the fact that a number of individuals prefer to address their financial needs only in a Shariah-compliant way and most Islamic banks initially focused their attention to this customer segment. However, this reliance led to a reactive business approach, outdated products, and low customer service levels because of a lack of investments in innovation, technology, and people. As a result, Islamic banks were progressively losing market share and were failing to attract new customers, especially on the corporate banking front; corporations were looking for banks that could address all their financial needs with advanced products, efficient processes, and competitive pricing.

Naturally, at a certain point in time a necessary change in innovation and service levels became a prerequisite for the further success of many Islamic banks. In Qatar, the change was further facilitated by increased competition after the establishment of two new Islamic banks and the opening of Islamic branches at conventional banks, which was later revoked. The increased competition between Islamic banks and their parallel efforts to expand beyond their traditional customer base led to multiple benefits. For customers, it meant better products and services and improved pricing. For Islamic banks, it led to innovation, a focus on efficiencies, and increasing market shares.

As a result, Islamic banking sector performance has witnessed strong growth rates over the last few years. The share of Islamic assets in the local banking sector now accounts for more than a quarter of total banking assets at 25.5%, QR 330 billion, while its share of deposits is nearly 29%, QR 217 billion, as of March 2017.

2. In which business segments and markets do you see growth opportunities for Qatar's Islamic finance

> "There is a growing concentration of experienced, knowledgeable and highly professional individuals in the Islamic financial industry in Qatar."

and Islamic banking industries in the next five years? What are the key areas for development for Qatar to position itself as an Islamic finance hub?

We expect growth to accelerate across all banking sectors as the remaining major infrastructure projects kick off in preparation for Qatar hosting the 2022 World Cup. Islamic banks over the years have developed strong capabilities and the capacity to structure and finance the major infrastructure projects taking place in Qatar as part of the country's National Vision 2030. Growth will also be supported by the numerous initiatives and programs introduced by the government and government bodies in order to support the development of the private sector, to increase the role of SMEs in the economy, and to strengthen the sectors that help Qatar become a self-sufficient society. Likewise, private consumption is also projected to grow thanks to increasing population. Undoubtedly, Qatar's Islamic banking sector has posted impressive growth rates in recent years, and has often been recognized as the fastest growing economy in the world. In addition, over the past decade, Qatar's regulatory authorities have enacted several changes to improve governance standards in Islamic financial services. There is a growing concentration of experienced, knowledgeable and highly professional individuals in the Islamic financial industry in Qatar. All these elements are creating a very solid foundation for Qatar to become an Islamic financial hub in the region. Of course, Qatar is not the only country with this ambition. I personally believe the future will be shaped by the role Qatari Islamic financial institutions will play in the cross-border or international arena as well as which country in the region will be able to become an Islamic banking hub particularly for Fintech companies.

3. With increased pressure on systemic liquidity in the banking system in recent years, how have Islamic banks tackled this issue compared to their conventional counterparts?

Traditionally, Islamic banks have enjoyed stable funding, with a larger part of their deposits coming from "sticky" personal banking deposits. In QIB today, we have a high market share of retail deposits deriving from a well-diversified large customer base.

In recent years, as Islamic Banks have been growing substantially, liquidity has been supported by the parallel growth of sukuk (Islamic bond) issuances. At QIB, we have successfully accessed the debt capital markets for a number of landmark transactions, both in the public and private markets. Our success demonstrates the confidence that international investors place in Qatar, its Islamic banking market, and QIB in particular.

It is interesting also to note that different types of sukuk structures are being issued. For example, QIB's perpetual sukuk, a first in the market, not only secures a relatively low cost funding base to support our long-term growth. It also allows the bank to maintain a strong capital adequacy ratio.

Finally, just like all financial institutions, Islamic banks around the world have been building strong and diversified relationships so as to raise liquidity in the international interbank markets.

4. In 2011, the QCB introduced a ban on conventional banks operating Islamic banking windows. Five years on, how has this decision impacted the Islamic banking landscape in Qatar?

The basic principles of Islamic banking are different from that of conventional banking, and the

QCB's decision was aimed at creating transparency to support growth for the entire banking sector. This decision has provided interested customers the assurances they were seeking that there is no mixing between Islamic and conventional assets. It also allowed for a new set of clear governance rules, principles, and prudential ratios to be developed for Islamic banks.

The impact of this specific decision on banks' business volumes and growth rates in Qatar has not been of material nature. It seems that there was not a significant number of customers with holdings at Islamic windows who, after the closures, felt that they had to move their accounts to a full-fledged Islamic bank. Furthermore, individual growth rates for banks during the last years has depended mainly on their readiness to support the Qatar National Vision 2030 initiatives, the 2022 World Cup-related infrastructure projects, and the financial needs of an increasing population. Last but not least, Islamic banks have started competing for business outside their traditional market segments, attracting all types of banking customers, by enriching their product offerings, improving their services, and adjusting their pricing.

5. In 2011, the QCB issued a regulation capping the value of personal loans offered to Qatari and non-Qatari nationals. What was the impact of this regulation on Islamic banking business in the retail segment? How has QIB adapted its business strategy in response to the new rules? Are there still growth prospects for Islamic banks in the retail segment?

Banking is one of the most highly regulated sectors, for good reasons. Qatar has the highest GDP per capita in the world and it is a very rich country, with its citizens enjoying different levels of wealth and exceptional social benefits. At the same time, it is crucial that credit is managed in a conservative manner to protect both individuals and banks. We are very supportive of such an approach. As a matter of fact, we have put in place a set of initiatives, as part of our social responsibility and beliefs, promoting a culture of saving and advising our customers to avoid overspending and overleveraging. The banking sector in Qatar has benefited greatly from the mentioned regulations, having one of the lowest non-performing financing ratios in the region at 1.7% as of December 2016. Such measures also increase competition among banks, boost innovation, and put much higher focus on quality rather than quantity.

When it comes to our business strategy, QIB has experienced tremendous growth rates in retail banking, where for some product categories we have doubled our market shares in the last five years. We have introduced a new range of products such as certificates of deposits in multiple currencies, flexible fixed deposits, a new revolving credit card, a comprehensive ladies' banking proposition and a series of takaful (insurance) and investments products. We have modernized and expanded our branch network offering modular outlets to cater for the distinctive needs of different customer segments: affluent, private banking and lady customers.

Furthermore, we have invested in new digital platforms, mobile banking and internet banking, to provide easy and convenient banking. Our customers are also supported by our customer call centre, which operates around the clock. Those investments in innovation and technology will continue as we are working to further improve the speed, portability and usability of our services to satisfy the needs and aspirations of the next generation of our customers.

6. Competitiveness in Qatar's banking sector has increased in recent years, and Islamic banks no longer compete with themselves but also with conventional banks. How does QIB differentiate itself from other Islamic and conventional banks in Qatar? What is the role of product innovation in this approach?

We always believed that competition is beneficial not only for end consumers but for the industry as a whole. It leads to innovation and lower costs, and it filters the market in a way that forward-looking players gain and survive in the long run. This is not easy, though. It requires a clear strategy as well as the right balance between building up long-term capabilities and being able to adapt with the constant change in the dynamic world in which we live and operate today.

At QIB, we have managed during the last few years to significantly increase our market shares, to become Qatar's largest Islamic bank, holding a 42% market share in Islamic assets, and the second largest bank in the country, with approximately a 12% share of total bank assets. The bank's strategy is closely tied with Qatar's National Vision 2030 and the government's commitment to investments in the country's infrastructure, the diversification of the economy and the development of a strong private sector.

We are an experienced, stable financial group that has expanded to cover all market segments and sectors during the last few years. We have introduced a series of new banking products and services, some of which have been introduced for the first time in Qatar. We have invested in technology to simultaneously improve the speed and convenience of our services and the efficiency of our operations. We have further strengthened our information security systems and controls to ensure secure banking for all our customers.

Those developments have allowed us to strengthen our relationship with our existing customers and to attract new ones, especially from the younger generation and individuals and companies new to Islamic banking. To address the specific question on product innovation, I would say that while it is an important factor, it is not enough in itself. At QIB, we are at least at par and in certain areas exceeding competition when it comes to our product suite and we have now become a "one-stop shop" institution for all the financial needs of our customers. At the same time, we do understand that banking products are becoming "commodities" and can be easily replicated by other banks. So what really differentiates a bank from another in the long term is the quality of service it can offer to its customers. This is an area in which we will continue innovating so as to improve our customers' experience in all dimensions.

Calligraphy sculpture by british artist Sabah Arbilli on the Corniche, Doha. FITRIA RAMLI / SHUTTERSTOCK.COM

DEVELOPMENTS IN REGULATION

ISLAMIC BANKING WINDOWS PROHIBITED IN QATAR

The most important recent regulation that has shaped Islamic banking in Qatar is the 2011 QCB directive instructing conventional banks operating in Qatar to cease taking deposits through Islamic banking windows and to shut down their operations by the end of the year. Since the beginning of 2012, Islamic banking activities have been limited to the four full-fledged Islamic banks operating under the QCB's jurisdiction. The share of Islamic banking assets of total banking assets in 2012 reached 24%. However, between 2012 and 2016 this share has risen to 26%. This is a good indication that clients of the shuttered Islamic windows originally remained with the parent conventional banks, but that some later moved their business to full-fledged Islamic banks. (See *Chapter 3: Islamic Finance Regulation and Industry Infrastructure*).

IMPOSING LIMITATIONS ON PERSONAL FINANCING

The QCB issued another regulation in 2011 limiting the growth of personal loans amid government concerns that increased household credit could result in higher rates of default on these loans. The regulation sets caps on charges and profit rates for consumer loans to the QCB lending rate plus 1.5 percentage points. It also limits the value of loans to Qatari citizens at QAR 2.5 million, and non-Qataris at QAR 2 million. This has resulted in banks redirecting some of their focus toward the corporate market, particularly the underserved SME segment, with plans in the pipeline to establish specialized operations catering to this segment. (See *Chapter 5: The Non-Bank Financial Sector*).

LOAN-TO-DEPOSIT CAP POTENTIALLY DELAYED AS LIQUIDITY TIGHTENS

Low energy prices have led to a decline of public sector deposits in the domestic banking system, which tightened liquidity and led banks to source funds from abroad. Liquidity pressures have also driven interbank borrowing costs upward.

Figure 39 IMPACT OF LOW OIL PRICES ON FUNDING COSTS IN QATAR 2015–H1 2017

Source: Thomson Reuters

After reaching a high of US$115 per barrel in June 2014, oil prices continued to plummet and reached a low of US$27 in January 2016, reflecting a sustained oversupply of crude oil in the market. Prices have since partially recovered, ending 2016 on a bullish note above US$55 following a November agreement between OPEC and non-OPEC oil producers to cut production for six months.

As oil prices remained far below their peak in 2014, the Qatar Interbank Offered Rate (QIBOR) has risen sharply between the beginning of 2015 and the first half of 2017, with the overnight QIBOR up 108 basis points and the 3 month QIBOR up 138 basis points during this period.

On the other hand, increasing demand for from both the public and private sectors to fund infrastructure projects has been met with increased lending, driving the loan-to-deposit ratio for Qatari banks to around 113% in 2016, the highest in the GCC. The ratio for Saudi banks is 88% and 100% for UAE banks.

In 2014, the QCB announced that domestic banks will have to comply with a 100% loan-to-deposit ratio by the end of 2017. As it stands, the deposit side of the ratio only covers customer deposits but not long-term wholesale funds, which have recently been the primary source of funding. Banks, however, are in negotiations with the QCB to include long-term wholesale funds under deposits for this ratio.[4] In light of tightening liquidity currently facing banks in Qatar, it is likely that the deadline for compliance with this requirement will be extended by one year, to the end of 2018.

As an alternative measure to maintain liquidity in the domestic banking system, the QCB has suspended multiple Treasury bond and monthly Treasury bill issuances intermittently since December 2015.More recently, Qatar's government mitigated the impact of regional sanctions on banks' balance sheets through increasing public sector deposits, amounting to QAR 65.2 billion in June and July 2017, as well as liquidity injections by the QCB. In a recent interview, the Governor of the QCB, H. E. Sh. Abdulla Bin Saud Al-Thani, disclosed that Qatar holds reserves of US$340 billion between the QCB (US$40 billion in cash and gold) and the QIA (US$300 billion), which can be liquidated to meet any future withdrawal of non-resident deposits.

Other plausible measures, still unexplored at the QCB, include direct commercial bond purchasing, allowing commercial bank liabilities to be used as collateral for QCB extraordinary loans or injecting equity into individual banks. (See *Chapter 3: Islamic Finance Regulation and Industry Infrastructure*).

IMPLEMENTATION OF BASEL III CAPITAL ADEQUACY REQUIREMENTS

In 2014, the QCB initiated Pillar 1 of the capital adequacy requirement under the Basel III directive. Banks are required to maintain a minimum Tier 1 CAR at 8% and a minimum total CAR of 10%, effective January 2014. Banks are also required to maintain a capital conservation buffer (CCB) at 2.5% of risk-weighted assets. Based on 2016 ratios, the overall banking sector in Qatar is in a favorable position in terms of compliance with capital adequacy requirements, with the Tier 1 ratio to risk weighted assets at 15.7%, and the ratio of total capital to risk weighted assets at 16.1%.

In addition, the QCB has also started implementing IFSB standards on capital adequacy for Islamic banks, to improve the segment's capital strength. Other regulatory requirements imposed on the banking sector in 2014 include a minimum liquidity coverage ratio of 60%, for helping to manage short-term liquidity requirements. This requirement is being increased by 10% annually to reach a required ratio of 100% by 2018. Banks are also required to maintain a minimum Net Stable Funding Ratio (NSFR) of 70%, effective 2015, which will gradually be increased to reach 100% in 2018.

Table 7 CAPITAL ADEQUACY RATIOS FOR QATAR'S BANKING SECTOR 2013–2016

Ratio	2013	2014	2015	2016
Tier 1 CAR (Regulatory Tier I Capital / Total Risk Weighted Assets)	15.3	15.8	15.2	15.7
Total CAR (Total Regulatory Capital /Total Risk weighted assets)	16.0	16.3	15.6	16.1

Source: Qatar Central Bank

4 Ministry of Development Planning and Statistics, "Qatar Economic Outlook 2016-2018". June 2016.

OPPORTUNITIES AND GROWTH POTENTIAL

With increased competition between domestic banks in Qatar, many of the larger players in the sector are looking abroad for new growth prospects.

REFOCUSING BUSINESS MODELS ON CORPORATIONS AND SMES

Banks in Qatar are well positioned in terms of liquidity and financial stability to capitalize on growth opportunities arising from increased government spending on infrastructure projects planned as part of the Qatar National Vision 2030 and the country's preparations for the FIFA World Cup 2022. Construction and transport projects represent more than 80% of the capital value of current infrastructure developments. Growth opportunities are most apparent in increased lending to large corporations in the private sector, which account for 54% of the domestic credit market. Islamic banks' credit is even more dominated by the corporate private sector with a share of 68% in 2016, with a stronger proportion of construction and real estate lending compared to their conventional peers.

In addition, regulatory limits on personal lending have further shifted the focus of banks to the corporate sector, including a special focus on financial services to SMEs. As the activity of large companies increases with the development of large-scale infrastructure projects, the need arises for smaller businesses to supply and serve them. This has added another incentive for banks to refocus resources from lost business in the retail segment on SMEs. Several banks are in the process of developing dedicated banking centers to cater to demand from this segment.

Many banks have also joined the Al Dhameen program under the Qatar Development Bank (QDB), which facilitates guaranteed lending from commercial banks and non-bank finance companies to SMEs. As part of this scheme, the QDB acts as a guarantor for SMEs with member lending institutions in order to facilitate accessible funding for these businesses. However, the business of financing SMEs is shaping up to be highly competitive. Non-banking finance companies, which have been greatly impacted by regulatory caps on retail lending, are also shifting their focus to the SME market. They are arguably better positioned to cater to the needs of this segment, given their specialization in offering small-ticket financing in both the retail and corporate spaces.

WITH INCREASED DOMESTIC COMPETITION, ISLAMIC BANKS LOOK ABROAD

With increased competition between domestic banks in Qatar, many of the larger players in the sector are looking abroad for new growth prospects. Banks including QIB, QIIB and Masraf Al Rayan have already established an international presence, and they are considering opportunities in nascent Islamic finance markets. Although the primary reason for overseas expansion appears to be to diversify operations and assets, this could likely be the first step in the direction of establishing large-scale international Islamic banks that are able to compete with international banking heavyweights such as HSBC and Citi.

QATAR'S ISLAMIC BANKS' STRATEGIC EXPANSION ABROAD

The relatively small size of Qatar's Islamic banking sector and its population pose limitations on rapid growth in the domestic market. As such, Qatari Islamic banks have put a new emphasis on expanding internationally, tapping into new markets and raising the profile of Islamic finance. Furthermore, expansion abroad fits with the Qatar National Vision 2030 in enhancing and promoting the prosperity of the non-energy private sector.

Qatar's four Islamic banks have taken a more active role in establishing their Islamic finance services abroad than their GCC counterparts, with each of these banks establishing overseas operations. Overall, the international footprint of Qatari Islamic banks across the world is considered impressive, given Qatar's relatively small Islamic banking segment.

CURRENT EXPANSION STRATEGIES

Each bank has adopted a different expansion strategy. Masraf Al Rayan, for instance, has aggressively introduced their brand into GCC markets through associates and in the UK through its subsidiary Al Rayan Bank UK. Meanwhile, banks such as QIIB have preferred to make partnerships with or buy significant stakes in successful overseas banks. The locations of these new branches vary widely, spanning emerging markets such as Egypt, to more established markets such as the UK, which boasts attractive investment opportunities, particularly its thriving real estate industry.

QIIB has also set its sights on entering the Moroccan market, a strong and diversified market that has great potential for growth in new banking services. Establishing a joint venture agreement with CIH Bank (Credit Immobilier et Hotelier), QIIB will hold a 40% stake in newly authorized Umnia Bank, which plans to open a total of four branches throughout Casablanca and Rabat in 2017.

As part of a development strategy plan in which it hopes to transform itself as a global Islamic bank, QIB has expanded its network to serve the cross-border needs of its customers as well as to establish an early foothold in areas with high potential for expansion in Islamic banking. It has expanded into four countries of which include Sudan, Malaysia, Lebanon and the UK.

OTHER REASONS FOR VENTURING ABROAD

Qatar's many Islamic banking ventures abroad provide alternative income streams and opportunities to diversify risk outside the domestic market. Expanding abroad also offers Qatari Islamic banks fruitful prospects to create economies of scale by combining core functionalities such as deep professional experience, risk management, human resources and Treasury to multiple branches. Finally, closer relationships with foreign countries provide these banks with much broader exposure to new markets and sources of capital.

FUTURE OUTLOOK

With a fast-growing Islamic banking sector, Qatar is poised to take centre stage and establish itself as a leading provider of Shariah-compliant products and services. The increased presence of its Islamic banking institutions abroad can be seen as a reflection of Qatar's commitment to developing this sector from niche to mainstream markets and competing with other banks around the globe. One potential restriction on this activity results from tightened liquidity among Islamic banks in the current economy. This has prompted the QCB to set precautionary limits on the ratio of foreign currency assets to foreign currency liabilities of banks to a minimum of 100%.

DR. ABDULBASIT AL-SHAIBEI

CEO, Qatar International Islamic Bank (QIIB)

Dr. Al-Shaibei is a strong proponent of Islamic banking, Dr. Al-Shaibei has guided the growth of QIIB over the last ten years. Dr. Al-Shaibei also serves as a member of the board of directors for various entities in both the government and private sector. Dr. Al-Shaibei holds a PhD in Business Administration and Bachelor of Science in Business Administration and Economics from the University of North Carolina and completed the Executive Management Program at the Wharton Executive Education Faculty, University of Pennsylvania.

1. In recent years, the growth of Islamic banking assets in Qatar has outpaced conventional banking assets. In your opinion, what were the key factors contributing to this growth, given that other Islamic finance sectors have underperformed their conventional counterparts?

Islamic banks by nature are largely free of derivatives and the complex risky assets that sank some of their conventional peers during the global financial crisis in 2008. For this reason, Islamic banks are well placed to achieve greater growth in the years ahead.

After the global financial meltdown, more and more people are seeking alternative forms of financing that are more ethical and less speculative and prone to crises. Shariah financing, or Islamic banking, having shown its resilience through the global financial crisis, meets this demand. In addition, the Qatari population has shown a naturally strong demand for Islamic banking services in both the retail and corporate segments. Hence, Islamic banking has managed to outperform its conventional peers in terms of growth, acquiring a share of nearly 26% of total banking assets in Qatar.

2. Low energy prices since 2014 have put a strain on government revenues and consequently on bank liquidity in Qatar. How have Islamic banks tackled this issue, compared to their conventional counterparts? What role does sukuk play in QIIB's strategy to manage its liquidity going forward?

Islamic banks and their conventional counterparts face the same set of challenges, including economic shocks. Adverse economic conditions affect the banking sector as a whole, but Islamic banking has developed into a strong sector that has adequate tools to withstand the challenges facing it.

Sukuk play a role in creating this strength by supporting Islamic banks' investment and liquidity needs. They provide a stable investment option for Islamic banks and can be tapped for liquidity through repos or sales. By the same token, sukuk issuers can also find ready demand and good pricing. For example, sukuk provide a stable financing platform for QIIB in the short, medium and long terms, which helps us in managing our liquidity position—similar to bonds for conventional banks.

Common conventional liquidity tools such as interbank deposits, repo operations, commercial paper, "The ban removed the serious governance and control failures that plagued Islamic operations at conventional banks, preventing the leakage or mixing of Islamic funds with conventional funds."

and treasury bills are substituted by Shariah-compliant structures. The range of liquidity tools, however, is less varied for Islamic banks compared to conventional banks, as not all conventional liquidity tools can be structured in a Shariah-compliant manner.

QCB, in providing monetary policy support for the banking sector, has also created Shariah-compliant treasury bills and sukuk to help Islamic banks manage their liquidity requirements.

3. Islamic banks in Qatar have been expanding their operations into new jurisdictions, such as QIIB's recently launched joint venture with CIH Bank in Morocco. What is the objective of overseas expansion? How does QIIB select new markets in which to expand its operations? In which area of QIIB's business do overseas operations focus: retail or corporate?

Overseas expansion for banks is generally dependent on their long-term growth and strategies. Such expansion normally takes place if banks have growth strategies that will be constrained if they remain in a single market, maintaining business operations in Qatar only.

For QIIB, the selection of new markets is dependent on a few factors. Some critical ones are the existence of an Islamic banking framework in the new market that the bank is exploring, and the level of interest or demand from that market's population for Islamic banking services. We seek markets with demand for universal banking including all retail, corporate and treasury, and investment banking business lines.

In the case of Morocco, there was a strong underlying demand for Islamic banking, which led to the introduction of Islamic banking laws in the country that enabled the establishment and operation of Islamic banks. Hence, it was an obvious choice for QIIB to enter the Moroccan market when the opportunity arose after Moroccan banks opened a search for Islamic banking partners.

4. In 2011, the QCB instituted a ban on operating Islamic banking windows in Qatar. In hindsight, how has this decision supported full-fledged Islamic banks and competition overall in the segment?

In Qatar, the opening of Islamic windows by conventional banks created a lot of awareness about Shariah-compliant and value-based Islamic banking, and its products and various services. Even when conventional banks provided Islamic banking services, Islamic banks in our country still witnessed tremendous growth in their business and assets.

Subsequently, the QCB decided to close down the Islamic windows of conventional banks. This clearly showed determination on the part of the QCB to maintain transparency and effective Shariah control, and to keep accounting procedures and balance sheets separate. This, we believe, reflects the QCB's positive vision and its determination to maintain the highest standards of discipline and customer safeguards in the banking sector.

The decision by the QCB to ban the Islamic banking operations of conventional banks has had a positive impact on the growth of Islamic banks in Qatar, as it limited competition from conventional banks. More importantly, it provided an environment with a clear definition of the Islamic banking framework for policy supervision and development of the sector. The ban removed the serious governance and control failures that plagued Islamic operations at conventional banks, preventing the leakage or mixing of Islamic funds with conventional funds. This has led to greater transparency in the Islamic finance industry, both from the central bank policy perspective, as mentioned earlier, and for the end-consumers.

5. At present, Shariah governance of Islamic financial institutions is decentralized, unlike some other Islamic financial markets. In your opinion, is there a need for the introduction of a centralized Shariah board in Qatar? In what ways could such a move improve the operating environment of Islamic banks?

Dynamic and good Shariah governance is at the core of the development of the Islamic banking and finance sectors. Good Shariah governance guarantees the vitality of Islamic finance growth. Having a centralized Shariah board is beneficial in providing guidance for strengthening corporate governance and increasing the consumer appeal of Shariah-compliant financial products by providing a standardized understanding of the Shariah principles being applied, addressing the issue of differing approaches and/or interpretations across different institutions.

Although it would be good to have standardization and consistency through a centralized Shariah board, it is also beneficial to have independent Shariah boards at each bank. Decentralized Shariah boards may be better able to innovate Islamic products, as there is less need to consider the issue of standardization across all institutions during the innovation phase. The ideal scenario would be to combine both approaches. SSBs at the institutional level should have some degree of independence, but would ultimately be subject to the oversight of a centralized Shariah Authority, through which innovative concepts could be subsequently modified for standardization. ■

The Katara Amphitheater, Doha.
FITRIA RAMLI / SHUTTERSTOCK.COM

ISLAMIC BANKING RETAIL AND CORPORATE CONSUMER SURVEY ANALYSIS

Our exclusive retail and corporate banking consumer surveys highlight a number of growth and investment opportunities for the Islamic banking sector in Qatar.

POPULATION AND SAMPLING

The Qatar Banking Consumer Survey 2017 includes responses from two separate groups of customers:

Retail customers

The retail banking consumer survey was conducted on a stratified random sample of 600 residents of Qatar above the age of 18. Respondents were selected from various socioeconomic backgrounds to obtain a cross-section of the domestic consumer market. Following best practice, this is a representative sample with a margin of error of 4% and 95% confidence level, ensuring the sample accurately reflects the preferences, behavior and opinions of the population at large.

Corporate customers

The corporate banking consumer survey was conducted on a sample of 100 businesses of varying sizes and operating across multiple sectors in Qatar. Survey respondents were either financial managers or executives with financial responsibilities within their organizations.

DATA COLLECTION AND SURVEY METHODOLOGY

Both the retail and corporate banking consumer surveys were conducted over a seven week period. Telephone interviews were conducted with respondents between June 15, 2017 and July 26, 2017.

Two types of questions were presented to the survey respondents—multiple choice questions and ranking questions—on their preferences when choosing a bank, their satisfaction with their current primary bank, and the areas in which banks can improve, specifically in their product offerings. For the ranking questions, results were analyzed weighting the highest ranked options more heavily than the other options. The weighted average results are represented in the charts.

We believe that the respondents' opinions and preferences provide an indicative and representative sample of the commercial banking sector in Qatar as a whole. We also note that the findings, conclusions, and recommendations delivered in the survey analysis are based on information gathered in good faith, whose accuracy we are not always in a position to guarantee.

RESPONSES FROM

600
Retail Customers

+

100
Corporate Customers

RETAIL BANKING CONSUMER SURVEY

RETAIL BANKING SECTOR HIGHLIGHTS

Customer Awareness

- A significant gap exists between perceived and actual retail consumer knowledge and awareness of Islamic finance and banking
- Social media can be leveraged to promote knowledge and awareness to consumers

Customer Experience and Satisfaction

- Product offering and customer service a priority for customers
- Developing customer-facing technology a key to differentiation and growth
- Professional qualifications for bank staff necessary to improve customer service
- Customers can be swayed to switch banks with product differentiation

Customer Product Preferences

- Customers still do most of their banking offline
- Basic banking products still in use, insurance most demanded addition

CUSTOMER OVERVIEW

Primary accounts of 30% of respondents held at Islamic banks

From our survey sample of retail banking customers, 30% of respondents hold their primary bank accounts with Islamic banks. Half hold accounts with Islamic banks alone and the other half also hold accounts with conventional banks. Meanwhile, 70% of respondents hold their primary bank accounts with conventional banks. Similar to Islamic bank account holders, these respondents are equally divided between those who only deal with conventional banks and those who also have accounts with Islamic banks. These ratios are relatively in line with Islamic and conventional shares of total banking assets.

Effectively, 50% of respondents hold accounts with both Islamic and conventional banks. Given that non-Qataris constitute 85% of this segment, it might be the case that they are required by their employers to set up an account with a certain bank other than their primary bank for the transfer of their salaries. Hence, there is a possibility that an individual with a conventional bank account is required by their employer to hold an account with an Islamic bank or vice versa. Another reason for consumers to hold accounts with both types of banks is to diversify—they want to reap the benefits of having both an Islamic and conventional bank accounts. They might seek one bank for lower rates, but with another one for the quality of its service, allowing themselves to evaluate their options with both banks.

It is worth noting that none of the survey respondents indicated not having a bank account. This is in line with the assumption that Qatar's unbanked segment of the population is negligible, which is mainly a result of to the Wage Protection System (WPS), which came into effect in 2015, amending the Labour Law to require employers to pay employee salaries through direct bank transfers. This led many Qatar residents to open bank accounts in 2015, especially expatriate workers, who constitute the vast majority of Qatar's population.

CUSTOMER AWARENESS

Significant gap between perceived and actual retail consumer knowledge and awareness of Islamic finance and banking

When asked to assess their understanding of Islamic finance and banking concepts, 79% of respondents, including the majority of Islamic bank account holders, believed that they had at least some understanding. 17% of respondents, of which 12% held their primary accounts with Islamic banks, stated that they had an excellent understanding of these concepts. Only 2% of respondents expressed they had no understanding of Islamic finance concepts, signaling a rather high level of perceived knowledge and awareness of Islamic finance, especially with a large expat population.

However, it appears that respondents generally overestimated their actual level of knowledge of Islamic finance concepts. Respondents were shown one true statement and three common misconceptions about Islamic finance, at varying levels of difficulty. Of the 79% that indicated at least some understanding of Islamic finance, only 1% selected the true statement only. Moreover, none of the respondents in this 1% evaluated their knowledge of Islamic finance as excellent – they either said they had some understanding or good understanding of Islamic finance concepts.

The majority of respondents who believed that they had excellent knowledge of Islamic finance actually agreed with at least two of the three presented misconceptions. The most selected misconception was that Islamic finance and banking do not focus on making profit (16% out of the 17%), followed by

Figure 40 AT WHAT TYPE OF BANK(S) DO YOU CURRENTLY HOLD ACCOUNTS?

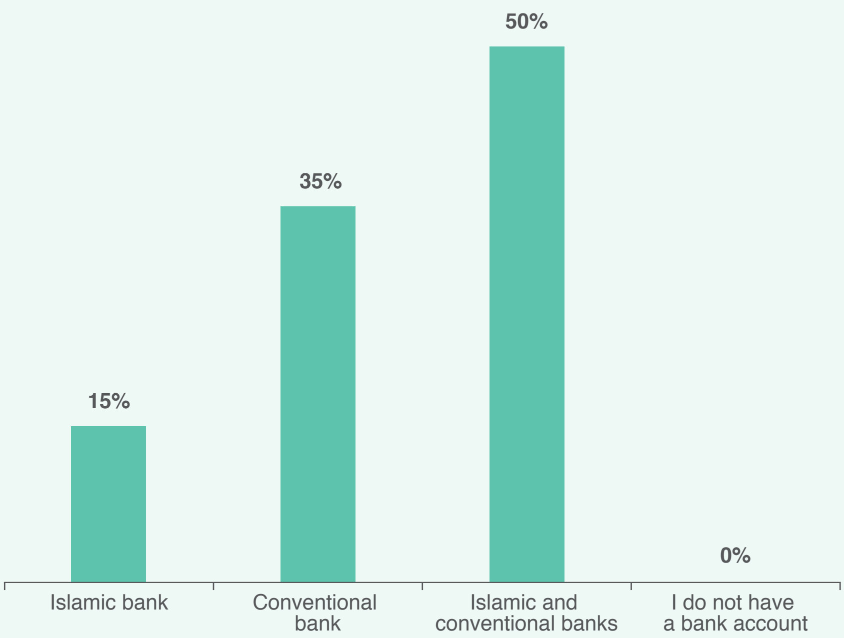


Figure 41 AT WHAT TYPE OF BANK DO YOU HOLD YOUR PRIMARY BANK ACCOUNT?

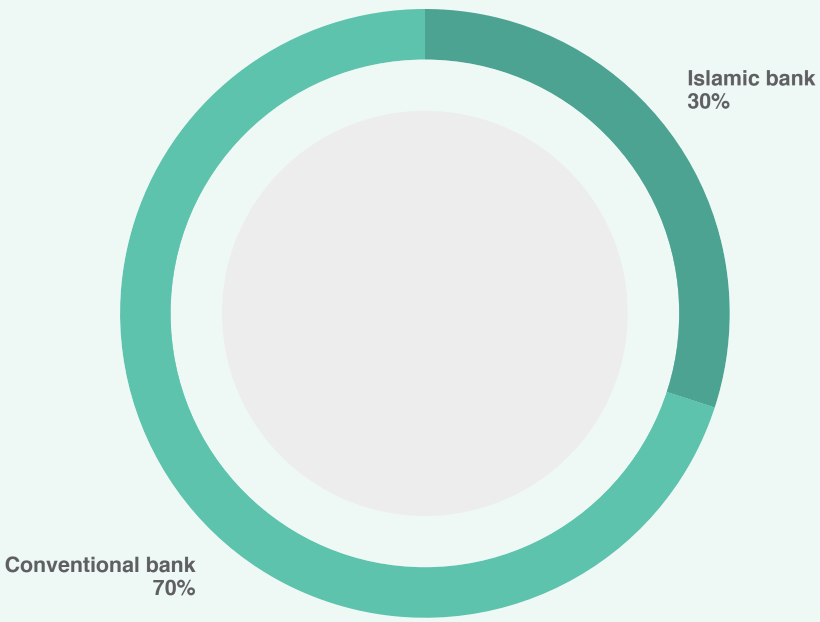


Figure 42 HOW WELL DO YOU UNDERSTAND ISLAMIC FINANCE AND BANKING CONCEPTS, PRODUCTS AND SERVICES?

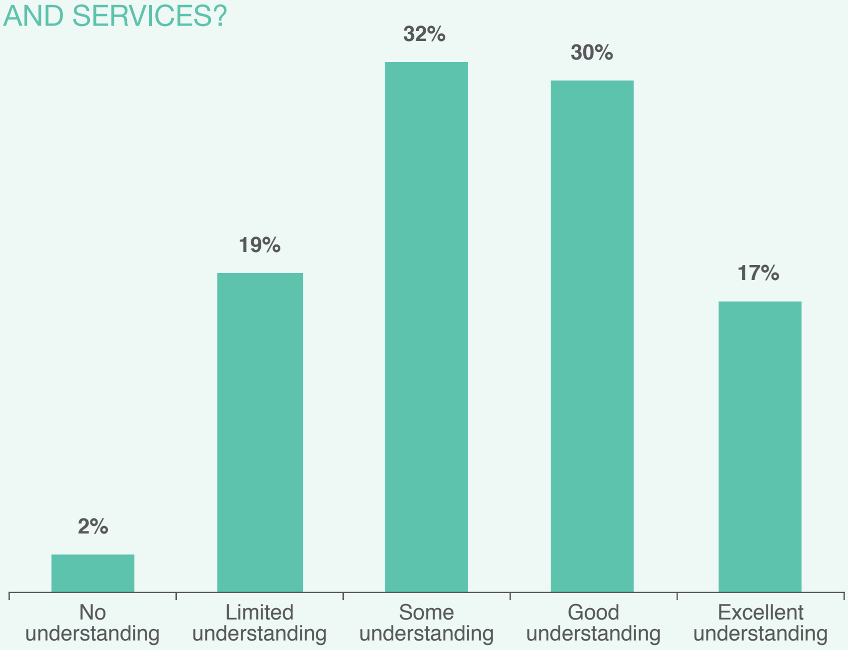
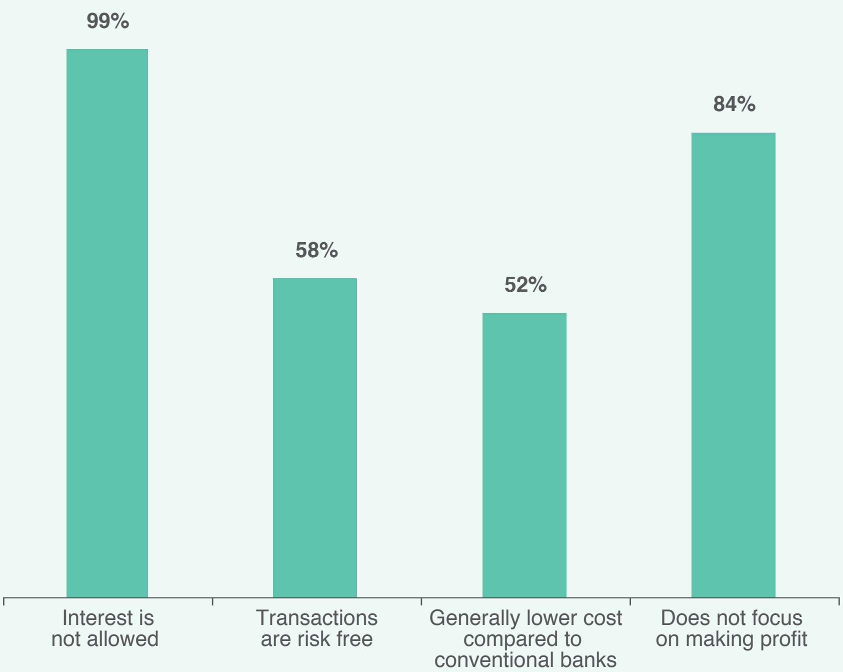


Figure 43 WHICH OF THE FOLLOWING STATEMENTS ABOUT ISLAMIC FINANCE AND BANKING DO YOU BELIEVE ARE TRUE?



transactions being risk-free (13% out of the 17%) and lastly that costs under Islamic finance were generally lower compared to conventional banking (10% out of the 17%).

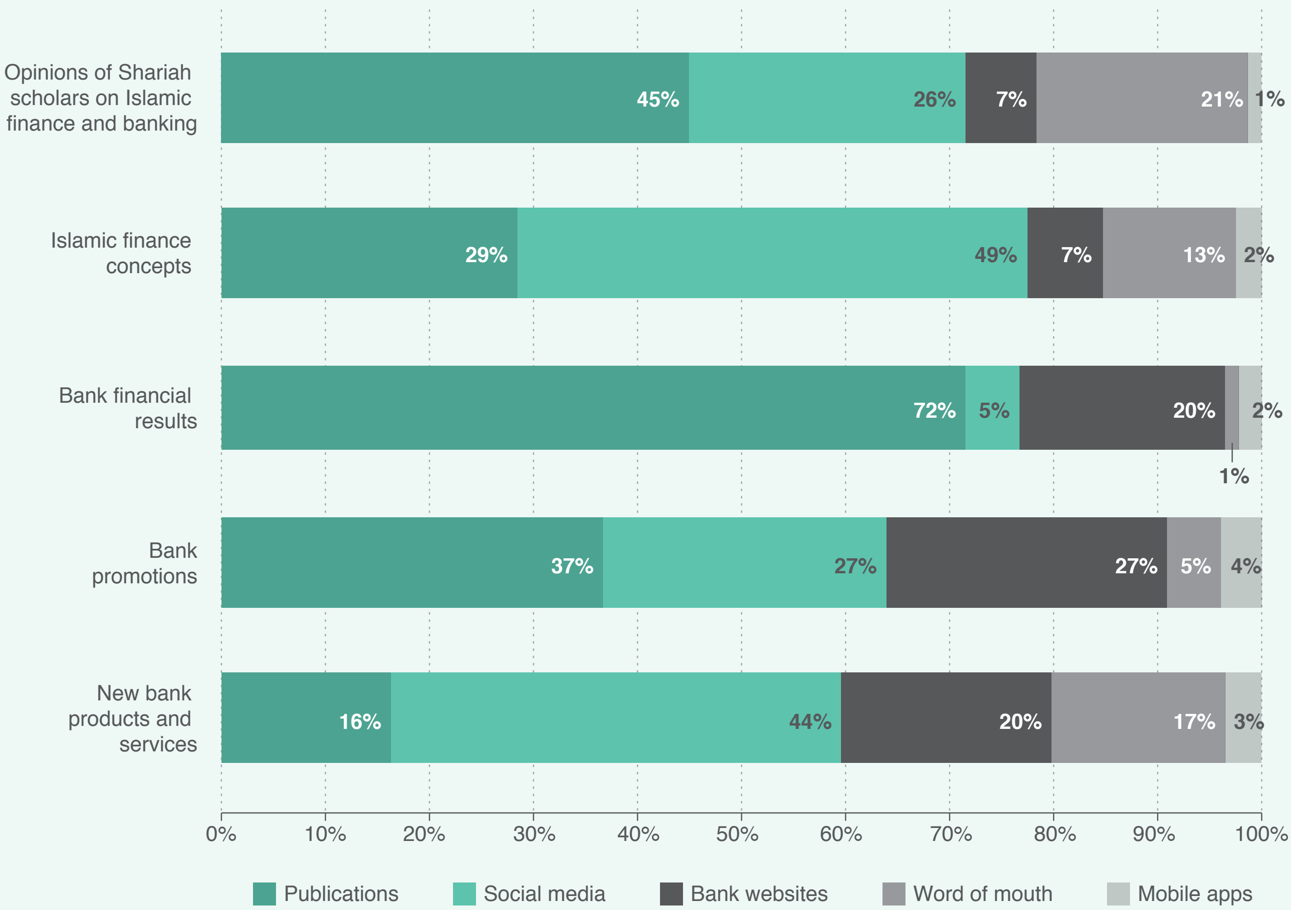
These results highlight a significant gap in the population's knowledge and awareness of Islamic finance and banking concepts, and that their existing knowledge may be influenced by misconceptions as a result of presumptions made about Islamic finance based on their religious beliefs, rather than being financially literate. This may also stem from a lack of efforts to raise awareness in the education system and at Islamic financial institutions. These institutions need to enhance their efforts to spread awareness in order to clarify the practical side of Islamic banking—that it is like any other business looking to make a profit, it generally costs more, and there is always some risk present in financial transactions, although it is managed in a way that is compliant with Shariah standards.

Social media can be leveraged to promote knowledge and awareness to consumers

A key tool that Islamic banks can leverage to spread awareness of Islamic finance and banking concepts is social media, especially targeting the young Qatari population, for which the biggest consumer segment is aged between 18 and 34. Respondents preferred social media to all other communications media (49%) for learning about Islamic finance and banking concepts, followed by publications (29%) and word of mouth (17%). Social media is also the preferred channel for obtaining information on bank products. Islamic banks can leverage these channels by launching a phased social media campaign that would start by raising awareness and invalidating misconceptions about Islamic finance. Further on, the campaign could share bite-sized information on Islamic banking products and services, promotions and news with consumers.

Mobile applications are the least preferred information channel for consumers to learn about Islamic finance and banking and any information relating to their banks. This is likely an indication that banking mobile applications currently available are not adequately developed. An interesting model for banks to follow is the Qatari mobile application 'Hasalty', which aims to promote financial literacy among children. The development of a customizable and all-inclusive Islamic finance literacy application for adults, in both Arabic and English, would not only improve consumer awareness of Islamic finance but also strengthen banks' direct communication with their customers.

