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Islamic Banking: From Niche to Global Industry

- **Global Islamic banking assets** reached about **USD1.56 tr** in end of 2014.
- **Islamic banking sector** with assets in full-fledged Islamic banks approximately **USD1.48 tr** in 2014.
- The sector has expanded at a **CAGR of 16.89%** in the last five years vs overall global banking growth of only 4.9%.
- This mode of finance is **expanding in terms of geography beyond OIC** countries too: as many countries are introducing sharia compliant products or issuing sukuk in their home markets. i.e UK, Luxembourg, Germany, Singapore, Russia.
- Moreover, in addition to IDB other **MDBs are increasing their involvement** in Islamic finance. i.e. WB, IMF, IFC

Main Feature of Islamic Banks

- Capitalization of Islamic banks **exceeds regulatory requirements** by several percentage points across all jurisdictions.

- Challenges remain regarding the **compliance of the capital structures with Basel III** standards. High capital ratios indicate an under utilisation of capital.

- This inefficiency is caused by the need to **keep higher capital buffers** to compensate for the lack of effective interbank markets and Sharīʿah-compliant lender-of-last-resort facilities.

- The funding of Islamic banks is dominated by deposits.

- The lack of liquidity management tools is a continuing concern of Islamic Banks.

- The financing exposure of Islamic banks to private-sector businesses is predominant in jurisdictions with underdeveloped corporate securities markets.

- Where private businesses can get funding from the capital market, Islamic banks show a higher exposure to the household sector.

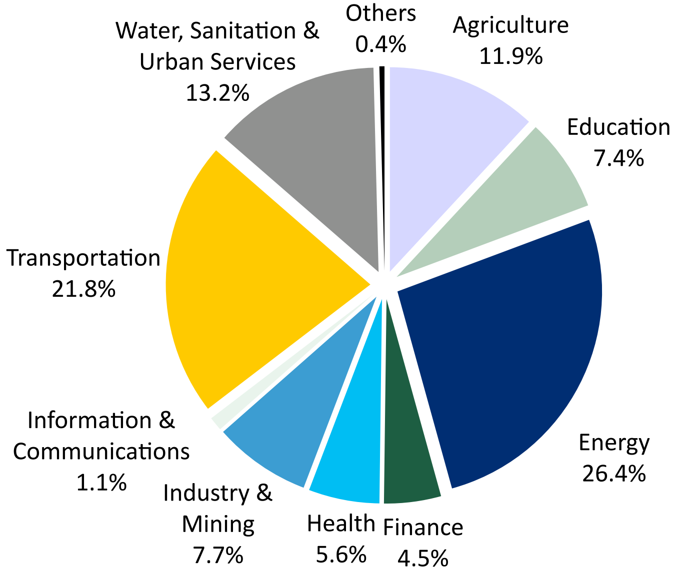
Infrastructure Financing Needs in IDB Member Countries

- Funding demand for infrastructure in OIC countries is estimated to touch **USD 350 bn** in 2015 and is expected to grow by 5% annually
- Tradable Sharia-compliant global Sukuk supply and demand **gap projected to be over USD 220 bn** in 2015
- **Over 70% of market participants indicate the presence of a liquidity management challenge**, driven by a lack of market makers, in addition to shortage of products that are flexible in meeting their demands
- A large number of OIC countries have **a funding deficit** (and are unable to finance infra projects on their own), hence the importance of PPP laws and Islamic banking regulation to raise funds through private sector source and issuance of sukuks

IDB a Pioneer in Islamic Finance

- Over **USD 100 bn** of financing since establishment in 1975. The volume of yearly financing increased to USD 5 bn in the new strategic plan
- IDB is **founder of 40 banks**, 5 takaful companies, 3 leasing companies, as well all Islamic finance bodies i.e. AAOIFI, IFSB, IIRA, IILM
- With more than USD 10 bn of sukuk issuance**, IDB is a sukuk market maker**
- Recent Initiatives to Support Infrastructure Financing
  - Establishment of the IDB Infrastructure Fund II
  - Establishment of the IDB-ADB Islamic Infrastructure Fund
  - IDB Member Countries Sovereign Investments Forum

