A look at Oman's Islamic finance legal and regulatory framework

Oman's Islamic finance sector has recorded spectacular growth in the short span of just over four years since its launch at the end of 2012. In this article, ASAD QAYYUM outlines the legal and regulatory framework underpinning the industry's rising star.

Asad Qayyum *is a senior associate in Islamic finance at Al Busaidy, Mansoor Jamal & Co. He can be contacted at bernadette.millard@amjoman.com.*

Introduction

Despite its late emergence onto the scene, Oman's Islamic finance industry has expanded at a rapid pace. Islamic financial institutions in the country today comprise two fully-fledged Islamic banks and six Islamic banking windows, as well as two Takaful operators and three Shariah compliant investment funds. By the end of 2016, the combined assets of Oman's Islamic banking sector have reached OMR3 billion (US$7.77 billion) and financing extended to the public and private sectors amounted to OMR2.4 billion (US$6.21 billion). This represents a 10% of the total banking market share that is forecasted to rise to 12-15% by 2020. The growth is dramatic when measured against markets such as Indonesia and Turkey which have both taken over two decades to gain a 5% market share. In Oman's Islamic capital market space, two sovereign and two corporate Sukuk issuances have successfully tapped into the growing demand for Shariah compliant investment products and set a pricing benchmark. A third sovereign Sukuk facility is in the pipeline.

Evolution of the legal and regulatory framework

The rise of Oman's Islamic finance sector is attributable in a large part to robust support from its regulators: the Central Bank of Oman (CBO) and the Capital Market Authority (CMA). In contrast to many other countries where Islamic finance is governed by conventional finance frameworks, the CBO and CMA have issued, after consultation with industry stakeholders, primary laws and regulations for each industry segment incorporating best practice Shariah governance and oversight mechanisms. Prior to legislation coming into force, however, they have not shied away from facilitating Islamic finance transactions based on Oman's existing commercial laws, as well as precedents and best practices from other jurisdictions.

> ***"The introduction of REITs will be a game-changer for the industry"***

As a result, today Oman is viewed as having one of the most developed Islamic finance legislative frameworks in the world. It is ranked fifth out of 73 countries for the overall strength of its Islamic finance ecosystem based on a number of indicators which measure quantitative growth, corporate governance, knowledge and awareness.

The Royal Decree 69/2012 issued in December 2012 is the foundation of the Islamic banking system and it introduced a short new chapter of six articles titled 'Islamic Banking' to Oman's existing Banking Law. The decree granted the CBO authority to license, regulate, manage and oversee Islamic banking activities in Oman conducted by Islamic banks or Islamic windows of conventional banks. The decree was followed by the release of the Islamic Banking Regulatory Framework, a detailed, 500-page document covering all aspects of Islamic banking in Oman. A month later, Oman's first Islamic bank, Bank Nizwa, started operations. The CBO also issued a regulation setting up the High Shariah Supervisory Authority to help oversee the industry. This centralized model is increasingly being adopted across the global industry but remains a rarity in the Gulf.

In the Islamic capital market space, in response to interest from the market in raising funds through Sukuk issuances, the CMA released a draft of a dedicated Sukuk regulation for stakeholder consultation. By mid-2013, a busy year for the fledgling industry, six conventional banks had set up Islamic windows, and Muscat Securities Market (MSM) launched a dedicated Shariah index for Shariah compliant companies. The last quarter of 2013 saw Oman's first-ever Sukuk issuance, a OMR50 million (US$129.43 million) Ijarah-based corporate offering, and an amendment to the Capital Market Law (Royal Decree 59/2014). This enabled the CMA to identify the terms of financial trusts and to regulate and supervise Sukuk issuances and SPVs. Additionally, two Takaful insurance companies, one a start-up and the other converted from a conventional insurer, closed IPOs the following year.

Following a hiatus in both transactions and legislation for 18 months due to depressed and uncertain market conditions, the successful selling of Oman's OMR250 million (US$647.13 million) debut sovereign Sukuk in November 2015 was the catalyst for renewed Islamic finance activity.

As the 'first of its kind' transaction and with Sukuk regulation still in the draft form, the issuance raised a number of novel legal and procedural issues. When the Sukuk regulation finally came into force in April 2016, it formally introduced the concept of a financial trust into Omani law and authorized issuances of both stand-alone Sukuk and Sukuk programs. It was quickly followed by a privately-placed US$76 million dual-tranche corporate Sukuk. To date, two private sector Sukuk programs totaling OMR300 million (US$776.56 million) have received the regulator's initial approval under the regulation. In addition, MSM's Bonds Market has been renamed the Bonds and Sukuk Market.

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Oman's long-awaited Takaful Insurance Law (Royal Decree 11/2016) also came into force in 2016. The law is based on AAOIFI guidelines and regulates all aspects of a Takaful operator's activities including oversight and reporting requirements, product standards and liquidity levels.

Imminent

A draft regulation for REITs – both Islamic and conventional – was released for consultation at the end of 2016. Existing legal restrictions on companies, funds and foreign investors owning property in Oman are hurdles the CMA has to navigate for the regulation to be approved by other government stakeholders. In a recent press statement, the CMA chief indicated that two investors who have already approached the regulator may be allowed to launch REITs in Oman before it passes into law. This robust approach by the CMA is indicative of the importance of REITs, which have already received support from the influential, public-private sector initiative 'Tanfeedh' for financing real estate sector development.

The CMA has also issued a draft securities law for consultation. This is designed to address asymmetries of information between issuers and investors, clients and financial intermediaries and between counterparties to transactions, and to ensure the smooth functioning of trading and clearing and settlement mechanisms.

Outlook

Oman's Islamic finance sector is expected to prosper throughout 2017, capitalizing on high levels of interest among investors internationally for its sovereign Sukuk issuances and the burgeoning demand for Shariah compliant investment products and instruments at home. The introduction of REITs will be a game-changer for the industry, generating considerable investor interest among individuals seeking investment options which align with their beliefs, and providing much-needed stimulus to the economy. A new securities law and changes mooted to the Banking Law will complete the regulators' ambitious legislative agenda and help to position Oman as a leading regional hub for Islamic finance in the years to come.