Figure 44 WHICH OF THE FOLLOWING SOURCES DO YOU PREFER TO GET INFORMATION ON THE FOLLOWING TOPICS FROM?



Fanar Islamic Cultural Center, Doha.

CUSTOMER EXPERIENCE AND SATISFACTION

Product offering and customer service a priority for customers

When it comes to choosing a bank account, the most important criterion for Qatar residents was product and service offerings (25%), closely followed by customer service (23%) and technology (21%). For respondents with primary accounts at Islamic banks, Shariah-compliance takes precedence over these criteria. Customer satisfaction in these three areas—product offerings, customer service and technology—would be not only be imperative for banks to attract new clientele, but also to retain their customers. The least important factor was reputation, which may indicate a perception by the population that banks operating in Qatar are very stable and reliable, giving them a sound reputation.

Developing customer-facing technology a key to differentiation and growth

More than half of survey respondents were at least somewhat satisfied with their experience with their primary bank. It is worth noting that Islamic banks in particular scored slightly higher (26%) in the 'very satisfied' category compared to banks altogether (23%). They registered a lower level of dissatisfaction (11%), with 14% of respondents dissatisfied with their banks overall.

Current bank technology scored the lowest in terms of customer satisfaction. 42% of customers were satisfied with their banking experience in terms of technology, with only 15% saying they were 'very satisfied'. Although it was third among retail banking customers' criteria, enhancing the technology behind customer-facing function could play a key role in increasing banks' competitiveness and market share.

Technology is the most important area where banks can improve their product and service offerings according to both conventional and Islamic bank customers. Making improvements to existing technology such as online banking portals and mobile applications will bring banking services up to par with customer expectations. Introducing new and innovative features to the customer experience, perhaps through a Fintech collaboration, will help banks differentiate their product offerings and customer service from the competition.

Figure 45 PLEASE RANK THE FOLLOWING CRITERIA FOR CHOOSING A BANK, BY IMPORTANCE TO YOU

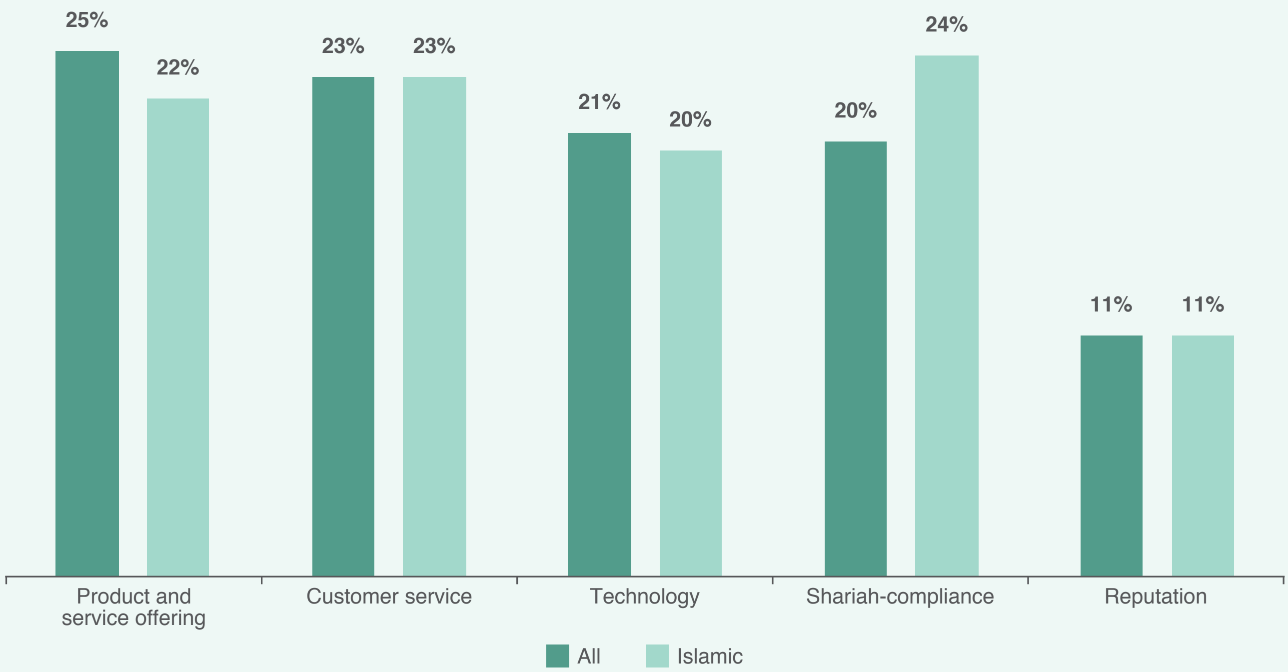


Figure 46 RATE YOUR SATISFACTION WITH YOUR PRIMARY BANK ON THE FOLLOWING ATTRIBUTES

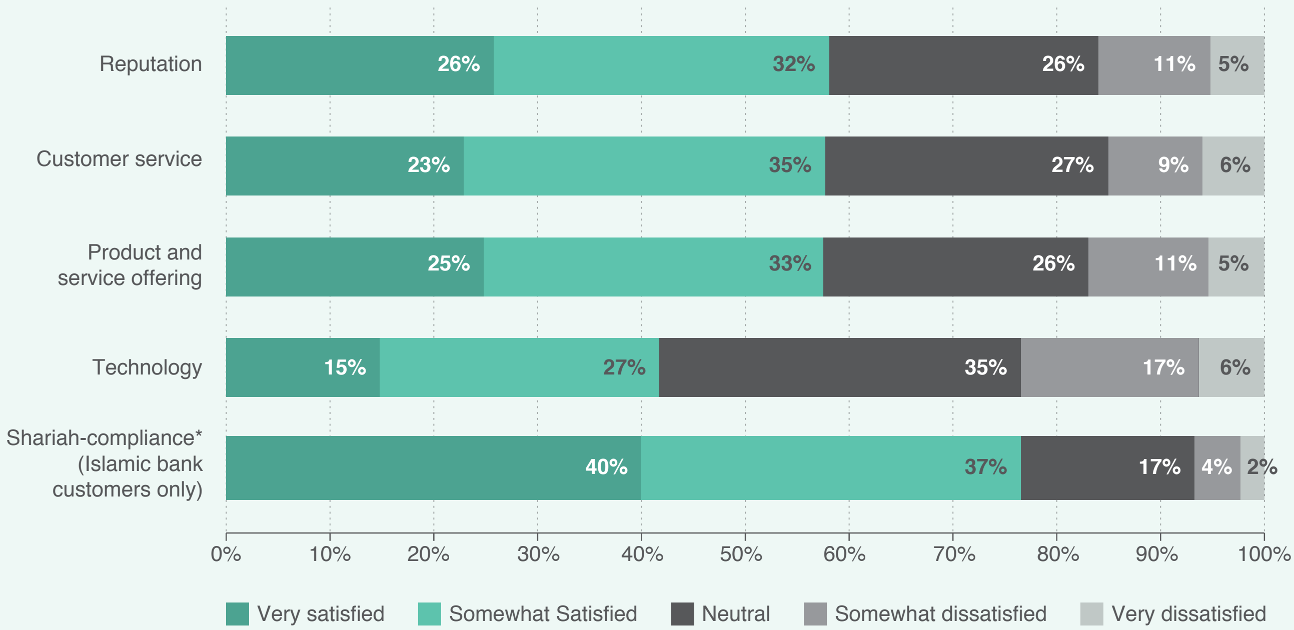
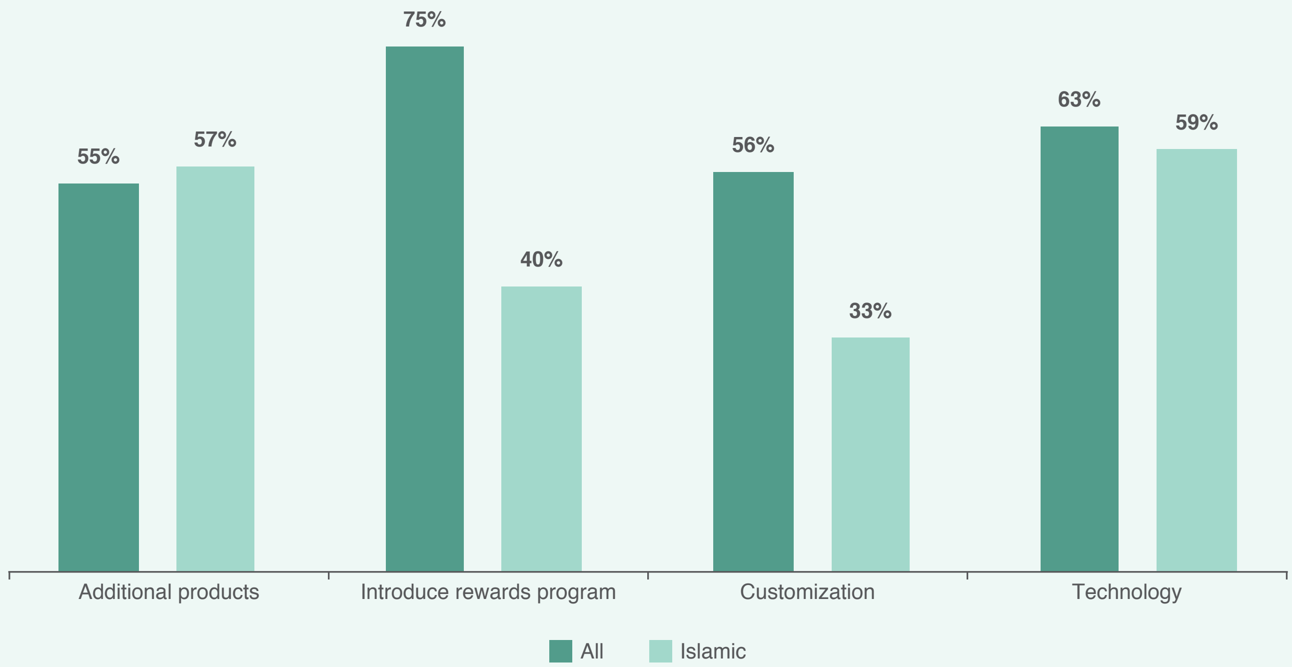


Figure 47 IN WHAT AREAS DO YOU THINK YOUR BANK CAN IMPROVE THE PRODUCTS AND SERVICES IT OFFERS?



No interest in switching to another bank, but customers can be swayed through product differentiation

87% of survey respondents said that they were not considering moving their primary bank account to another bank. But of those considering moving banks, 7% of respondents said they were considering switching to Islamic banks, which is more than those looking to move to a conventional bank. 40% of those considering moving to an Islamic bank already held their primary accounts with Islamic banks, but were not satisfied with their experience and the product offerings of their banks in particular. The majority of respondents considering switching to an Islamic bank currently hold their primary accounts with conventional banks. They are also not satisfied with their banks, especially in terms of product offerings. There is an opportunity here for Islamic banks not only to compete and gain market share from other Islamic banks, but also from conventional banks, through product differentiation. Overall, 58% of respondents ranked limited product and service offerings as the most important reason for switching to another bank.

Of respondents who do not wish to switch to Islamic banking, 51% (excluding those who already hold primary accounts with Islamic banks) stated “other” reasons, mainly that they were not considering changing their primary bank in general. Alternate reasons respondents named included costs at Islamic banks being higher than those at conventional banks and the perception that Islamic banks are not really Shariah-compliant.

Figure 48 ARE YOU CONSIDERING SWITCHING YOUR PRIMARY BANK ACCOUNT TO ANOTHER BANK?

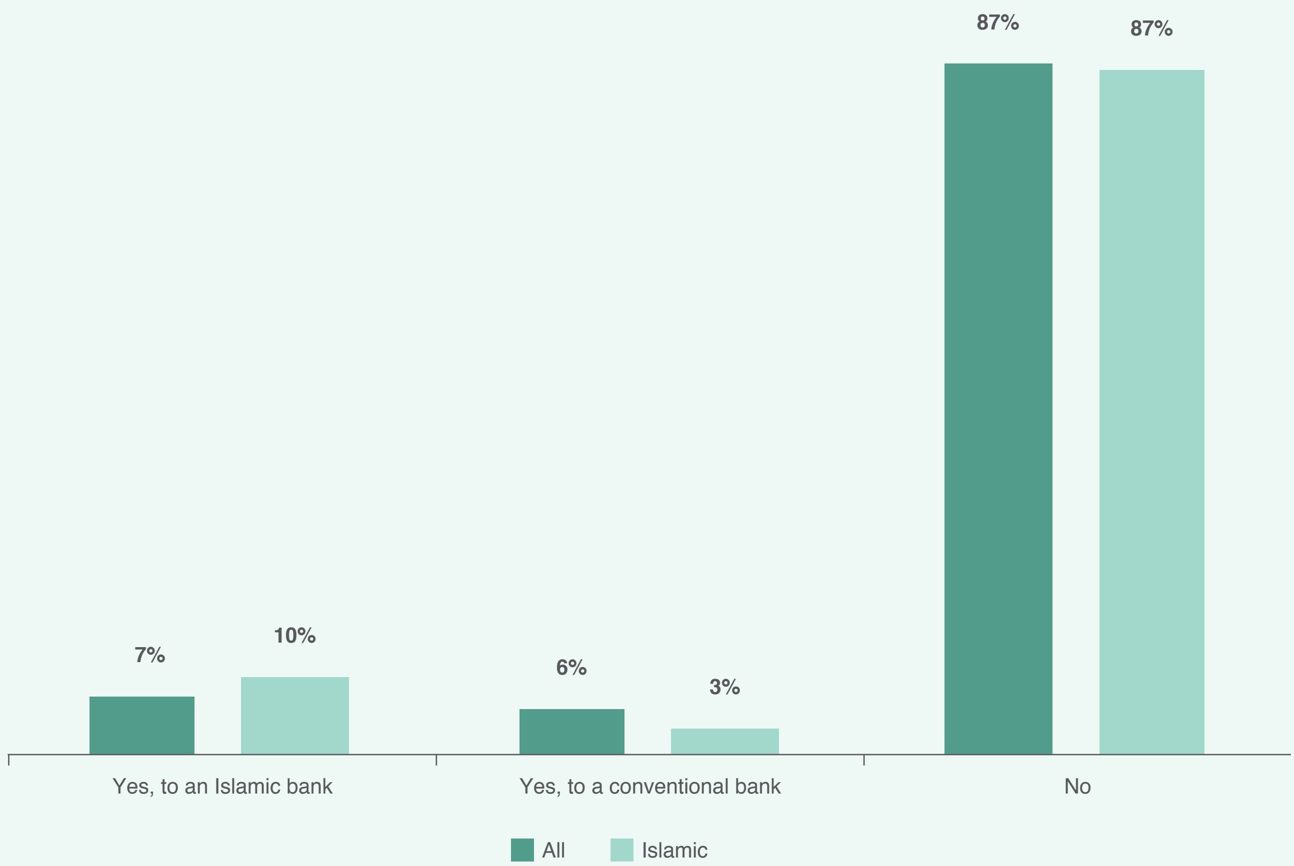


Figure 49 WHICH OF THE FOLLOWING REASONS WOULD MAKE YOU SWITCH TO ANOTHER BANK?

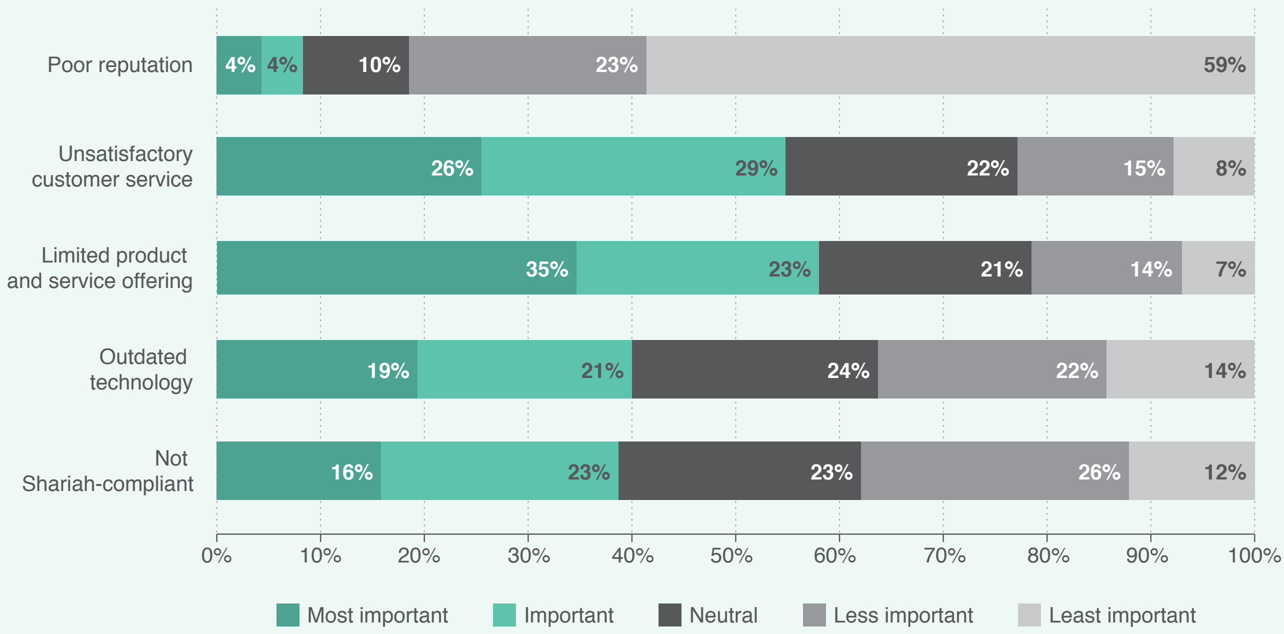
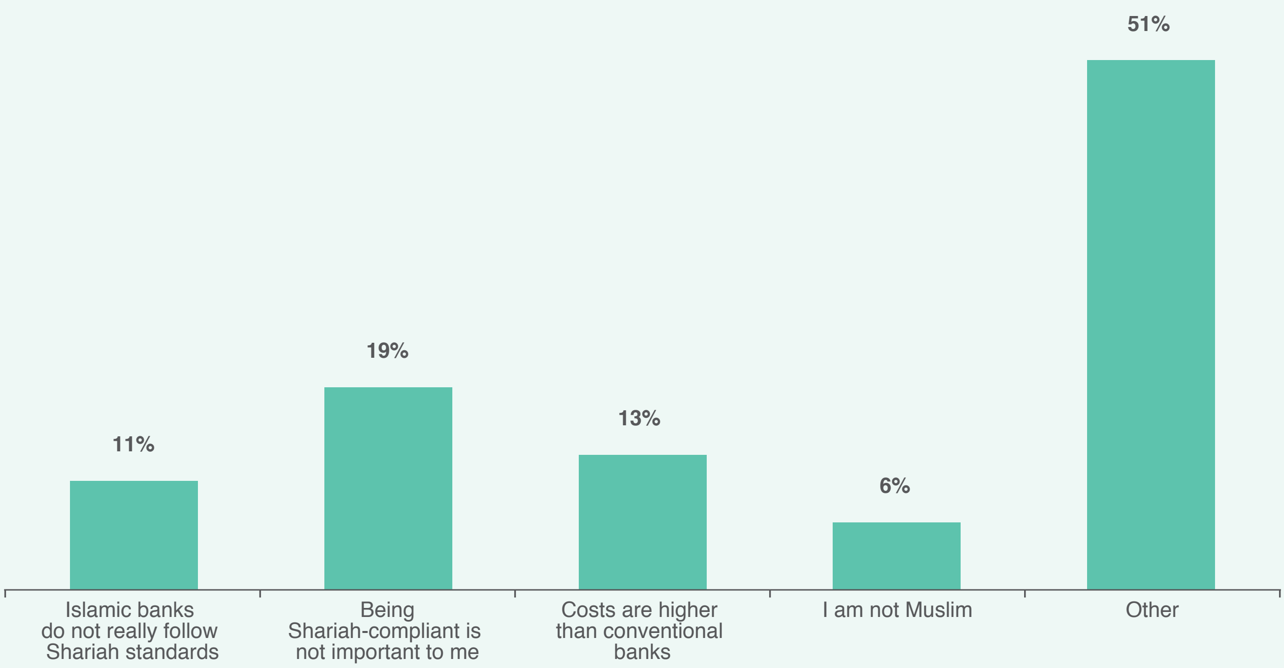


Figure 50 WHAT IS THE MAIN REASON YOU ARE NOT CONSIDERING SWITCHING TO AN ISLAMIC BANK?



CUSTOMER PRODUCT PREFERENCES

Customers still do most banking offline, mainly through branches

According to most respondents, their most preferred channel for carrying out banking transactions and accessing banking services is by visiting a branch. On average, the least preferred channel is ATMs, as they are not viable channels for all options offered. The next least preferred channel is mobile applications, followed by online banking. This supports our analysis that generally low satisfaction with technology is the result of the limitations and underdevelopment of technology in banks' product offerings and customer service.

As social media is the most popular channel for customers to obtain information, it makes sense that mobile applications could also become a popular banking channel, given the high level of smartphone usage in Qatar and the convenience of these tools. However, this will require both further technology development and better-trained human resources to use this technology. Better use of technology would also help banks' product and service differentiation and enhance their competitiveness.

Basic banking products still in use, insurance the most demanded addition

With the obvious use of current and savings bank accounts, the most used banking products are financing through credit cards, used by 52% of respondents, and loans/financing (43%). For Islamic bank customers, financing was the most used product followed by investments and credit cards, which were ranked equally. No other products were specified.

The majority of respondents (83%) stated that they would like their banks to also provide insurance products. Several banks, both Islamic and conventional, already provide insurance and/or takaful products, and some conventional banks also offer Bancassurance. The respondents' choices indicate that they lack awareness of the other financial products offered by their banks, or that the offerings at their bank are limited to credit, life, and sometimes vehicle insurance or takaful.

For banks currently offering insurance or takaful products, increasing customer awareness of these products through promotions could boost revenues for non-bank business lines. Banks can also make their insurance products more accessible to customers by offering them as add-ons to bank accounts. Banks with limited or no insurance offerings may benefit by considering Bancassurance or BancaTakaful, partnering with insurance and takaful companies, and acting as a sales channel for their products.

Other products respondents said they would like their banks to offer were investment products (65%) and private banking (39%). In order to retain these customers but still control costs, retail-oriented banks could partner with investment banks that operate in the areas of asset management and private banking and wealth management. Banks could offer a sales channel for white label products of these investment banks that are tailored to the retail and high-net worth markets.

Figure 51 WHAT IS YOUR MOST PREFERRED CHANNEL FOR CARRYING OUT THE FOLLOWING FINANCIAL SERVICES AND ACTIVITIES?

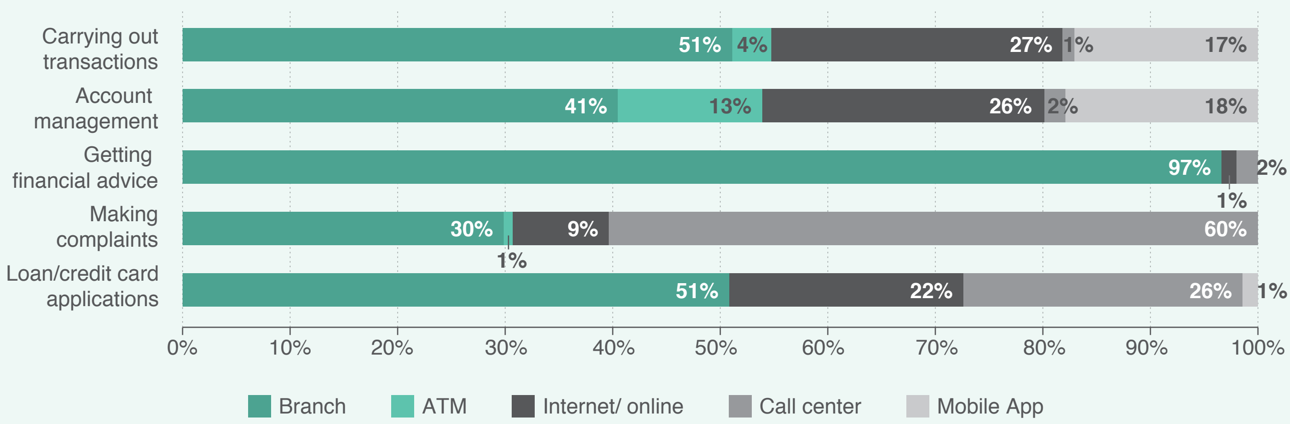


Figure 53 WHICH OF THESE PRODUCTS AND SERVICES HAVE YOU EVER USED AT YOUR PRIMARY BANK?

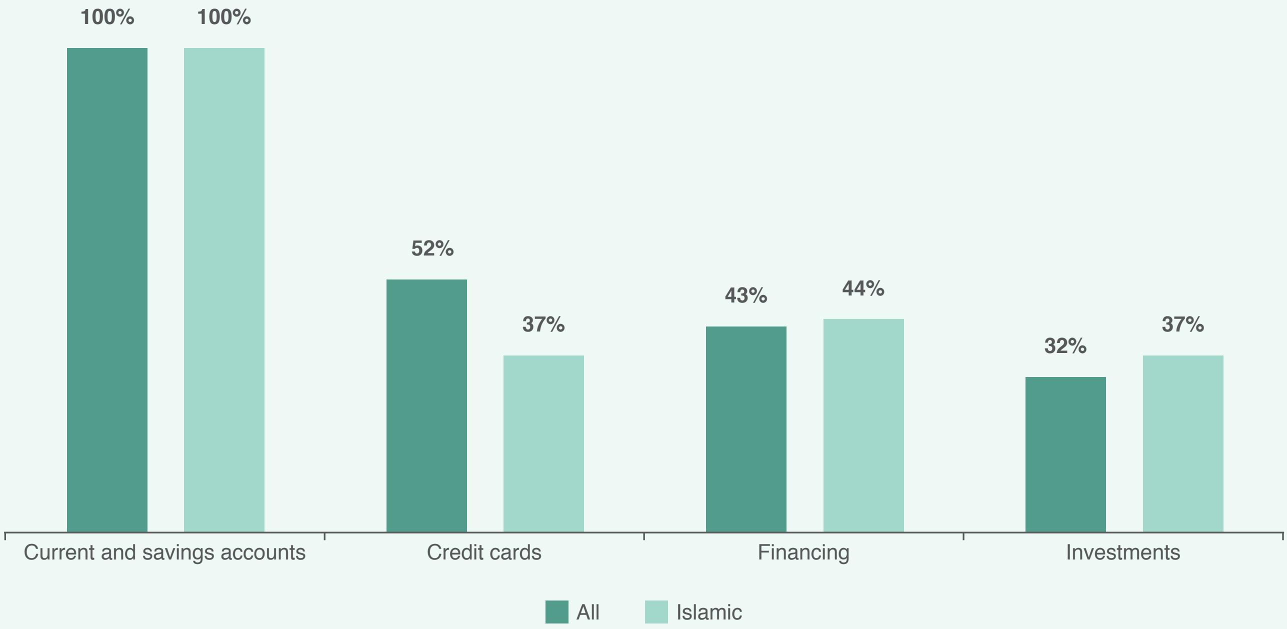
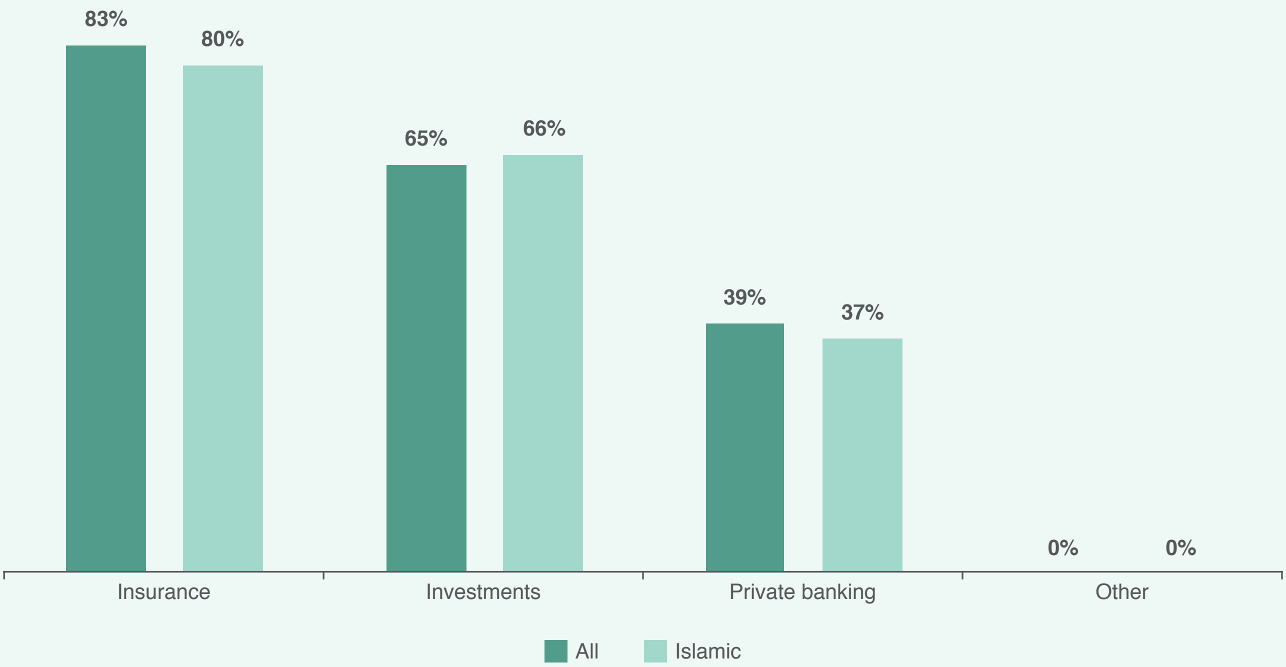
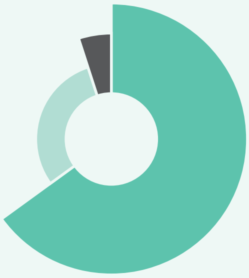


Figure 52 WHICH OF THESE PRODUCTS AND SERVICES WOULD YOU LIKE YOUR PRIMARY BANK TO PROVIDE?



SURVEY METHODOLOGY

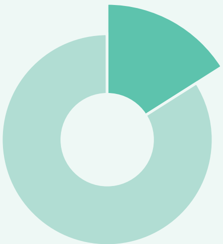


AGE

- 65% 18-34 years old
- 30% 35-54 years old
- 5% 55 years or older

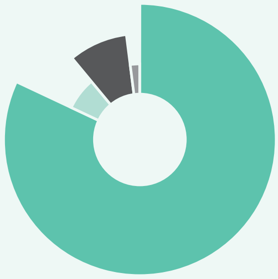
GENDER

- 70% Male
- 30% Female



NATIONALITY

- 16% Qatari
- 84% Non-Qatari

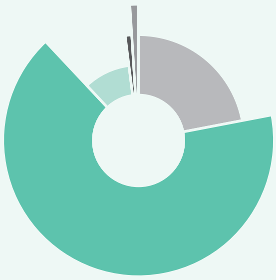


RELIGION

- 82% Islam
- 7% Christianity
- 9% Hinduism
- 2% Buddhism
- 0% Other

GEOGRAPHIC DISTRIBUTION

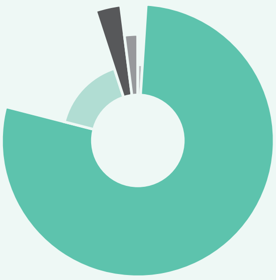
- 38% Doha
- 25% Al Rayyan
- 13% Al Wakrah
- 9% Al Sheehaniya
- 8% Al Khor
- 7% Um Salal
- 2% Al Daayen
- 0% Al Shamal



EDUCATION

- 22% Postgraduate*1
- 67% Undergraduate*2
- 10% High school
- 1% Incomplete high school
- 1% Prefer not to disclose

*1 (Masters, PhD, etc.)
*2 (Bachelors or equivalent)



EMPLOYMENT

- 1% Self-employed
- 78% Employed
- 16% Unemployed
- 3% Student
- 2% Retired
- 0% Prefer not to disclose

INCOME

- 23% < 10,000
- 40% 10,000 – 24,999
- 29% 25,000 – 49,999
- 6% 50,000 – 74,999
- 2% > 75,000

CORPORATE BANKING CONSUMER SURVEY

CORPORATE BANKING SECTOR HIGHLIGHTS

Customer Interest in Islamic Banking

- No "one-stop-shop" model for corporate banking needs.
- Banking business for construction, real estate, and transportation sectors increased in the last two year.
- Competing on cost and product differentiation will increase Islamic banks' corporate market share.

Customer Experience and Satisfaction

- Development required across all aspects of banking experience to increase customer satisfaction.
- Shariah governance disclosure and regional focus of networks will raise customer satisfaction with Islamic banks.

Customer Product Preferences

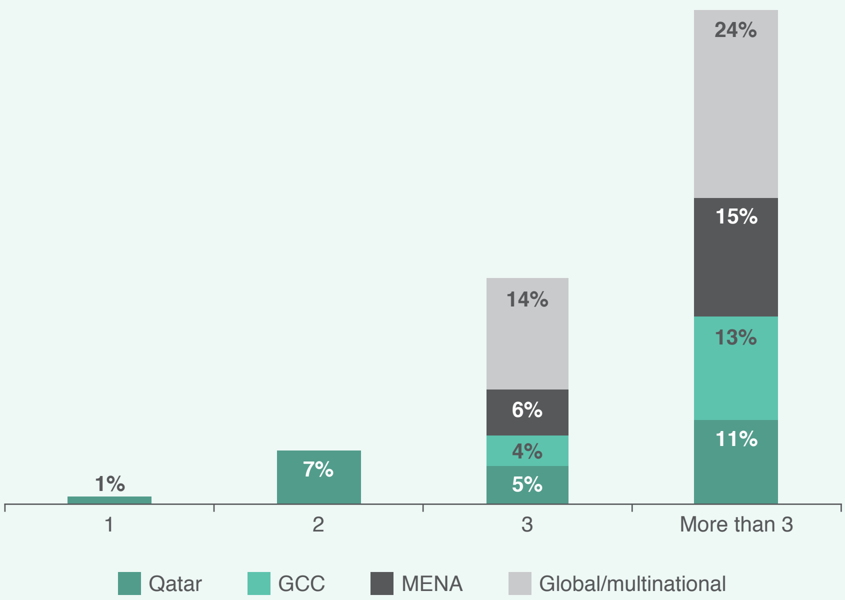
- Leveraging technology to streamline bank systems and processes will reduce bottlenecks for obtaining corporate credit as financing needs are expected to increase.

CUSTOMER OVERVIEW

Majority of corporations, mainly multinationals, hold more than three accounts

The results of the corporate banking customer survey show that 99% of respondents hold multiple bank accounts, with the majority (63%) having more than three accounts for their business. This is perhaps an indication that these companies' business needs are not all satisfied at one bank that acts as a one-stop-shop, or that their primary banks do not offer competitive pricing across all their services. Only Qatari businesses in the sample (8%) held two or less bank accounts in the sample, while global/multinational businesses primarily held three or more bank

Figure 54 HOW MANY BANKS DOES YOUR COMPANY DEAL WITH?



accounts. Global companies in Qatar also likely deal with a combination of local and foreign banks. The largest five banks in Qatar, all local, control over 90% of the sector's assets, and they are an obvious choice for multinationals for their operational and trade finance requirements. Foreign banks, on the other hand, are preferred for conducting financial transactions and financing requirements involving their parent companies, such as the repatriation of profits.

Banking business in the construction, real estate, and transportation sectors increased in the last two years

36% of respondents indicated an increase in the value of business carried out with their primary banks. Most of these respondents operate in the construction and real estate (17%), transportation and logistics (9%) and retail (7%) sectors. In light of increased spending on infrastructure projects in the lead up to the FIFA World Cup 2022 and the implementation of the Qatar National Vision 2030, credit to the private sector, and construction and real estate in particular, has seen double-digit growth between 2012 and 2016.

Executives of 86% of the companies where banking business increased said that the value of business was up between 0% and 10%. The remaining 14% of respondents, only construction, real estate and transportation companies, said the value of their banking business grew by 10% up to 30%.

Figure 55 HAS THE VALUE OF YOUR COMPANY'S BUSINESS WITH ITS BANK INCREASED OVER THE LAST TWO YEARS?

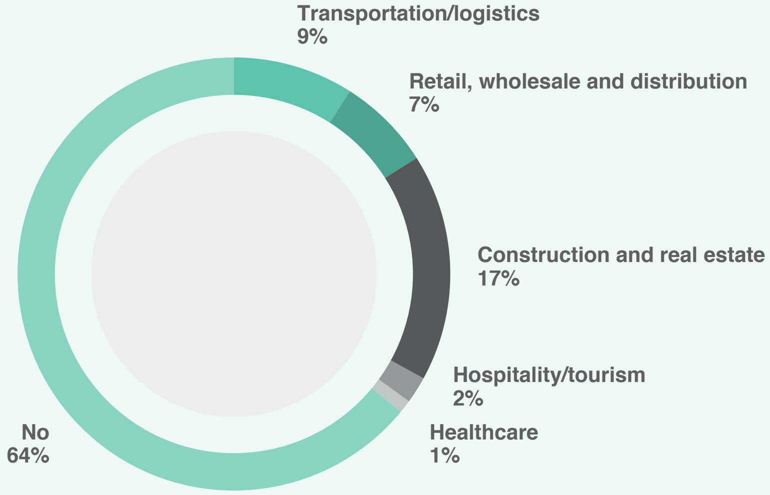
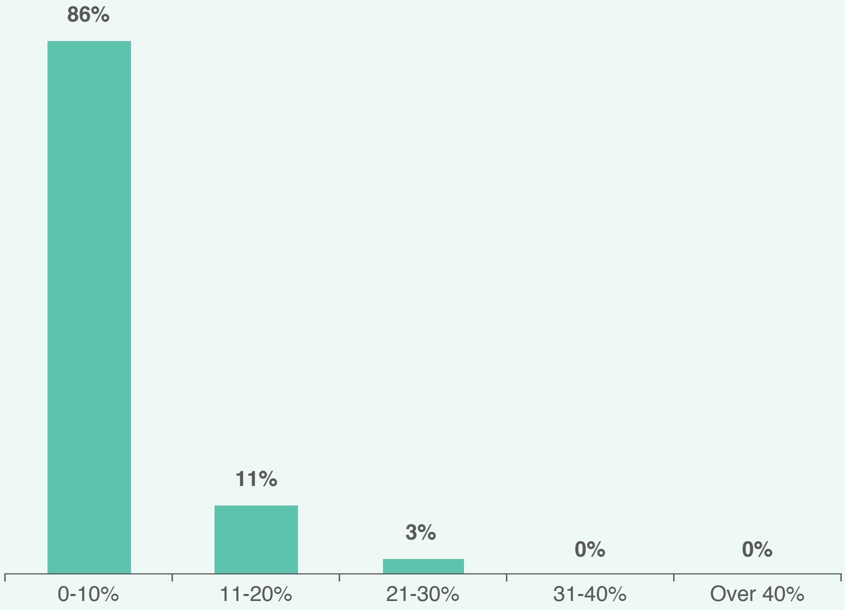


Figure 56 BY WHAT PERCENTAGE HAS THE VALUE OF YOUR COMPANY'S BUSINESS INCREASED WITH ITS BANK?



INTEREST IN ISLAMIC FINANCE

Primary accounts of 12% of respondents held at Islamic banks

Only 12% of corporations in the survey sample hold their primary accounts with Islamic banks. This segment comprises Qatari (5%) and other GCC and MENA-based companies (7%), but does not include any global/multinational companies. Corporations are more indifferent to Shariah-compliance when choosing a bank compared to retail consumers. Many multinationals are headquartered in countries where Islamic banking is much less prominent than in Qatar, explaining their preference for only dealing with conventional banks.

Majority of corporations do not follow a formal process for bank selection, likely focus on lower costs

The majority of respondents in the survey sample, particularly Qatar, GCC and MENA-based corporations, do not follow any formal process when selecting the banks that they deal with. In other words, these companies are flexible with their criteria for choosing their banks and they are inclined to select the banks they deal with purely based on pricing. However, the majority of multinationals and global corporations follow formal processes, such as taking requests for proposals (RFPs), by which they assess banks based on a set of criteria such as their financial stability and geographical reach.

Figure 57 AT WHAT TYPE OF BANK DOES YOUR COMPANY YOU HOLD ITS PRIMARY BANK ACCOUNT?

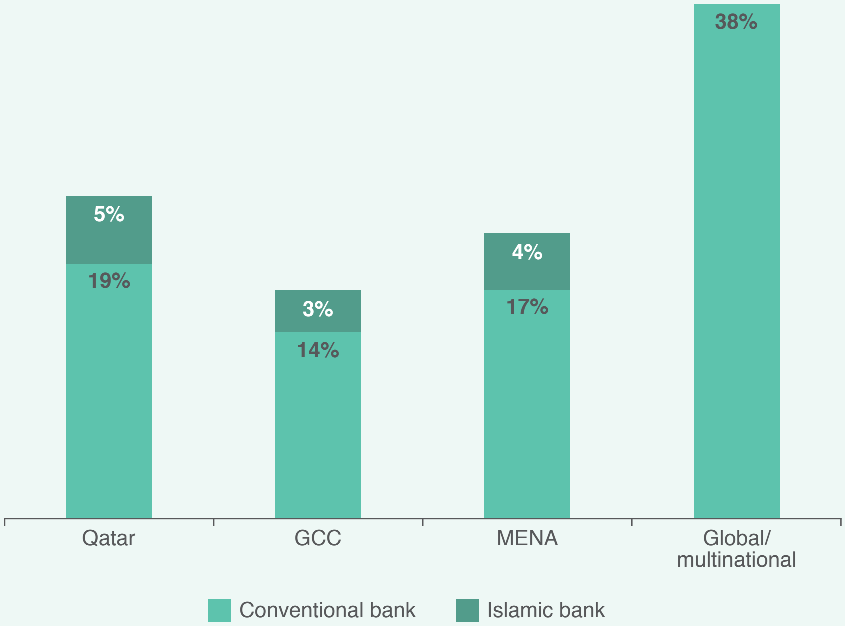
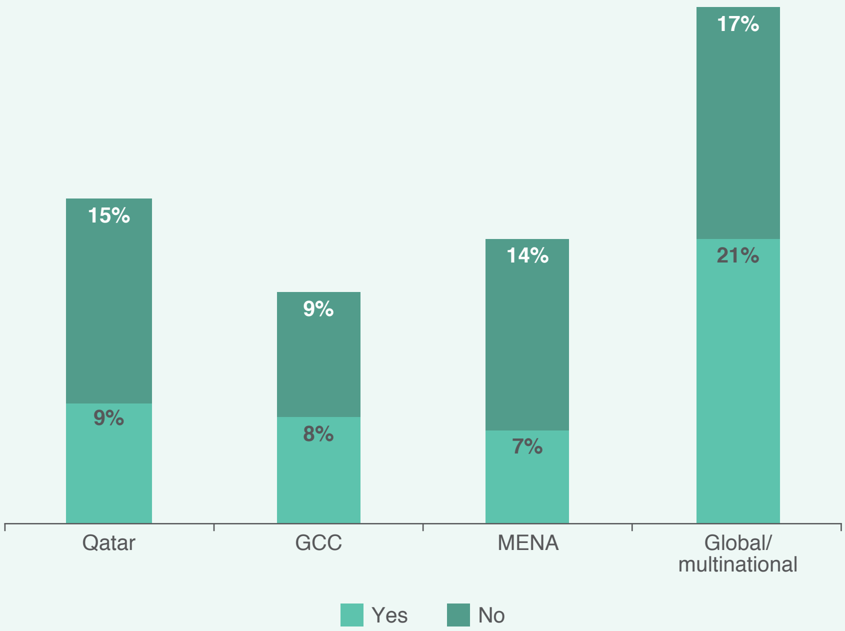


Figure 58 DOES YOUR COMPANY FOLLOW A FORMAL PROCESS IN SELECTING ITS CORE BANKING PARTNERS (SUCH AS RFPS)?