Infrastructure has the lion share in terms of financing volume



Consistently Rated 'AAA' Since 2007

IDB's 'AAA' rating is predominantly derived from its standalone credit profile in contrast to other multilateral development banks' ("MDB") reliance on 'AAA' rated callable capital

Moody's
(Since 2006)
Last Rating: Oct. 2014

FitchRatings
(Since 2007)
Last Rating: July 2014

STANDARD & POOR'S
(Since 2002)
Last Rating: Sep. 2014

"Low leverage…"

"Very strong capitalization…"

"Established track record in terms of asset quality…"

"Preferred Creditor status…"

"Strong commitment from shareholders…"

"Strong liquidity…"

Zero Risk Weighted

EUROPEAN CENTRAL BANK
EUROSYSTEM

Accepted as marketable assets in the European Central Bank (ECB) list

BANK OF ENGLAND

Eligible as Level B collateral for the Bank's operations

FCA FINANCIAL CONDUCT AUTHORITY

Eligible for inclusion in the liquidity buffer of banks under the FCA supervision
(BIPRU 12.7.2)

Source: Rating Agencies Reports

IDB Group and Mandate

IDB Activities

- **Project Finance, Loans and Technical Assistance aimed at the development of:**
  - Agriculture
  - Basic Infrastructure & Industrial sectors
  - Education
  - Healthcare and other Social Sector Institutions
- **Equity Investment and Lines of Financing for the development of Financial Institutions**

IDB Priority Areas

- **Human Development**
- **Agricultural and Rural Development and Food Security**
- **Infrastructure Development**
- **Private Sector Development (ICD)**
- **Intra-Trade Among Member Countries (ITFC)**
- **Research and Development in Islamic Banking and Finance (IRTI)**

Key IDB Group Members*

- **International Islamic Trade Finance Corporation (ITFC)**: Supports trade finance activities amongst member countries.
- **Islamic Corporation for the Development of the Private Sector (ICD)**: Supports the private sector in the member countries.
- **Islamic Corporation for Insurance of Investment and Export Credit (ICIEC)**: Provides investment protection and export credit insurance for member countries.
- **The Islamic Research and Training Institute (IRTI):** Leads the development and sustenance of a dynamic and comprehensive Islamic Financial Services Industry.

* These institutions have their own separate balance sheets and member countries except IRTI.

Take Away Points : Real Opportunity in Infrastructure Sector

- ✓ A large number of OIC countries have a funding deficit (and are unable to finance infra projects on their own)
- ✓ OIC countries often pay a premium for financing due to risk perception. For instance, **CDS spreads of AA rated OIC countries are 60-80 bps higher** than European comparables
- ✓ Islamic finance (e.g., Sukuk) providing natural solution for infrastructure funding; resurgence seen in infra Sukuk as they represented ~30% of all Sukuk in GCC (up from 7% in 2013)

Take Away Points: Increasing Demand for Liquidity Management

- ✓ IFI balance sheet structures are more stretched (compared to conventional banks) due to a lack of adequate liquidity management products (**IFIs rely far more on interbank lending with ~9% of assets in interbank versus only ~4% for conventional banks**)
- ✓ Acceptance of Sharia compliance varies when it comes to existing liquidity management products. **Large proportion of short-term products are commodity Murabaha (~30% or more)** with Sukuk investments less than 10% of portfolio
- ✓ Insufficient access to money and capital markets is causing IFIs to rely more heavily on customer deposits than on conventional banks. **Customer deposits** as a proportion of total liabilities **are 5-10% higher** for Islamic banks compared to conventional banks

Take Away Points: Opportunity to Provide Islamic banking Products

- ✓ **Market participants indicate liquidity management challenge**, driven by a lack of availability of instruments, market makers and flexibility in products
- ✓ Clear supply gap exists in the market with insufficient stock of instruments; estimated global supply gap of Sukuk in 2015 of **~USD 220 billion.**
- ✓ **Market demand for greater tradability** is clearly acknowledged by Islamic financial institutions and financial experts.