Bank product and service quality top priority for corporations, but Shariah compliance is the main driver for choosing an Islamic bank

When choosing a bank, the most important criterion cited by 56% of respondents was product quality, followed by customer service quality (21%) and global geographic footprint.

For companies holding their primary accounts with Islamic banks, the most important criterion was Shariah-compliance, which half the respondents cited. None of the Islamic bank customers indicated that Shariah-compliance was "less" or the "least" important criteria for choosing their bank. This would mean that customers of Islamic banks are less sensitive to pricing and product and service quality as long as their bank is Shariah-compliant. 58% of respondents banking with Islamic banks said that service and product quality were important considerations when choosing a bank, with 42% saying service quality was the most important compare to 8% for product quality.

CUSTOMER EXPERIENCE AND SATISFACTION

Just under half of corporate customers are satisfied with their banks

Nearly 50% of respondents said that their companies were at least somewhat satisfied with their experience with their primary banks, with 32% being neither satisfied nor dissatisfied with their primary banks. However, satisfaction levels are relatively lower with Islamic banks, with a higher proportion of customers saying their companies were "very dissatisfied" (17% of Islamic bank customers compared to 9% of overall customers).

Customer satisfaction levels across the individual criteria previously mentioned averaged just under 50%, with between 17% and 37% of respondents saying that they were neither satisfied nor dissatisfied with their banks in these aspects. The areas in which respondents' companies were most satisfied are financial stability (48%), product quality (43%), and geographic footprint (42%). Although dissatisfaction levels are relatively low, banks in Qatar require further development, especially in product and service quality.

Figure 59 PLEASE RANK THE FOLLOWING CRITERIA FOR CHOOSING A BANK, BY IMPORTANCE TO YOUR COMPANY.

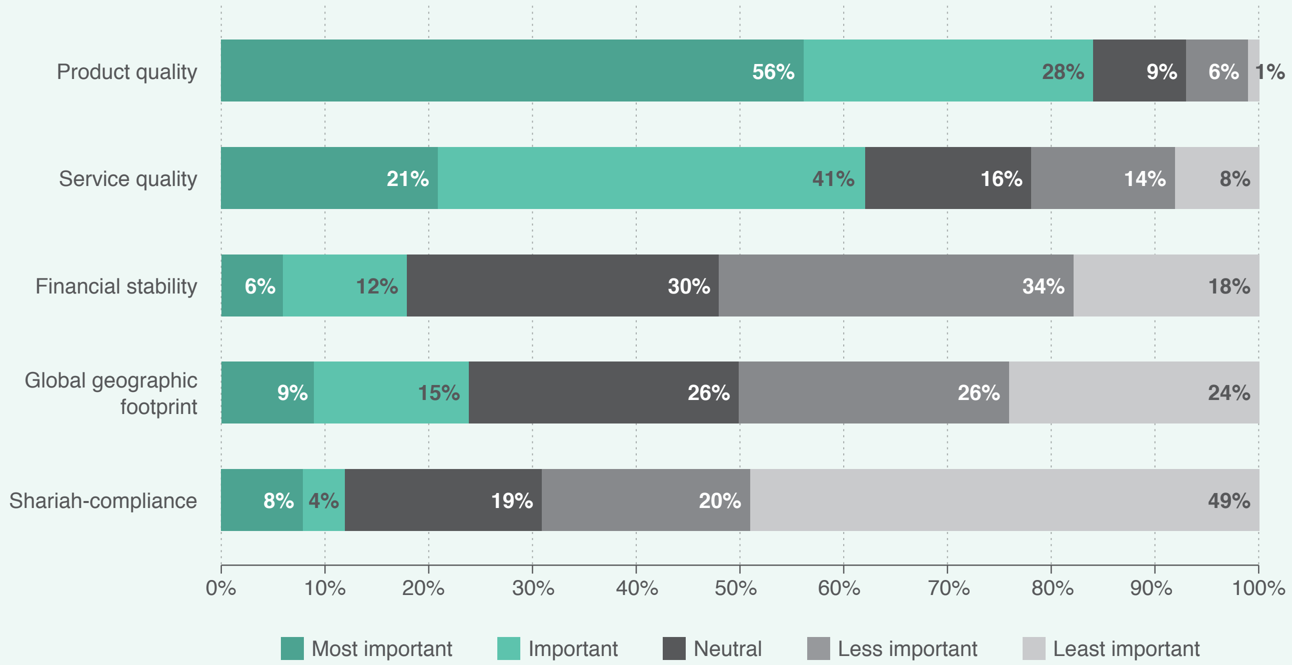


Figure 60 HOW WOULD YOU RATE YOUR COMPANY'S OVERALL SATISFACTION WITH ITS PRIMARY BANK?

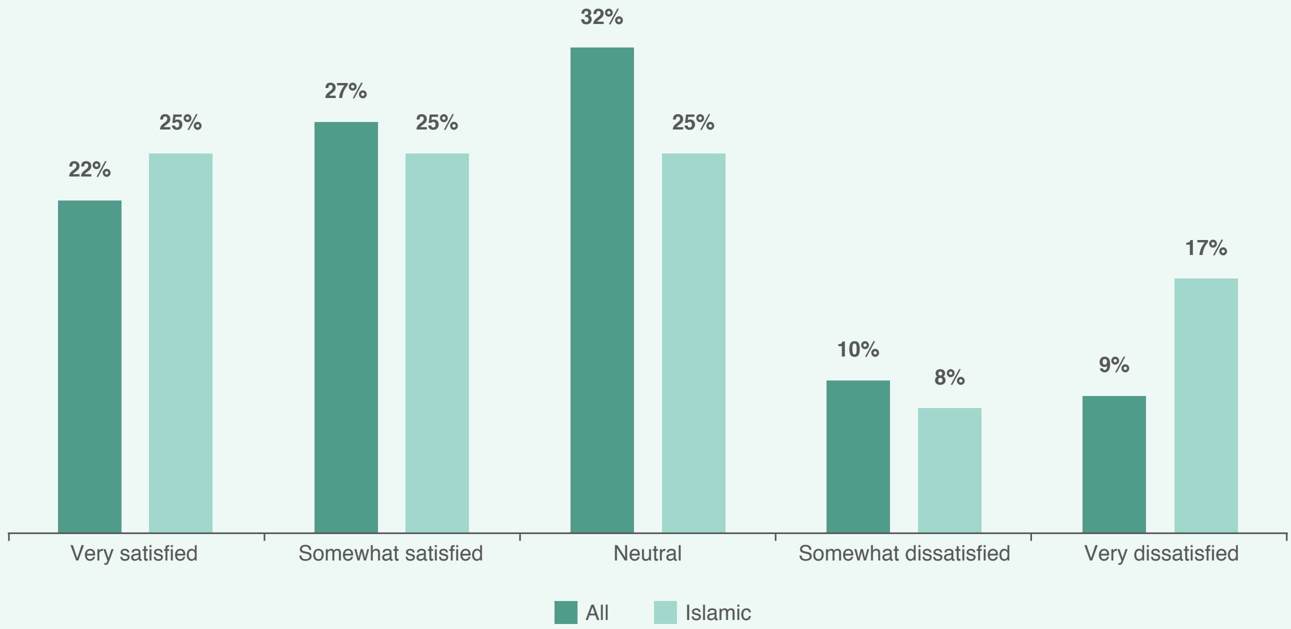
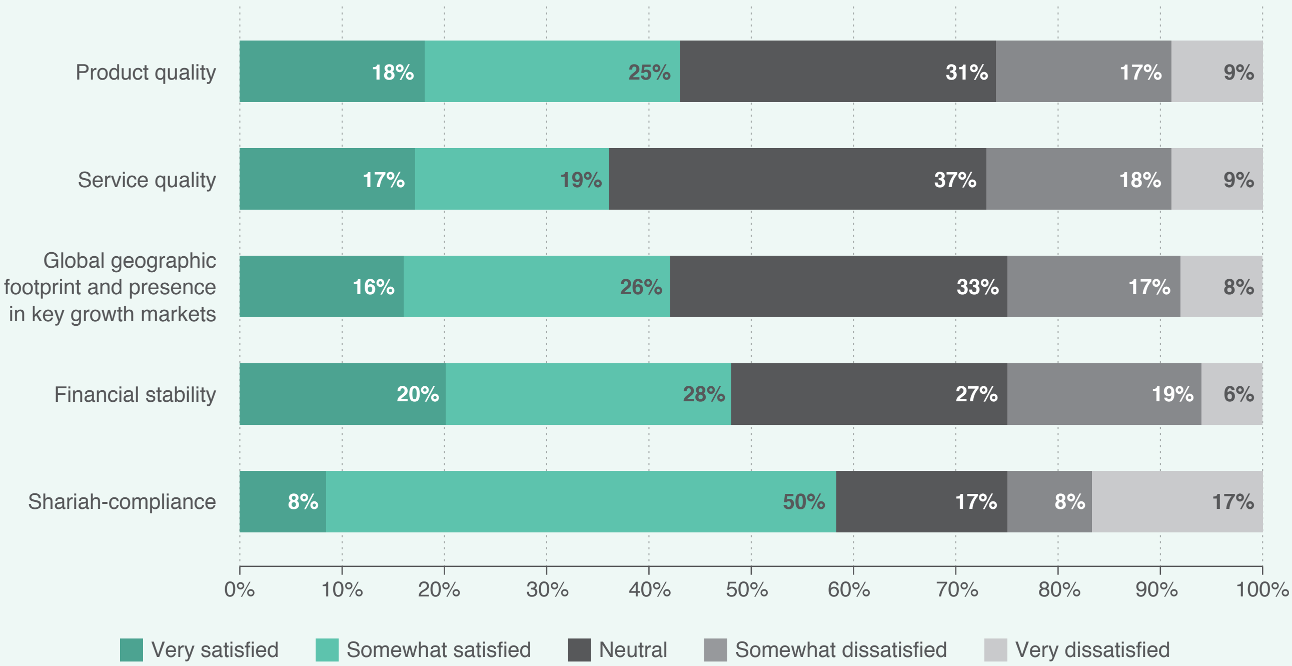


Figure 61 RATE YOUR COMPANY'S SATISFACTION WITH ITS PRIMARY BANK ON THE FOLLOWING ATTRIBUTES.



Islamic banks need to improve Shariah governance disclosure focus networks regionally to raise customer satisfaction levels

The aspects of Islamic banks about which their customers were most satisfied were financial stability (67%), Shariah-compliance (58%) and product quality (34%). Although more than half of Islamic bank customers were satisfied with their banks in terms of Shariah-compliance, only 8% said they were very satisfied. This is a point of concern for Islamic banks, given that Shariah-compliance is the top reason for these customers to choose an Islamic bank as well the as the top reason for them to switch to another bank. Therefore, it is imperative for these banks to boost their customers' satisfaction in this respect with more public transparency on Shariah standards through timely, better promoted, and more detailed disclosures of Shariah governance.

It is worth noting that no Islamic bank customers are satisfied with their bank's geographic reach and presence in their key growth markets. All the companies in the survey sample that have primary accounts with Islamic banks are based locally or within the MENA region, and naturally, they would prefer their banks to have strong regional networks. However, Islamic banks in Qatar have only expanded their networks into nascent Islamic finance jurisdictions with minimal coverage in the MENA region. This expansion strategy capitalizes on the first-mover advantage in these markets; Islamic banks could see increased business from their existing clients by establishing operations in key commercial hubs in the MENA. Although these Islamic banks may have a growing international network, it doesn't match their corporate clients' profiles. While their international operations may better suit multinationals, the survey sample shows that these companies are not a significant customer segment for them to date.

No interest in switching to another bank, but customers can be swayed through product differentiation

The majority (88%) of respondents are not interested in switching their primary account to another bank. This is likely due to the fact that over 60% of respondents already hold more than three bank accounts. Out of the 12% that were interested in switching to another bank, 7% were customers of conventional banks who were considering moving to another conventional bank, whereas 5% were interested in switching to an Islamic bank. Out of the latter, 3% were conventional customers interested in shifting to an Islamic bank, which indicates an opportunity for Islamic banks to obtain some market share from their conventional counterparts. It is worth noting here that none of the respondents holding primary accounts with Islamic banks said they were considering shifting to a conventional bank, reaffirming that Shariah-compliance is the priority for these companies when dealing with a bank.

In line with their preferred criteria for choosing a bank, 81% of respondents said that poor product quality would be an important reason for their company to switch to another bank with 53% saying it would be the most important

Figure 62 IS YOUR COMPANY CONSIDERING SWITCHING ITS PRIMARY BANK ACCOUNT TO ANOTHER BANK?

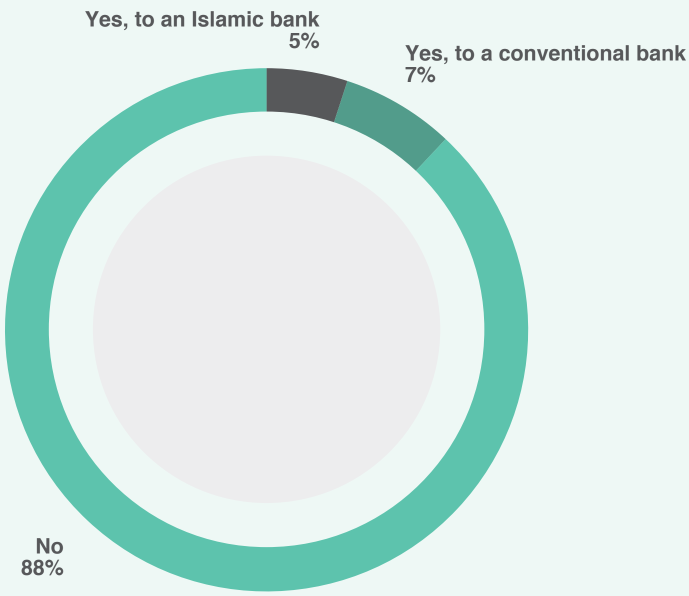
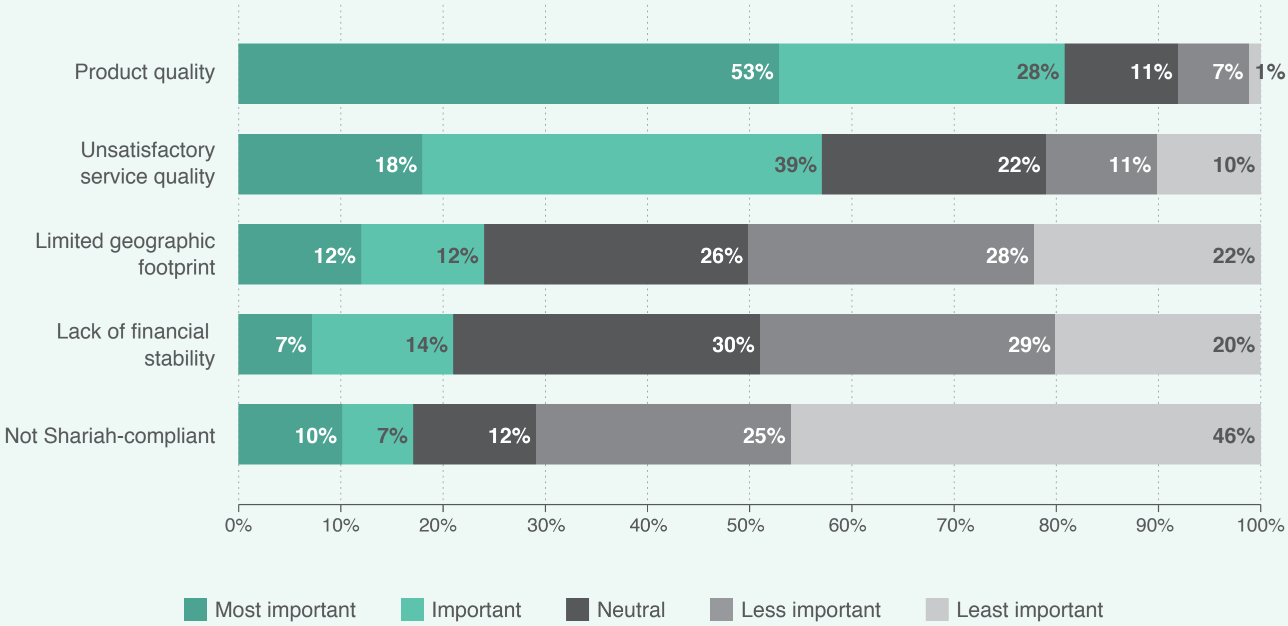


Figure 63 FOR WHICH OF THE FOLLOWING REASONS WOULD YOUR COMPANY SWITCH TO ANOTHER BANK?



reason to do so. The next important reason was unsatisfactory service quality, which was cited by 57% of respondents, but with only 18% saying it would be the most important reason.

42% of respondents from companies primarily dealing with Islamic banks equally ranked lack of Shariah compliance and poor product quality as the most important reasons to switch to another bank. Although respondents ranked service quality as the second most important criteria for choosing a bank, it appears that they are more tolerant of their banks underperforming in this area. Interestingly, limited geographic footprint did not feature as an important reason that corporate customers with Islamic banks would switch to another bank, although this was previously highlighted as an area where none of these companies were satisfied.

CUSTOMER PRODUCT PREFERENCES

Growing business operations driving increased trade finance needs of corporations

16% of survey respondents confirmed that their companies will see a change in their financing needs in the short term, while just over half of corporations stated that financing requirements might change in the next one to two years. All corporations in the survey sample currently use operational financing with their banks to support their day-to-day operations. This is unlikely to change, given that these are the most basic and essential of a company's financing requirements.

Respondents indicated that their companies' overall financing needs would increase over the next two years, with the greatest increase expected in trade finance. Compared to only 53% of companies in the sample using trade finance (e.g. letters of credit, import/export finance, guarantees, etc.) over the last two years, 61% expected to need this type of financing in the near future. There was also a marginal increase in the percentage of corporations expecting to use corporate financing for capital expenditures and other forms of financing, such as tapping capital markets for funding.

Of the factors driving this anticipated increase in financing needs, 37% of respondents cited plans to expand into new markets, in addition to the growth of their business in general and as a result of Qatar hosting the World Cup in 2022. Reasons cited for lower or no changes in financing needs were the increased financing costs following multiple recent Fed rate hikes, as well as the recent political developments in the country.

Streamlining processes and developing internal bank systems will reduce bottlenecks for corporations obtaining finance

17% of corporations in the survey sample, which mainly comprised larger companies with a turnover higher than QAR 5 million dealing with conventional banks, said that they have faced challenges in obtaining bank financing. The most common challenge faced by more than half of these companies was managing the complex processes and systems at their banks. This indicates a high level of bureaucracy in the operations of some banks, along with the need to further streamline and standardize their processes for corporate credit facilities, especially for larger companies. By standardizing their documentation requirements, and leveraging new industry technologies to simplify and expedite the credit application process, banks will see fewer bottlenecks and shorter turnaround times for their customers. As revealed in the analysis of the retail banking customer survey, technology was one of the key areas for development for banks overall.

Other challenges these companies have also faced include requests for financing being repeatedly denied, likely a direct result of a bank processes being too complex. It could also be connected to other factors, such as high collateral requirements and the rejection of too-small loan/financing requests. However, these reasons are likely to predominate at smaller companies; they could be addressed by enhancing the product offerings for SMEs. Many banks in Qatar already offer products tailored to SMEs and are partners with Qatar Development Bank in its Al Dhameen program, where they offer SME financing for which the development bank stands as a guarantor.

Figure 64 CHANGE IN FINANCING NEED OVER THE NEXT TWO YEARS

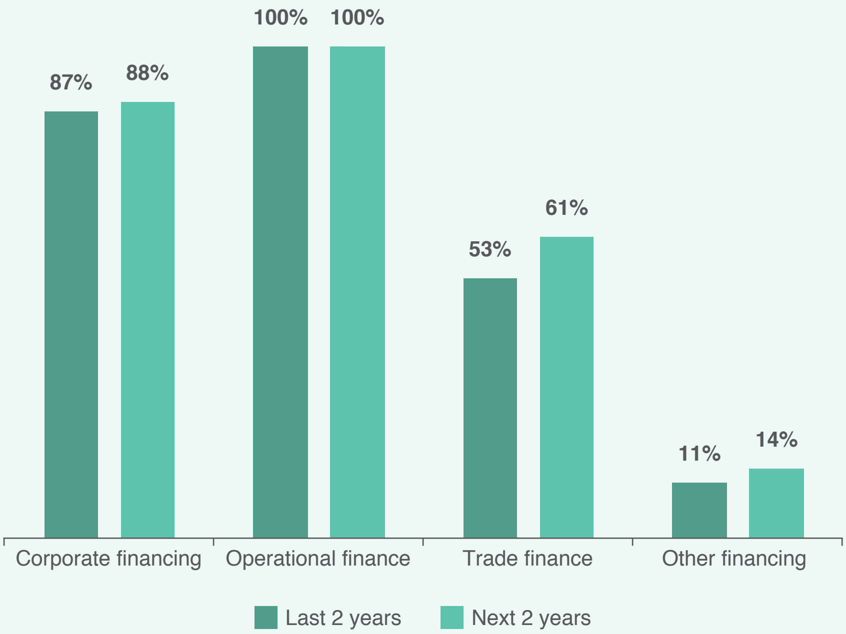
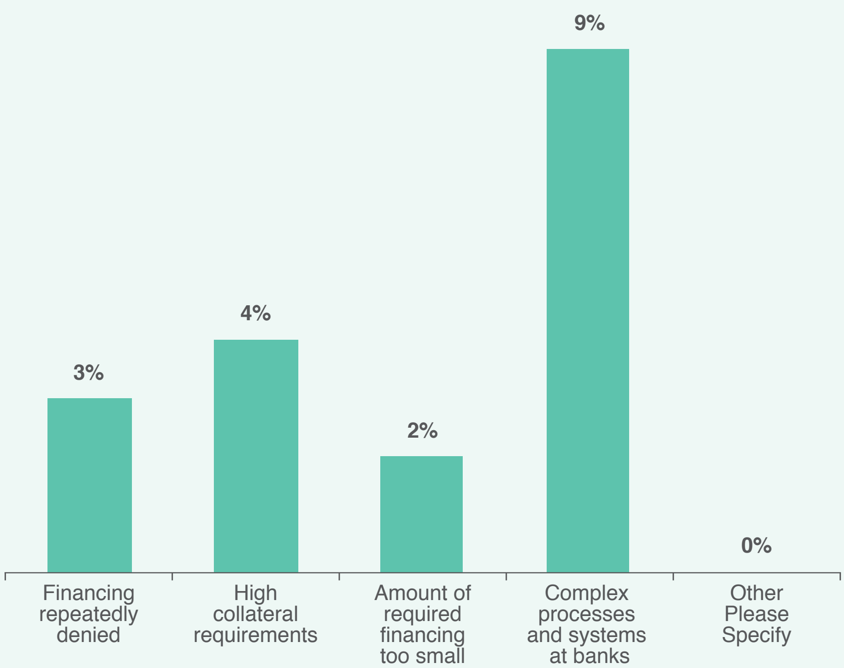
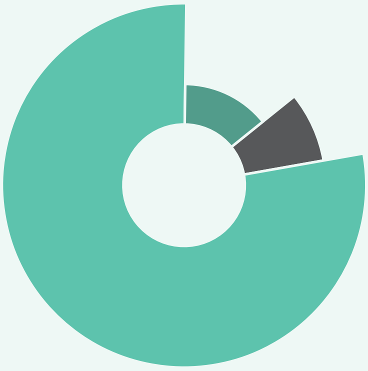


Figure 65 WHICH OF THE FOLLOWING CHALLENGES HAS YOUR COMPANY FACED IN OBTAINING BANK FINANCING?



SURVEY METHODOLOGY

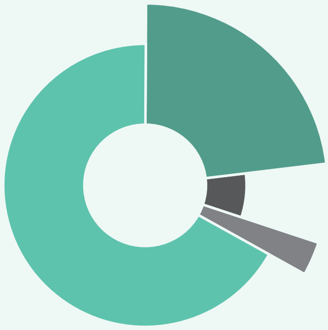


POSITION

- 8% Business unit manager
- 78% Finance manager
- 14% CEO or MD

NATIONALITY

- 24% Qatar
- 17% GCC
- 21% MENA
- 38% Global/multinational



ANNUAL TURNOVER

- 0% < 100,000
- 0% 100,000 – 500,000
- 3% 500,000 – 1,000,000
- 7% 1,000,000 – 5,000,000
- 23% 5,000,000 – 10,000,000
- 67% > 10,000,000

ECONOMIC SECTOR

- 40% Construction and real estate
- 29% Transportation and logistics
- 20% Retail, wholesale and distribution
- 5% Manufacturing
- 2% Hospitality and tourism
- 2% Media and telecommunications
- 2% Healthcare

The Pearl of Doha aerial view, Doha.

THE NON-BANK FINANCIAL SECTOR

NON-BANK FINANCIAL SECTOR IN QATAR

QCB NON-BANK FINANCE COMPANIES

Companies: Al Jazeera Finance • First Finance Co. • Qatar Finance House Co.

	2012	2013	2014	2015	2016
Total Assets (QAR million)	3,962	3,073	2,997	3,141	3,210
% of GDP	0.57%	0.42%	0.40%	0.40%	0.40%
% of banking assets	0.49%	0.34%	0.30%	0.28%	0.25%

CAGR
-5.1%

QCB INVESTMENT COMPANIES

Companies: First Investor Co. • Investment House

	2012	2013	2014	2015	2016
Total Assets (QAR million)	516	545	667	650	645
% of GDP	0.07%	0.08%	0.09%	0.08%	0.08%
% of banking assets	0.06%	0.06%	0.07%	0.06%	0.05%

CAGR
12.3%

NON-BANK FINANCIAL SECTOR LANDSCAPE AND PROFILE

Qatar's non-bank financial sector comprises a limited number of companies, a majority of which are Shariah-compliant. Although Qatar ranks third in the GCC in terms of Islamic finance assets after Saudi Arabia and the UAE, it has the fewest non-bank finance companies and investment companies besides Oman, which has no Islamic non-bank financial institutions as a nascent Islamic finance market.

The number of non-bank finance companies and investment companies in Qatar has remained unchanged since 2012, indicating that the growth and development of the non-bank financial sector has been limited.

There are three non-bank finance companies operating in Qatar, which are licensed by the Qatar Central Bank (QCB). These are Al Jazeera Finance, First Finance Co., and Qatar Finance House Co. All three non-bank finance companies are full-fledged Islamic financial institutions, and they compete with Islamic banks in the retail segment of their lending business. Shariah-compliant consumer loans, such as mortgages and auto finance, constitute the major part of non-bank finance companies' business.

As for investment companies, there are a total of 12 operating in Qatar, with total assets amounting to QAR 11.1 billion. Two of these companies are licensed by the QCB: the First Investor Company and Investment House, both of which are fully Shariah-compliant. These companies provide services that include asset management, investment banking, as well as real estate investment.

Table 8 NUMBER OF ISLAMIC NON-BANK FINANCIAL INSTITUTIONS IN GCC COUNTRIES (2016)

Country	Saudi Arabia	UAE	Kuwait	Bahrain	Qatar*	Oman
Non-bank finance companies	16	10	3	–	3	–
Investment companies	44	23	58	21	5	–

*Including QFC

Source: Thomson Reuters

QFC NON-BANK FINANCIAL INSTITUTIONS

There are ten companies forming the investment banking and investment management sectors in the Qatar Financial Centre (QFC), accounting for 25% (QAR 10.5 billion) of QFC's financial institution assets at the end of 2016.[1] Three of the companies, Al Rayan Investment, QInvest and Qatar First Bank, are full-fledged Islamic financial institutions.

Al Rayan Investment, a subsidiary of Masraf Al Rayan, was the first Shariah-compliant financial institution to be authorized by QFCRA in 2007. It is an investment management company that offers bespoke investment solutions to both high net worth individuals and institutional investors, with a special focus on investments in the GCC and Asia.

Islamic investment banking had previously been exclusive to boutique and niche financial institutions, which attracted very little interest from regional investors because of low capital and limited reach outside Qatar. This segment of the market has since expanded with QInvest's entry in 2007. The investment bank provided a boost to domestic capabilities in areas such as investment banking and advisory, principal investment, private client advisory and brokerage services. Qatar First Bank, another Shariah-compliant investment bank, had focused on private equity investing using its own funds when it was established in 2009. However, this focus has broadened in recent years to cover real estate, private banking and wealth management catering to high net worth, corporate and institutional investors.

Islamic investment banking had previously been exclusive to boutique and niche financial institutions, which attracted very little interest from regional investors because of low capital and limited reach outside Qatar.

1 QCB Financial Stability Report 2016.

Pearl Fountain at the Corniche, Doha. AHMED ADLY / SHUTTERSTOCK.COM

SECTOR SIZE AND GROWTH

NON-BANK FINANCE COMPANIES

Shrinking asset base following caps on consumer lending

Non-bank finance companies operating under QCB jurisdiction ended 2016 with an asset base worth QAR 3.2 billion, up 2.2% from QAR 3.1 billion in 2015. Since 2011, the value of non-bank finance companies' assets has systematically declined, seeing the biggest drop in value in 2013. During 2011, total assets dropped significantly by 22% from approximately QAR 4 billion in 2012. This mainly resulted from a substantial decline in financial investments of around 86% and a drop in Islamic financing activities of around QAR 1 billion (32%). After further marginal decline in 2014, total assets of non-bank finance companies recovered in 2015, increasing 4.8% solely from growth in Islamic financing assets.

Since 2011, non-bank finance companies in Qatar have been operating in a business environment even more challenging than for banks. In April 2011, the QCB issued a new regulation aiming to limit consumer credit growth by introducing new limits on interest and financing charges. Given that non-bank finance companies are not deposit-taking institutions, they do not have similar access to cheap funds as banks do. This move has placed downward pressure on profit margins, forcing them to revise their business models and shift their focus to SME financing.

Although their profitability actually improved in 2012, non-bank finance companies faced the delayed effect of this decision. According to the most recent data, their total net profit fell by 19% from QAR 160 million in 2012 to QAR 130 million in 2013, and remained at this level in 2014. This drop is attributed to reduced income from profit charges on financing activities during this period, with its share of total income dropping from 93% in 2012 to 71% in 2014. Data on the profitability of non-bank finance companies after 2014 is not available.

As all three non-bank finance companies operating under QCB regulation are Shariah-compliant, Islamic financing assets constitute the major part of their total assets. In 2015, Islamic financing accounted for 74.3% of total assets (QAR 2.3 billion), up 10.9% from the previous year. These assets had fallen by 32% during 2013, contributing to the significant decline of total assets. This decline was due to reduced demand for credit in the domestic market, in addition to the continuing impact of the 2011 directive capping consumer loans. Growth rates accelerated in the following years, increasing to 7.3% in 2014 and 10.9% in 2015. The share of Islamic financing assets stood at 71.9% or QAR 2.31 billion at the end of 2016, which dropped marginally by 1.1% from the previous year.

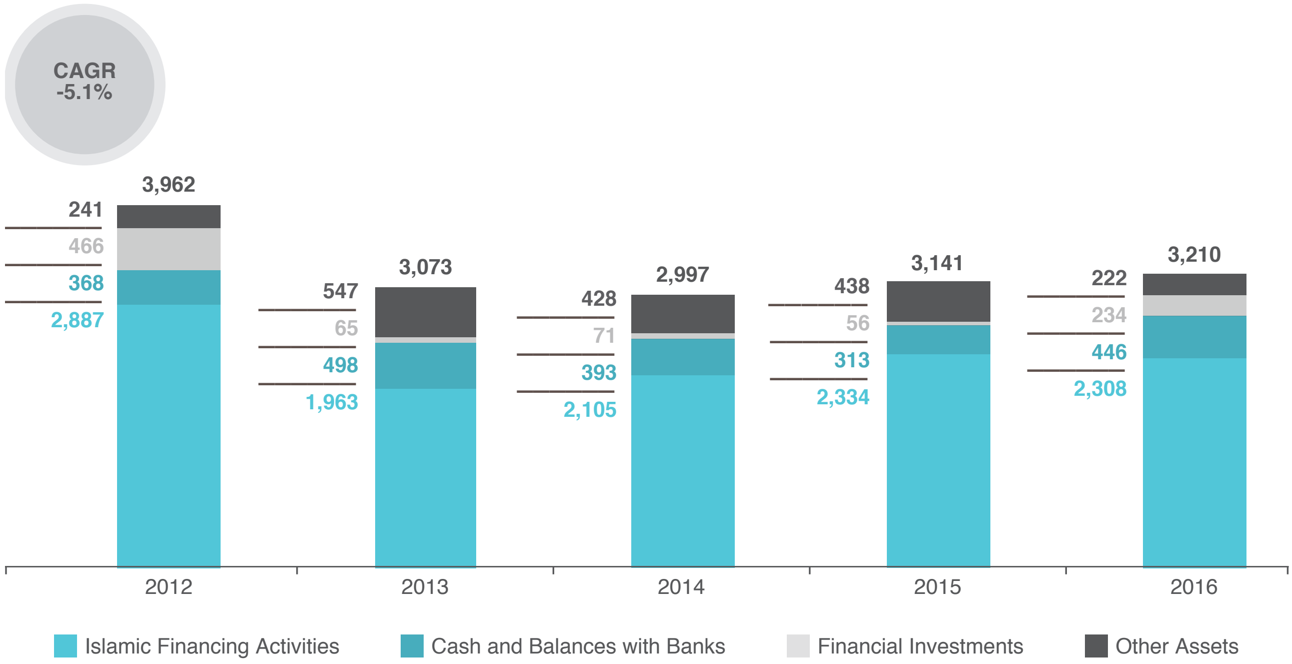
Cash and balances with banks increased by 35% in 2013 from QAR 368 million, increasing its share of total assets from 9% in 2012 to 16% in 2013. This signaled a notable improvement in liquidity for non-bank finance companies, primarily because of reduced lending activity and borrowing from other financial institutions during the year. However, this share of liquid assets fell from 16% in 2013 to 13% in 2014 and 10% in 2015 as lending activity recovered. This consistent decline raises a red flag about the overall liquidity position of non-bank finance companies.

The total asset base of non-bank finance companies has also seen a shift in its composition, with the share of financial investments dropping from 12% in 2012 to 2% in 2013 and remaining at this level until the end of 2015. During 2015, financial investments fell by 21%, reflecting the adverse impact of oil prices on the investment environment in Qatar. This was met with an increase in the share of other assets, which jumped up from 6% in 2012 to 18% of total assets in 2013, settling at a 14% share in 2015. It is likely that this shift was caused by a QCB directive issued in June 2013, which imposed a 10% limit on banks' real estate investments, which are Islamic financial institutions' favored asset class.

Building up shareholders' equity, reducing leverage

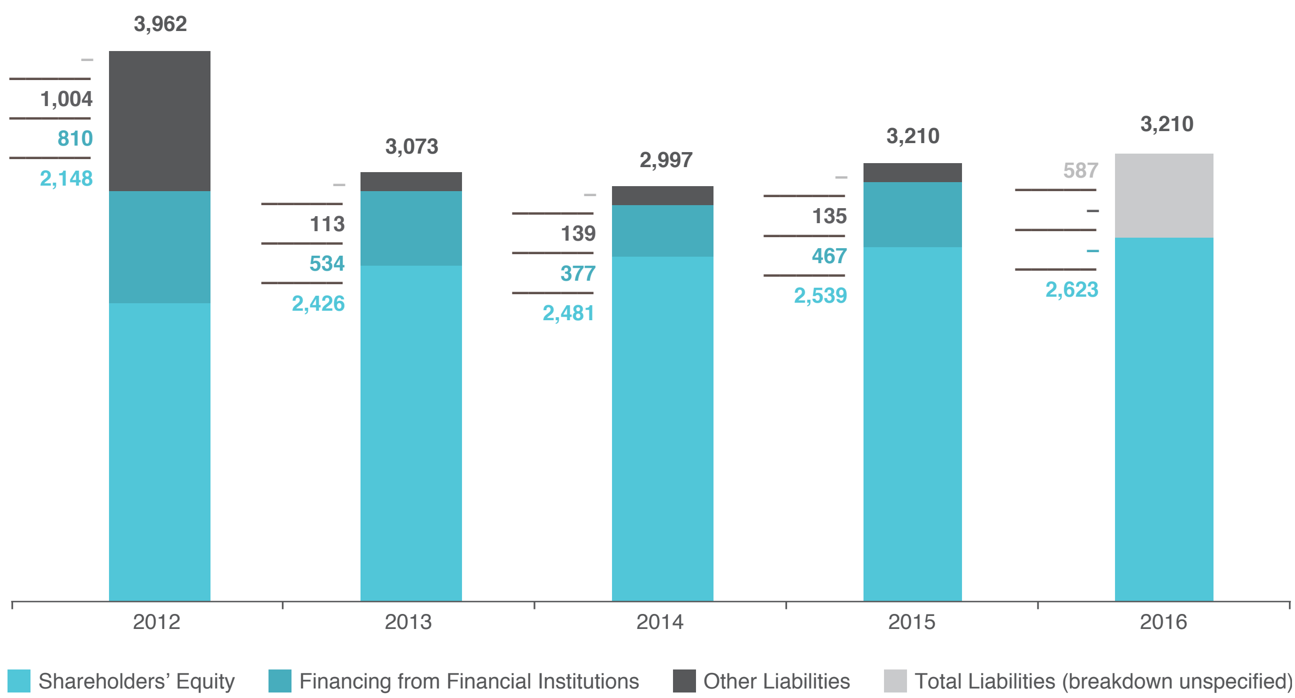
The funding mix for non-bank finance companies has witnessed a significant shift between 2012 and 2015. In 2012, shareholder equity accounted on average for 54% of balance sheets, with the share of financing from financial institutions at 20%. During the following years,

Figure 66 ASSETS OF QCB NON-BANK FINANCE COMPANIES (QAR MILLION) 2012–2016



Source: Qatar Central Bank

Figure 67 LIABILITIES AND EQUITY OF QCB NON-BANK FINANCE COMPANIES (QAR MILLION) 2012–2016



Source: Qatar Central Bank

the share of equity increased substantially, reaching 81% in 2015. Conversely, the share of financing from financial institutions gradually declined from 20% in 2012 to 15% in 2015. The boost in equity bodes well for non-bank finance companies, reducing the risk on the balance sheet resulting from now lower leverage. It also allows them to increase their lending activities without compromising their financial stability. Other liabilities, which made up 25% of non-bank finance companies' aggregate balance sheet in 2012, ended 2015 with a share of 4%. A breakdown of liabilities of non-bank finance companies is not available for 2016.

INVESTMENT COMPANIES

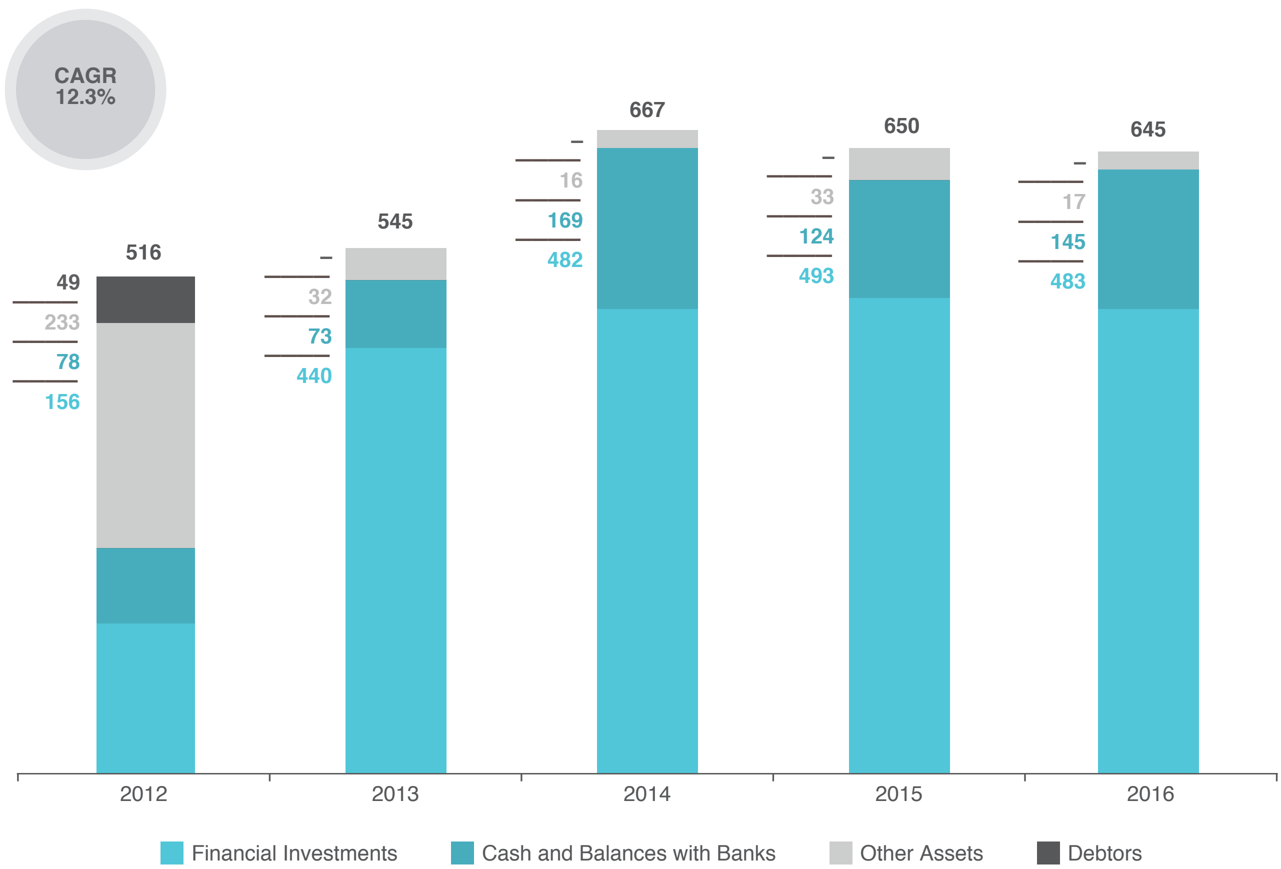
Note: The analysis in the following section is limited to investment companies regulated by the QCB, given that the QFC companies account for only 1.6% of total assets. Additionally, a breakdown of balance sheet and income statement items for QFC investment companies by Shariah-compliance is not available.

Asset growth driven by financial investments

Total assets of investment companies at the end of 2016 were valued at QAR 645 million, down by 0.8% from QAR 650 million in 2015. Despite this slight drop, this was a slower rate of decline than the 2.6% fall registered in 2015. Over the longer term, however, the growth of total assets has been healthy. Investment companies' asset base has grown 26% from QAR 516 million in 2012, mainly driven by the growth of financial investments and liquid assets.

Financial investments reached QAR 483 million in 2016, seeing exceptional growth in 2013 as these assets almost tripled compared to QAR 156 million in 2012. Their share of total assets more than doubled, growing from a 30% share in 2012 to 75% in 2016. This substantial growth came at the expense of "other" assets, besides liquid assets and investments, whose share fell significantly from 45% in 2012

Figure 68 ASSETS OF QCB INVESTMENT COMPANIES (QAR MILLION) 2012–2016



Source: Qatar Central Bank

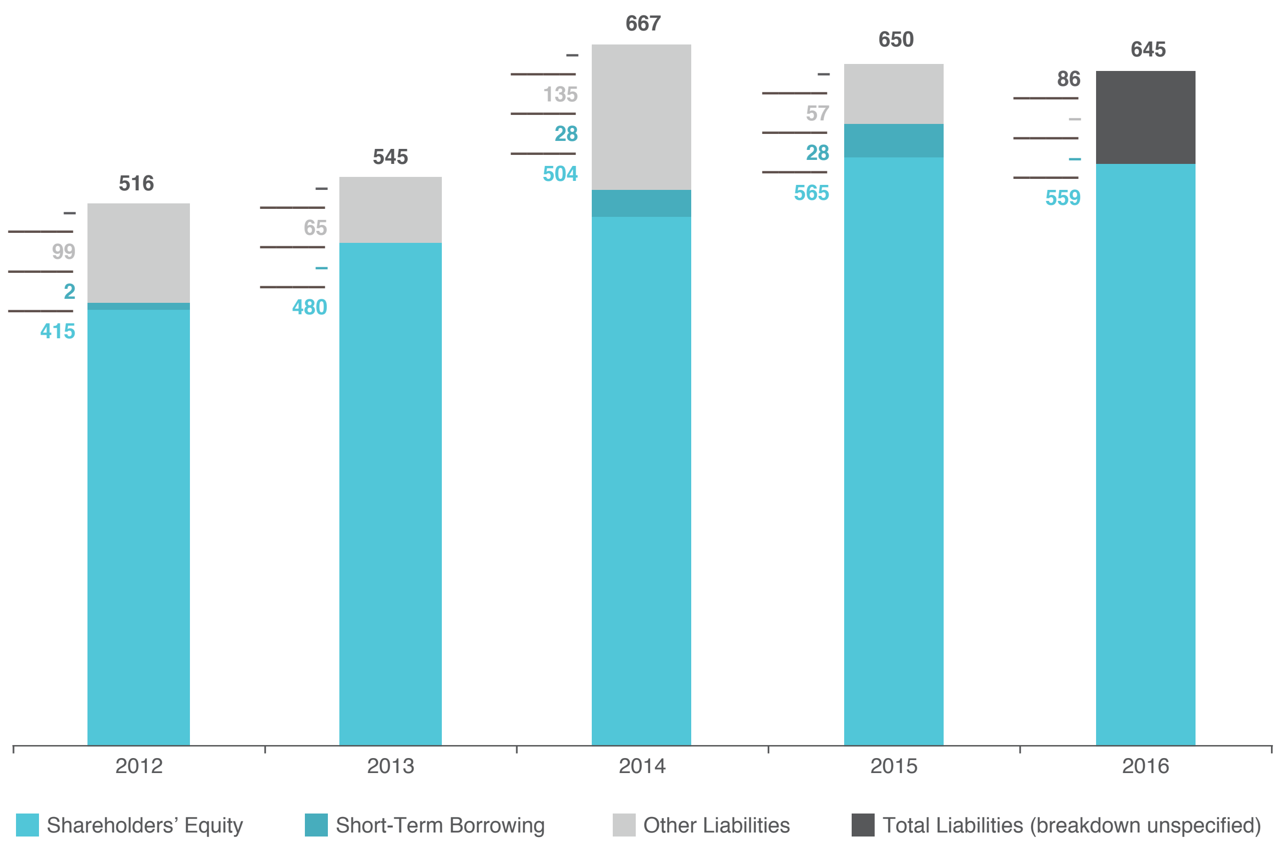
to 2.6% in 2016. This marked a shift in the investment companies' asset structure, with the main focus now on financial investments. Taking a closer look, financial investment assets fell by 2% in value during 2016, after growth had considerably slowed to 2% in 2015 from 10% in 2014. This slowdown in growth is in line with reduced investment in Qatar resulting from the slump in oil prices and poor stock market performance in 2015 and 2016.

Liquid assets (cash and balances with banks) have fluctuated between 2012 and 2016 but still grew by 85% during this period, indicating efforts to improve liquidity management at investment companies. After dropping by 7% in 2013, these assets picked up, growing by 133% to reach QAR 169 million (or 25% of total assets). However, this growth rate has not been maintained. Investment companies' liquidity positions have deteriorated as cash and balances with banks fell by 27% in 2015. However, by the end of 2016, liquid assets were up 17% and valued at QAR 145 million.

Stable funding structure for investment companies

The structure of investment companies' liabilities remained relatively consistent between 2012 and 2016. Shareholder equity is the major source of funding for investment companies, accounting for 87% of their balance sheet in 2016 at QAR 559 million, indicating the low financial leverage of these companies. Equity grew by 16% in 2013, 5% in 2014, and 12% in 2015, to end the year at QAR 565 million. The share of short-term borrowing went from a negligible level in 2012 and 2013 to 4% of balance sheet funding in the following two years. A breakdown of investment companies' liabilities for 2016 is not available.

Figure 69 LIABILITIES AND EQUITY OF QCB INVESTMENT COMPANIES (QAR MILLION) 2012–2016



Source: Qatar Central Bank

DEVELOPMENTS IN REGULATIONS

CONSUMER LENDING RESTRICTIONS RESHAPING NON-BANK FINANCE COMPANIES' BUSINESS MODEL

In April 2011, the QCB issued a new regulation aimed at curbing the growth of household credit and addressing a high debt service ratio relative to other GCC countries. This decision followed government concerns that more liberal consumer lending during a period of economic boom, especially to Qatari citizens, would lead to increased defaults.

The regulation imposes a range of limits capping consumer loan charges and profit rates. This followed a credit-tightening exercise in 2008, when personal loans extended to Qatari citizens were capped at QAR 2.5 million. Under the new regulation, the cap was reduced to QAR 2 million on loans to Qatari citizens, secured only against their salaries, and the upper limit for credit extended to expatriates was set at QAR 400,000. Monthly repayment installments were capped at 75% of the monthly salary for Qataris and 50% for non-Qataris. Additionally, the QCB limited profit rates on consumer lending to the QCB lending rate plus 1.5 percentage points.

The QCB issued a draft regulation in August 2014, which eased limitations on the size of credit facilities previously imposed on non-bank finance companies. This proposed regulation would enable non-bank finance companies to offer larger loans to their clients with the value of an individual loan reaching 2-3% of the lender's equity. This would allow non-bank finance companies to boost their lending activity in the market, especially benefitting those with a lower level of equity. To date, this regulation has not been approved.

A MASTER PLAN FOR THE DEVELOPMENT OF ISLAMIC NON-BANK FINANCIAL INSTITUTIONS

According to the ICD-Thomson Reuters Islamic Finance Development Report, global Islamic non-bank assets were valued at US$106 billion in 2015 and will reach an estimated US$135 billion in 2021. The Islamic non-bank financial sector is concentrated; most institutions are in the GCC, Iran, and Indonesia. However, it remains an overlooked sector by regulators in most Islamic finance jurisdictions, including Qatar.

Non-bank financial institutions in Qatar, the majority of which are Shariah-compliant, are currently presented with strong opportunities

> *Non-bank finance companies should be able to capitalize on their experience in retail lending to expand their operations in the SME segment.*

A visitor tours the Museum of Islamic Art, Doha. REUTERS/AHMED JADALLAH

for growth. Non-bank finance companies should be able to capitalize on their experience in retail lending to expand their operations in the SME segment. Opportunities for investment companies lie in Qatar's largely untapped domestic private wealth. However, for the non-bank financial sector to achieve its growth potential, a comprehensive development plan is required to create a solid foundation and regulatory stability for the sector.

The Islamic non-bank financial sector in Indonesia is one the most developed in the world, especially in terms of regulation. The country has taken steps to regulate its non-bank financial industry (NBFI) since 2009, when its Capital Market and Financial Institutions Supervisory Agency (Bapepam-LK)[2] introduced a development plan for the capital market and NBFI in 2009. The 2010-2014 Capital Market and NBFI Master Plan addressed the structural weaknesses in the country's non-bank financial industry and regulatory framework.

The plan's primary focus was the development of the regulatory framework for the industry in areas such as regulatory reporting and disclosures, corporate and Shariah governance and investor protection. Another important aspect of the master plan was to develop the Shariah-compliant non-bank financial industry in Indonesia by establishing a comprehensive regulatory framework governing non-bank financial institutions in line with sector needs and the fatwas of the Shariah National Board. Priorities were the development of new and diversified Shariah-compliant non-bank financial products, as well as improved human capital by building the technical knowledge of the industry and setting professional qualification standards and certifications at non-bank financial institutions.

It is possible for Qatar's financial regulators to adapt some of the strategies mentioned here to create a strategic plan and comprehensive regulatory framework for non-bank financial institutions. This would help establish more structurally sound financial institutions in the non-bank financial sector, supported by robust infrastructure and regulatory and supervisory frameworks.

2 In 2010, the supervisory agency was replaced by the Financial Services Authority of Indonesia in regulating capital markets and NBFIs.

OPPORTUNITIES AND GROWTH POTENTIAL

Non-bank finance companies… specialize in personal loans that are offered in smaller amounts, meaning that they will be able to offer financing to SMEs more efficiently…

SMALL AND MICRO-ENTERPRISE LENDING A STRONG GROWTH AREA FOR NON-BANK FINANCE COMPANIES

The lending environment in Qatar has been evolving in recent years, mainly in the space of corporate credit. Lending institutions have historically preferred to cater to the financing needs of larger, lower-risk corporations. Indeed, the most recent figures from 2013 show that SME lending in Qatar accounted for only 0.5% of total credit during the year. However, this underserved segment of the credit market is set to become more prominent in coming years. Qatar's lending institutions are becoming more proactive in their approach to lending to smaller businesses, introducing SME-friendly measures including dedicated SME branches, teams and products.

Since the QCB implemented caps on profit rates and charges on personal loans in 2011, profits at non-bank finance companies have been under pressure. As a result, assets from Islamic financing activities fell by 20% between 2012 and 2016. This has pushed these lenders to reconsider their strategies, shifting their focus to the SME sector, which has strong potential for revenue growth. This shift is likely to benefit from increased government spending on infrastructure, oil and gas projects.

Following this change in regulation, non-bank finance companies increased their involvement in SME financing activities. They all joined the Qatar Development Bank's Al Dhameen SME loan guarantee scheme, seeing increased competition to tap opportunities in this segment.

An opportunity for growth at non-bank finance companies presents itself in particular with micro, small and medium enterprises (MSMEs), for which financing requirements are far below most lenders' minimum offering for SMEs. Most banks are unlikely to consider financing smaller and micro businesses, which are usually looking for funding of around QAR 1-2 million, whereas SME loans at most banks in Qatar start at QAR 10 million.

Non-bank finance companies have a unique advantage in the MSME segment. They specialize in personal loans that are offered in smaller amounts, meaning that they will be able to offer financing to this segment more efficiently, while banks are not able to compete. Many SME clients value quick turnaround times for their financing applications that are offered by these finance houses. Moreover, as all the non-bank finance companies are Shariah-compliant they enjoy the added advantage of Islamic banks in the SME market, given the risk-sharing nature of their transactions.

FINTECH THE CUTTING EDGE FOR SUSTAINED ISLAMIC FINANCE GROWTH

Financial institutions have long been resistant to adopting new technology, and many continue to rely on traditional systems and processes in their operations. However, an increasing number of financial institutions across the globe are looking to leverage new technology to enhance the efficiency of their operations and expand their customer base.

The global financial technology (Fintech) industry has seen exponential growth over the past decade with total equity funding increasing from US$15.3 billion to US$78.6 billion between 2010 and 2016. The Fintech industry in Qatar remains very small, but it has seen a few start-ups such as Hasalty, a mobile application improving financial literacy for children supported by the Qatar Business Incubation Centre. However, Fintech has been gaining popularity as financial institutions begin to explore avenues for digitalizing their business and transforming their current practices. As a part of its efforts to support the Qatar National Vision 2030, the QFC held a Fintech event in January 2017. The aim of this event was to increase awareness and facilitate the adoption of Fintech in Qatar.

Islamic Fintech remains a nascent segment accounting for a minute (less than 1%) share of the market, reflecting a currently limited number of participants. The most common area for financing from new Islamic Fintech start-ups is MSMEs. One of the most important and disruptive Islamic Fintech ventures is Dubai-based Beehive, a certified Shariah-compliant peer-to-peer (P2P) platform providing low-cost alternative funding to SMEs, which provided more than US$ 4 billion in financing to SMEs in the UAE.

ISLAMIC FINTECH TO TRANSFORM ISLAMIC FINANCING MODELS

As the growth of the Islamic finance industry continues to outpace that of conventional finance, Islamic Fintech will become an important factor in maintaining industry growth. With a wealth of opportunities on the horizon, Fintech will transform traditional models of Islamic financial services, expanding the reach and availability of Islamic finance products. Islamic financial institutions will benefit greatly from Fintech and blockchain technologies, which will help simplify transactions that are based on complex structures. By standardizing and expanding their offering online, expecting to see a significant increase in mobile payments and money transfer platforms.

Shariah-compliant P2P lending and crowdfunding platforms are expected to play an important role in filling the gap in SME funding provided by Islamic banks, offering more choices and better access to funds at competitive prices. These platforms operate online, making their processes more streamlined and efficient in terms of operating costs and application turnaround times compared to Islamic banks.

REGULATION A KEY CHALLENGE

The primary challenge posed to Islamic Fintech is regulation. As only a few regulators have begun to develop frameworks for the Fintech industry, the implementation of these regulations often lags behind. The rapid development of technology, the main driver of the Fintech industry, makes it difficult for regulators to keep up pace with these changes.

Islamic Fintech practices in particular require further scrutiny by regulators, in terms of adherence to Shariah governance and compliance standards. This oversight is imperative for ensuring financial stability, consumer protection and attracting wider participation from investors in the market.

QATAR AND THE GCC'S COMPETITIVE ADVANTAGE

There is a consensus among various stakeholders that nurturing local Fintech ecosystems is important for the region. GCC countries are still in the early stages of developing deep Fintech ecosystems; however they already possess key elements to harness Fintech potential. These factors include:

- Business environment offering a dynamic technology startup community developing state-of-the-art solutions tailored to the region;
- Government and regulatory support through economic development initiatives that facilitate setting up of Fintech start-ups and the development of the ecosystem;
- Access to capital and financial expertise through government-backed funding programs and incubators, venture capitalists, and local financial institutions.

A tourist takes pictures of a ceramic cenotaph from Central Asia in the Museum of Islamic Arts, Doha. REUTERS/JAMAL SAIDI

THE INSURANCE SECTOR IN QATAR

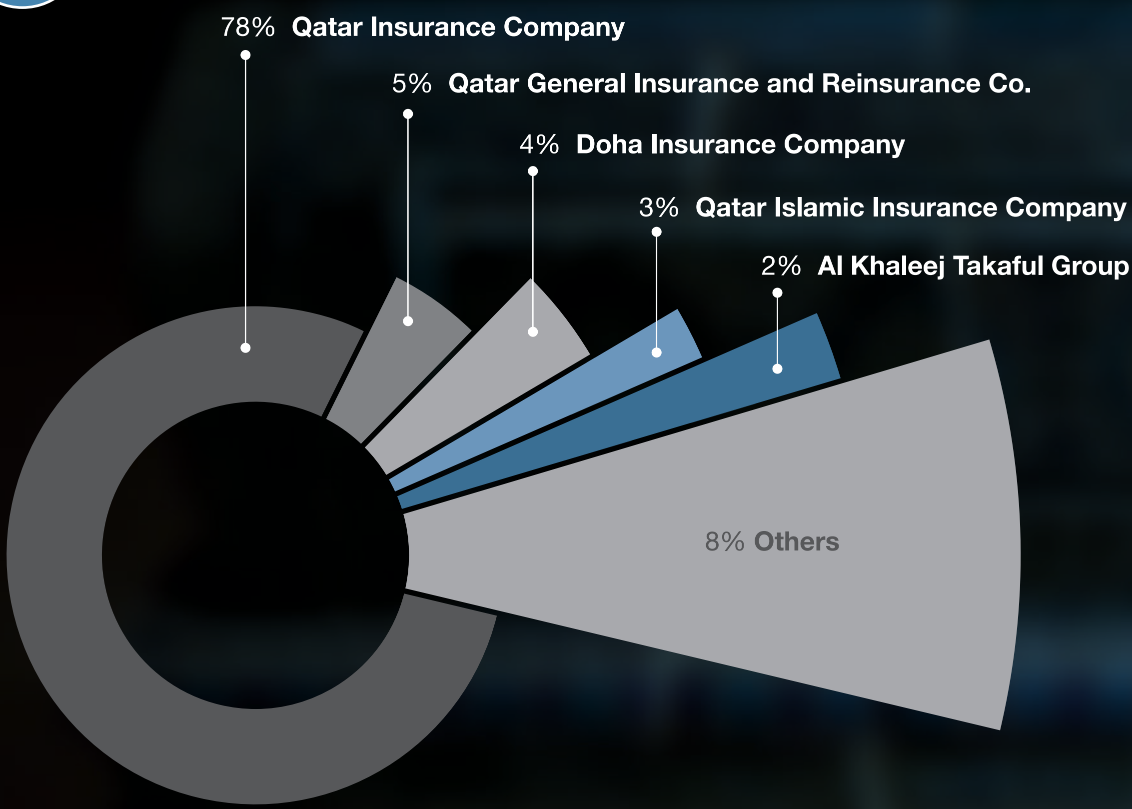
INSURANCE SECTOR IN QATAR

QCB TAKAFUL OPERATORS (No. of companies: 5)

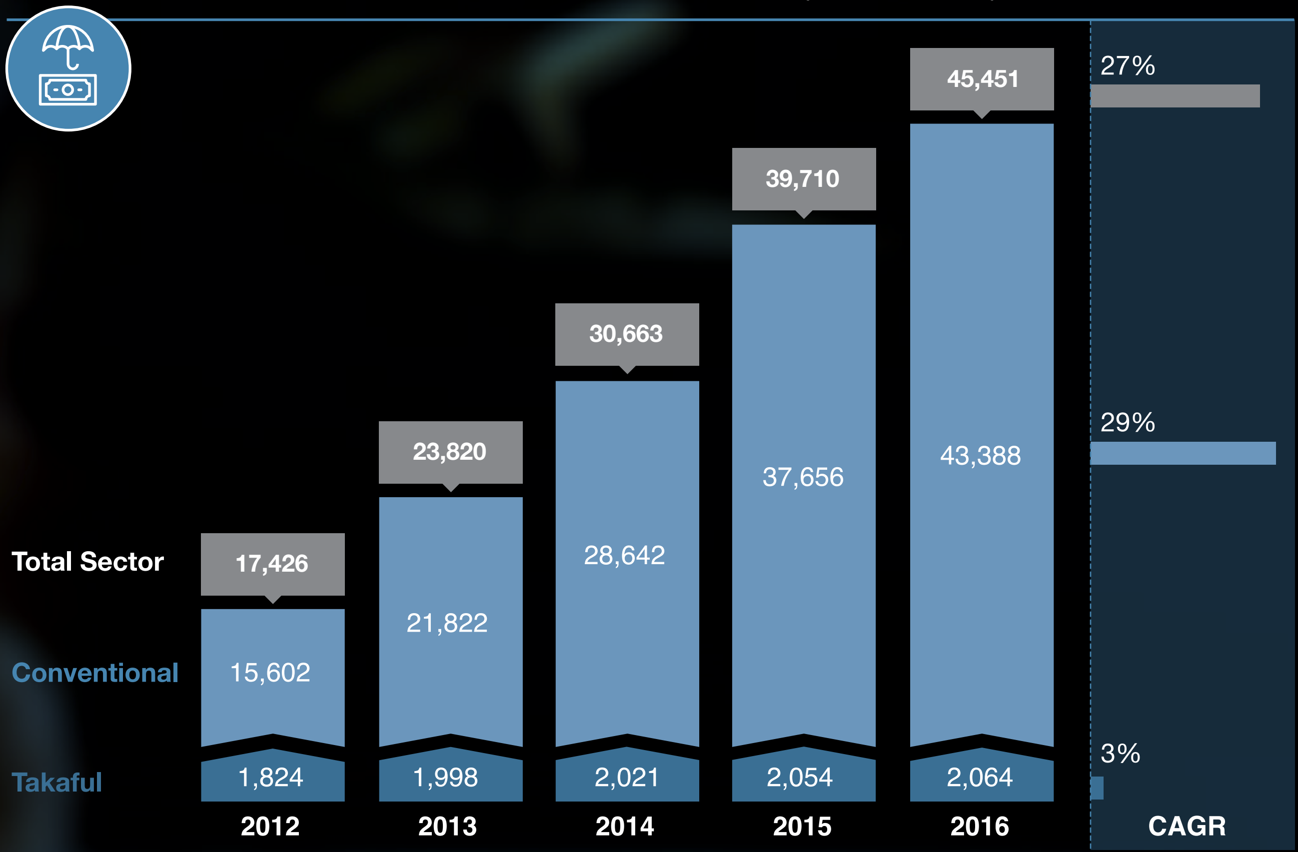
- Qatar Islamic Insurance company
- Al Khaleej Takaful Group
- Daman Islamic Insurance Company (Beema)
- Doha Takaful
- General Takaful

THE BIG FIVE — INSURANCE CONCENTRATION

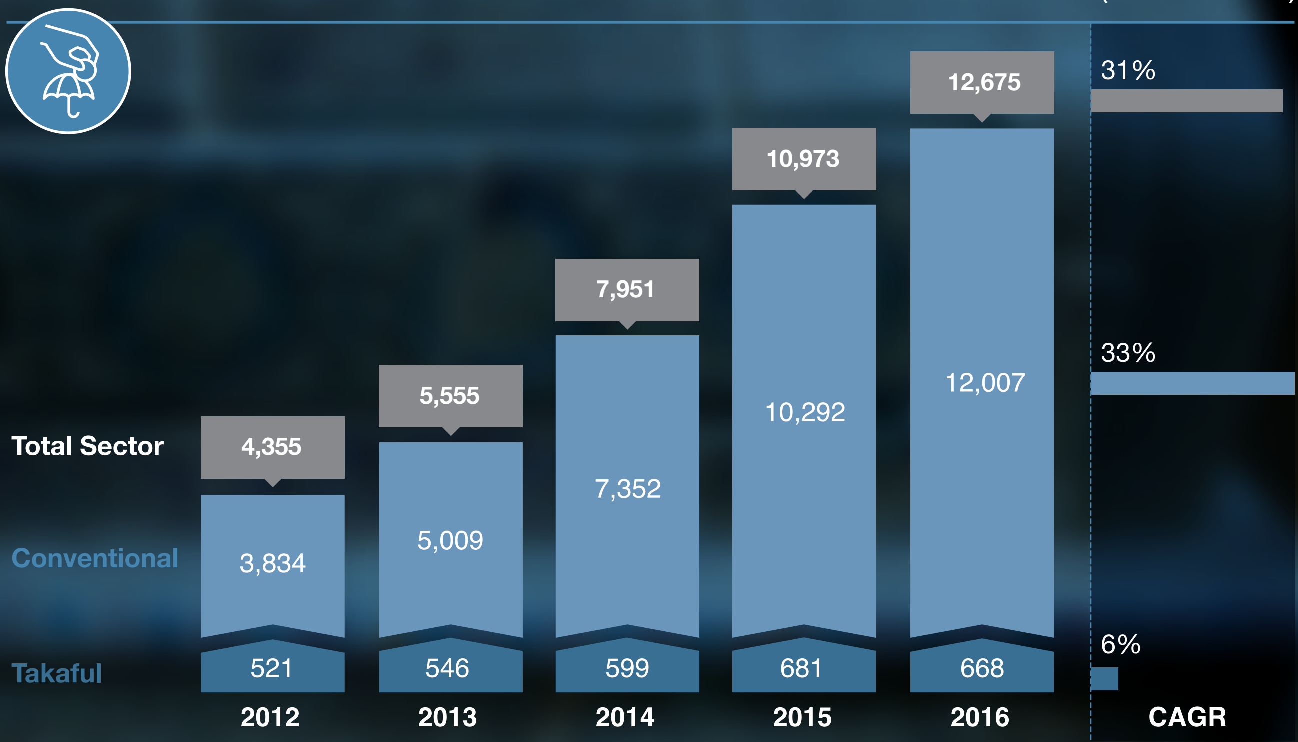
By Gross Written Premiums/Contributions



ESTIMATED INSURANCE SECTOR ASSETS (QAR Million)



ESTIMATED GROSS WRITTEN PREMIUMS/CONTRIBUTIONS (QAR Million)



INSURANCE SECTOR LANDSCAPE AND PROFILE

Qatar's insurance sector has been the fastest growing in the GCC in recent years as insurance assets maintained double digit growth—a CAGR of 27% between 2012 and 2016. Qatar has become the third largest market in the region, with premiums estimated at QAR 15.8 billion in 2016 for insurers operating under Qatar Central Bank (QCB) and Qatar Financial Centre (QFC) jurisdictions. Sector growth has capitalized on infrastructure development as part of the country's preparations for the FIFA World Cup 2022 and ongoing investment in the non-oil sector.

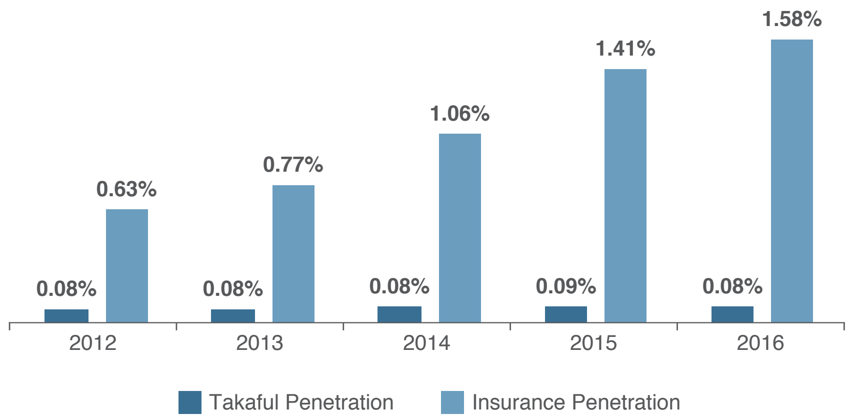
INSURANCE PENETRATION REMAINS LOW AMID RAPID GROWTH

Despite this progress, insurance penetration in Qatar remains low. The insurance penetration rate, an indicator of the development of a country's insurance sector, is the ratio of the sector's gross underwritten premiums and contributions to GDP. Insurance premiums and takaful contributions accounted for 2% of Qatar's GDP in 2016, of which 1.6% is attributed to insurance and takaful companies operating under QCB jurisdiction. This is one of the highest rates among GCC countries after the UAE and Bahrain; however, it is behind the global average of 6.9%.[1]

The penetration rate for the overall QCB insurance sector[2] has more than tripled from 0.6% of GDP in 2012, although takaful penetration has remained flat at 0.08% during

1 Swiss Re Sigma, "World Insurance in 2016: the China growth engine steams ahead," No 3/2017, accessed 6 September 2017.
2 Historical analysis of insurance penetration excludes QFC insurers as financial data for QFC insurance sector is only available from 2014.

Figure 70 QCB INSURANCE AND TAKAFUL PENETRATION IN QATAR (GROSS PREMIUMS/CONTRIBUTION AS % OF GDP) 2012–2016



Source: Annual Reports, Thomson Reuters Analysis

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 GDP growth has been particularly high in the past decade.

Qatar insurance density highest in GCC, supported by commercial lines

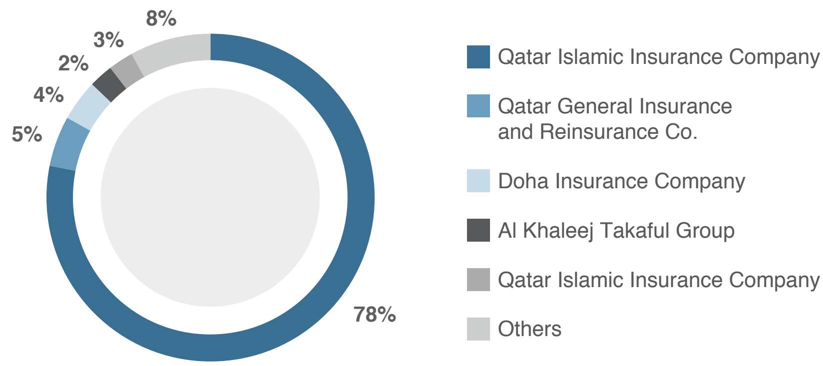
Defined as the ratio of gross premiums and contributions of the insurance sector to the total population, insurance density is a measure of insurance coverage in the country. In line with insurance penetration for the overall sector, insurance density in Qatar has also seen consistent growth between 2012 and 2016. In 2016, the level of insurance density in Qatar was estimated at US$1,352 per capita, compared to a global average of US$638 per capita. Qatar's insurance density is the highest in the GCC, with only the UAE also passing the US$1,000 per capita mark. High insurance density in Qatar has been driven by double-digit growth in gross premiums and contributions, mainly in commercial lines owing to increased government spending on large-scale infrastructure projects.

INSURANCE ASSETS CONCENTRATED AT THE "BIG FIVE" INSURERS

As at the end of 2016, there were 28 insurance firms operating in Qatar. These firms fall into two segments: those that operate under QCB jurisdiction and those operating inside the QFC. The insurance sector regulated by the QCB comprised 13 firms — eight conventional insurers and five takaful operators. These firms generate the major share of the industry's premiums, dominated by five domestic insurers that control 92% of the sector's assets under the QCB's jurisdiction. Known as the "Big Five," these firms are: Qatar Insurance Company (QIC), Qatar General Insurance and Reinsurance Company (QGIRC), Doha Insurance Company, Qatar Islamic Insurance Company (QIIC), and Al Khaleej Takaful Group. All five are general insurers, which offer primarily non-life insurance policies including marine and aviation, engineering, property and casualty, medical and personal insurance.

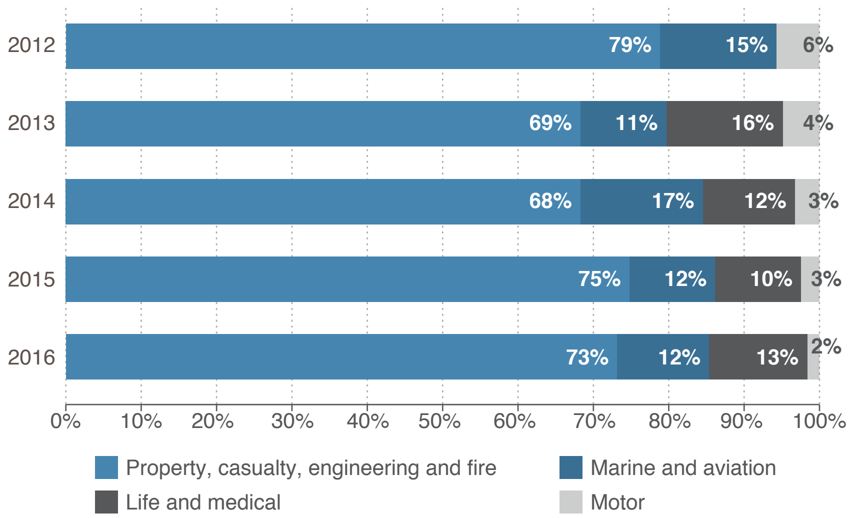
QIC is the dominant player in the insurance sector, with nearly an 80% market share based on gross premiums, which has increased significantly from a 59% share in 2012. This significant increase in market share was driven by rapid growth in property and casualty premiums, which was at an average of 60% per

Figure 71 “BIG FIVE” MARKET SHARE OF QATAR INSURANCE MARKET (% OF TOTAL PREMIUMS/CONTRIBUTIONS) — 2016



Source: Annual Reports, Thomson Reuters Analysis

Figure 72 BREAKDOWN OF GROSS WRITTEN PREMIUMS/ CONTRIBUTIONS FOR QCB INSURANCE SECTOR 2012–2016*



*Based on a sample of insurance and takaful companies accounting for 85% of gross written premiums/ contributions.
Source: Annual Reports, Thomson Reuters Analysis

year in 2014 and 2015, followed by over 30% annual growth in health and life premiums. The remaining four of the “Big Five” insurers each hold a share of 2-5% of industry premiums.

Takaful segment dominated by two key players

The introduction of takaful in Qatar occurred in 1995 with the establishment of QIIC. For the following 15 years, QIIC was the sole takaful operator in the country, and it achieved strong growth in takaful contributions. In 2010, Al Khaleej Insurance and Reinsurance Company (now Al Kahleej Takaful Group) converted to a full-fledged takaful operator, joining QIIC. These two companies dominate the takaful sector, as two of the Big Five insurers. The other three takaful operators are either partly or fully owned by the Big Five conventional insurers. They include one full-fledged operator, Daman Islamic Insurance Company (partly owned by QIC). There are also two takaful windows: Doha Takaful (a branch of Doha Insurance Company) and General Takaful (a subsidiary of QGIRC).

QFC insurance sector – relatively small, mostly international operators

Alongside the firms regulated by the QCB, there were 15 insurers operating within the QFC. The majority of these firms are foreign, split between five LLCs and ten branches. Of these firms, three are takaful operators. The QFC’s insurance sector is relatively small: the assets of its 15 insurers totaled QAR 4.5 billion at the end of 2016, equivalent to only 10% of the insurance sector outside the QFC (regulated by the QCB). This is the result of moderate barriers to market entry: the “Big Five” national insurers that dominate the sector have the first right of refusal on contracts for government infrastructure projects.

INSURANCE AND TAKAFUL DRIVEN BY NON-LIFE BUSINESS

The insurance sector in Qatar primarily serves non-life business lines: the largest category is property, casualty, engineering and fire insurance, which has grown in line with the country’s rapidly expanding energy sector. Marine and aviation insurance are the next major line of business, followed by motor insurance, driven by a mandatory third-party insurance law. Another quickly expanding non-life business is medical insurance, which has gained traction since the government imposed compulsory medical insurance for all nationals and expatriates in Qatar. The government-run scheme, "Seha," that was launched to provide this insurance was suspended and ceased operations by the end of 2015. The government decided instead to hand over the management of the scheme to private insurers, aiming to develop the private insurance sector. In 2015 and 2016, health and life premiums for QIC grew by over 30% in each year, and contributions for the same segment at Al Khaleej Takaful grew by 25% in 2016, which can be attributed to increased awareness on the back of the campaign for the "Seha" program.

Conversely, life insurance as a market segment is almost non-existent. It contributes minimally to the overall insurance sector and its premiums maintain a flat level of 0.03% of GDP.[3] As a result of high levels of government social spending and socio-religious beliefs, demand for life insurance from the local population remains considerably low. It is worth noting that the life insurance segment is controlled by international firms based in the QFC.

With new regulations for insurance intermediaries soon to be issued by the QCB, the operational efficiency of insurance brokers will likely improve, lifting the operating standards of the segment as a whole.[4] Revamping business practices will remedy low penetration in personal lines of insurance, and insurance intermediaries will be able to boost their commissions on these lines, especially the life business, by targeting the retail market.

Table 9 AGGREGATE REINSURANCE CESSION RATE IN QATAR (% OF TOTAL GROSS PREMIUMS AND CONTRIBUTIONS) 2012–2016

	2012	2013	2014	2015	2016
Overall sector	49%	41%	33%	23%	21%
Conventional	47%	40%	31%	21%	19%
Takaful	52%	54%	56%	50%	49%

Source: Annual Reports, Thomson Reuters Analysis

Insurers reducing reliance on reinsurance

Qatar's insurance sector is small and fragmented, with local insurers lacking capacity to manage their high levels of risk coverage for energy-related projects, both in terms of expertise and capital. As a result, the local insurance sector transfers a significant share of its gross premiums to the reinsurance sector. Many firms have traditionally sought reinsurance services outside the country, mainly in the Middle East, Asia and Europe.

Although many underwriters had historically retained less than 10% of their gross premiums, this percentage increased significantly in the past decade. The reinsurance cession rate is an indicator of the level of risk that is retained by insurers, as measured by the percentage of gross written premiums that is ceded to reinsurers. By 2012, the aggregate cession rate for Qatar's overall insurance sector stood at 49%, while takaful operators ceded 52% of their written contributions. In the past five years, cession rates have continued to drop, falling to 21% for the overall sector and to 49% for takaful operators in 2016. This can be attributed in part to insurers expanding their portfolios in lower-risk segments, such as motor and health insurance, which typically have a higher retention rate.

In addition, firms such as QIC have set up their own reinsurance entities, which focus on external markets to develop their operations. QIC established Qatar Reinsurance in 2009, which was then named the largest reinsurer in the MENA region by insurance rating agency AM Best. Qatar Reinsurance recorded gross premiums of QAR 5.82 billion (US$1.6 billion) in 2015, doubling from the previous year. The next top reinsurers in the region reported less than QAR 1.1 billion (US$300 million) in gross premiums in the same year. To expand its international business, the reinsurer has established branches in Zurich and Bermuda as well as a representative office in London.

3 Swiss Re Sigma, "World Insurance in 2016: the China growth engine steams ahead," No 3/2017, accessed 6 September 2017.
4 Clyde & Co. "Qatar Central Bank: Executive Instructions to Insurers," 8 May 2017.

SECTOR SIZE, GROWTH AND PERFORMANCE

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 92% of sector assets.

INSURANCE SECTOR SEES DOUBLE DIGIT GROWTH, TAKAFUL STAGNANT

By the end of 2016, Qatar's insurance sector assets reached an estimated QAR 45.5 billion, after a five-year CAGR of 27%. Assets grew by 15% in 2016 alone, up from QAR 39.7 billion in 2015—a reduced rate compared to previous years. The sector was valued at QAR 17.43 billion in 2012, and grew by 37% in 2013, 29% in 2014 and 30% in 2015 respectively. The strong growth of these years was the result of rapidly increased spending on infrastructure development and the high price of hydrocarbons, boosting energy and engineering insurance. However, as energy prices have remained consistently low since 2014, stagnation in the energy industry has put friction on Qatar's economic growth overall. Even if insurance growth slows, it 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.

In general, the growth of total insurance assets has been driven by double digit growth in assets of conventional insurers, which dominate activity in the sector. Asset growth in this segment reflects a consistent and healthy level of growth in cash and equivalents as well as insurance receivables, in line with a CAGR of 30% in gross premiums for the segment.

On the other hand, growth in the takaful segment has remained muted. After a 10% jump in the value of takaful assets in 2013, growth dropped to 1% in 2014, falling further to 0.5% in 2016. This segment was dragged down by a significant decline in cash and contributions receivables experienced by Al Khaleej Takaful Group, the largest operator in the segment. This was met with a significant drop in Al Khaleej's retained earnings between 2013 and 2016, which fell by around 98% (a drop of around QAR 220 million).

STRONG PREMIUM GROWTH, BUT TAKAFUL HELD BACK BY MAJOR PLAYER

Insurance premiums for the overall sector are estimated to have reached QAR 12.7 billion by the end of 2016, following the same growth trajectory as insurance assets. Gross premiums grew by 16% from QAR 11 billion. However, growth has significantly slowed down compared to previous years. Premiums saw outstanding growth of 43% in 2014, but this growth began to slow in the following year to 38%. As with assets, growth in premiums follows the country's pattern of slowing economic growth since 2014.

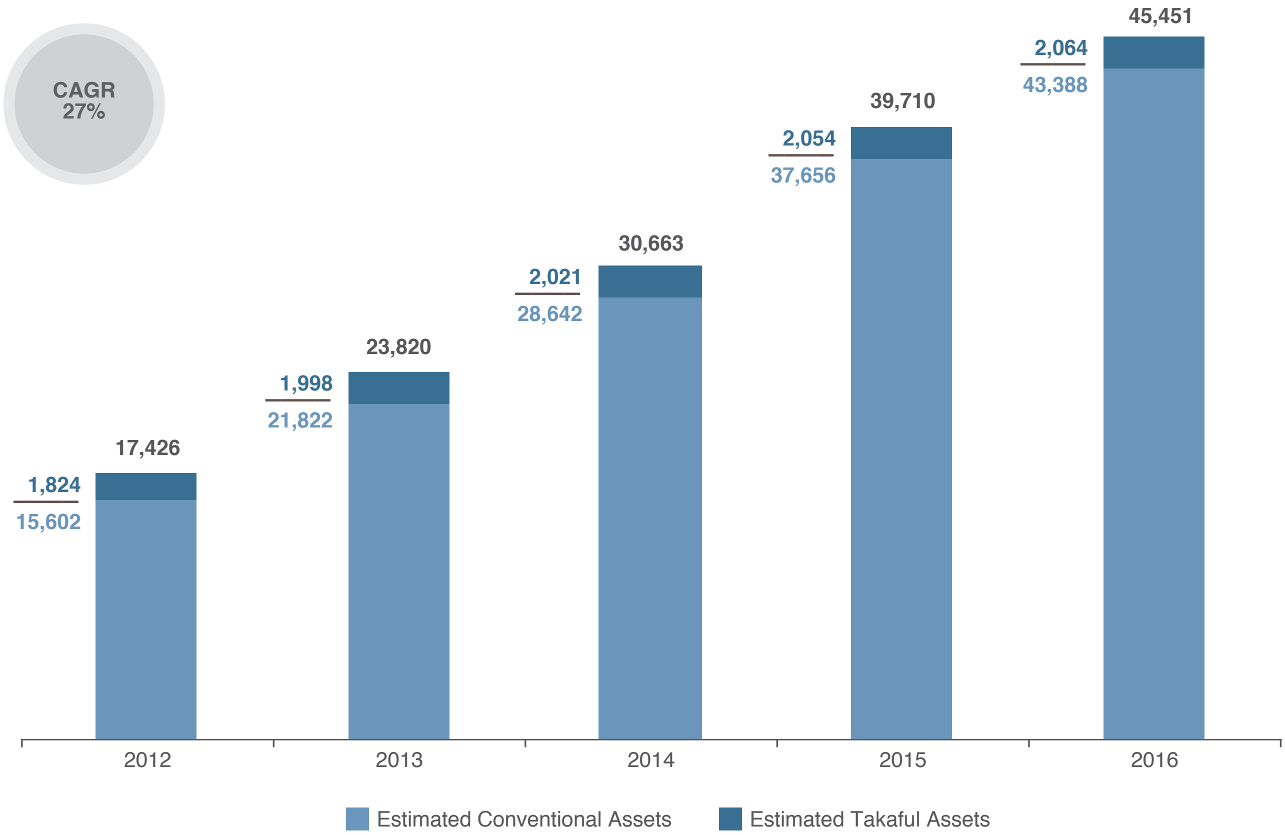
Growth in premiums is attributed to the conventional segment of the sector, which grew at a CAGR of 33% between 2012 and 2016. The significant growth in this segment was focused in the non-life business, which is dominated by conventional insurers. The property and casualty line, in particular, has seen significant growth in premiums within this segment in line with growing spending on the country's infrastructure development projects.

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.