ISLAMIC DEVELOPMENT BANK GROUP

Contact Details

P.O Box 5925 Jeddah 21432 K.S.A
Tel: +966-12-646-7422
Fax: +966-12-636-7554
Email: idbi@isdb.org
Website: http://www.isdb.org

Infrastructure Financing Instruments

- Sukuk
  - The Sukūk market has overtaken the Islamic banking sector as the most rapidly expanding Islamic finance sector. In the last 5 years, longer maturity issues of ten years and above form almost 20% with the greatest surge seen in the group with tenors between 10 – 20 years.
  - The above factors have been instrumental in driving the growth of the Sukūk sector across diverse geographical regions, as sovereign successes in the international markets, particularly by non-Organisation of Islamic Cooperation (OIC) issuers, generate publicity and raise the confidence of other issuers while giving them an encouraging example. In the longer term, interest is emerging from new domiciles in Central Asia, Europe, and North and Sub-Saharan Africa wanting to explore Sukūk as viable tools for fund-raising.
- Islamic Fund Management
  - Islamic fund management remains a niche sector of the global Islamic finance industry. As a result of uncertain global macroeconomic circumstances as well as certain sectorspecific challenges (such as smaller scale and limited distribution channels), its growth has moderated in the post-GFC period with Sharīʿah-compliant assets under management (AuM) recording a modest CAGR of 6.6% from 2009 to 2013.
  - As of end 2014, the Islamic funds sector grew 4.6%, with their AuM reaching an estimated USD75.8 billion. The cumulative number of Islamic funds stood at 1161 in the same period.

Infrastructure Financing Instruments

- Private Equity

  Islamic private equity is one of the fastest-growing areas both within the private equity and the Islamic finance space The popularity of these funds is growing tremendously; over the last year alone, Islamic private equity funds announced exceeded US$25 billion, demonstrating a strong and yet unmet investor demand. Considering the growth in assets of global and GCC Islamic banks and financial institutions, it is estimated that the Islamic private equity will be worth US$200 billion by 2020.

  What is needed to accelerate the Islamic finance and the Islamic private equity industry's development in particular is skilled and educated human capital, as well as a higher level of standardisation across countries, disciplines and products of the entire Islamic finance space. Critical success factors on the micro level include product development expertise, client relationship management and competitiveness, both in terms of quality and pricing, among others. In this context, innovation is the key, as it enables individual players and the industry as a whole to draw the link between conventional and Islamic financial products by structuring the former in adherence to Shariah principles.

- Islamic Syndication financing

  While great strides have been made, Islamic syndications lag way behind conventional syndications because of: „ The absence of uniform international Sharia principles that can assure borrowers and investors that their transactions and structures are Sharia compliant, will be upheld and can give them the same confidence and protections they have in conventional syndicated financings. „ A developing secondary market for Sharia-compliant financings which has, for the time being, led to investors holding their primary commitment.

The Investments Department (IDBi)

"The Investments Department is responsible for undertaking and managing the IDB's medium and long term direct and funds investments made from the Ordinary Capital Resources of IDB, the IDB Waqf Fund, Staff Pension Fund, Islamic Solidarity Fund for Development".

Investments Department

Equity Investment Division

- ✓ *Manage & Monitor current Portfolio*
- ✓ *Invest in new IFIs & companies*
- ✓ *Rebalance the Portfolio*

Fund Management Division

- ✓ *Manage & Monitor current Funds Portfolio*
- ✓ *Identify & Process new Fund investments*

Resource Mobilization Division

- ✓ *Structure & Launch new investment Funds*
- ✓ *Initiate Co-branded Funds with other Institutional Investors*