Although gross takaful contributions have also witnessed double-digit growth since 2012, they have not kept the pace of conventional premiums. Gross contributions grew by 5% in 2013, 10% in 2014, and 14% in 2015. However, in 2016 total takaful contributions fell by 2%.

Both QIIC and Al Khaleej Takaful have enjoyed positive contribution growth between 2012 and 2015. However, as QIIC's revenues continued to grow in 2016, Al Khaleej saw a 9% reduction in its gross contributions. The downturn at

Figure 73 ESTIMATED QCB INSURANCE SECTOR ASSETS (QAR MILLION) 2012–2016



Source: Annual Reports, Thomson Reuters Analysis

Al Khaleej occurred in the contributions of its two largest businesses, motor insurance and general accident (including engineering and fire insurance). While the latter segment's contribution fell by 6.5% in 2016, the biggest hit to total contributions came in the motor business, where gross contributions plummeted by 29% during 2016.

On the other hand, the life and medical takaful business at Al Khaleej, which had expanded gradually between 2012 and 2015, saw a significant jump in contributions of 25% in 2016. As for the smallest segment, marine and aviation insurance saw minor fluctuations in contribution levels since 2012, with overall growth remaining flat. Nonetheless, positive results in revenues from the smaller business segments were not sufficient to offset the significant loss in contributions of the larger segments.

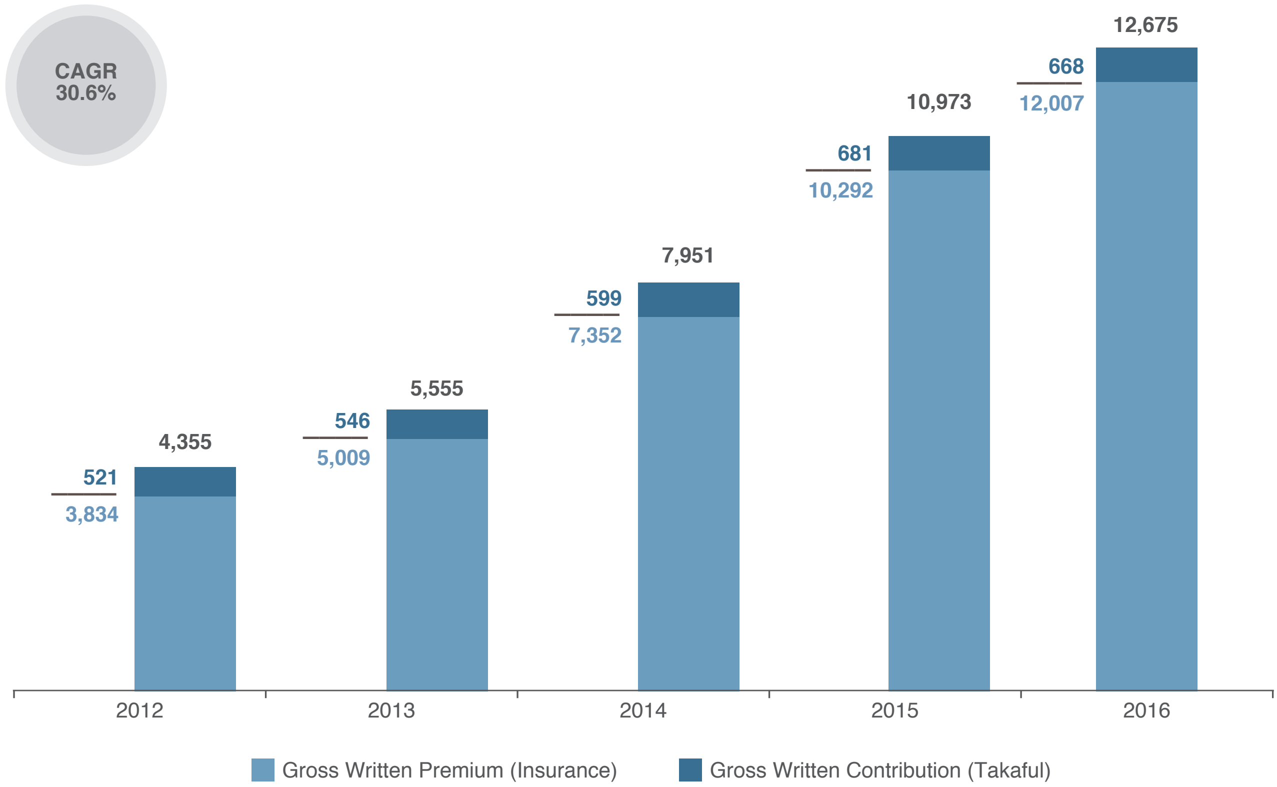
The reason for this poor performance appears to be idiosyncratic. The cause behind lower contributions does not stem from market developments, as the overall sector sustained high levels of growth over the past five years. The overall sector saw a significant slowdown in premium and contribution growth in 2016, and Al Khaleej has historically performed poorly compared to its peers, including its main takaful competitor QIIC.

Sector profitability in decline despite notable contribution growth

The declining profitability of the insurance sector at large indicates that the exponential growth seen over the last five years has come at a cost. Total profits have fallen each year after an outstanding one-time growth of 136% in profit to shareholders in 2013. Profits fell by 38% in 2014, 21% in 2016 and 22% in 2016. Owing to their majority share of the market, conventional insurers saw a similar level of decline in their profit.

Takaful operators, on the other hand, fared slightly better than their conventional counterparts in 2014, as profits actually grew by 8%.

Figure 74 GROSS WRITTEN PREMIUMS/CONTRIBUTIONS (QAR MILLION) 2012–2016



Source: Annual Reports, Thomson Reuters Analysis

However, they subsequently fell by 15% in 2015 and 39% in 2016. The decline in profitability throughout the sector can be attributed to rising operating expenses, mainly general and administrative expenses, signaling the need for insurers and takaful operators alike to improve the cost efficiency of their business models.

SIGNIFICANT IMPROVEMENT IN TAKAFUL LOSS RATIO

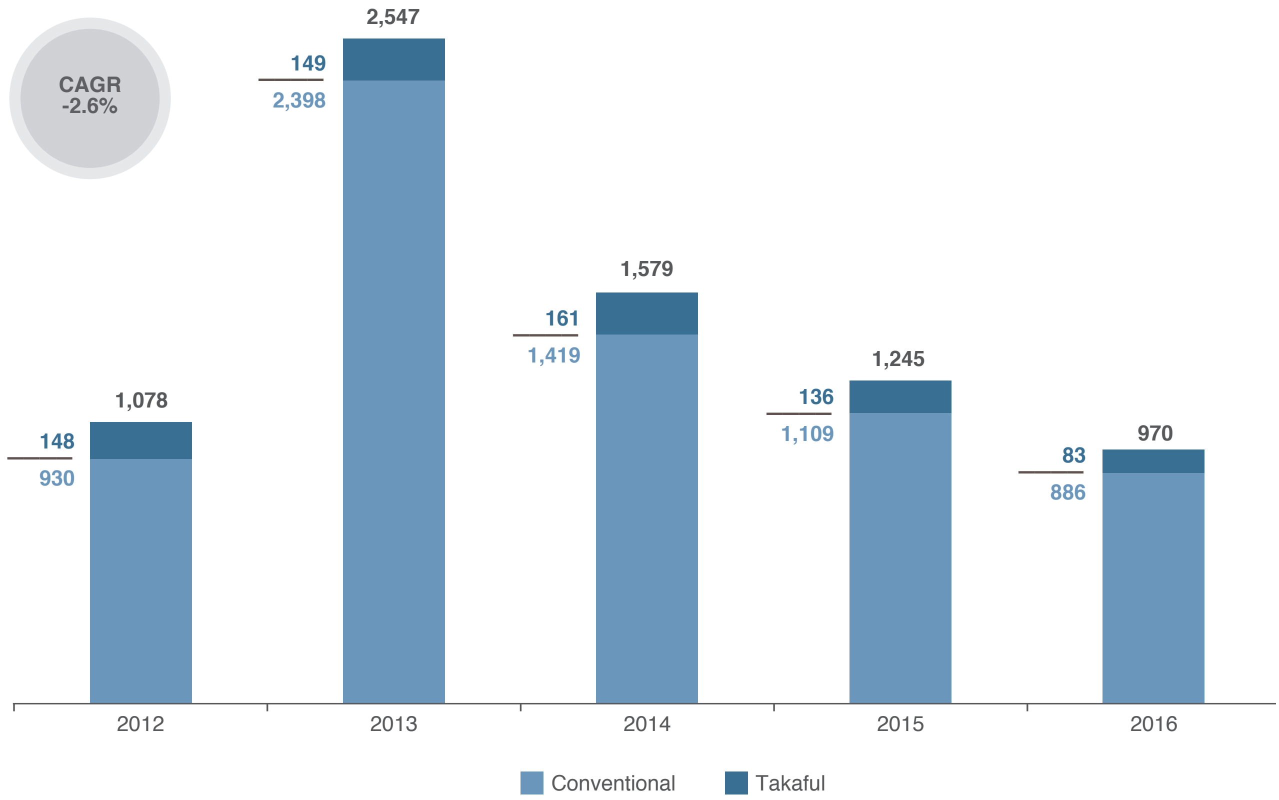
The sector's loss ratio, i.e. net claims paid to net earned premiums, has remained relatively stable over the last five years, rising by only 2% between 2012 and 2016 and remaining mostly around the 66% level. Conventional insurers have seen the highest loss ratios in the health and life segment, which remained over 70% since 2013. This is followed by the motor insurance segment with a claims ratio exceeding 60% during the same period.

As for takaful operators, their loss ratio has significantly improved, dropping from 68% in 2013 to 44% in 2016. The motor takaful segment at Al Khaleej Takaful had the highest claims ratio of any segment, reaching 83% in 2016. Nonetheless, this significant improvement in claims ratios reinforces the conclusion that operating expenses have been a drag on profits in recent years, as expense ratios for takaful operators have increased by 6% between 2012 and 2016.

The expense ratio for the takaful segment far exceeds that for the overall insurance sector. This is primarily a result of the additional management costs from wakalah and mudarabah fees. The smaller scale of takaful operators means that they are less able to capitalize on economies of scale to efficiently manage their operating expenses.

Takaful operators can improve the cost efficiency of their operations through bancatakaful. By leveraging the larger scale of Islamic banks' client bases and distribution channels to sell their products, takaful operators would be able to broaden their client base and more efficiently manage their costs through economies of scale.

Figure 75 ESTIMATED PROFIT/SURPLUS FOR QCB INSURANCE SECTOR (QAR MILLION)



Source: Annual Reports, Thomson Reuters Analysis

Table 10 LOSS RATIO FOR QCB INSURANCE SECTOR (NET CLAIMS INCURRED/NET PREMIUMS EARNED) 2012–2016

	2012	2013	2014	2015	2016
Overall	66%	65%	65%	66%	68%
Takaful	62%	68%	57%	52%	44%

Source: Annual Reports, Thomson Reuters Analysis

Table 11 EXPENSE RATIO FOR QCB INSURANCE SECTOR (OPERATING EXPENSES/NET PREMIUMS EARNED) 2012–2016

	2012	2013	2014	2015	2016
Overall	38%	39%	35%	33%	38%
Takaful	71%	72%	74%	65%	77%

Source: Annual Reports, Thomson Reuters Analysis

OPPORTUNITIES AND GROWTH POTENTIAL

INFRASTRUCTURE DEVELOPMENT OPENING DOORS FOR DOMESTIC INSURERS

In line with Qatar's overall economic growth projections, it is anticipated that insurance growth will slow in coming years as the government introduces measures to rationalize public spending and promote the role of the private sector and SMEs in the economy. Although it may moderate, Qatar's insurance sector is still expected to grow at a faster pace than the rest of the region until 2019, according to the QFC's 2015 "MENA Insurance Barometer." Growth opportunities will be concentrated in the non-life segments of the market, primarily in property and casualty insurance, which are projected to see premium growth of up to 10% annually over the next two years, according to S&P Global Ratings.

Privatization of compulsory health insurance a boost for health and life competitiveness

In 2013, the government introduced "Seha," a state-run mandatory health insurance program that was intended to serve Qatari citizens and expatriates alike. However, in 2015, prior to implementing the scheme's final phase, the government suspended the program. This decision by the Qatari Cabinet aimed to support private insurers, whom it deemed would be able to manage the scheme more efficiently, given their established medical insurance businesses and their expertise in this field. Following this, the Ministry of Public Health, the Ministry of Finance and the QCB formed a committee to develop a similar scheme in its place that would be privately managed by the insurance sector, to be introduced in 2017. The plan is intended to encourage insurers to enhance their medical offerings and subsequently reduce price wars between operators. It could significantly boost Qatar's health insurance market, which remains smaller than those of most countries in the region.

> *Growth opportunities will be concentrated in the non-life segments of the market, primarily in property and casualty insurance, which are projected to see premium growth of up to 10% annually over the next two years.*

INFRASTRUCTURE DEVELOPMENT DRIVING NON-LIFE GROWTH PROSPECTS

Infrastructure projects in preparation for World Cup in 2022, Doha.
SOPHIE JAMES / SHUTTERSTOCK.COM

Growth will primarily be sustained by increased government spending on infrastructure and construction projects related the upcoming FIFA World Cup 2022 and National Vision 2030. This, coupled with the government's preference to award such contracts to local companies, bodes well for the Big Five domestic insurers.

NATIONAL INSURANCE CONSORTIUM

As the sector remains relatively small, individual insurers present in Qatar currently do not possess the capacity to cover project risk on the large scale of currently ongoing infrastructure projects in the country.

Tackling this challenge, domestic insurers have formed various consortiums in recent years to pool their risk capacities, enabling them to provide insurance coverage for multiple large-scale projects. One such consortium is the National Insurance Consortium, which has been awarded 80% of the capital expenditure insurance contract for the construction of seven stadiums for the 2022 World Cup. The consortium was formed by six domestic insurers: Qatar Islamic Insurance Company, the leader in this particular contract, Qatar Insurance Company, Qatar General Insurance & Reinsurance Company, Al Khaleej Takaful Group, Doha Insurance Company, and Al Koot Insurance & Reinsurance Company.

The consortium also provided extensive insurance cover to other major development projects. In April 2014, Qatar Rail—the government entity developing the country's new rail network—awarded the country's largest ever insurance contract to National Insurance Consortium, in partnership with QFC-based SEIB Insurance.

DEVELOPMENTS IN REGULATION

REGULATORS STRIVING FOR ROBUST REGULATORY FRAMEWORK FOR INSURANCE

With aims to establish Qatar as a global financial hub, the QCB has been taking steps in recent years to improve the insurance sector's regulatory environment and to adopt international best practices and standards. Significant changes are expected, following the QCB's introduction of a regulatory framework for insurers, which is likely to be in line with international industry standards and the Insurance Core Principles set by the International Association of Insurance Supervisors (IAIS).

As a part of the QCB Law (Law No.13 for 2012), the QCB assumed the regulation of the insurance sector from the Ministry of Economy and Commerce, becoming the sector's primary regulator. With the QCB's more proactive approach to regulation, the sector has seen increased supervision particularly in the areas of reporting and analytics. At the same time, the QCB has also shown more flexibility regarding technical requirements.

In 2015, the QCB issued new regulatory guidelines for the insurance sector covering insurers, reinsurers and takaful operators operating outside of the QFC. These guidelines were introduced aiming to further tighten control over the sector and to restrict insurers from cross-border activities, requiring insurers operating in or from Qatar to be licensed by the QCB and only to carry out business within the scope of their licenses. They also clarify issues and requirements pertaining to the prudential and business conduct of sector players, addressing licensing, reporting and risk management. In addition, the new rules prohibit composite insurance operations, with the exception of licenses specially approved by the QCB. However, life insurers will be able to operate health and accident insurance without any special requirements. This step is intended to improve regulation of the sector. The segregation of life and non-life businesses is expected to bring consolidation in the life insurance business, although it constitutes a negligible share of the market unworthy of this separation.

The QCB's newly issued insurance guidelines filled a long-standing regulatory gap in the insurance sector and leveled the playing field for national and QFC-based insurers, which had been subject to much stricter regulation by the QFCRA compared to companies operating outside the QFC. These regulations come as part of efforts to harmonize Qatar's financial regulatory environment between Qatar's three financial regulatory agencies: the QCB, QFCRA and QFMA.

Although generally enforcing a stricter regulatory framework for insurers, the QFCRA has continued to introduce further regulatory changes in recent years. In October 2013, the QFCRA introduced a new comprehensive insurance framework, the amended QFCRA Prudential Insurance Rulebook, which was put into effect in January 2015. Similar to the QCB's 2015 guidelines, the new framework includes requirements to enhance risk management practices, impose stricter capital adequacy and valuation controls, and improve reporting procedures.

Regulators expect that imposing stricter demands on capital and management will result in smaller insurers struggling to meet these requirements, and could result in a round of mergers and acquisitions in the market.

Overhaul of insurance regulation continues, prohibiting windows and moving on to intermediaries

In March 2016, the QCB issued executive instructions for the insurance sector, in addition to principles for the governance of insurance companies, which took effect in April 2016. These instructions pertain to insurance licenses, regulations and business controls, risk management and reporting to the QCB. They also define topics relating to ownership, and converting and terminating business, allowing for a one-year transition period to the new requirements.

The executive instructions prohibit takaful operators from pursuing non-takaful business, and advise insurance companies to close any pre-existing takaful windows within two years of the instructions taking effect. Moreover, these new instructions require that listed insurance companies maintain capital of QAR 100 million, or risk-based capital determined by the QCB. The capital requirement for unlisted insurers is set by the QCB.

In another effort to enhance the insurance industry in Qatar, the QCB issued a draft for 'Intermediary

Turkish porcelain Islamic name at the Museum of Islamic Art, Doha. REUTERS/FADI AL-ASSAAD

and Service Provider Regulations' in October 2016. Expected to be issued later in 2017, these regulations primarily target insurance brokers in Qatar and aim to improve their operating standards. The new regulations are a part of the QCB's efforts to crack down on insurance brokers in violation of operating standards, and licensed brokers operating in activities other than insurance brokerage.

When the new regulations for insurance intermediaries are issued, insurance and reinsurance companies in Qatar will be required to use only licensed brokers to sell their products. These rules will also restrict brokers from operating outside the scope of licensed activities. Brokers will be required to submit regular feasibility studies and financial statements to the QCB, in addition to maintaining staff and headquarters in the country. Insurance intermediaries will need to meet qualifications set by the QCB in order to be listed as licensed insurance brokers. So far, 30 brokers have met the new qualifications, and the QCB has urged unlicensed intermediaries to follow suit.

Only 25% of insurance premiums in Qatar are currently generated through brokers, with most premiums coming through direct sales channels. However, insurance brokerage is growing as a distribution channel, with significant demand from larger businesses. Given the anticipated growth of this segment, the QCB regulations are well timed. An overhaul in the operating standards of insurance intermediaries will enhance their efficiency and increase competitiveness as their operations become standardized. Another likely outcome is the merger of smaller brokers that are already facing difficulties with operating efficiency and profitability and would struggle to meet the QCB's new requirements.

New stadium construction for the World Cup 2022, Doha. PHILIP LANGE / SHUTTERSTOCK.COM

ENHANCED REGULATORY FRAMEWORK NEEDED TO BOOST LIFE TAKAFUL

The global takaful industry has seen significant growth in recent years, which is projected to continue over the coming five years. According to the ICD-Thomson Reuters Islamic Finance Development Report, global takaful industry assets were valued at US$38 billion in 2015 and will reach an estimated US$54 billion in 2021. The takaful industry is concentrated in two markets, Malaysia, where life/family takaful is the major segment, and the GCC market, which focuses on non-life segments.

LIFE INSURANCE AND TAKAFUL STRUGGLING TO GAIN TRACTION

In the GCC, health or medical insurance and takaful are gaining ground, seeing rapid growth in premiums and contributions. However, life insurance penetration and particularly life takaful, lags behind. In Qatar, life insurance penetration is estimated at 0.03% of GDP, and life takaful penetration is likely to be even smaller. This is due to a lack of awareness and the inhibitions of the local population regarding life insurance, resulting in a lack of demand.

There are significant growth opportunities for life takaful in Qatar, given its low penetration rate. Even though group life insurance policies are compulsory for some private and semi-government sectors, the challenges facing life takaful growth still remain to be tackled by promoting Shariah-compliant insurance and further developing regulatory frameworks.

MALAYSIA'S LIFE FRAMEWORK PROVIDES POTENTIAL GUIDELINES FOR QATAR REGULATIONS

Malaysia has been a pioneer in regulating the takaful industry. Aspects of Malaysia's Life Insurance and Family Takaful framework (LIFE) can be adapted to implement better practices in regulating Qatar's life insurance and takaful segments, in addition to recent insurance regulations issued by the QCB.

The LIFE framework was introduced in 2013 to foster initiatives supporting the sustainable growth and development of the life insurance and family takaful industry, aiming for 75% life insurance and takaful penetration (up from 54% in 2013). LIFE follows a two-phased approach to place the necessary safeguards and to achieve several key performance indicators. At the same time, it ensures that consumers receive proper advice.

The framework entails the following three initiatives, which take into consideration "the current state of readiness of the industry, the level of market development and consumer literacy, and also the future vision of the industry."[1]

- Allowing greater operational flexibility in promoting product innovation while preserving policy/certificate value
- Diversifying distribution channels to widen outreach
- Strengthen market conduct to enhance consumer protection

With the implementation of the framework, the life insurance and takaful market will evolve, becoming more competitive, with diverse operators offering an expanded range of innovative products and services. Consumers will be more empowered, demanding new delivery channels, an increased level of professionalism and enhanced transparency by insurance providers.

1 BNM (2013), "Life Insurance & Family Takaful Framework: Concept Paper," accessed 6 September 2017.

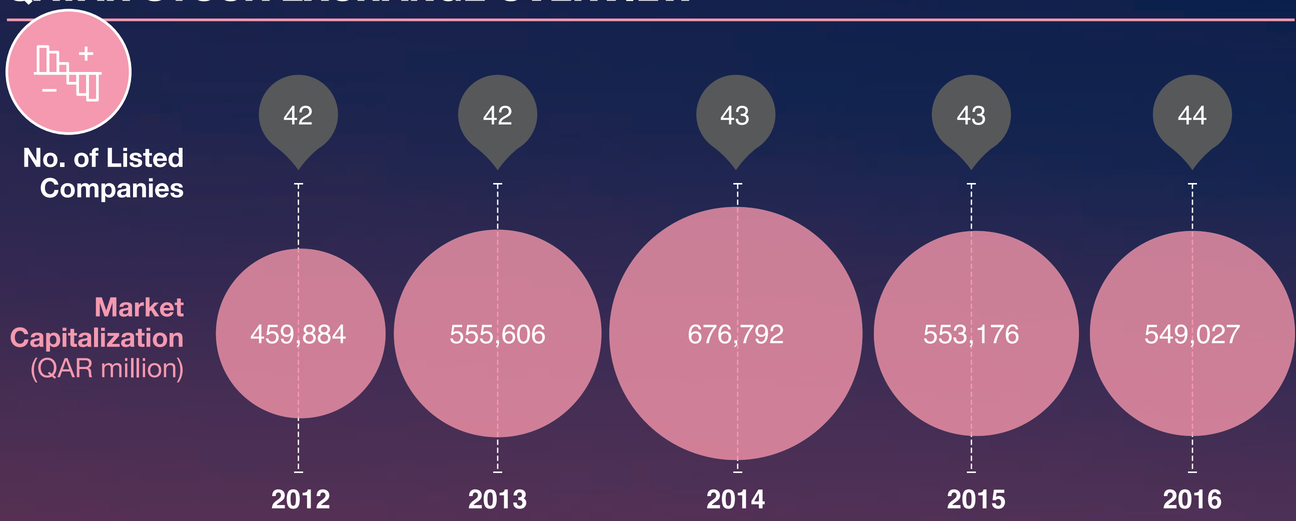
Doha Corniche, Qatar. AHMED ADLY / SHUTTERSTOCK.COM

CAPITAL MARKETS IN QATAR

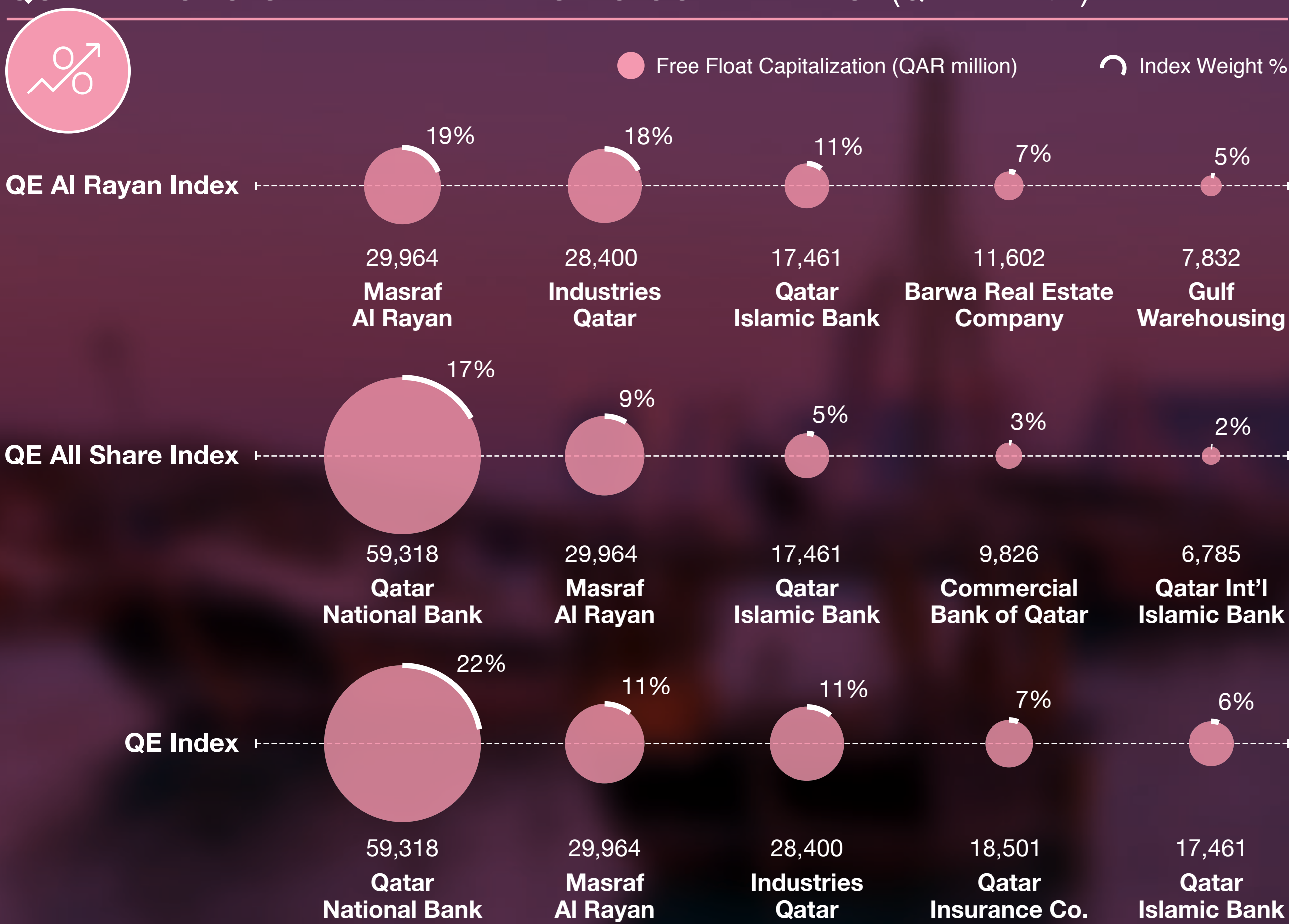
الأسواق المالية

CAPITAL MARKETS IN QATAR

QATAR STOCK EXCHANGE OVERVIEW



QSE INDICES OVERVIEW — TOP 5 COMPANIES (QAR Million)



Source: Qatar Stock Exchange

QATAR SUKUK HIGHLIGHTS

Sukuk was first issued in **2003** by the Qatari government

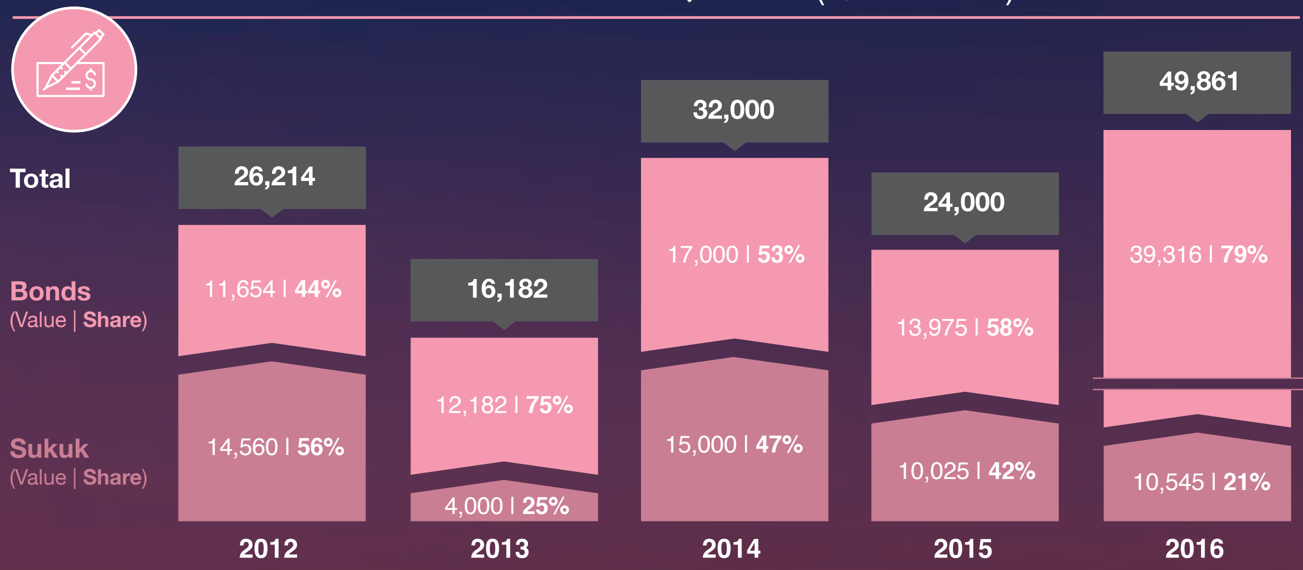
87% of Qatar sukuk are issued using ijarah structure

87% of sukuk were issued by government from 2012–2016

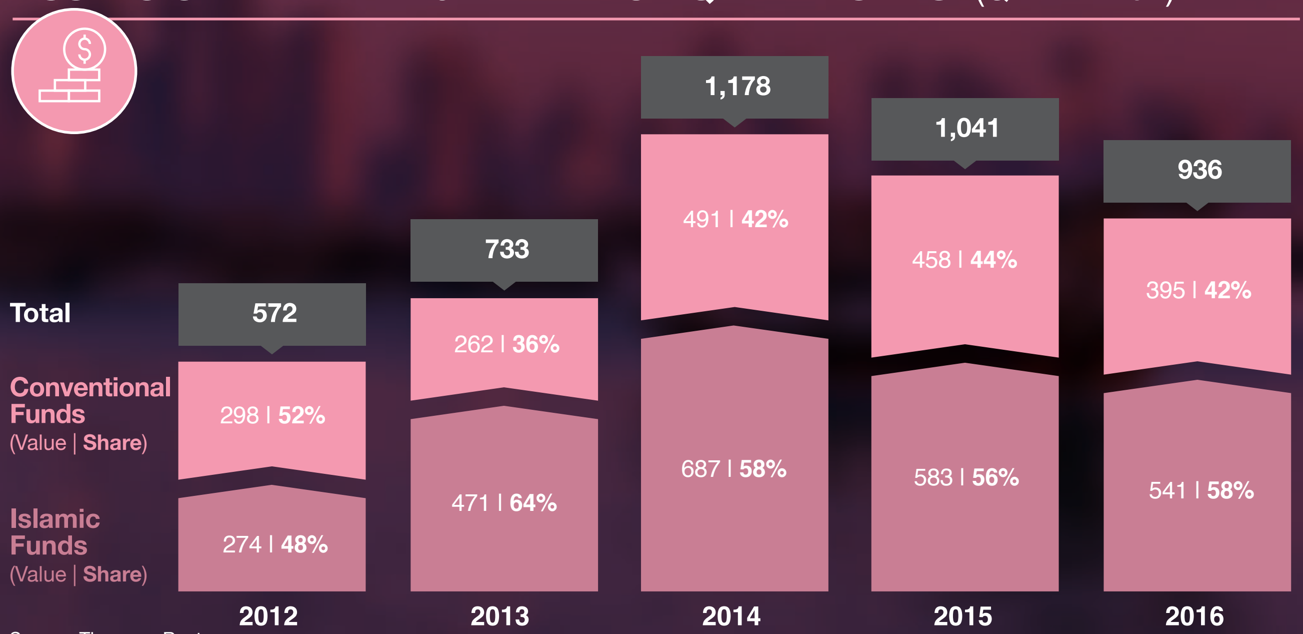
The largest sukuk to date was issued in 2011 by the government, raising **QAR 33 Billion**

QAR 25 Billion worth of sukuk will mature by 2018, accounting for 44% of the value of sukuk outstanding at the end of 2016

BONDS AND SUKUK ISSUANCES IN QATAR (QAR Million)



ASSETS UNDER MANAGEMENT FOR QATAR FUNDS (QAR Million)



Source: Thomson Reuters

CAPITAL MARKETS DEVELOPMENT

The Qatar Stock Exchange (QSE) was established in 1995 under its previous name, Doha Stock Market (DSM), and officially started operations in 1997. The main objectives of the QSE are to support the country's economy by providing a venue for local corporations to trade investment instruments and to raise capital in a transparent manner. The stock exchange is also a platform for investors and the public at large to obtain market information about listed securities and their performance.

QSE WITNESSED SIGNIFICANT DEVELOPMENT IN THE LAST DECADE

The QSE has come a long way in the past two decades, developing competency and regulations, in addition to attracting foreign investors. The stock exchange is regulated by the Qatar Financial Markets Authority (QFMA), which is also the supervisory authority for capital markets in Qatar. The stock exchange became more active following the launch of its website in 2002, which allowed investors to buy and sell shares on the same day. In 2005, non-Qatari investors were allowed to invest up to 25% of traded shares of a given Qatari shareholding company, for the first time. This limit was subsequently increased in 2014 to 49% stake in a publicly traded company.

In June 2009, Qatar's sovereign wealth fund, the Qatar Investment Authority (QIA), and NYSE Euronext signed a partnership deal to further develop capital markets in Qatar. The latter acquired a 20% share of the bourse for US$200 million.

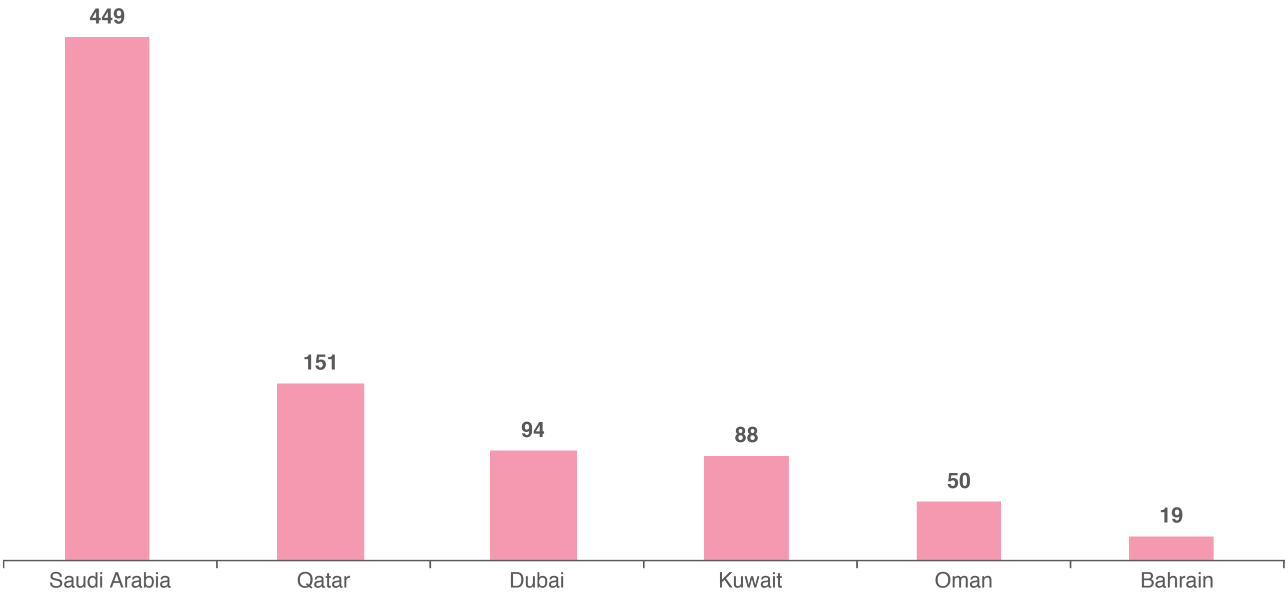
As a result of the partnership, the DSM was subsequently rebranded as the "Qatar Stock Exchange". In 2011, the Qatar Central Bank (QCB) approved the listing of Treasury bills on the QSE followed by the listing of government bonds in 2013, therefore establishing a full yield curve for the country.

The QCB introduced the Qatar Central Securities Depository (QCSD) in 2014 to assume the responsibility for clearing and settlement, which had previously been undertaken by the QSE. It also looks after securities offered for public subscription. These securities include shares, bonds, sukuk, t-bills, etc. Although the QCSD has had limited activities related to sukuk, especially in the secondary market, sound infrastructure has been put in place, which will assist a future increase in issued and traded sukuk.

The QSE launched its dedicated SME market, QE Venture Market, in 2015. In a drive to diversify the products it offers, the QSE has planned to launch Shariah-compliant ETFs as part of its offering in 2017, with the possible listing of Real Estate Investment Trusts (REITs) still under consideration.

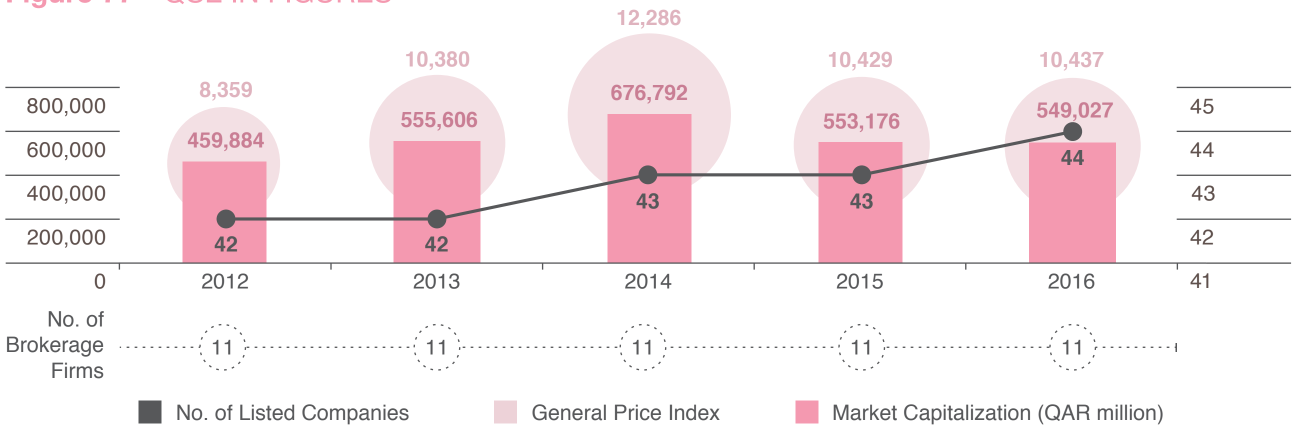
In 2017, the index witnessed the delisting of Ezdan Holding Group

Figure 76 GCC MARKET CAPITALIZATION COMPARISON (US$ BILLION) 2016



Source: GCC Stock Exchanges

Figure 77 QSE IN FIGURES



Source: Qatar Stock Exchange

Figure 78 QSE MILESTONES

1997
The first day of securities trading on the Doha Securities Market (DSM).

1998
Introduction of the Central Registration System.

1999
Investors are able to sell shares purchased on the day following the day of their purchase (T+1).

2000
Implementation of companies' linkage project through the internet. The first of its kind in the GCC at the time.

2001
Launch of the electronic trading project to replace the manual trading systems.

2002
Launch of DSM web site.

Investors able to sell their purchased shares on the same day.

Approval of a new market index to reflect changes in listed companies' prices more reliably and accurately.

2003
Move to a new building to better serve the investment community.

2005
Non-Qataris permitted to invest up to 25% of the shares offered for trading.

2006
Integration of both the regular and irregular markets.

2007
DSM becomes a member of World Federation of Exchanges (WFE).

2009
Strategic partnership agreement with NYSE Euronext to transform the DSM into Qatar Stock Exchange, a world-class market.

2011
QSE first GCC exchange to implement delivery-versus-payment (DvP) system.

QCB approves the listing of T-bills on QSE for the first time.

2013
Introduction of the selling of government bonds on QSE.

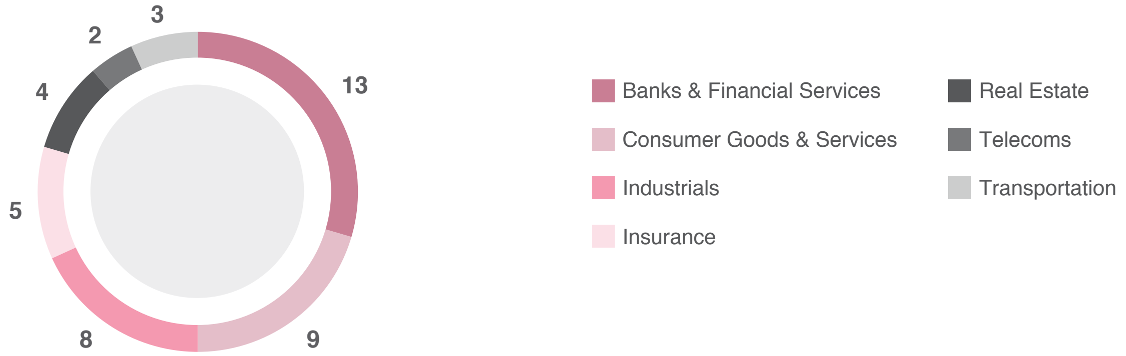
2014
Limit on Non-Qatari investment increased to 49% of the shares offered for trading.

2015
Launch of QE Venture Market, QSE's dedicated SME equity market

2016
Listing of QFC-based Qatar First Bank on the QSE

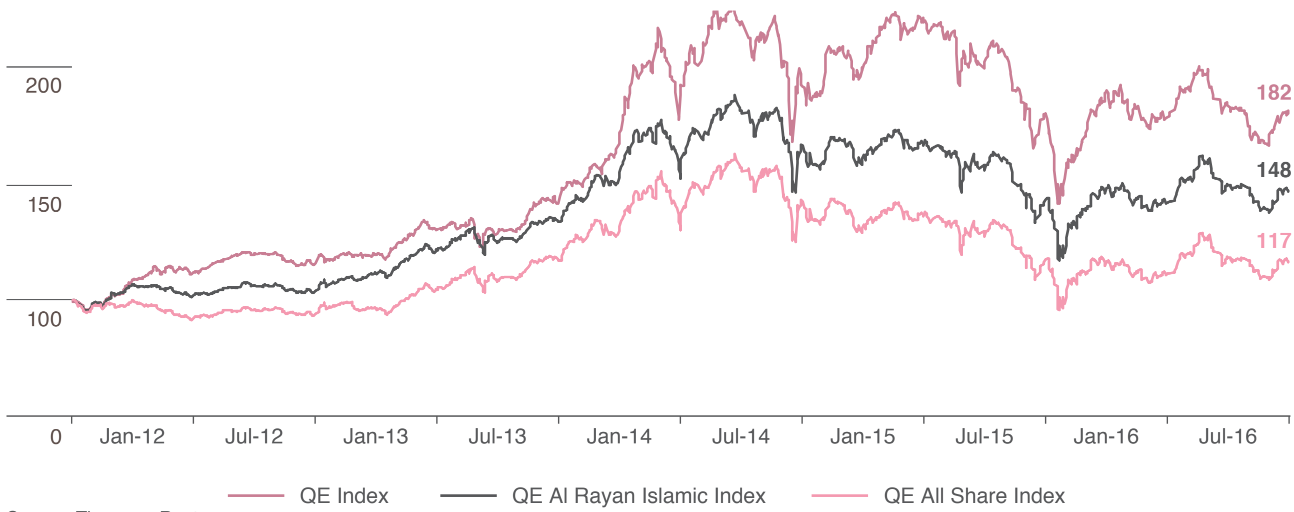
2017
Delisting of Ezdan Holding Group

Figure 79 NUMBER OF QSE-LISTED COMPANIES BY SECTORS 2016



Source: Qatar Stock Exchange

Figure 80 NORMALIZED PERFORMANCE OF QSE INDICES 2012–2016



Source: Thomson Reuters

following a decision by its shareholders to take the company private. Ezdan's share of total market capitalization had been more than 12% of the index; it was the second largest stock after Qatar National Bank (QNB). Ezdan's strategy is contrary to recent efforts by the QSE to attract more companies to be publicly listed, with the aim of increasing transparency in business.

Forty-four companies from seven sectors are listed on QSE

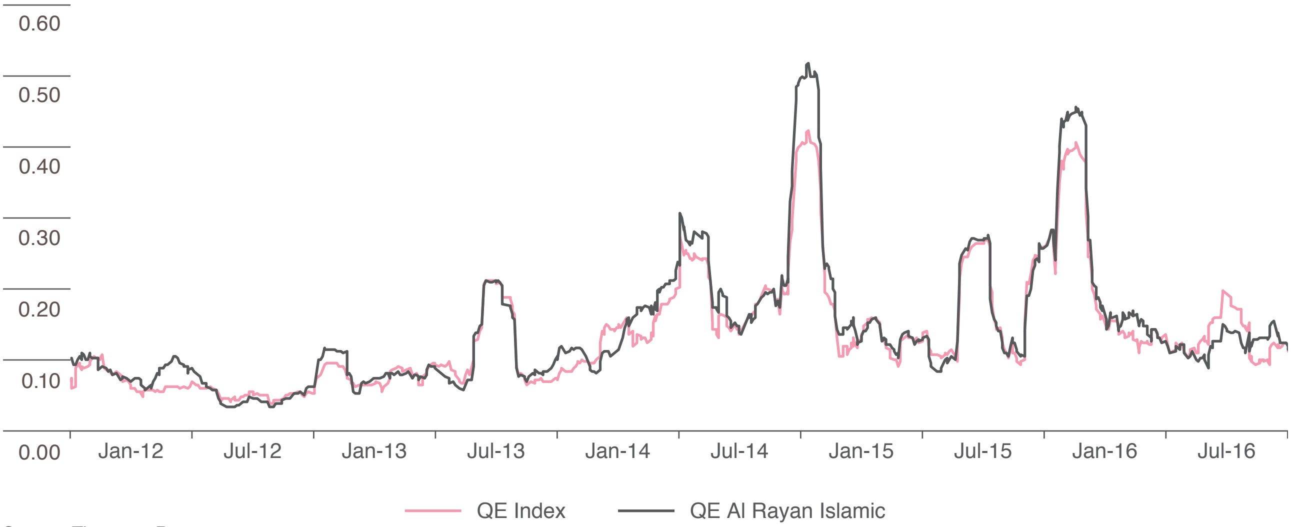
The QSE was home to 44 companies from seven different sectors at the end of 2016. The largest sector was banks and financial services, with 13 financial institutions listed on the exchange, followed by consumer goods and services (9) and industrials (8). The number of listed companies grew from 42 in 2012 to 44 in 2016 with the addition of Mesaieed Petrochemical Holding Co. and Qatar First Bank.

Generally, the main incentive for companies to seek listing on a stock exchange in the GCC is to raise capital and to provide financial transparency. In Qatar, all listed companies have investors from GCC and other foreign countries, although the majority of investors remain Qatari citizens. As of August 2017, Qatari investors invested QAR 11.8 billion, compared to GCC investors with QAR 138 million and foreign investors with QAR 997 million. By law, the QSE has capped foreign ownership of listed companies based on their size and the sector they operate in. The cap reaches a maximum level of 49% of a given company's shares, as per the 2014 amendment to the Law No. 13 of 2000.

STRONG PERFORMANCE FROM QE ISLAMIC INDEX, BUT UNDERPERFORMS QEI

The QSE maintains three stock indices, of which one is Islamic. The three indices, Qatar Exchange Index (QEI), QE All Share Index, and QE Al Rayan Islamic Index, are

Figure 81 QE AND QE AL RAYAN ISLAMIC INDEX 30-DAY VOLATILITY 2012–2016



Source: Thomson Reuters

all based on market capitalization. The performance of QSE indices has witnessed a period of stability in the past two years, following a period of fluctuation after the 2014 drop in oil prices. The QEI ended the year on a strong note, despite taking a deep dive in January 2016, growing in value by 82% between 2012 and 2016. The Islamic and the QE All Share indices have mirrored the performance of the QE Index, increasing by 48% and 17% respectively during the same period.

Masraf Al Rayan among the leading companies on QSE

The QEI consists of the top 20 companies weighted by free-float market capitalization and daily average traded value. In order to become eligible, constituents must have at least 1% individual shareholders and have had shares traded during at least 80% of the trading days in the last quarter of the review periods, in April and October. The top three companies by value by the end of 2016 were Qatar National Bank (QNB), which accounted for 9.5% of trading value, followed by Masraf Al Rayan (7.2%) and Gulf International Services (6.9%). The fact that Masraf Al Rayan is among the leading companies on the QSE is evidence of the prominence of Islamic finance in Qatar.

The QE All Share index was launched in April 2012, with a base period starting in January 2007, and includes all 44 stocks on the exchange. During 2016, the stock exchange reported that, of 44 listed companies, 12 companies posted higher share prices, 31 companies saw lower prices, and one remained unchanged.

QE Al Rayan Islamic Index is the only Shariah-compliant index on the stock exchange. The index does not have a fixed number of constituents, and any company can become eligible if they comply with conditions set by Masraf Al Rayan's Shariah Supervisory Board. The index was launched in January 2013, also with a base period starting in January 2007. The Islamic segment of the stock exchange remains relatively small.

QE Islamic Index registers significant drop in volatility

The QEI's performance witnessed a period of volatility from 2014 until the first quarter of 2016 owing to the drop in commodity prices. Index volatility averaged 13.5% between 2012 and 2016. Although the Islamic index recorded lower returns compared to QEI, the volatility of these returns was relatively higher, with an average of 15% for the same period. During 2016, the performance of the QEI became less volatile, falling from a standard deviation of 40% in February to 11% by the end of the year. After peaking at 52% in the third quarter of 2014, the volatility of the Islamic index began to drop lower than the QEI, ending 2016 at a level of 3%.

These economic conditions affected a majority of listed companies during this period. Qatar is the second largest gas exporter in the world after Russia, and relies heavily on gas revenue. The drop in commodity prices has impacted all GCC countries, given their high reliance on oil and gas, which subsequently pushed the governments to diversify their economies away from the energy sector.

Investors monitor market activity at the Qatar Exchange, Doha. REUTERS/MOHAMMED DABBOUS

THE SUKUK MARKET

DESPITE SLOWED DEVELOPMENT, QATAR SUKUK MARKET ON THE RIGHT TRACK

Historically, Qatar has issued both bonds and sukuk to finance projects and budget deficits, although its reliance on bonds has traditionally been greater. Qatar, along with other GCC countries, issued bonds as far back as the 1990s. Qatar saw its first ever bond issuance in 1996 from the Ras Laffan Liquefied Natural Gas Company. The government made its debut bond issuance in 1999.

In terms of sukuk, Qatar issued its first Islamic certificates in 2003, when the government issued a three-year sukuk of US$700 million in the international market. Up until 2012, the Qatari market had only four issuances in total: three from the government and one from Qatar Real Estate Investment Company (QREIC). The largest sukuk in Qatar until that time was the 2011 government issue of QAR 33 billion (approx US$9 billion), one of the largest sukuk issuances at the time in the Middle East. These sukuk provided much needed investment opportunities for Shariah-compliant investors.

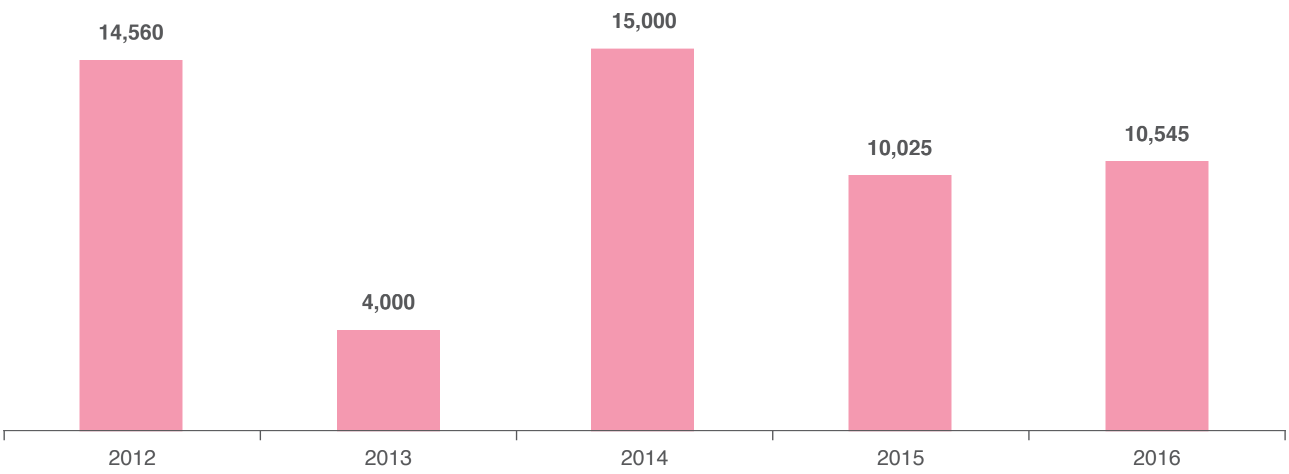
The market has become relatively more active since 2012. For the first time, two sukuk were issued in the same year. Interestingly, the two issuances in 2012 were the last two Qatari issuances denominated in US dollars. After 2012, all Qatari sukuk were issued in local currency, which has not affected foreign investors as the Qatari riyal is pegged to the dollar.

Sukuk market activity reached a recent peak in volume in 2014, when the government raised QAR 15 billion through five sukuk issuances. During the same year, the global popularity of sukuk was on the rise outside its traditional markets. The governments of the UK, Hong Kong, South Africa and Senegal all issued sukuk for the first time.

In 2015, the market matured and saw continued sukuk activity. The Qatari market welcomed the first corporate sukuk by a financial institution by Qatar Islamic Bank (QIB), for the purpose of boosting its capital adequacy ratio. Despite the increasing number of issuances in 2015, the total value of issuances fell. The decline in energy prices and economic slowdown pressured the government to tap debt capital markets as a source of funding to meet the state budget. Although most of this funding was raised using bonds, the government and QIB still issued in excess of QAR 10 billion in sukuk during the year.

Corporate sukuk issuances in Qatar continued to grow in 2016, with both Qatar International Islamic Bank (QIIB) and Ezdan Holding Group making their sukuk debut. QIIB became the second financial institution in Qatar, after QIB, to issue a Tier 1

Figure 82 SUKUK ISSUANCES IN QATAR (QAR MILLION) 2012–2016



Source: Thomson Reuters

sukuk to boost its capital. Overall, 2016 saw fewer sukuk issuances, as the government preferred bonds for budgetary funding. In the same year, the government sold US$9 billion worth of bonds with three maturities, issuing US$3.5 billion in five-year and 10-year issuances, respectively, and a US$2 billion 30-year issuance. This was the largest bond sale in the Middle East at the time, before Saudi Arabia issued the world's largest government bond to date of US$17.5 billion in October 2016.

QATAR SUKUK MARKET DRIVEN PRIMARILY BY GOVERNMENT ISSUANCES

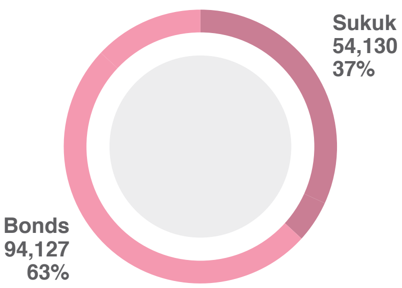
The government has been the backbone of the sukuk market in Qatar, representing 87% of all issuances by value. In fact, it follows a similar pattern throughout the GCC. Sukuk issued by the Qatari government mainly funds budget deficits and provides working capital. In other GCC countries such as Bahrain, and previously Malaysia, sukuk issuances have also been used by central banks to manage excess liquidity in the financial system. Sukuk issuances by the government have reduced since 2014 as preference for government funding shifted to bonds. The decision as to which fixed income instrument to issue depends on market demand, which also typically drives its pricing. The demand for sukuk is expected to remain strong because of the limited investment options available to Shariah-compliant investors, primarily Islamic financial institutions. Demand for bonds has been equally strong since 2015, especially from foreign investors who are looking for high-rated issuers with generous returns.

2015 and 2016 demonstrated the potential for non-government sukuk with four corporate issuances, although the corporate segment remains significantly underdeveloped. The global corporate sukuk market, with the exception of Malaysia, remains largely underdeveloped. Increasing the market share of corporate sukuk issuances continues to be a challenge for many countries, as corporations are typically not large enough to tap into the sukuk market. Identifying the appropriate securities for structuring potential sukuk is also challenge. However, some sectors such as oil and gas, power and other utilities are in a favorable position to issue sukuk, given their large-scale operations and construction projects. The long-term nature of sukuk also matches the common funding requirements of power and oil companies. However, there have been a limited number of issuances from these sectors, except in Pakistan where K-Electric has frequently tapped the sukuk market.

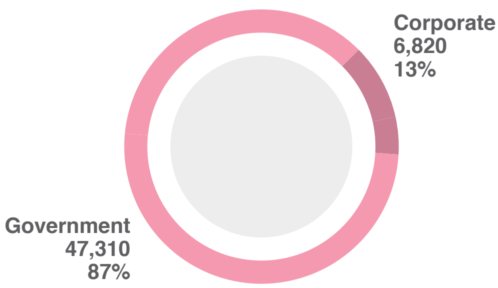
In the GCC, financial institutions have been leading corporate issuances. Ezdan Holding Group is the only corporation outside of financial institutions to issue sukuk in Qatar. Ezdan's sukuk is considered a key development in the industry, and it is expected to lead the way for other corporations in the country to use sukuk to finance their operations. The Ezdan sukuk was oversubscribed by 1.76 times, indicating high demand for Qatari corporate issuances. Notably, 21% of new investors came from Europe, 11% from Asia, and the remaining from the Middle East.

Figure 83 QATAR SUKUK ISSUANCE BREAKDOWN

QATAR SUKUK VS. BONDS ISSUANCES
AGGREGATE ISSUANCES (QAR MILLION) 2012–2016

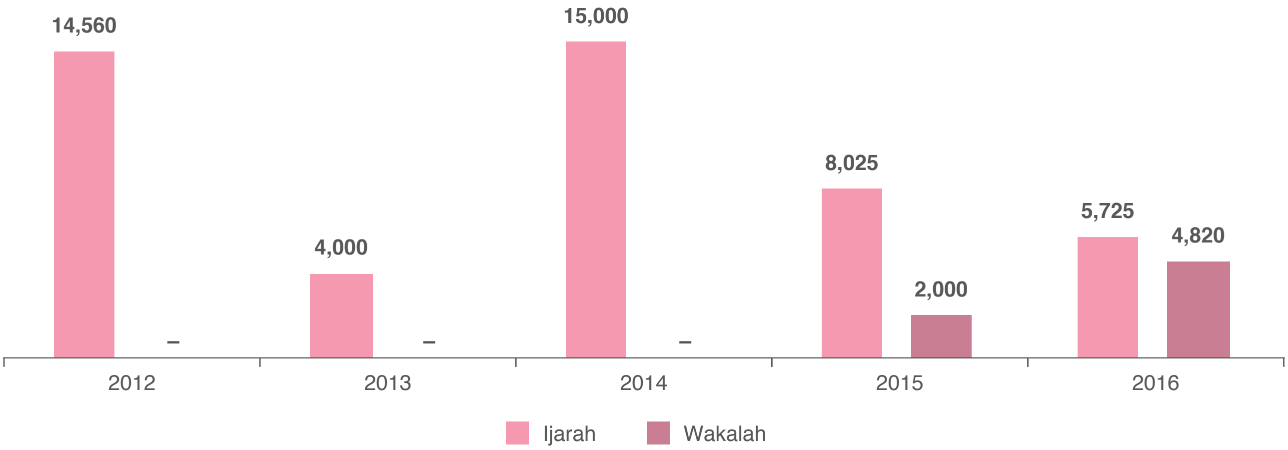


QATAR AGGREGATE SUKUK ISSUANCES
BREAKDOWN BY ISSUER (QAR MILLION) 2012-2016



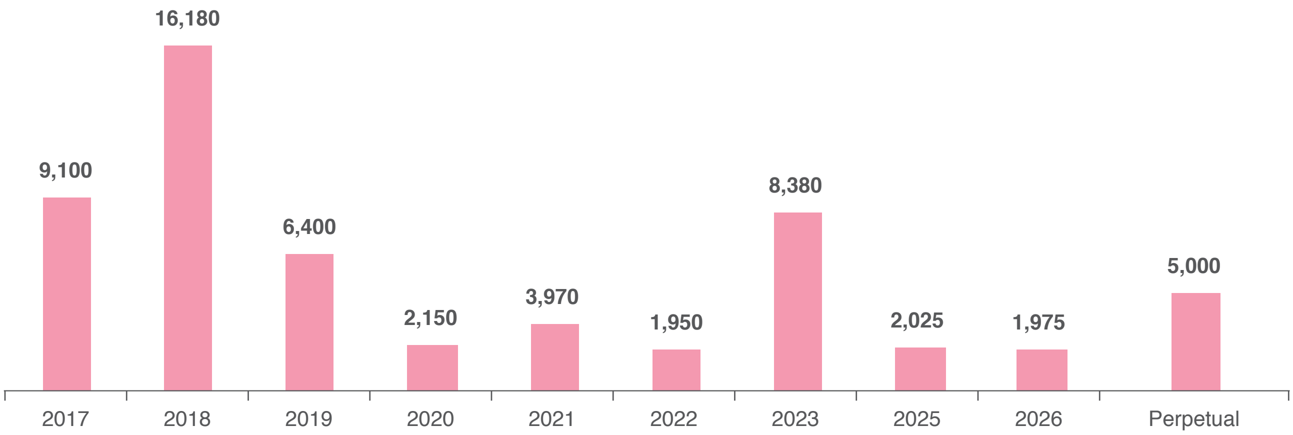
Source: Thomson Reuters

Figure 84 SUKUK ISSUANCES BY STRUCTURE (QAR MILLION) 2012–2016



Source: Thomson Reuters

Figure 85 MATURITY PROFILE FOR SUKUK OUTSTANDING IN QATAR (QAR MILLION) 2012–2016



Source: Thomson Reuters

Certain European countries, such as Germany and Netherlands, have witnessed a period of negative yield, which has pushed some investors to look for positive yields in markets such as the GCC.

Apart from the Ezdan sukuk, QIB and QIIB issued sukuk in 2015 and 2016. These issuances came following the adoption of the Basel III and IFSB-15 standards in 2014, which provide guidelines on Tier-1 and Tier-2 regulatory capital, resulting in a substantial increase in the number and size of sukuk issuances by Islamic banks both globally and in Qatar.

Abu Dhabi Islamic Bank (ADIB) issued the world's first Additional Tier-1 capital sukuk, a US$1 billion issuance based on mudharabah, which was massively oversubscribed 31 times. As a result of huge demand, ADIB's perpetual sukuk launched a trend for such issuances at Islamic banks to bolster capital adequacy ratios. However, owing to the small number of Islamic banks in Qatar, future Tier-1 and Tier-2 sukuk issuances will be limited.

87% of Qatar sukuk are issued using ijarah structure

Ijarah continues to be the most popular sukuk structure in Qatar, as well as in the rest of the GCC. In the GCC, sukuk issuers' preferred structures are ijarah and wakalah. Investors also prefer these structures because they are highly tradable, compared to other structures such as murabahah have limited tradability per AAOIFI standards. In the GCC, issuers and investors follow AAOIFI standards that permit the issue of sukuk with debt-based structures such as murabahah. However, they prohibit trading such sukuk based on Shariah opinions banning the tradability of debt. Malaysia is one of the few countries that permits the trade of debt-based structures such as murabahah and bai' al-'inah.

However, Malaysia is also trying to diversify its sukuk structure base. The government is now extending sales tax breaks for issuers of ijarah and wakalah sukuk until 2018. These tax breaks are primarily intended as an incentive to attract overseas investors to the Malaysian market, away particularly from GCC markets; and as a source of funding rather than liquidity management.

Qatari corporate sukuk have all been issued based on the wakalah structure, which is favored by Islamic financial institutions for issuing Tier-1 sukuk. Wakalah has been gaining popularity in the recent years and by the end of 2016 was one of the most issued structures globally.

The availability of different structures in Islamic finance opens the door for companies in different sectors to issue sukuk. For instance, with the growing real estate sector in the GCC, construction companies are capitalizing on the forward ijarah structure, which allows investors to undertake payment during the construction period, while issuer payments start within a specific period following the completion of the project. This helps the issuer finance operations until the project is completed. Although forward sales are not permitted in Islamic finance, forward contracting through ijarah is allowed only if the rent amount is paid by the issuer after delivery of the underlying asset.

ALMOST HALF OF OUTSTANDING SUKUK WILL MATURE IN 2018, FURTHER HINDERING SUPPLY

One of the main challenges facing investors in today's Islamic capital markets is the recent decline in sukuk issuance and the looming maturity of outstanding sukuk. Put simply, there are not enough sukuk in the market to meet demand from Shariah-compliant investors looking to fill their books. Because of the scarcity of sukuk in the market, investors have no option but to hold their sukuk investments to maturity, which also dampens the secondary market for sukuk in the local market.

The situation is no different in Qatar, where over QAR 25 billion worth of sukuk will mature by 2018, which accounts for 44% of the value of sukuk outstanding at the end of 2016. With the ongoing growth of Shariah-compliant institutions, new issuances are vital in helping them invest excess funds in a way that generates income. However, if no sukuk are issued in the country to replace the maturing ones, Shariah-compliant investors might look to other sukuk investments outside Qatar. However, finding sukuk with the right characteristics can be challenging as GCC investors generally prefer to invest in local currencies or USD to avoid currency risk. On the other hand, new investors from Europe and Asia, who are likely indifferent to the Shariah-compliance of their investment holdings may likely shift their investments to bonds or other asset classes in Qatar once their sukuk investments mature, to retain exposure to the Qatari market.

In order to expand the sukuk market, government support is necessary. It is important for governments to systematically use sukuk in their borrowing program to ensure a sufficient supply of sukuk in the market, which consequently activates the secondary market. In the GCC, the secondary market is almost non-existent as investors are reluctant to trade their sukuk investments, given the difficulty of replacing traded sukuk.

RETAIL SUKUK REMAINS UNTAPPED BY MOST JURISDICTIONS

Retail sukuk remains an untapped segment in most of jurisdictions, especially in the GCC. There is no doubt that the development of retail segment has many advantages for any country aiming to develop its Islamic finance sector. Among Islamic finance jurisdictions, Indonesia is at the forefront of retail sukuk, thanks to its huge Muslim population. The world's first retail sukuk was issued in 2009 by the Indonesian government, with a value of IDR 5.5 billion (US$412,660). Since 2009, the government has introduced an annual program to issue a retail sukuk. Among other jurisdictions, retail sukuk have also been issued in Malaysia and Bahrain.

Qatar can capitalize on selling sukuk to the retail market to promote both the primary and secondary capital markets. Issuers can find favorable conditions when issuing sukuk to the retail market, as they are able to find slightly cheaper pricing, with interest rates offered to the retail segment potentially lower than what institutional investors demand. Competitive pricing for retail sukuk is the result of limited investment options available to retail investors in Islamic financial markets, other than savings accounts and fixed deposits.

ISLAMIC LIQUIDITY MANAGEMENT TOOLS REMAIN LIMITED

A majority of GCC central banks either do not have a dedicated Islamic finance tool for interbank liquidity management, or they depend on commodity murabahah. In the event there is no Shariah-compliant tool to absorb liquidity, GCC Islamic banks will generally deposit some of their excess liquidity with the central bank in the form of reserves, at times above central bank requirements. However, banks that follow this approach end up sacrificing their returns, because central bank deposits do not generate income for the banks.

Like its regional peers, Qatar does not have a dedicated Islamic liquidity management tool. The QCB principally manages liquidity through treasury bills, in addition to bonds and sukuk. Because of the limited number of Shariah-compliant investors in the country—mainly Islamic financial institutions—the QCB continues to focus on treasury bills as a liquidity tool, instead of a dedicated Islamic tool. The QCB had issued QAR 5 billion in treasury bills issued year-to-date in July 2017. Demand is quite high for treasury bills: the QAR 1 billion issuance on July 4, 2017 attracted orders worth QAR 1.5 billion, which indicates demand for these short-term instruments.

The only central bank in the GCC that uses sukuk for liquidity management is the Central Bank of Bahrain (CBB), which issues sukuk with three different maturities on a regular basis. The shortest-term sukuk are issued weekly with a wakalah structure, followed by sukuk al-salam issued every 91 days and al-ijarah sukuk with a tenor of 180 days. Sukuk are one of the preferred methods for Islamic liquidity management, and they work well for countries where there are a large number of Islamic banks. By the end of 2016, Bahrain had the largest number of Islamic banks in the GCC, reaching 36 banks.

Aside from Bahrain, other GCC countries, such as Kuwait, rely on commodity murabahah, also known as tawarruq. In simple terms, in commodity murabahah one party buys a commodity and sells it to the other party with deferred repayment. In the UAE, the central bank provides to investors Islamic certificates of deposits with tenors ranging from one week to one year. The government of UAE is also a regular sukuk issuer and provides Islamic banks with more than one option for liquidity management.

> *Because of the limited number of Shariah-compliant investors in the country—mainly Islamic financial institutions—the QCB continues to focus on treasury bills as a liquidity tool, instead of a dedicated Islamic tool.*

Figure 86 ISLAMIC LIQUIDITY PROGRAMS AND INSTRUMENTS ISSUED BY RESPECTIVE CENTRAL BANKS IN GCC

Liquidity Instruments

Country	Product	Tenor	Liquidity
Kuwait	Tawarruq with Central Bank	3 and 6 months	Not tradable
UAE	Islamic Certificates of Deposit	1 week – 1 year	Not tradable
Global	IILM Sukuk	3-, 4- and 6-month	Tradable
Bahrain	Sukuk al-Salam	91 days	Not tradable
Bahrain	Sukuk al-Ijarah	180 days	Tradable
Bahrain	Wakalah	1 week	Theoretically tradable
All	Central bank reserves	Overnight – 1 year (not all central banks offer returns)	Not tradable

Liquidity Programs

Country	Product	Tenor	Liquidity
UAE	Collateralized murabahah Facility	Overnight – 3 months	Not tradable
UAE	Wakalah deposits by central bank in Islamic banks	Perpetual	Not tradable

Source: Central bank websites and Thomson Reuters. "Survey of Characteristics of Short Term Financial Instruments Used by Islamic Banks," Presentation delivered at the IILM Roundtable on Liquidity Management, 16 April 2015, Washington, DC.

The Aspire Tower outside the Khalifa International Stadium, Doha. SEAN NEL / SHUTTERSTOCK.COM

Table 12 CURRENT MAJOR INFRASTRUCTURE PROJECTS IN QATAR

Projects	US$ Billion	Year Completed	Project Owner
Ras Laffan Petrochemical Complex	7	2018	Qp / Qapco JV
Lusail Development	45	2019	Qatar Diar
FIFA World Cup Stadiums	6.5	2019	Qatar 2022 Supreme Committee
Inner Doha Resewerage Integration Scheme	2.5	2019	Ashghal
Qatar Rail	35	2020	Qatar Railways Co.
Barzan Gas Development	10.3	2022	Ras Gas
New Doha Port	7	2030	New Port Project Steering Committee

Source: Project Qatar

There is no doubt that making sukuk available to retail investors not only benefits financial markets by increasing financial inclusion, but it also spreads awareness of Islamic finance in the general population. Diversifying the investor base is another key reason that governments have cited for issuing retail sukuk. The Qatari government can benefit from retail sukuk to increase financial inclusion, especially considering its GDP per capita is among the highest in the world, indicating the need for investment opportunities among its population.

SUKUK STRUCTURES IDEAL FOR FINANCING INFRASTRUCTURE PROJECTS

A number of major infrastructure projects are in the works in Qatar, most notably as a part of the preparations for the FIFA World Cup 2022 and the implementation of the Qatar National Vision 2030. These projects include the construction of new stadiums, roads, hotels and other facilities. Qatar is in a favorable position to decrease its reliance on bonds and increase its sukuk issuances with the upcoming projects. These projects will also provide opportunities for replacing the sukuk due to mature from 2018 onwards. Currently, Qatar has one of the highest spends on infrastructure projects in the GCC region. The country is expected to invest around US$110 billion in infrastructure by 2030.

The role of sukuk in financing infrastructure worldwide has been generally limited to date. Globally, Pakistan is one of a few countries that have used sukuk for infrastructure projects. Pakistani utility corporations such as K-Electric have also used sukuk for large long-term projects.

Theoretically, sukuk is structured in a way that is ideal for financing infrastructure projects. Sukuk are closely tied to ‘real assets’ of a potential infrastructure project in their structure, and it features risk sharing, which remains a crucial element of authenticity in Islamic finance. In reality, however, financial structuring for such immense projects is easier said than done.

Certain factors restrict the applicability of sukuk, especially where projects involve public-private partnerships (PPPs). The biggest limitation on infrastructure sukuk is in their tradability: large infrastructure projects like stadiums or railways would require long tenors to coincide with their completion. According to AAOIFI standards, issuers and investors would not be able to trade their sukuk certificates until after the asset or project under construction is 50% completed.

ISLAMIC ASSET MANAGEMENT LANDSCAPE

A SMALL MARKET SURROUNDED BY LOCAL INVESTORS

The Qatar Islamic asset management industry is small yet adequate for the limited number of Shariah-compliant local investors. However, in order to attract foreign asset managers and investors to the country, the Islamic segment must grow. In today's time, Shariah-compliant investments have expanded beyond their traditional markets and have become equally important for conventional institutional and retail investors. A significant number of conventional investors continue to invest heavily in Islamic products for diversification and return.

The country has five Islamic non-bank financial institutions partaking in Islamic asset management. Al Rayan Investment, QInvest and Qatar First Bank are based in the Qatar Financial Centre (QFC), the other two are the First Investor Company and Investment House, which are based outside QFC and are regulated by QCB. Like its regional neighbors, Qatar's system offers a single regulatory authority in the QCB, although some sectors may also have oversight from either the QFCRA or the QFMA.

Although the majority of investors in Qatar are local, it comes as no surprise that Asian investors are showing a growing appetite in the region. This is the result of ample liquidity in key developed markets, coupled with record low interest rates, which have pushed Asian investors into the emerging markets, particularly the GCC, looking for higher yields and high credit ratings. Market statistics show that Asian investors invested in more than US$9 billion of US dollar-denominated GCC fixed income securities in 2016, doubling from 2015.

STRONG CORRELATION BETWEEN QATAR ISLAMIC ASSET MANAGEMENT AND OIL PRICES

Qatari investments continue to be tied to the performance of global markets, especially where local asset managers heavily invest in international markets. The performance of Islamic funds in Qatar has shown a strong correlation with the performance of global markets, and more specifically with oil prices. After reaching a high of US$115 per barrel in June 2014, oil prices turned as low as US$27 in January 2016, reflecting sustained oversupply of crude oil in the market.

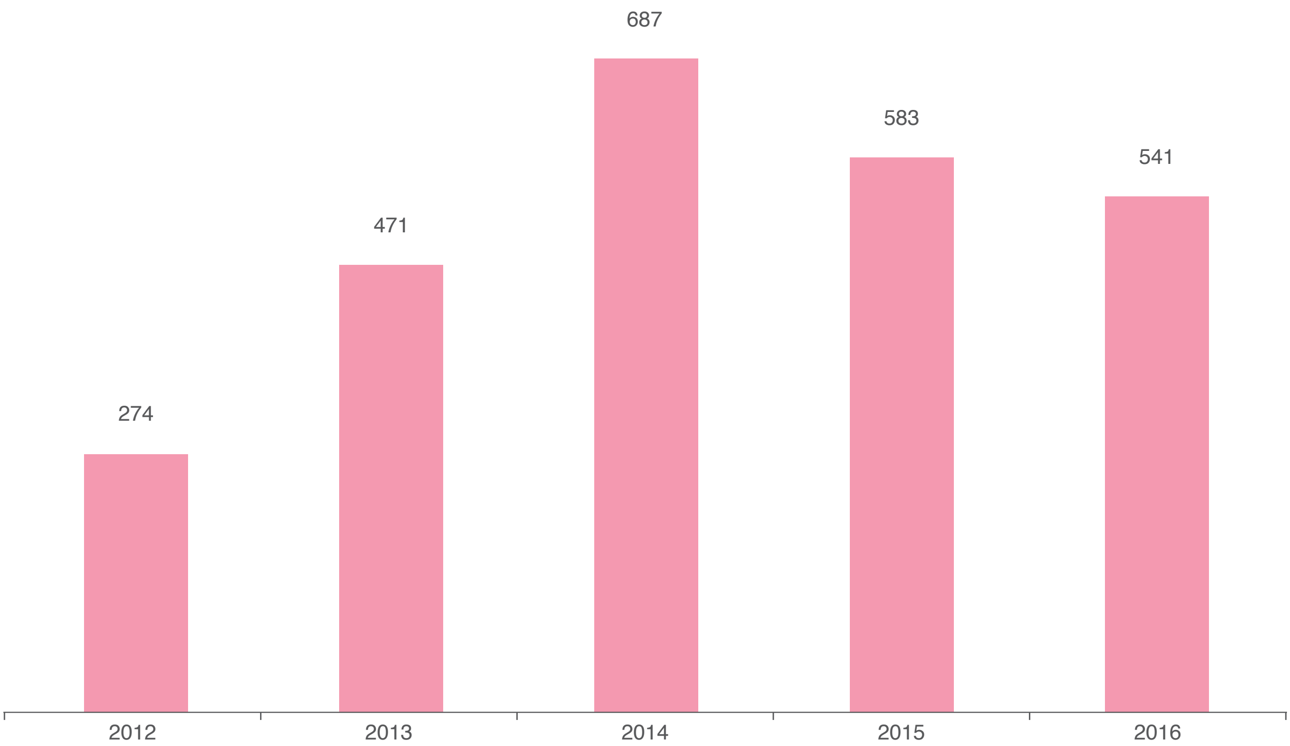
Similar performance has been witnessed in Qatar's Islamic asset management. The best performance was witnessed in 2014 when the Islamic assets under management (AuM) registered a record high of QAR 687.2 million. However, with the drop in oil prices, AuM declined in 2015 to QAR 583 million and subsequently to QAR 541 million by the end of 2016. In 2017, oil prices have partially recovered, and have stabilized, either side of US$50 per barrel. As long as oil prices remain relatively stable, Qatar Islamic asset management in the country is expected to bounce back.

Global Islamic asset management has grown at a moderate CAGR of 2.4% to US$58.9 billion in AuM between 2012 and 2016, despite the economic challenges in the GCC caused by falling oil prices. Saudi Arabia and Malaysia together hold 67% of Islamic assets under management in this segment and 49% of the total number of Islamic funds outstanding by the end of 2016. This is a sign of high concentration in the Islamic asset management industry.

A NEW POTENTIAL DESTINATION FOR FOREIGN ASSET MANAGERS

Qatar's strategic location can make it a new destination for Islamic and conventional foreign asset managers, especially as regulations in some countries are becoming tighter. For instance, a few countries—the UK and India among them—have started to tighten tax laws for asset managers' offshore investments in 2016. India has amended its tax treaties with Mauritius, Singapore and Cyprus and asset managers have considered moving to other financial centers that provide similar incentives. Financial centers in the GCC such as QFC can become the destination of choice for accessing the region because of their vibrant ecosystem, coupled with its continuous efforts to enhance ease of business and an enabling Qualified Investor Funds regime.

Figure 87 ISLAMIC FUNDS IN QATAR BY ASSETS UNDER MANAGEMENT (QAR MILLION) 2012–2016



Source: Thomson Reuters

SCALE REMAINS A KEY CHALLENGE FOR THE ISLAMIC ASSET MANAGEMENT INDUSTRY

Despite strong demographics for Shariah-compliant investments, scale remains one of the main challenges for the Islamic asset management in today's industry when compared with its conventional counterpart. Qatar's asset managers are encouraged to increase their activities and increase the size of their funds in order to compete with conventional asset managers. Globally, the industry is suffering from its small scale, which is a result of poor market strategies in targeting different market sectors and regions which has been largely ineffective.

Inadequate government support and recent market conditions particularly low oil prices have also impaired market performance. Government support can also play an important role in channeling institutional capital into Shariah-compliant funds such Islamic pension funds.

ISLAMIC PENSION FUNDS' POTENTIAL SCARCELY TAPPED

Pension funds in particular present one way to add scale and grow Shariah-compliant asset management in Qatar. By value, pension funds represent less than 1% of global Islamic funds. However, since 2012, the number of pension funds has almost doubled, and AuM has increased more than eightfold. The outstanding AuM mix consists of 56% equity funds, 27% mixed assets, 12% sukuk and 5% money market funds. The significant potential of Islamic pension funds remains scarcely tapped. Public pension funds, both conventional and Islamic, in the GCC alone amount to around US$400 billion out of which Qatar has about US$14 billion at mid-year 2015.[1] If just 30% of these funds were invested in a Shariah-compliant manner, the region would be home to a US$120 billion Islamic pension fund industry and Qatar can increase its Islamic funds AuM by about US$ 4.2 billion.

1 EY, "The EY GCC wealth and asset management report 2015: Fast growth, divergent paths", 2015

MR. TAMIM AL KUWARI

CEO, QInvest

Mr. Al Kuwari joined QInvest in 2012 from Goldman Sachs, where he was a Managing Director and Country Head for Qatar. In addition his role as CEO, Tamim also heads the Principle Investments team. Prior to joining Goldman Sachs, Tamim was the Chief Financial Officer for Qatargas' Transport Company, Nakilat, where he successfully implemented an US$8 billion program to finance 27 liquefied natural gas (LNG) vessels that ship LNG from Ras Laffan to customers worldwide. Prior joining Nakilat, Tamim served as the treasurer for the Qatargas Company. Earlier in his career he also worked as a trader at Qatar National Bank, where he traded a range of financial products.

Tamim has over 18 years of experience in investment banking and executing transactions, having worked at a number of leading Qatari and international institutions. He holds a BA in International Business with a minor in Political Science from George Washington University and an MBA from the American University — Washington, D.C.

1. In 2013, QInvest unveiled a new strategy to deliver long-term sustainable growth, refocusing its operations on investment banking, principal investments and asset management. It also included plans to launch 30 new Islamic funds in the following three years. How has this strategy contributed to the QInvest's impressive growth in assets under management and its top and bottom lines over the past five years?

Since 2013, we have delivered on this strategy to become the leading investment bank and asset management group in Qatar, while also acting as a gateway for business and capital between Qatar and global markets.

We achieved this despite challenging market conditions, unpredictable geopolitical events and the effects of oil falling from over US$100 to under US$50 a barrel. Our prudent management of such issues and robust balance sheet, as well as timely exits from higher risk investments at a significant profit, has allowed us to protect our gains and post strong financial results.

Meanwhile, the launch and growth of QMAP (QInvest Managed Account Platform) enabled the firm to develop a leading asset management business, which covers multiple geographies and asset classes through the launch of a series of funds. QMAP was the first fully open-architecture, Shariah-compliant asset management platform, and this has helped establish QInvest as a serious competitor in the regional markets.

Our performance has been underpinned by growth in the top line, with revenue increasing consistently every year, and from US$35 million in 2013 to US$114 million in 2016. Based on this, we have been able to deliver net profit in each of the last four years, while assets under management have increased to US$3.5 billion in 2017.

Looking forward, the bank will continue to deploy its capital cautiously and retain its existing risk management policies to protect its gains and prepare for any market uncertainties ahead. On this basis, we maintain a strong capital adequacy ratio and significant liquidity ready to be deployed to anchor the right investment opportunities. In conjunction, we will develop our banking business by building a diversified portfolio of investments in real estate, credit, and equity, while continuing to deliver best-in-class products and advice to our clients. QInvest will also continue to develop and roll out the QMAP platform with the addition of new asset classes.

"We had identified Turkey as a market with significant growth potential for our asset management business, especially after changes in legislation within the pension industry that could act as a catalyst for long-term growth."

2. In recent years, QInvest has strengthened its international asset management business in markets such as the UK and Turkey through acquisitions and partnerships. How did you come to adopt this method of growth?

While QInvest has a strong footprint in Qatar and the region, the bank has ambitious plans for its asset management business. Given the limited universe in the Middle East, it is natural that we would consider additional international markets. Early on, we reviewed multiple markets to see where it would make sense for QInvest to expand. The aim was to identify opportunities where there would be significant long-term growth prospects.

Since Qatar gives us a regional footprint, we needed to find markets with strong growth potential for an institutional-quality asset management platform and appetite for a GCC based asset management group. Whilst the UK acquisition was a tactical decision taken to expand our sukuk management capabilities by acquiring a leading investment team with one of the oldest sukuk fund track records, the expansion into Turkey was a strategic decision.

We had identified Turkey as a market with significant growth potential for our asset management business, especially after changes in legislation within the pension industry that could act as a catalyst for long-term growth. Ergo Portfoy was identified as an ideal target, due to their strong team and their focus primarily on pension clients. Our view was that adding the Portfoy group would enhance QInvest's capabilities in dealing with pension funds on a global level, while the expertise QInvest had with HNW and institutional clients would augment the firm's offerings in Turkey by providing QInvest's strong Shariah capabilities and best-in-class know-how.

We therefore acquired Ergo Portfoy at the start of 2016, rebranding it QInvest Portfoy. The company is one of the leading asset management groups in Turkey with over 1.5 billion Turkish Lira in assets under management, providing pension and mutual fund and discretionary portfolio management services.