IDBi - Equity Portfolio

Over 70 investments in 26 countries

Disbursed amount of US$ 704 million

Market value of US$ 1.53 billion

Contributes more than 10% of IDB's net income

As of 26 April 2015

IDBi - Funds Portfolio

More than US$ 460 million commitments in 11 Funds

Conventional Asset Classes

- Listed Equity
- Sukuk
- Trade Finance
- Leasing & Ijarah

AIRBUS
AN EADS COMPANY

Alternative Asset Classes

- Real Estate
- Infra-structure
- Private Equity

ACWA POWER
الراجحي المالية
Al Rajhi Capital
ASMA CAPITAL
اسما كابيتال
SEDCO CAPITAL
سدكو كابيتال
THE ABRAAJ GROUP
BTG Pactual

IDBi- Investment Principles & Process

- Sharia Compliance (conventional debt maximum – 1/3 of financing structure) for Brownfield projects
- 100% Shariah compliance for Greenfield projects
- Global coverage (not limited to Member Countries)
- Public and Private sponsors are eligible
- Greenfield or Expansion projects with development attributes
- Sound reputation and solid track record of sponsors
- Feasibility study done by a reputable firm
- Maximum 33% stake taken by IDB
- No single major shareholder stake

IDB Infrastructure Fund II

Target Size:	US$ 2 billion
Description:	- Successor to the US$730 million IDB Infrastructure Fund I - The largest dedicated infrastructure fund for IDB member countries beyond core infrastructure sectors of power, telecommunications, transportation, and includes investment in oil and gas, refinery and petrochemicals, steel and aluminum, mining, logistics and an allocation for healthcare, education, and financial services.
Main Investors:	IDB, Public Pension Agency of the Kingdom of Saudi Arabia, the Public Investment Fund of the Kingdom of Saudi Arabia, the Ministry of Finance of the Kingdom of Bahrain and the Ministry of Finance of the Sultanate of Brunei Darussalam
Expected IRR:	18% (based on the figures of Fund I)
Funds to be Mobilized:	Up to US$24 billion
Fund Manager:	ASMA Capital Partners B.S.C.(c), established by IDB and the founding investors in the Kingdom of Bahrain

Kingdom of Bahrain Ministry of Finance

ASMA CAPITAL اسما كابيتال

كمنترين كواغن KEMENTERIAN KEWANGAN Ministry of Finance BRUNEI DARUSSALAM

Airbus Leasing Islamic Fund

Target Size:	US$ 1 billion
Description:	The first Shariah compliant Aircraft Leasing Fund seeded by Airbus and exclusively dedicated for buying and leasing AIRBUS planes mainly to GCC, MENA, CIS and southeast Asian airline carriers.
Main Investors:	IDB, Airbus Industries, Tabuung Hajji, Warba Bank, Kuwait International Bank and Tharawat Holding
Fund Type:	Open Ended
Expected IRR:	15%
Fund Manager:	International Air Finance Corporation