QInvest Portfoy is expected to play a major role in attracting new investments into Turkey, delivering high-value services to a larger client base. It will also benefit from the world-class capability that QInvest currently provides.

3. How has QInvest contributed to innovation in the Islamic asset management space?

We have increasingly seen growing demand from investors for innovative Islamic products. To meet this, we have launched and expanded our pioneering open architecture, Shariah compliant fund platform, QMAP. From the time of its launch, the platform took a different approach to other providers by implementing best-in-class systems and processes, and moving away from the approach of only using domestic or niche products.

One of the strongest successes has been the development of a platform that offers a range of fund choices, each managed by a leading investment firm but where there has been no compromise on Shariah principles.

We continue to expand our product line when we see opportunities that make sense for both ourselves as an asset management firm or for clients. As an example, earlier this year, we launched the oversubscribed QInvest SQN Income Fund, a Shariah-compliant closed-ended fund focusing on equipment leasing that provides a unique opportunity for investors to access income-generating assets in developed markets. Whilst we had come across a few existing funds in this space, we identified a gap for funds offering a monthly payout (the first fund has a 7% p.a. effective yield with a monthly distribution) and a strong collateral (the fund is only invested into western markets and the overall portfolio has no exposure to cyclical sectors or poor credit).

Making such products funds accessible and understood is a priority for us, and we will continue to create innovative Shariah-compliant products and services that meet our clients' needs and risk appetite.

4. What is your outlook on the growth of Islamic asset management both globally and in Qatar? Where do you see the best growth prospects for the sector—in the retail or institutional markets?

We anticipate that the Islamic asset management sector will continue to grow over the coming years, both globally and in the Middle East. Today, there is more confidence in Shariah products, as well as in the quality and caliber of fund managers, because of greater awareness and understanding of what Islamic finance represents. In general, Islamic funds provide a more conservative and defensive approach with a lower degree of exposure to excessive volatility. This is increasingly appreciated amongst conventional investors seeking to diversify their portfolios and to manage risk.

The next wave of development will be Islamic finance diversifying into countries beyond the GCC and Malaysia, across Asia, Southeast Asia, and into Europe. We are already seeing promising signs in countries such as Pakistan, Indonesia, and parts of sub-Saharan Africa. There is also growth in Central Asia, with encouraging early signs in Kazakhstan, which is working on a financial centre with an element of Islamic finance.

While this is the trend in the long term, we envisage that Qatar will remain a key market for global Islamic finance and we are committed to supporting its continued growth. The institutional market continues to drive the industry, but there are opportunities to reach retail investors with lower-fee products that are currently more prevalent among conventional finance offerings.

5. According to a report by Thomson Reuters and Lipper, around 10% of Islamic mutual funds have assets greater than US$100 million. How do you believe this segment will evolve over the next five years? Does QInvest plan on expanding its operations in this space?

The Islamic asset management industry is still at a very early stage in its development and is yet to catch up with the growth of the Islamic banking and sukuk issuances. While the overall Islamic finance industry is estimated to be nearly US$2.5 trillion, less than 5% of this is currently in investment funds. Meanwhile, some of the biggest global sectors, such as the global pension fund industry have a very small component in Islamic assets, despite Muslims making up over 25 percent of the global population.

In the last few years we have seen an increase in the number of funds on offer to investors; however they remain a very small fraction of the global asset management industry, both in terms of volume and number of funds. Currently, GCC and Malaysian asset managers dominate the industry, with a limited number of others in the more established financial centers.

This is starting to change with the emergence of an increasing number of asset managers and funds that adopt leading investment practices, a greater range of choice of funds on offer, and a wider understanding of the benefits of Islamic funds. However, there is still the need for more. Given the size of the potential industry, this presents a significant opportunity.

At QInvest, we launched QMAP, the world's first open-architecture Islamic managed account platform. It brings best practices from the conventional fund industry to Shariah investors through a range of global partnerships with managers around the world. Our current funds have performed well and there has been a great deal of investor demand for

> "We also expect to see an increasing appetite for our Shariah-compliant funds from non-Muslim investors who are attracted to the ethical and social characteristics of the assets."

more products. We have a healthy pipeline of new funds and products, with several being actively developed right now.

We also expect to see an increasing appetite for our Shariah-compliant funds from non-Muslim investors who are attracted to the ethical and social characteristics of the assets, or are looking to diversify their portfolios away from particular assets that are more prominent within conventional funds and are more susceptible to economic volatility. This presents a real area of focus, and it can support our growth over the next five years.

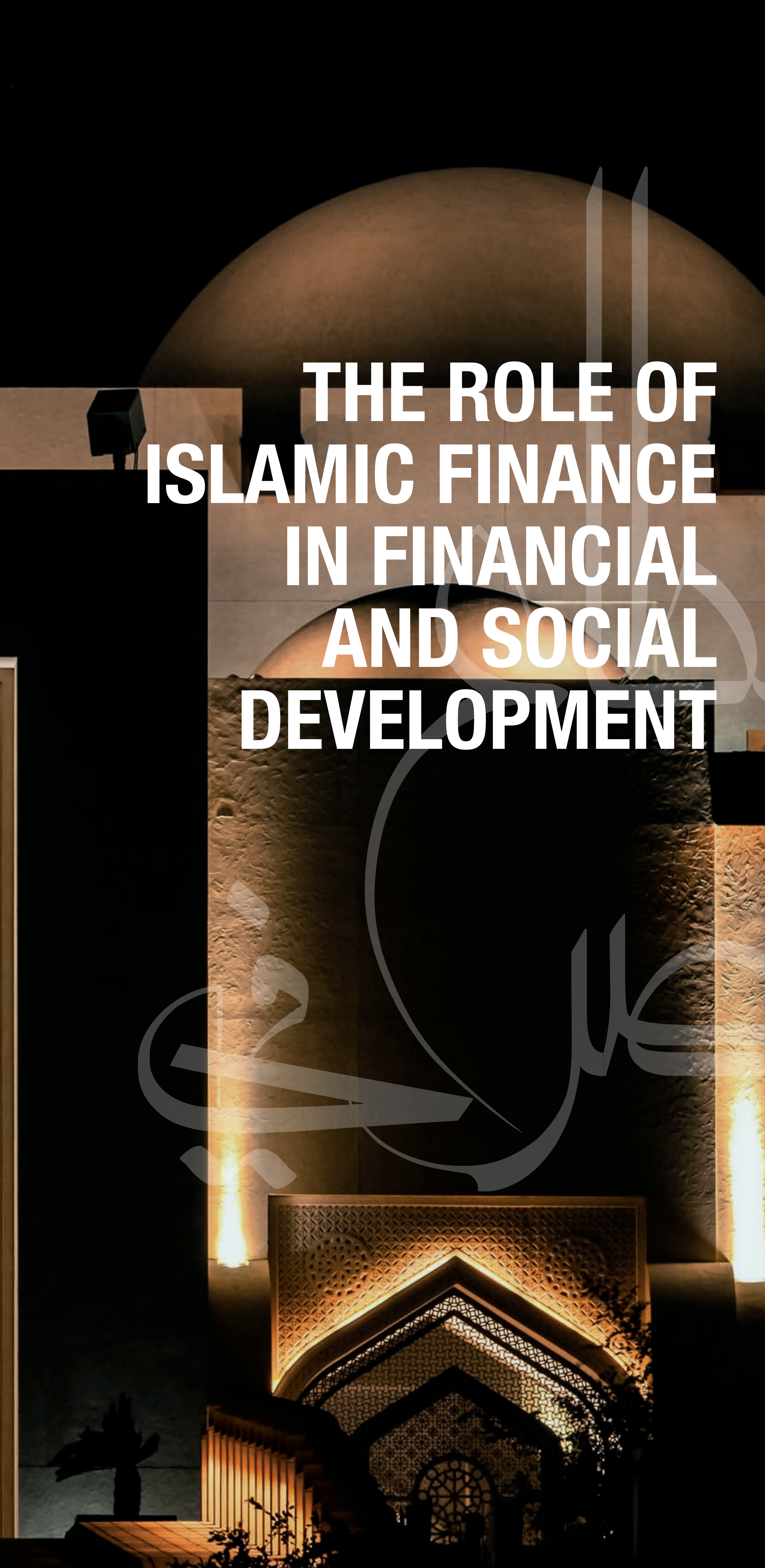
6. How has QInvest benefited from establishing its operation in the Qatar Financial Centre?

With its state-of-the-art facilities, seamless infrastructure and strong regulatory framework, the Qatar Financial Centre (QFC) represents a natural home for QInvest.

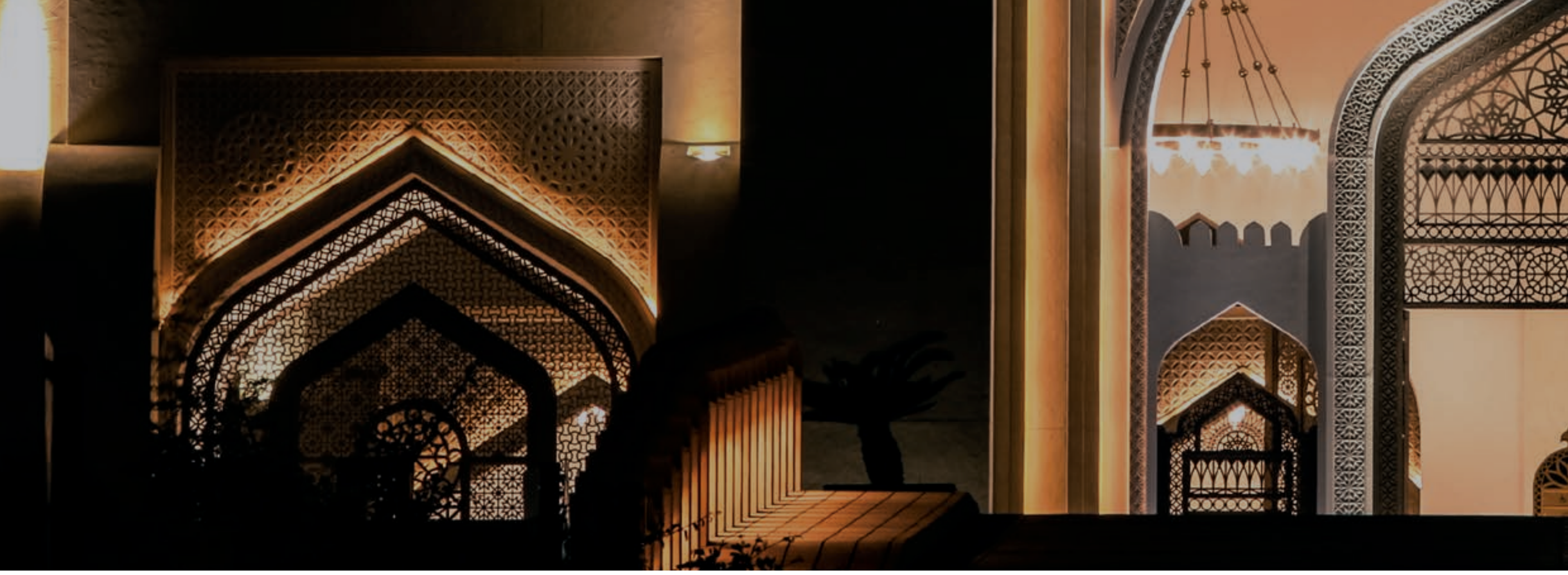
We are closely aligned with QFC in its ambition to lift Qatar's reputation as a global destination to do business, and we look forward to many more years of strong performance and growth operating from our headquarters here.

Mosque detail in Katara Cultural Village, Doha.

State Grand Mosque, Doha.



THE ROLE OF ISLAMIC FINANCE IN FINANCIAL AND SOCIAL DEVELOPMENT



THE ROLE OF ISLAMIC FINANCE IN FINANCIAL DEVELOPMENT

Islamic finance has played a prominent role in Qatar. Islamic finance promotes financial inclusion, offering alternative vehicles for saving, financing, and insurance to segments of the population often excluded from conventional financial systems. The majority of the Qatar's population has access to financial services, but many Qatari citizens may not accept conventional services because of religious concerns. The further development of Islamic finance will broaden the variety of available financial products and services and increase their acceptance among concerned people. Islamic finance enriches the financial market. It therefore aids financial development and promotes economic growth.

A well-developed financial system with sound financial institutions, diverse financial instruments and deep financial markets helps the efficient allocation of resources, promotes savings and investments, shares and diversifies associated risk, and reduces transaction costs, all of which is essential for economic growth. Financial development also promotes financial stability; a deep and liquid financial system helps secure a country's resilience from economic and financial shocks.

However, the degree of this impact depends on the size, efficiency and stability of the financial system, as well as the public's access to and acceptance of the financial products and services it provides. Highly developed financial systems can reach a point of "too much finance," where the costs of financial development outweigh their benefits. The impact of financial development on economic growth tends to weaken at higher levels of financial development, a result of financial deepening, despite allowing greater access or higher efficiency.[1]

During the initial stages of financial development, the volatility of economic growth occurs at lower levels, quickly opening new opportunities for diversification and effective risk management. At a certain point after further development in the financial system, however, volatility in macroeconomic growth begins to increase.

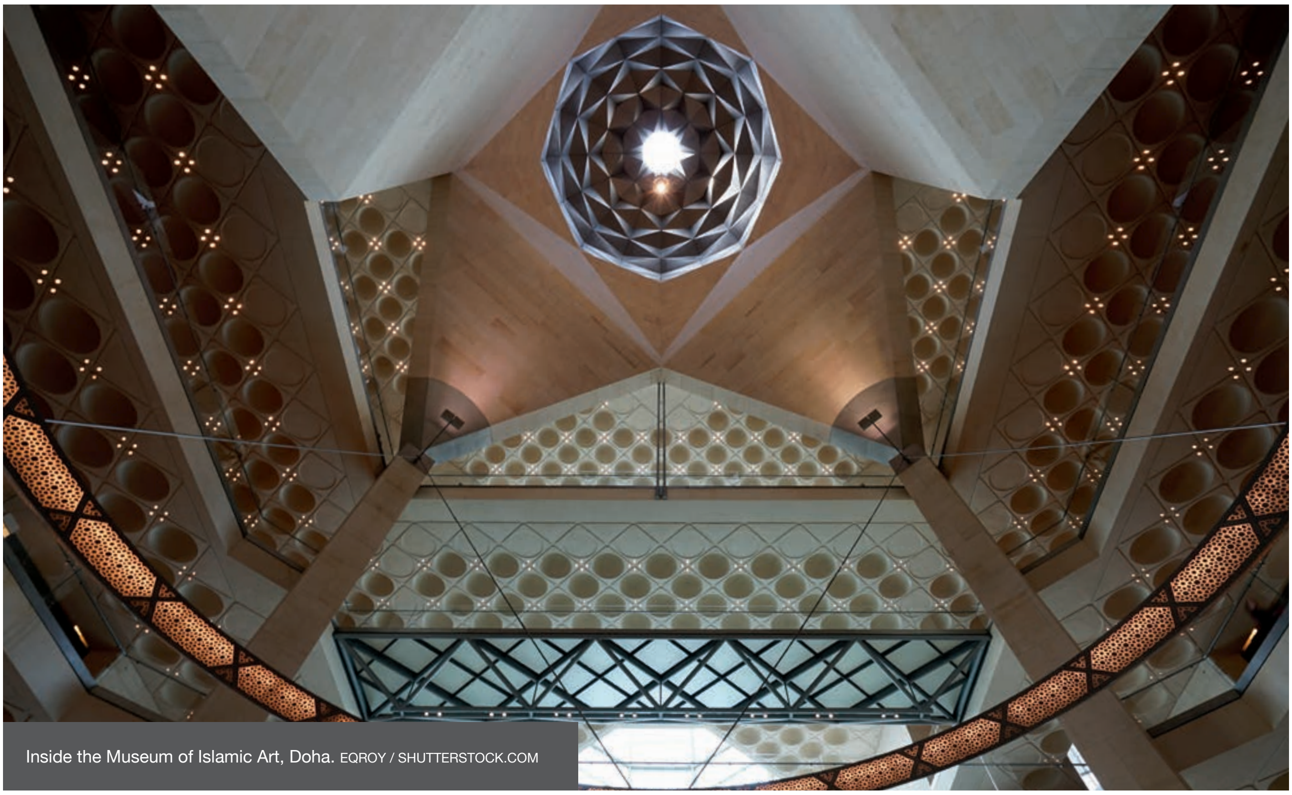
Moreover, a faster pace of financial development and deepening translates to an increased likelihood of financial crises and economic instability, all other conditions being equal. Without appropriate and adequate supervision and regulation, rapid financial development can encourage market players to take imprudent risks and excessive leverage. It becomes imperative to develop robust regulatory frameworks as financial development continues.

While Islamic finance assets constitute a small fraction of the global financial system, it has been proven a stable form of financial intermediation with strong potential to contribute to economic growth and financial stability. The Islamic finance industry—banking in particular— has exhibited relatively better performance compared to conventional counterparts, sustaining growth even during recent periods of global financial turmoil. This is the effect of an important strength of Islamic finance—that it is linked to "productive economic activity that predisposes the economy to financial deepening without excesses, its emphasis for accountability, disclosure and transparency, and its inbuilt checks and balances."[2]

Islamic finance has the potential to facilitate financial deepening. Islamic financial transactions are subject to a fundamental Shariah requirement that they be backed by an underlying economic activity and that they engage in socially responsible financial innovation. The profit-sharing and risk-sharing features of Islamic financial transactions provide Islamic financial institutions (IFIs) an incentive to conduct appropriate due diligence on these transactions, thereby ensuring that profits match the risks assumed.

1 IMF. "Rethinking Financial Deepening: Stability and Growth in Emerging Markets". IMF Staff Discussion Note SDN/15/08. May 2015 https://www.imf.org/external/pubs/ft/sdn/2015/sdn1508.pdf

2 Keynote address by Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia, at the 6th World Islamic Economic Forum, "The Transformation of the International Financial System and the Role of the Islamic Financial System", Kuala Lumpur, 20 May 2010.



Inside the Museum of Islamic Art, Doha. EQROY / SHUTTERSTOCK.COM

Shariah supervisory boards at IFIs are vital institutional safeguards that prevent extreme behavior in the Islamic financial system.

ISLAMIC BANKING AND FINANCIAL STABILITY

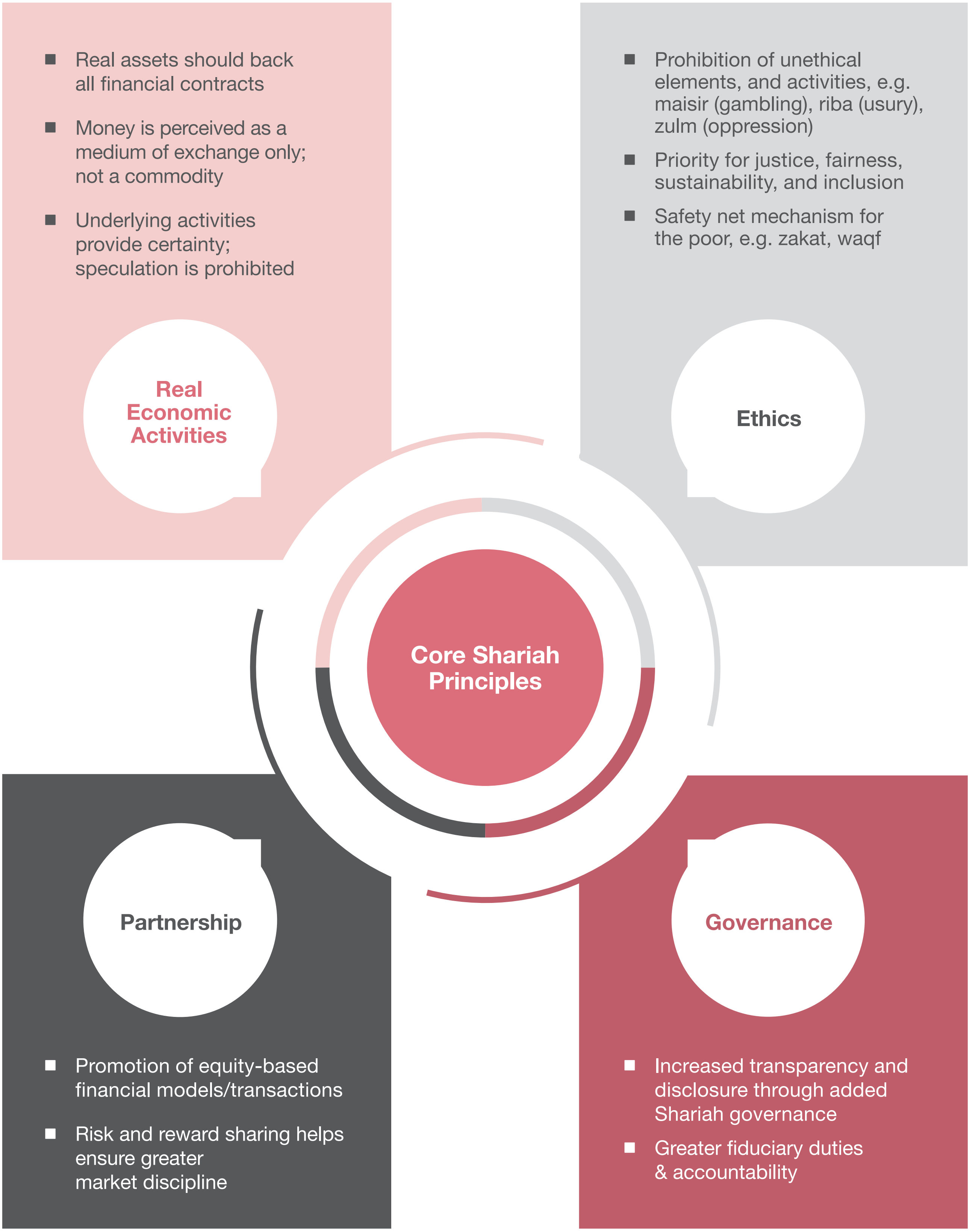
From another perspective, Islamic finance helps to enhance financial stability. One common view of Islamic finance is that IFIs' robustness and soundness results from certain inherent features in Islamic finance that promote financial stability, as evidenced by a limited record of distressed IFIs since the industry's establishment. According to its principles, real assets should back all its financial contracts, speculation is prohibited, and risks should be shared among partners. A stable financial market will motivate saving and investment activities by building up market confidence in future results and reducing uncertainties.[3]

Excessive borrowing and overall high levels of leverage have proven the main drivers of financial instability in the conventional financial industry. Islamic finance models, on the other hand, are based on equity and profit-and-loss risk-sharing financing, which can promote the development of financial sectors that are closely correlated with the real economy and prevent bubble markets. These principles, which govern IFI operations, have been key elements recommended in financial reform plans following the recent global financial crisis, which can theoretically bring more discipline to financial system behavior.

The application of Islamic finance principles, which prioritize justice, fairness, sustainability, and inclusion limits excessive speculative behavior and minimizes unethical transactions and unnecessary financial engineering. In addition, equity-based financial transactions can reduce formidable dependence to debt funding and therefore the risks arise from the excessive external borrowing could be mitigated. As a result of risk-sharing principles in particular, Islamic banks have shown more resilience in the face of adverse economic and financial shocks compared to their conventional counterparts. Islamic banks exhibited relative stability in the first wave of the recent financial crisis, demonstrating that IFIs had limited their exposure to subprime and "toxic" structured products.

3 Belouafi, Ahmed & Bourakba, C & Saci, K. (2015, July). "Islamic finance and financial stability: A review of the literature". Journal of King Abdulaziz University, Islamic Economics. 28. 3-44. 10.4197/Islec.28-2.1.

Figure 88 CORE PRINCIPLES OF ISLAMIC FINANCE PROMOTE FINANCIAL STABILITY



OVERVIEW AND DEVELOPMENT OF MICROFINANCE AND SMES

MICROFINANCE

Islamic microfinance has developed to bring working-class clients into the formal financial system, while providing the opportunity to fulfill a key goal of Islamic economics—promoting social justice through economic development. It provides such clients a valuable and alternative source of capital to general commercial banks that may not serve them. This development will have a significant positive impact on societies by reducing poverty and unemployment among the younger generation by enhancing economic capacity and social capital, provided that it also encourages an entrepreneurial spirit embedded in moral and Islamic values.

Despite a gloomy economic climate and ongoing worldwide financial volatility, the microfinance sector in most Arab countries has continued to develop both in terms of infrastructure, with growing branches and staffs, and operations. The growth of loan portfolios and development of new products continues apace. However, there are striking disparities in the maturity and performance of the microfinance market in different countries. As a high-income country with GDP per capita of roughly US$130,000, Qatar has no microfinance firms available due to a lack of demand in the country.

SMES IN QATAR

In Qatar, a move towards economic diversification has been underway for some time. From its early stages, the government has recognized that the creation of a vibrant and expansive sphere of small and medium-sized enterprises (SMEs) is critical to the success of this goal. It has therefore sought measures to help create the investment, expertise and entrepreneurial cultures necessary to ensure a vibrant SME sector becomes a reality. More specifically, in line with its National Vision 2030, the Qatari government has outlined key strategic goals for SMEs, including the creation of a diversified economy in which the private sector and SMEs in particular, play a pivotal role in increasing innovation and entrepreneurship in the country.[4]

Promoting innovative business ideas by providing access to training, development, and funding is vital to the growth of the SME sector in any economy. It is particularly important in Qatar, however, as businesses continue to face obstacles when entering the market. IMF research also shows that bank lending to SMEs accounts for only 0.5% of the total loans made in Qatar, making it extremely challenging for the sector to grow.[5] The average share of SME lending in the GCC is only 2%, while its share in non-GCC countries of the Middle East is 15%.[6]

A study[7] by Silatech and Gallup found that 29% of young Qataris were planning to start a business within the following 12 months, yet fewer than half (47%) believed it would be easy to obtain funding to do so. Only 56% thought the government made the required paperwork and permits "easy" for prospective businesses.

In most economies, funding for SMEs is not only provided by the government, but also by both private and public-private organizations in the form of equity funds and venture capital. In Qatar, major steps are still being taken to encourage the private sector to invest in SMEs and to introduce funding options for businesses.

The Qatar Development Bank (QDB) runs one of the most important government-backed initiatives to facilitate SMEs access to funding. The QDB primarily operates a partial credit guarantee scheme, Al Dhameen, in which it provides lending institutions a guarantee on up to 85% of the principal of approved SME loans. Participating institutions, including three of Qatar's Islamic banks and both Shariah-compliant non-bank financing companies, are not permitted to charge an interest rate higher than 7% on these loans.[8]

4 General Secretariat for Development Planning. (2008). "Qatar National Vision 2030".
5 IMF. 2016 Article IV Consultation for Qatar - Staff Report, §18.
6 Qatar Development Bank. "The State of Small and Medium Enterprises (SMEs) in Qatar – 2016."
7 Silatech, "The Silatech Index: Voices of Young Arabs," January 2010, § 71,
8 World Bank. (2016) "Competition in the GCC SME Lending Markets: An Initial Assessment".

Islamic banks are considered a good platform for financing SMEs and start-ups. According to the World Bank, "Islamic finance's emphasis on asset-backed financing and risk-sharing features means that it could provide support for small and medium–sized enterprises."[9] Shariah-compliant lenders can leverage the suitability of the profit-loss sharing model for SME financing to develop new financing products in addition to their existing offerings for this segment.

The banking sector, including Islamic banking, has not generally contributed to the financial inclusion of SMEs, although this segment has great growth potential. Islamic banks, in particular, face several challenges when it comes to providing financing to SMEs:

- A shortage of diversified Islamic financial products specifically catering to SMEs, as product offerings for this segment are currently limited to murabahah.
- The lack of standardization in Islamic financial contracts.
- Higher transaction fees and taxes charged on Islamic finance products compared to conventional finance, as a result of complex Shariah verification processes and unfavorable taxation frameworks.
- SMEs lack non-movable collateral. To enable SMEs to use movable collateral, a robust framework is required.
- Limited Islamic financial literacy and awareness among SMEs, compared to that for conventional finance.
- Banks face a significant lack of human resources trained in Islamic financing practices for SMEs.[10]
- Additionally, the asset-based and equity-based characteristics of Islamic private equity, venture capital and capital markets.

Some asset-based and equity-based non-banking Shariah-compliant financing options offer alternative financing channels for SMEs. These include SME funds, venture capital and private equity funds, crowdfunding platforms, angel investment networks and capital markets.[11] By offering all of these Islamic banking and non-banking financial services, the financing gap for SMEs can be reduced.

Qatar's Supreme Council for Economic Affairs and Investment approved the establishment of a junior market for SMEs at the Qatar Stock Exchange (QSE) in 2015. The project was implemented with input from relevant financial and governmental entities, including Enterprise Qatar, the QDB, and Silatech. This platform gives SME owners the opportunity to be listed on the QSE in accordance with lighter and more flexible regulations. Listing can give them further financial sources to grow and expand their businesses. It will offer investors more options as well by increasing the number of companies available for investment.

In Qatar, non-bank finance companies, which are predominantly Shariah-compliant, have an advantage over commercial banks in the SME funding space. These companies are accustomed to offering smaller loans compared to banks, allowing them to more efficiently offer financing to this segment. More specifically, micro, small and medium enterprises (MSMEs) present an even more unique opportunity for non-bank finance companies. MSMEs financing needs do not meet most lenders' minimum offerings to SMEs.

Some asset-based and equity-based non-banking Shariah-compliant financing options offer alternative financing channels for SMEs.

9 IMF. (2015, May). "Rethinking Financial Deepening: Stability and Growth in Emerging Markets". IMF Staff Discussion Note SDN/15/08.
10 World Bank. (2016). "Competition in the GCC SME Lending Markets: An Initial Assessment."
11 World Bank. (2016). "Competition in the GCC SME Lending Markets: An Initial Assessment."

OVERVIEW AND DEVELOPMENT OF ZAKAT AND AWQAF

Islamic finance can offer a viable framework that facilitates the achievement of sustainable development and shared prosperity. This framework is based on four fundamental pillars, one of which is an institutional and regulatory framework aligned with the core objectives of Islam (maqasid al-Shariah). Maqasid al-Shariah include promoting and preserving religion, intellect, dignity, interests of future generations, and wealth and prosperity

The optimal institutional and governance structure must be able to:

- Design policies that foster inclusive growth and development through entrepreneurship, risk-sharing, and equity participation;
- Encourage individuals to contribute to economic, social, human, and moral capital creation; and
- Reduce poverty by redistributing wealth, with a greater focus on the most disadvantaged.

Another pillar is financial and social inclusion, as channels to contribute to sustainable development and equitable distribution of wealth. This pillar aims to ensure that every segment of society benefits from the returns of higher growth, either by participating in economic growth or through Islamic instruments of redistribution.[12]

Social finance plays an important role in improving the social prospects of the underprivileged in society. It enables the unemployed and working class to have access to public and private goods and work and business opportunities. Zakat, sadaqat and waqf are three key components of Islamic social finance. They have been important in ensuring social protection, encouraging wider social and financial inclusion, and reducing extremes of wealth and poverty.

Governments and the private sector in most majority-Muslim countries strive for the welfare of their poor population through Islamic social finance. The Government of Qatar also uses the tools of Islamic social finance for providing various social benefits to its citizens as well as to its expatriate population. Beneficiaries of Qatari philanthropy also include the underprivileged outside the country. The following section highlights some of the efforts of the country in this direction.

ZAKAT AND SADAQAT

The Government of Qatar established its Zakat Fund[13] in 1995 under the Ministry of Endowments (Awqaf) and Islamic Affairs. Qatar is a tax-free country for its own nationals, but they are required to pay zakat at the rate of 2.5% on their investment profits. The fund carefully studies aggregated data on Qatar's population to determine its zakat liability and how this may be collected.

The government employs multiple channels for zakat collection such as kiosks and desks in every big mall in the country with dedicated ATMs and boxes placed for this purpose. The fund has set up an additional 12 branches for raising zakat funds. In the interest of convenience for salaried Qataris, as well as general efficiency in zakat mobilization, deduction from salaries is also permitted. More recently, the fund has introduced an online facility to pay zakat.

The salaries of the zakat administration and the other administrative expenses are not paid out of the zakat proceeds held by the fund. These expenses are borne by the government, and are financed through budgetary allocations. The government seeks transparency in the distribution of zakat funds, which has increased the trust of the fund's employees, the zakat payers, and zakat recipients.

The Zakat Fund supports education for the poor. For this purpose, the fund has established a special department, which sponsors poor students of all nationalities registered with private or public schools. The department has transparent selection criteria. It receives applications for sponsorship; after a process of inquiry and due diligence regarding

12 World Bank Group and Islamic Development Bank Group. (2016). "Islamic Finance: A Catalyst for Shared Prosperity?"
13 Hukoomi.qa. (2017, Sep. 15). Zakat Fund - Hukoomi - Qatar E-government.

the family's financial need, the student is provided with tuition fees and cash to cover stationery, clothing, and transportation. Likewise, the fund provides fees and transportation expenses to the poor students registered in universities.

In the in the fund's first year, 1996-97, 125 poor students from public schools were the beneficiaries of this scheme. Later on, all other types of schools were included in the recipients' category. The latest data shows the fund has sponsored 42,963 students between 1996 and 2011 including 23,975 students from government schools, 12,838 from private schools, 4,070 from independent schools and 2,080 university students. It also provided clothing and school supplies to 50,589 students.

The Qatar Zakat Fund has spent increasing amounts on this program. In the beginning, its budget amounted to QAR 50,000, but this has increased over time to help more poor students. From the inception of the program up to the year 2010-11, the fund has spent a total of QAR 102.52 million on the scheme, including QAR 9.47 million on students from government schools, QAR 47.11 million on private schools, QAR 1.7 million on independent schools, QAR 12.9 million on university students, and QAR 31.3 million on clothing and school supplies to 2010-11.

WAQF AND CHARITY FOUNDATIONS

The General Directorate of Endowments (Awqaf), also under the Ministry of Endowments (Awqaf) and Islamic Affairs, is responsible for the overall supervision of waqf endowments in Qatar. Its responsibilities include managing and investing endowment funds according to Shariah principles, with the aim of developing these funds and disbursing them following conditions set out by waqf contributors. Some of the endowments managed by the directorate include the Sh. Abdulla Bin Zaid Al Mahmoud Islamic Cultural Center and several residential buildings.[14] Further details on awaqf in Qatar are not available because of limited published information.

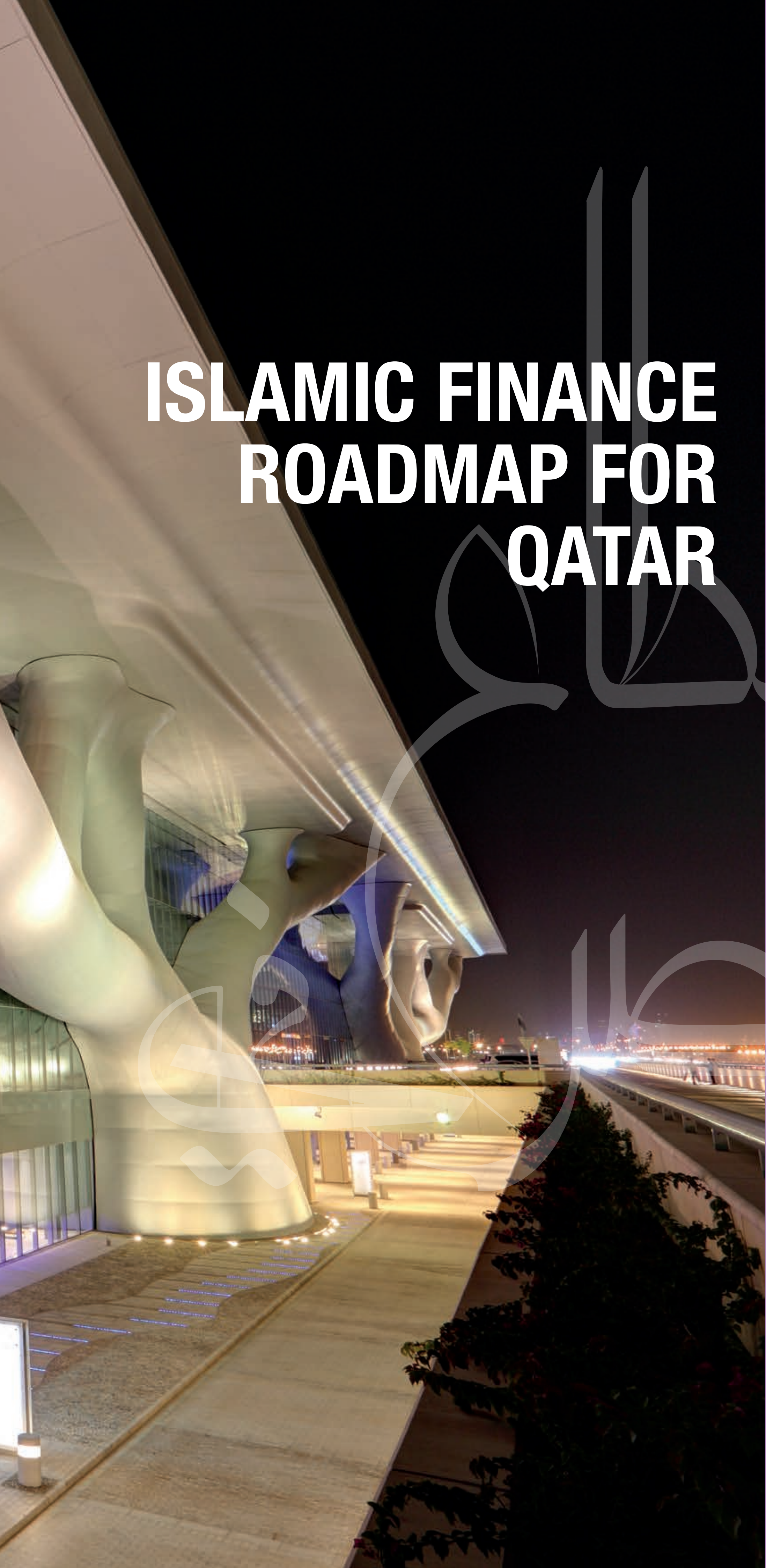
The country has an independent governmental Regulatory Authority for Charitable Activities (RACA)[15], which was established by Emiri Decree No. (43) of 2014. Its purpose is to develop, encourage, and support philanthropic and humanitarian works so they may reach a high level of efficiency and transparency. It also aimed at organizing their work with the development of standards, instructions, and guidelines for the dissemination of a culture of charitable and humanitarian work in the state of Qatar.

For the purpose of strengthening the trust of the Qatari community in charitable associations and private foundations, the authority motivates donors to choose projects and to follow up with them. The authority involves the community in supervising the work of private charities and associations by opening channels of communication between it and the members of the community for suggestions, complaints and providing information.

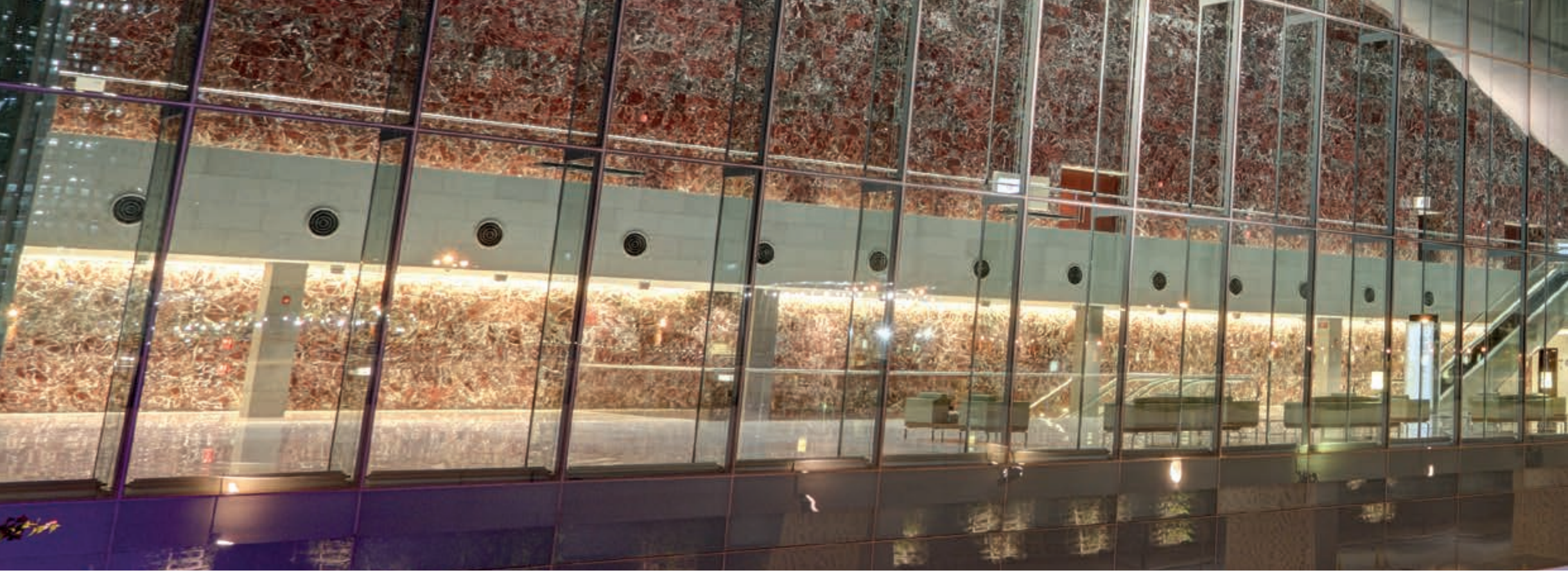
The authority works in cooperation with other bodies and agencies concerned to organize charitable and humanitarian work. Together, they produce rules and regulations covering charitable and humanitarian work, supervise and direct the activities of charitable associations and private institutions, register and supervise fundraising activities and issue fundraising licenses for individuals and other agencies. The authority also audits the administrative and financial operations of charitable bodies and private foundations in Qatar.

14 Awqaf.gov.qa. (2017). Qatar General Directorate of Awqaf website. Accessed 15 Sep. 2017.
15 Hukoomi.qa. (2017). Charity Work - Hukoomi - Qatar E-government. Accessed 15 Sep. 2017.

National Convention Centre, Doha. PHILIP LANGE / SHUTTERSTOCK.COM



ISLAMIC FINANCE ROADMAP FOR QATAR



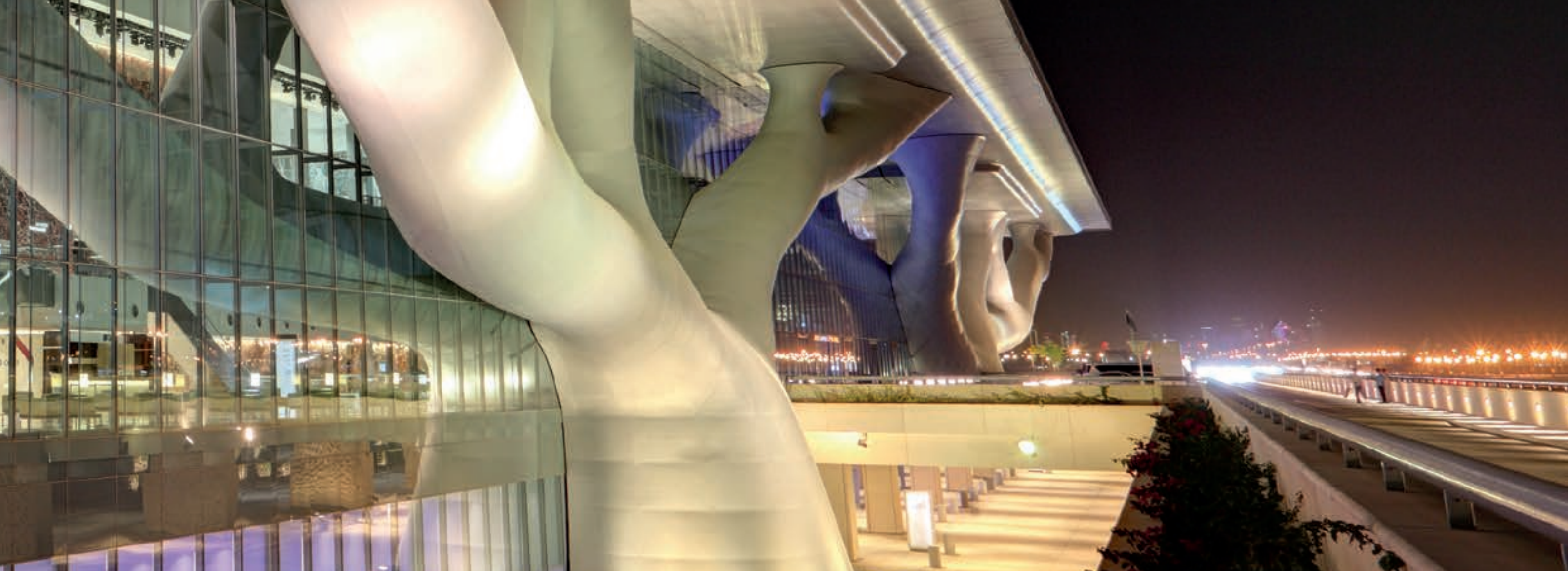
QATAR'S COMPETITIVE ADVANTAGE

Qatar's location in the Middle East places it at the intersection of three important regional economies connected by large volumes of financial flows. It offers a convenient time zone and travel times for financial institutions bridging Europe, Africa and Asia more than any single market within those regions. The wealth produced by Qatar's natural resources also makes it a destination for many financial institutions seeking capital and a low-tax country in which to domicile.

GROWTH OF SOUTH-SOUTH INVESTMENT BOOSTS FINANCIAL CENTERS IN EMERGING MARKETS

The characteristics of financial flows are changing as wealth creation shifts from developed markets towards emerging markets, making Qatar's physical location more important. The new wealth being created within markets in Africa, the Middle East and Asia has been accompanied by greater financial flows between emerging markets themselves.

In previous years, many emerging markets' economies were commodity-driven and their largest export destinations were developed markets. Often, the revenues generated from the sale of commodities were moved—for safety, liquidity or both—into financial institutions in developed markets, Europe in particular. This cycle of funds de-emphasized the role of emerging market financial centers, except as



Qatar's effort to develop its financial regulatory system… has been a key step in encouraging financial institutions to use Qatar as their hub for Africa, Middle East and Asian business.

lightly regulated offshore tax havens and as asset collectors for developed market financial institutions.

A new model emerged during the rise of the "BRIC" emerging economies that moved the investment centre of gravity towards developing markets, where wealth was being created and reinvested. Although some of these investments still ended up in developed markets, much more capital was reinvested domestically or in other emerging markets. Meanwhile, investment from developed markets in emerging markets accelerated. With both of these trends, the number of emerging market financial centers has burgeoned.

QATAR'S IMPROVED REGULATORY SYSTEM IMPROVING TO ATTRACT FINANCIAL INSTITUTIONS

Qatar's effort to develop its financial regulatory system to the standard of quality seen in developed markets has been a key step in encouraging financial institutions to use Qatar as their hub for Africa, Middle East and Asian business. Efforts such as the harmonization of regulations between the Qatar Central Bank (QCB), Qatar Financial Centre Regulatory Authority (QFCRA), and Qatar Financial Market Authority (QFMA) allow for a reduction of potential overlapping or contradictory rules for different financial institutions.

The ability of Qatar Financial Centre (QFC) financial institutions to offer products (apart from retail deposits) both onshore and outside Qatar, in the GCC and other regions, is attractive to financial institutions that are pursuing both markets. This can save them the cost of having multiple regional offices without limiting the activities they can perform.

INVESTMENT OPPORTUNITIES AND TRENDS

Qatar's economy was one of the fastest growing in the world between 2006 and 2011, growing at an annual rate of 18% according to data from the World Bank as its natural gas production and exports accelerated.[1] The growth is continuing on a new level with the development of infrastructure to support Qatar's National Vision 2030 as well as in the nearer-term to provide the facilities necessary for the 2022 World Cup in Qatar.

INFRASTRUCTURE DEVELOPMENT OPENS NEW OPPORTUNITIES FOR INVESTORS IN QATAR

Thanks to Qatar's abundant hydrocarbon wealth, it does not need and has not indicated a desire to tap foreign investors for the financing of the mega-infrastructure projects being developed for the World Cup 2022 or the National Vision 2030. However, this has not restricted the many opportunities arising for financial institutions in Qatar as these infrastructure projects are a catalyst for other investments. These large projects require financing and insurance services for the private institutions who bid on the projects, if not for the project financing itself.

The scale of the primary investment in infrastructure projects is massive. For example, QAR 164 billion (US$45 billion) has been slated for the Lusail development, a new coastal city being built north of Doha scheduled for completion in 2019. QAR 127 billion (US$35 billion) has been committed for Qatar Rail projects due to be completed by 2020, and QAR 25 billion (US$7 billion) for a new port in Doha by 2030. The railway includes four planned lines in the first phase, which is scheduled to be completed by the opening of the World Cup.[2] After the World Cup, the metro system will be expanded and complemented with long-distance rail both within Qatar and regionally.

The development of these large new infrastructure projects will help Qatar's economy to continue growing after 2022, as World Cup projects become integrated into the wider economy. For foreign institutional and corporate investors looking for longer-term investment opportunities in the Middle East region, the World Cup will have sped up the development of infrastructure that will support the growth of Qatar's economy over the coming decades.

The development of these large new infrastructure projects will help Qatar's economy to continue growing after 2022, as World Cup projects become integrated into the wider economy.

1 World Bank Data Bank. "GDP growth (annual %)" (Accessed August 9, 2017)
2 Qatar Rail. "Doha Metro," (Accessed July 16, 2017).

QATAR AS AN ISLAMIC FINANCE HUB

For Qatar to become an Islamic finance hub, the favorable conditions of its geography and the investment programs being undertaken to support the World Cup 2022 and the Qatar National Vision 2030 must be leveraged to deepen the involvement of the financial industry in Qatar, and particularly to develop and utilize the unique attributes of Islamic finance.

BANKS

The banking system holds the largest share of total Islamic finance assets in Qatar but following a period of high growth, the banking sector as a whole has largely saturated the domestic market. This means future growth in the Islamic banking market share would come at the expense of conventional banks. With the entire banking system facing a period of retrenchment, particularly in the personal loan market, the prospect for significant growth in Islamic banking assets at above trend growth rates is limited.

Qatar's banks look abroad for growth

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 Sharia 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. Moreover, they have attracted significantly more deposits internationally than they have provided financing, which partially offsets a shortage of domestic deposits.

These market dynamics present a challenge to Islamic banks in particular, but they also present key opportunities. Islamic banks often have difficulty competing with conventional banks on large-ticket projects.

Qatari Islamic banks bring expertise to new markets for Islamic finance

An opportunity presented to Islamic banks in Qatar from expanding internationally arises due to the increase in net foreign funding (foreign deposits minus foreign finance). This may insulate the banks from funding cost increases relative to non-bank financial institutions. Qatar's Islamic banks are pursuing such strategic opportunities, seeking to operate in international markets such as Morocco and the UK.

Morocco's five newly approved Islamic banks will be operated as joint-venture arrangements between domestic conventional banks and foreign Islamic banks, including QIIB. The benefit of this approach for Morocco is that it transfers skills into a market where Islamic banking talent may currently be lacking. For the foreign banks, it opens a new market 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 financial technology (Fintech). Fintech investment has grown rapidly in previous years and this investment is beginning to translate into greater adoption, although most banks are still proceeding cautiously. One of the opportunities for Islamic banks is in the SME market, where Fintech could help in the deployment of blockchain technology to replace some of the paper recordkeeping associated with inventory, receivables and trade financing.

Successful deployment of a blockchain-based Fintech solution by Islamic banks would greatly expand the number of SMEs that could be financed. Increasing the efficiency of the financing application and review process would allow Islamic banks to take advantage of their economies to scale. This process had been previously challenging because of the high administrative costs for SME lending. 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.[3]

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 such as Anti-Money Laundering/Counter Financing of Terrorism (AML/CFT) rules for early stage Fintech startups.

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. They are also granted a license to operate in the sandbox for a limited duration, usually two years. At the end of the agreed period, startups will either have to exit the market or transition to full licensing and follow all applicable regulations for the business area in which they operate.

NON-BANK FINANCIAL INSTITUTIONS

As previously mentioned, the rules introduced to curb the growth of personal lending have forced a shift by non-bank financial institutions 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.

Despite the challenges facing non-bank financial institutions as a result of their shifting business model and heightened competition, they do 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 for both non-bank financial institutions and banks, regulators should follow developments already occurring elsewhere, where regulatory "sandboxes" are providing a live-testing ground for Fintech companies. In these sandboxes, which could include consumer-facing Fintech as well as products designed for financial institutions, the regulators focus their oversight on the areas of greatest concern including consumer protection (where relevant) and AML/CFT.

Outside of Fintech, non-bank financial institutions will benefit from ensuring a close tie with one of the banks, either through ownership or other linkages, to maintain access to capital as liquidity tightens and interbank rates rise. For banks, this would offer a way to shift their exposure toward the SME market while avoiding the higher administrative costs that would occur if they entered the market directly. Besides bank financing, non-bank financial institutions should also explore, with necessary regulatory support, securitization transactions including securitization of sukuk and tapping capital markets to diversify their funding sources.

CAPITAL MARKETS

The capital markets in Qatar have seen significant development in sovereign issuances that has not been matched to date by comparable corporate issuances. With a large share of outstanding sukuk 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.

This unfavorable result can be avoided by regulatory preference given to local currency sukuk held by banks, which increases the likelihood that the government will issue a significant volume of sukuk through the QCB to finance the maturing sukuk. 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 supply. Instead, the government, quasi-sovereign institutions and corporations may want to consider differentiating their sukuk offerings from other GCC sovereigns and corporates with multicurrency issuances (including Asian currencies like ringgit), and green and socially responsible sukuk.

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

3 Das, S. (2017, April 11). "Qatar Commercial Bank Completes International Money Transfer Blockchain Pilot," *Fintech Rankings*.

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. Included in the taxable income is the share of any capital gains recognized in Qatar that is attributable to the non-GCC shareholders.

In most sukuk transactions, this tax would be triggered by the sale of an asset owned by the company needed to complete the structuring process for most sukuk structures, including ijarah, which is most commonly used in the State of Qatar. This may be possible to restructure in a way that is tax-neutral for the sukuk investors, using a special purpose vehicle (SPV) domiciled in the QFC. However, to the extent the underlying asset is owned by a non-QFC company, the tax issue will make sukuk a less appealing opportunity relative to conventional bonds.

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 Malaysia, the tax deductibility of these expenses has been established in the income tax law, but 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.[4]

As an alternative, depending on whether the desired issuers were subject to the companies' tax, an incentive could be enacted to operate through the VAT tax system on the fee-based services providers instead.[5] This would provide an incentive that would benefit both local issuers that are subject to VAT but not income tax, as well as encouraging the development of the necessary infrastructure (lawyers, accountants and Shariah advisory firms) to support sukuk issuers.

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 been the primary issuer to date in the Qatari Riyal-denominated sukuk market and 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.

Together with greater harmonization between different regulatory bodies that is aligning most financial regulations inside and outside of the QFC, the backdrop for issuers has been laid out. 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

The asset management sector in Qatar remains limited in the field of mutual funds, which account for just QAR 939 million (US$ 258 million) in assets under management. Notably, the sector has been more developed in Shariah-compliant funds, which represent just over half of total assets. Opportunities in Qatar's fund and asset wealth exist, despite the currently limited development of the fund industry.

The bigger opportunity is in domestic private wealth, estimated at QAR 127 billion (US$35 billion), with 290 ultra-high net worth individuals with more than US$30 million (QAR 109 million) in investable assets, 4,200 with more than US$1 million (QAR 364 million) and 216,000 affluent individuals each holding more than US$100,000 (QAR 364,000) to invest.[6] These individuals are being targeted by the QFCRA through special licenses 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 licensing.[7]

Asset management has a US$35 billion opportunity

The gap between investable assets and the share that is ultimately invested in domestic funds is striking, and it presents an opportunity that can be most realistically addressed by developing an asset management sector. 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

4 Securities Commission. "Special Incentives — Islamic Capital Market" (Accessed July 18, 2017).
5 Deloitte. (2017). *GCC VAT Fundamentals in the Financial Sector.* Dubai: Deloitte & Touche (M.E.).
6 Michael, B., and Apostoloski, N. (2014). "The Middle Eastern Wealth Management Industry: Boon or Bust?" *MPRA paper no. 52069.*
7 The new rules prohibit investment clubs that are organized in a way to be carried on 'by way of business'. Staff writer. (2017, April 18). "QFC to accommodate investment clubs and foundations," *The Peninsula Qatar.*

management sector because of the legal framework in place. It will also be the area where foreign asset managers will establish offices—because of the ability to manage both QFC and non-QFC funds for QFC-registered firms—that can increase the industry's capabilities.

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.

Qatar could be a bridge between wealth and investment opportunities in Africa and Asia

Regional opportunities beyond Qatar are significant. Potentially more important will be looking beyond the GCC to countries in the wider MENA region where Qatar's financial institutions have a footprint, such as Morocco, as bridges between emerging markets in Africa and areas with significant concentrations of wealth in Asia.

As economic growth opportunities increasingly center in emerging markets, growing pools of wealth will also originate in emerging markets, especially in developing Asia, and this new wealth will be deployed into other emerging markets for investment. The reason for emerging market wealth to target other emerging markets is the same as for investors from developed markets. The low demographic and economic growth in developed markets offer fewer investment opportunities and the large range of emerging markets provides sufficient diversification for all types of investors. There is some opportunity with funds and asset managers buying listed assets including stocks, bonds and sukuk, but even more opportunity with alternative investments such as real estate, commodities, infrastructure, private equity and venture capital.

Alternative investments add diversification opportunities

The benefit from holding alternatives is that they can diversify, potentially increasing returns above market averages (alpha) and, in some cases, generate yield that may be lacking in portfolios. With regards to yield generation, investors in the Middle East and Africa held 50% of their wealth is held in cash and deposits which have earned very low yields since the financial crisis.[8] In response, some of the investors have shifted towards money market funds, which offer slightly higher yields but which are still below common alternative assets including real estate.

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 is limited by the lack of technology and biotechnology enterprises which are key targets for venture capital investment. Private equity is limited by the presence of many large family-owned firms that are less likely to be potential acquisition targets and equity markets are too underdeveloped to make effective exits. 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. The listed equity markets are one of the first areas where responsible investment practices have grown. The Qatar Stock Exchange (QSE), as a member of the Sustainable Stock Exchanges Initiative, began its implementation of ESG data reporting by issuing voluntary guidelines for listed companies to use when reporting their ESG data. Starting with the voluntary guidelines, the QSE explains, is testament to the fact "that no transition will happen overnight [but the guidelines are] a first step in what we hope will be the start of a transformative process in our market."[9]

With asset managers and owners worldwide responsible for US$62 trillion in assets integrating ESG principles, efforts are underway to increasingly apply the same principles in other asset classes, including fixed income, private equity and real estate. The growth in responsible investment has until now been

8 Beardsley, B., Holley, B., Jaafar, M., Kessler, D., Muxí, F., Naumann, M., Rogg, J., Tang, T., Xavier, A., and Zakrzewski. A., (2017). *Global Wealth 2017: Transforming the Client Experience.* Boston: Boston Consulting Group.
9 Qatar Stock Exchange. (2016). *Guidance on ESG Reporting.* Doha: Qatar Stock Exchange, p. 4.

primarily driven by developed markets but, like economic growth, the growth of responsible investment is also shifting towards emerging markets. China, which was almost entirely absent from the green bond market in 2014, issued US$36 billion in 2016, or 40% of global issuance.[10]

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, in part, by establishing a regional sustainable investment forum (MESIF), it will have an edge over other regional financial centers.[11] 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.

INSURANCE AND 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.

The slow growth of expertise among local staff and the capacity to absorb risk remains a challenge. The former should be an important focus for the regulator, in order to bring the sector up to global levels with the high barriers to entry for foreign firms into the largest segment of the market, government business, which reduces opportunity for skills transfer to local staff. The latter has been largely occurring already and the regulatory responsibility will be to ensure that underwriting capacity matches the rise in gross premiums retained.

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 commoditized 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 Insuretech companies. These companies bring many of the same risks as traditional insurers, but they may also have additional cyber security risks.

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.

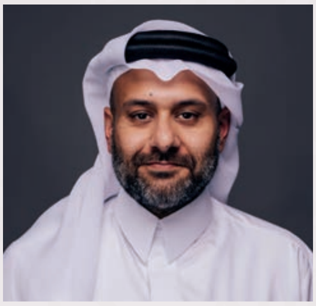
For example, it is unclear whether the lack of differentiation reflects Shariah compliance challenges or is merely due to lack of experience by management. The infusion of technology into low-margin businesses could be a challenge for takaful operators. The lack of agreement among Shariah scholars about 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 defensible market for successful takaful operators, which is important given the existing market structure.

10 Hornby, L. (2017, May 17). "China leads world on green bonds but the benefits are hazy," *Financial Times.* Green bonds are bonds where the proceeds are ring fenced and only used for projects with positive environmental impact, often with some form of second party opinion as verification. Currently standards are fragmented across markets but they are gradually becoming harmonized.

11 MESIF. (2017, March 16). "Middle East Sustainable Investment Forum (SIF) Launch Event Round Table," Press Release.

MR. YOUSUF AL-JAIDA

CEO, Qatar Financial Centre (QFC)



Mr. Al-Jaida was appointed Chief Executive Officer of the QFC Authority (QFCA) in June 2015. He was previously Deputy Chief Executive Officer and Chief Strategic and Business Development Officer at the QFC where he was responsible for the overall strategic development.

Prior to joining the QFC, Yousuf was Head of Indirect Investment at the Qatar General Retirement and Pension Authority, overseeing the management of hedge fund, private equity, real estate, fixed income and equity portfolio investments. His previous experiences include engineering project work for Qatar Petroleum and Dolphin Energy and managing various real-estate projects in Qatar.

He represents the QFCA on the boards of the Qatar Exchange, the Qatar Finance and Business Academy, and the Financial Markets Development Committee. He also sits on the Advisory Council of Qatar University's College of Business and Economics. He has previously sat on the boards of Nakilat QSC and the US$1 billion strategic investment fund of Unicorn Investment Bank, as well as serving as Vice Chairman of Mayadeen Real Estate Company KSCC.

He graduated from the University of Arizona, USA.

1. In recent years, Qatar has seen substantial growth in its financial sector and expanding investment opportunities resulting from its efforts to diversify its economy. In your opinion, what are Qatar's key advantages to becoming a global financial and investment hub?

In order for Qatar to continue to prosper and grow, it is vital that we continue our mission to be a global financial and investment hub. Doing so helps ensure the country's economic growth and the prosperity of the Qatari people.

To achieve this aim, we are attracting investors from around the world and showing them the number of diverse opportunities available here. This is where Qatar has the advantage. Simply put, Qatar offers entry into a market that is not saturated, but rather one that is continuously growing, offering endless possibilities as a highly sophisticated and competitive market.

Qatar is one of the world's best-developed countries in information and communications technologies (ICT). It is also one of only 37 countries the World Economic Forum has characterized innovation-based economy this year, with key innovative projects in place, such as a US$7.4bn project in Hamad Port.

Qatar's market strength and location make it an ideal location for businesses looking to expand to Qatar, the Middle East, Africa and Asia. It also offers a well-developed and competitive local market, as well as a highly developed value chain that can support the needs of investors.

2. QFC has made strides since it was established in 2005, with total combined assets reaching QAR 75 billion in 2016. What has driven its success so far?

Our success has been driven by our determination to show the world the reasons Qatar has huge potential for investment and for businesses to grow through the QFC platform.

The QFC has been a critical factor in to the country's non-hydrocarbon growth, bringing around 400 firms to Qatar, from a range of regulated (financial) and non-regulated industries. This includes a range of top international FTSE- and Nasdaq-listed companies as well as local firms, which we have helped provide a platform for international growth.

Since our inception 12 years ago, we have come a very long way. There have been many milestones in our journey. Two of which

I am very proud include Qatar First Bank's listing as the first QFC firm on the Qatar Stock Exchange (QSE) and the establishment of the Qatar Finance and Business Academy (QFBA) to help organizations and professionals achieve their learning and business objectives.

3. QFC recently announced its roadmap for 2017 to 2022, outlining its objectives for the coming five years. What are the new initiatives in the roadmap that will help QFC promote itself as a leading destination for business? What role does the roadmap envision QFC will play in Qatar National Vision 2030?

His Highness the Emir Sheikh Tamim bin Hamad Al-Thani recently stressed the importance of diversifying Qatar's sources of income. At the QFC, our mission is, and has always been, to drive economic development and diversification. We continue to focus on attracting firms that will serve Qatar's goal of diversifying its economy, in line with the Qatar National Vision (QNV) 2030.

The QFC is key to the QNV 2030 roadmap by helping to diversify Qatar's economy. Over the next few years, we expect the non-hydrocarbon sector and the private sector to contribute significantly to Qatar's growth, and we expect to see more financial consultancies, management consultancies and professional services set up shop. These sectors are naturally thriving in the region as it moves and matures into a more diverse, sustainable, knowledge-based economy.

We are also playing a key part in the QNV 2030 roadmap by helping promote Qatar as a whole, and the numerous business opportunities that exist in this thriving nation. We have recently conducted roadshows across Asia, Europe and the UK, and we are seeing a lot of interest from these markets. We are planning even more roadshows to demonstrate to international businesses how they can benefit from Qatar's multi-billion investment portfolio.

4. A number of Islamic financial institutions currently operate in the QFC. What are QFC's plans to further promote Islamic finance, to position Qatar as a hub for this industry and to attract global players to the market?

Islamic finance is a key and growing sector and one that is very relevant for both the QFC and for Qatar.

At the QFC, there are currently many efforts underway to promote Islamic finance. Some of these efforts include collaborating with the College of Islamic Studies and Hamad bin Khalifa University on Shariah governance and other Islamic finance research activities.

We are also looking to host roundtables, events, and workshops where there will be open dialogue sessions among Islamic finance practitioners, academics and Shariah scholars to discuss trends and challenges surrounding Islamic Finance, such as the infrastructural complexities of Islamic finance instruments.

In order to attract global players, we believe it is important to open up local Islamic finance offerings to new global trends such as social and green financing. We will pursue such developments by ensuring these topics are discussed in an open forum at relevant events we host.

Collaborating with experts in Islamic finance and creating dialogue will create opportunity for understanding and enhancing the field of Islamic economics and finance. This will bring prominent Shariah scholars and experts from around the world to Doha, which in turn will help our efforts to show the world why Qatar is a key hub for the growth of Islamic finance and to attract global players to the Islamic financial market.

5. Regionally, the QFC faces competition from offshore financial free zones operating with zero-tax regimes. Given that QFC imposes tax on entities with part or full foreign ownership, is this a challenge in attracting foreign financial institutions and companies to Qatar? What incentives does QFC offer that counteracts the lure of zero taxes?

International tax initiatives such as the Base Erosion and Profit Shifting (BEPS) project and the Automatic Exchange of Information standard mean zero-tax regimes are actually a challenge rather than an advantage to companies.

Having a moderate tax plan in place actually puts the QFC in a better competitive position when it comes to tax transparency and fairness assessments by international regulators and organizations such as the OECD.

Investors are very mindful of such assessments in the jurisdictions where their investors operate, and they will ensure such transparency is in place and tax regimes are compliant with their business needs.

6. What are the benefits of the QFC platform?

The QFC platform is truly unique, offering its own legal, regulatory, tax, and business infrastructure and allowing 100% foreign ownership and 100% repatriation of profits and allowing businesses to trade in any currency.

Our competitive tax regime of 10% corporate tax on locally sourced profits is unmatched and unlike other financial centers in the region, and the QFC does not impose an 'end date' on this guarantee. We boast a robust and transparent tax regime, and companies established under the QFC also benefit from Qatar's extensive Double Taxation Agreements with over 60 countries.

Our firms also benefit from a regulatory environment that conforms to international best practices. It features an independent court with judgments enforced in the State of Qatar and a regulatory tribunal and dispute-resolution centre.

Firms at the QFC also have access to Qatar's business community, especially after our expected move to Msheireb Downtown Doha, which will serve as a new financial and business capital for Qatar

We also offer firms entry into a market that is not saturated—rather, it is continuously growing. Qatar's market strength makes it an ideal location for businesses looking to expand to the wider region and other parts of the world, including Africa and Asia.

To sum up, we offer businesses the right platform to expand locally, regionally, and internationally, and we take care of all logistics so that they can focus on growing their business.

7. Establishment in the QFC, as with other financial centers, carries benefits to foreign-owned entities in terms of ownership and repatriation. However, around 30% of companies at QFC currently are local. How does a local entity benefit from setting up in QFC?

Attracting foreign companies isn't the only factor in creating a successful financial and business centre. To be a true business centre, Qatar needs to nurture and support the growth of local companies as well. The QFC plays an important role in supporting this aspect of Qatar's growth, and we are very proud that more than 30% of our licensed companies are local.

In our conversations with them, these local firms acknowledge the QFC's robust legislation as an important facilitator in their success as

> "Having a moderate tax plan in place actually puts the QFC in a better competitive position when it comes to tax transparency and fairness assessments by international regulators and organizations such as the OECD."

they expand in Qatar and beyond. Recently, Qatar First Bank became the first Qatari QFC licensed firm to be listed on the QSE. This and several other local success stories add to the real impact that the QFC has on Qatar's economy.

Additionally, local companies also benefit from the QFC having its own legal, regulatory, tax and business infrastructure, no restriction on currencies used for trading and a competitive rate of 10% corporate tax on locally sourced profits.

8. As part of its new roadmap, does QFC plan to expand into new sectors? In which of QFC's sectors do you see the greatest potential for growth over the next five years? What role could Fintech companies play in this expansion?

The great thing about being a global financial and business centre is that we can welcome all sorts of different businesses from a huge array of sectors to join our platform. That said our current core clusters surround healthcare, transport, tourism and culture, and sports and events.

Fintech certainly plays a part, and we foresee future growth in this area in Qatar. Fintech companies are rapidly expanding by providing alternative solutions and business models to improve financial services. Other sectors, including cyber security, legal, and compliance services, will see rising demand for their services to ensure Fintech technologies are operating in tandem with local regulations and that the risks of such technologies are properly assessed.

There is also a key role for Fintech to play in the Islamic finance space, as it positively contributes to the evolution of Islamic finance product and service offerings. New innovations such as Fintech platforms with Islamic finance capabilities are also contributing to promoting Islamic finance worldwide. ■

Msheireb Downtown Doha

A STRATEGIC ROADMAP FOR ISLAMIC FINANCE IN QATAR

Objective	Strategies
Improve Shariah governance	Establish greater consistency in Shariah governance Provide centralized guidance on fit and proper criteria for Shariah scholars Offer a dispute resolution facility for Shariah-compliance issues
Reform interbank liquidity management	Study leakages from Islamic banks through interbank finance
Promote Fintech development	Evaluate how to support Fintech startups with 'sandbox' regulation Consider lifting lending limits and interest rate caps for Fintech startups Encourage collaboration between banks, non-bank financial institutions and Fintech
Enhance differentiation in asset management	Promote sustainable investment initiatives Develop a responsible finance regulatory framework to attract regional managers
Strengthen the unique proposition of takaful	Develop the single business model and consumer awareness for takaful
Improve public awareness of Islamic finance	Launch an Islamic Finance awareness campaign focusing on financial literacy
Develop human resources by tackle specific skills gaps	Introduce testing programs for Islamic bank staff
Recognize and manage cost barriers in Islamic finance	
Balance the industry need for Islamic derivatives against Basel III push towards centralization	

IMPROVE SHARIAH GOVERNANCE

Establish greater consistency in Shariah governance

This is a critical aspect for aspiring Islamic finance hubs, as the model for Shariah governance continues to shift globally. Whereas Malaysia was nearly alone for many years in having a Shariah governance system built into its regulatory framework, the approach has been growing in popularity, with Oman, Morocco, the United Arab Emirates, and Pakistan among countries adopting a national approach in recent years.

Provide centralized guidance on fit and proper criteria for Shariah scholars

The centralization 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. However, national Shariah boards provide some level of market-wide consistency in the implementation of Islamic finance criteria at institutions. They may also be able to advise on fit and proper requirements for Shariah board members at Islamic financial institutions.

Offer a dispute resolution facility for Shariah compliance issues

A centralized board can provide a neutral party in case of dispute between Islamic financial institutions, which can encourage greater predictability for market participants.[12]

REFORM INTERBANK LIQUIDITY MANAGEMENT

Study leakages from Islamic banks through interbank finance

In the banking sector, Qatar has led the world in ensuring in the authenticity of Shariah-compliant bank assets with QCB and QCFRA requirements separating Islamic and conventional banks entirely. In order to ensure this segregation remains effective in substance as well as in form, there should be a review to determine the feasibility in interbank markets for the central bank to limit flows from Islamic banks to conventional banks in their liquidity management operations using murabahah. The concern around leakage occurs when Islamic banks place funds through murabahah interbank placements with conventional banks. The returns are permissible profit on a sale transaction, but the underlying source of the returns is interest-based loans. Therefore, 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.

PROMOTE FINTECH DEVELOPMENT

Evaluate how to support Fintech startups with 'sandbox' 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. This collaboration should be built on a mutual interest in expanding financing to the SME market and the respective skills of each type of institution. 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.

12 Vizcaino, B. (2017, July 6). "Amid Dana debacle, Islamic finance seeks safeguards against illegality claims," *Reuters*.

The Grand Mosque, Doha. FITRIA RAMLI / SHUTTERSTOCK.COM

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. In addition to continuing to develop the regulatory framework for the asset management 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 OF TAKAFUL

Develop the single business model and consumer awareness for takaful

It's necessary 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 Insuretech 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, according to the survey results presented in *Chapter 4*. Although almost half of people surveyed 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.

For example, in addition to the impermissibility of interest, Islamic finance is based on rules governing speculation, transparency, and the protection of different parties in a financial transaction. These rules provide tangible benefits that may not be apparent to someone choosing an Islamic bank simply to avoid interest, particularly if there is a cost differential with conventional products and services. 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 TACKLE SPECIFIC SKILLS GAPS

Introduce testing programs for Islamic bank staff

Although the maturity level of the Islamic finance industry has grown over recent years, with developments in regulations at the local and the global levels, it has not been accompanied in equal measure by the development of professional skills. The survey included in the report (*Chapter 4*) found that just fewer than 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. One potential reason for a deficiency in this particular skill may be an overemphasis on the theoretical or structural approach of Islamic finance in education and training programs. Although it is important for some bank employees to have deep understanding of these areas, it is relatively less important for customer-facing employees.

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.

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. This will allow the area of testing to target weak points in skill development and provide universities and training providers an active role in training their students/trainees so that they can move on to a career in Islamic finance with both the skills needed for an entry-level position and the knowledge for future career advancement.

RECOGNIZE AND MANAGE COST BARRIERS IN ISLAMIC FINANCE

Islamic financial institutions, by and large, compete with their conventional peers. In the survey presented in *Chapter 4*, half of people surveyed reported using both Islamic and conventional banks. When such a sizeable proportion of potential customers act in a way that indicates a willingness to use both conventional and Islamic banks, cost may be acting as an important barrier for clients that prefer Islamic banks but may not be willing to pay extra for that choice.

Higher costs can result from several sources, and each will have different effects in retail banking than in the capital markets. Additional costs for Islamic banks come from two primary factors: additional fees for governing their Shariah-compliance through their Shariah supervisory boards and internal Shariah audits, and small institution sizes. The smaller size of Islamic banks in Qatar hinders their ability to efficiently manage their costs by achieving economies of scale, with additional costs passed on to the customer. In capital markets, there are higher up-front costs for additional structuring of sukuk and Shariah board approval. These costs can be offset by a potentially lower cost of financing due to high demand for sukuk, which is constrained by limited supply. In Malaysia, the profit rate on the 5-year government sukuk issued in 2016 was 12.3 basis points higher than the coupon rate on an equivalent government bond. However, this spread declined substantially in 2017 issuances to 6.6 basis points. The lower spread for this particular tenor of sukuk reflects a more significant demand-supply gap compared to longer tenors.

In order to minimize some of the direct costs to encourage new issuers, particularly from the corporate sector for whom these issues may be the deciding factor, Malaysia introduced tax preferences for sukuk. Among these incentives, it amended its income tax law to provide a tax deduction for the issuance costs for sukuk through 2018 for issuers using ijarah or wakalah structures.[13]

Thomson Reuters estimates the global gap between demand and supply in sukuk at US$113.9 billion as of 2016. It forecasts it to grow to US$271 billion by 2021, which should provide a significant overhang of demand and a resulting lower funding cost for sukuk issuers relative to conventional bonds. However, estimating this precisely is difficult, especially for Qatar, because of the dearth of corporate sukuk, where a pricing difference would have the most impact in driving issuer behavior.[14]

In Islamic banks, the cost gap results from different factors. It appears from the additional Shariah governance costs, which is aggravated as most Islamic banks are operating below the minimum level of scale. This means that they are not able to fully take advantage of economies of scale available to larger (conventional) banks and must pass on increased costs to their customers.

As Islamic banks grow larger, as they have in Qatar through the closing of Islamic windows and the proposed consolidation between Masraf Al Rayan, Barwa Bank and the International Bank of Qatar, the cost differential will shrink thanks to greater scale efficiencies as well as a likely reduction in Shariah oversight costs relative to the institution's overall cost base.

BALANCE THE INDUSTRY NEED FOR ISLAMIC DERIVATIVES AGAINST BASEL III PUSH TOWARDS CENTRALIZATION

The development of Shariah-compliant derivatives has been a controversial topic in some areas of the Islamic finance industry. That being said, there is a real need to manage specific risks such as profit rate risks and foreign exchange risks, and the inability of Islamic banks to manage these risks in ways comparable to conventional banks introduces greater volatility in their earnings. This could raise costs for customers if bank shareholders demand return on equity for Islamic banks closer to that of conventional banks.

For Islamic banks in Qatar, the dollar peg provides a natural hedge against many currency risks, because it allows banks to tap both local and international (USD) markets without introducing direct foreign exchange risk. However, as they have expanded operations internationally into countries whose currencies are not pegged to the US dollar, they will see increasing FX risks that many will prefer to hedge.[15] Similarly, with US interest rates remaining low for many years, the QCB has also maintained low rates to support the dollar peg. This has limited the need for significant profit rate hedging against funding cost increases. Now that the US Federal Reserve has begun increasing rates, there is a greater two-way profit rate risk. This occurs when higher rates increase the funding cost of lower fixed-rate assets or lower rates create rollover risk on higher yielding assets with fixed rate medium-term funding.

In general, the way that the Islamic derivatives have been structured in the past was through bilateral agreements between Islamic banks or between an Islamic bank hedging through a larger conventional bank. This is becoming much more challenging because of the shift towards centralized clearing houses enforced by Basel III standards, with increased margin requirements on over-the-counter derivatives.

The centralization of derivatives clearing and centralization of counterparty risk will affect the development of Islamic derivatives because their current structure relies upon bilateral contracts and often use commodity sales to synthesize the desired risk transfer. These structures often use debt-based contracts that Shariah regulations may make challenging to move ex post to centralized clearinghouses. Moreover, there may not be enough transaction volume to make it worthwhile for centralized clearinghouses to take this business, even if they can be modified to incorporate a third party within the structure.

13 Securities Commission Malaysia. "Special Incentives — Islamic Capital Market," (Accessed August 18, 2017)
14 Thomson Reuters. (2016). *Sukuk Perceptions & Forecast Study 2017: Poised for Growth.* Dubai: Salaam Gateway
15 Errazzouki, S. (2017, June 27). "Morocco prepares for first stage of currency flexibility", *Reuters*.

ABBREVIATIONS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
AML/CFT	Anti-Money Laundering/Combating Financing of Terrorism
CBQ	Commercial Bank of Qatar
CPI	Consumer Price Index
DSM	Doha Stock Market
ETF	Exchange-Traded Fund
FDI	Foreign Direct Investment
Fintech	Financial Technology
IBQ	International Bank of Qatar
IFSB	Islamic Financial Services Board
IILM	International Islamic Liquidity Management Corporation
IMF	International Monetary Fund
LIFE	Life Insurance and Family Takaful Framework (Malaysia)
MDPS	Ministry of Development Planning and Statistics (Qatar)
MESIF	Middle East Sustainable Investment Forum
NHS	National Health Strategy
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of Petroleum Exporting Countries
P2P	Peer-to-peer
PISA	Programme for International Student Assessment
QCB	Qatar Central Bank
QCSD	Qatar Central Securities Depository

QDB	Qatar Development Bank
QEI	Qatar Exchange Index
QFC	Qatar Financial Centre
QFCRA	Qatar Financial Centre Regulatory Authority
QFMA	Qatar Financial Markets Authority
QIA	Qatar Investment Authority
QIB	Qatar Islamic Bank
QIBOR	Qatar Interbank Offered Rate
QIC	Qatar Insurance Company
QIIB	Qatar International Islamic Bank
QIIC	Qatar Islamic Insurance Company
QNB	Qatar National Bank
QNV 2030	Qatar National Vision 2030
QSA	Qatar Statistics Authority
QSE	Qatar Stock Exchange
REIT	Real Estate Investment Trust
SME/MSME	Small and Medium Enterprise/Micro, Small and Medium Enterprise
UNDP	United Nations Development Programme
VAT	Value Added Tax
WEF	World Economic Forum

GLOSSARY

Bai' al 'inah
Sale in which a purchaser buys merchandise from a seller for a stipulated price on a deferred payment basis and then sells the same merchandise back to the original seller for a price lower than the original price on cash basis, the net effect of which is a loan with interest.

Bancatakaful
Sale, marketing and distribution of takaful products by a bank on behalf of a takaful operator.

Banking penetration
Measurement of the development of the banking sector in a country, calculated by the ratio of banking assets to GDP.

Blockchain
Software that is a shared record of information on financial transactions, maintained and updated by a network of computers rather than a central authority.

Capital Conservation Buffer (CCB)
Common Equity Tier 1 capital required to be held under CRD IV to ensure that banks build up surplus capital outside periods of stress which can be drawn down if losses are incurred.

Composite insurer
Insurer licensed to carry out both life and general insurance business.

Cost-to-income ratio
Measure of operating expense as a percentage of operating income, which is used to gauge a bank's efficiency and productivity. Lower ratios generally indicate higher efficiency.

Expense (claims) ratio
The percentage of premiums used to pay all the costs of acquiring, writing, and servicing insurance and reinsurance, calculated by the ratio of operating expenses to earned premiums.

Family takaful
Takaful contract that provides benefits payable to an individual upon death/total permanent disability or periodic income to participant upon retirement.

Fatwa
Formal religious opinion concerning Islamic law, issued by an expert jurist.

Ijarah
Sale of a defined usufruct of any asset in exchange for defined compensation. In the context of Islamic finance, it refers to an arrangement under which one party leases equipment, buildings or other facilities to a client for an agreed rent.

Insurance density
Ratio of gross premiums and contributions of the insurance sector to the total population, insurance density is a measure of insurance coverage in the country.

Insurance penetration
Indicator of the development of a country's insurance sector, is the ratio of the sector's gross underwritten premiums and contributions to GDP

Islamic window
On-balance sheet component of a conventional financial institution (a branch or a dedicated unit), that provides Shariah-compliant financial services, with separate funds.

Loan-to-deposit ratio
Assesses a bank's liquidity by dividing its total loans by its total deposits. If the ratio exceeds 100%, it means that the bank may not have enough liquidity to cover any unforeseen fund requirements.

Loss ratio
Measures the level of claims as a percentage of net earned premiums and policy fees, calculated as insurance benefits and losses net, which include paid claims, claims incurred but not reported and claims handling costs, divided by net earned premiums and policy fees.

Maqasid al-Shariah
A juristic-philosophical concept developed by the later generations of the classical jurists, who sought to formulate the goals and purposes of the Shariah in a comprehensive manner in the process of investigating new cases and organizing previous existing rulings.

Mudharabah
A form of partnership where one party provides the funds while the other provides expertise and management. Any profits accrued are shared between the two parties on a pre-agreed basis, while loss is borne by the providers of the capital.

Murabahah
Financing scheme in which a financial institution, usually a bank, agrees to purchase merchandise for a client provided that the client promises to purchase it from the financial institution at an agreed mark-up.

Net interest margin
Measures the percentage of annualized net interest income of average customer assets.

Net Stable Funding Ratio (NSFR)
Ratio of available stable funding to required stable funding over a one year time horizon, assuming a stressed scenario. The ratio is required to be over 100%.

Non-performing loans/financing (NPL/NPF)
Loan or financing for which full redemption is uncertain. The borrower has stopped paying the installments on the principal and interest—the loan or financing is effectively in default or very close.

Regulatory sandbox
Set of rules allowing innovators to test their products or business models in a live environment without following some or all legal requirements, subject to predefined restrictions.

Reinsurance cession rate
Indicator of the level of risk that is retained by insurers, measured by the percentage of gross written premiums that is ceded to reinsurers.

Sadaqat
Voluntary charitable contributions by Muslims.

Salam
Forward sale where the full price of the goods is paid in advance at the time of contract; the goods are not available for immediate delivery but can be delivered at a specified time in the future.

Sukuk
Financial certificate equivalents to conventional debt issuances such as bonds. However, unlike debt issuance, sukuk holders are the legal and/ or beneficial owners of the underlying assets, and as such, receive the equivalent of a coupon from the performance of the yielding asset.

Takaful
Islamic alternative to conventional commercial insurance based on the concept of mutual support. It provides mutual protection of assets and property. Takaful is similar to mutual insurance in that members are the insurers as well as the insured.

Takaful contributions
Similar to insurance premiums, monetary contribution provided once or periodically by a participant to a Takaful operator for the purpose of investment and donations.

Tawarruq
Monetization; to convert something to cash.

Wakalah
Standard Islamic practice, often used in financial transactions, wherein one party acts as an agent (wakeel) for another party.

Waqf
Charitable trust: an endowment or a charitable trust set up for Islamic purposes (usually for education, mosques or for the poor). It involves tying up a property in perpetuity so that it cannot be sold, inherited to anyone.

Zakat
Obligatory almsgiving, one of five pillars of Islam. Muslims with wealth above a prescribed amount are required to give money to a designated Islamic authority for distribution to the poor and the needy. In the absence of an Islamic authority, well-off Muslims are required to distribute alms among the poor and the needy themselves.

FIGURES AND TABLES

FIGURES

TABLES

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

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Sincerely,
IFCR Team

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QATAR
ISLAMIC FINANCE
REPORT 2017

EXPANDING HORIZONS

A JOINT INITIATIVE BY

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