AIRBUS

Marina Mall - Morocco

Expected IRR: 17%

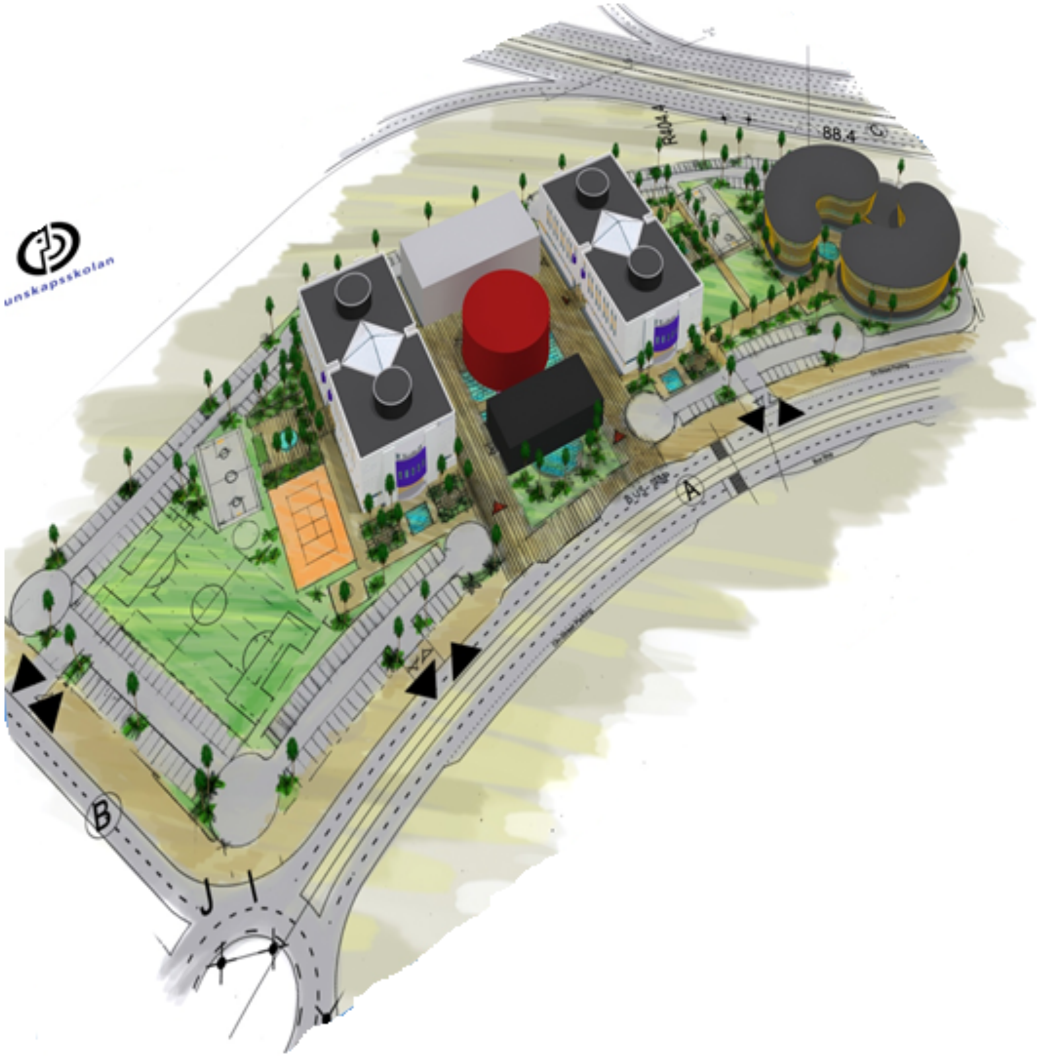
- Marina Mall is a real estate development project where IDB partnered with SMI (Societe Marita Immobiliere).
- SMI is a real estate development company established in 2003 and based in Morocco with track record internationally mainly in Europe and Africa.
- Marina Mall is the largest commercial area in Rabat.
- Covers 8.5 acres in Rabat-Sale's Bab al Bahr District which is in the heart of New Rabat.
- It is a mixed use project with the last generation of real estate complex including premium housing, offices and a shopping mall with 38.000 sqm on the ground floor (parking included).
- The Mall will be managed by Poly World, a shopping mall operator operating 65 malls globally.

KED Schools – Kingdom of Saudi Arabia

Kunskapsskolan

Expected IRR: 22%

- KED is a world class international school operator managing over 40 schools internationally in Europe, UK, USA and India.
- KED is partnering with strong local investors to open a chain of bi-lingual schools in KSA that offer world class American curriculum along with Arabic curriculum.
- Education is a sector of core significance to IDB.



MOUs Signed

- Public Pension Agency (KSA),

  Ministry of Finance (Bahrain) and

  Ministry of Finance (Brunei)
- Sovereign Investment Authority (Nigeria)
- Caisse de Depot et de Gestion (Morocco)
- Sovereign Wealth Fund (Gabon)
- Pertamina (Indonesia)

Areas of Potential Cooperation

- Co-Investments
- Joint initiatives, i.e. funds
- Exchange of information & expertise
- Investments in IDB Sukuk
- Participation in IDB trade syndication
- Participation in IDB debt financing