Growth and future of the Islamic finance industry in Oman

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Oman was the last member of the Gulf Cooperation Council (“GCC”) to formally introduce Islamic finance. A Royal Decree 69/2012 issued by His Majesty Sultan Qaboos bin Said al Said in 2012,) paved the way for establishment of dedicated Islamic banks and Islamic windows of conventional banks. This delay in the formal introduction of Islamic finance in Oman has worked to Oman’s advantage as it has permitted the banking regulator, the Central Bank of Oman (“CBO”), to learn from the experiences of other countries and to undertake extensive groundwork to develop and implement a robust sharia-compliant governance framework, which culminated in the issuance of the Islamic Banking Regulatory Framework (the “IBRF”) in December 2012. In addition to the IBRF, the Capital Market Authority of Oman (the “CMA”) is in the process of finalising regulations relating to takaful operators and the issuance of sukuk; it is expected that these regulations will be promulgated by the first quarter of 2016.

Following issuance of the IBRF, Oman saw the official launch of its Islamic finance industry when the first fully dedicated Islamic bank, Bank Nizwa, opened its doors in Oman. Taking this as the period when Islamic finance commenced in Oman, the growth in this industry has been phenomenal –the last two years have seen the establishment of two full-fledged Islamic banks, six Islamic banking windows, three sharia-compliant funds and two Takaful operators in Oman. In addition, the country saw its first corporate sukuk in 2013, the Muscat Securities Market launched the sharia-compliant index, the Government set up the High Sharia Supervisory Authority to provide expert opinion and advice to the CBO on sharia matters related to the Islamic banking business and the CBO set up a sharia supervisory body to oversee Islamic banking, with the aim of building resources and expertise and centralising all aspects of Islamic banking regulation and issuance in Oman. As at the date of writing this article, the subscription period for the five-year Government of Oman debut sukuk has closed with the issuance being oversubscribed by 1.7 times; given this encouraging response from the investors, the Government has increased its issuance size from OMR 200 million to OMR 250 million. It is expected that this sukuk will establish a benchmark and precedent for other public and private players looking to raise capital to follow.

At the end of the first 12-month period following the launch of Islamic banking in Oman, 3.5 per cent. of the total banking assets were attributable to the Islamic finance industry; this figure, as of the date of writing this article, has grown to approximately 6.3 per cent of the total banking assets. Such growth is impressive given that other countries have had Islamic finance industries which trace their roots back decades; for example, Indonesia, Turkey and Egypt where the total banking assets attributable to the Islamic finance sector is just under 6 per cent. of the total banking sector. Oman’s Islamic finance sector’s growth is even more impressive when you consider that Pakistan has been trying to fully Islamise its banking system for almost 30 years now and has in that period only reached 10 per cent. of banking assets that are attributable to Islamic finance.

On a regional / GCC level though, on average GCC Islamic finance industries enjoy 25 per cent. of the market share against the 75 per cent share of its conventional counterparts. This is something that Oman's Islamic banks and windows should aim to achieve and, in due course, exceed. For now though, a report from Thomson Reuters estimates that the Islamic finance industry of Oman will grow to hold 10 per cent. of the total banking assets in the country by 2018.

It is a testament to the systemic and exponential growth of Oman's Islamic finance industry that the Reuters' Islamic Finance Development Indicator (IFDI), which is the only numerical measure representing the overall health and growth of the Islamic finance industry globally, has ranked Oman's Islamic Finance industry as the third most developed in the world (after Malaysia and Bahrain).

Whether the Islamic finance industry continues to grow and meet the above mentioned targets will depend largely on the effectiveness of the Government and the key players in the Islamic finance industry in making legislative and policy adjustments, where necessary, for the development of innovative products and spreading awareness of Islamic banking amongst the public at large and within Government ministries and departments. Whilst significant progress has been made in the introduction of new legislation to facilitate Islamic banking transactions (for example, Royal Decree No. 69/2012 ("RD 69/2012") amended the Omani banking law (Royal Decree No. 114/2000) (the "Banking Law") to permit banks licenced to conduct Islamic banking activities to, inter alia, own, sell, lease or invest in real estate notwithstanding any restrictions contained in any law (Article 124); RD 69/2012 further amended the Banking Law to provide that banks licenced to conduct Islamic banking activities shall be exempted from payment of fees / charges on transactions related to acquisition or leasing of real estate (Article 125)), there continues to remain the need for further review and harmonisation of pre-existing interpretations of law and new requirements with regard to registration of the transactions at the concerned regulatory authorities, as may be applicable to Islamic products and investments.

In addition, there is relatively low penetration of the banking sector amongst the Omani populace; this is a golden opportunity for the Islamic finance industry as it can reach out to the population with products which also appeal to their religious values.

Another important factor that will spur growth of the Islamic finance industry will be its continued support by the Government, the CBO and the Capital CMA to facilitate effective operations of the banks and development of new products. In this respect, the CMA should finalise and issue the proposed sukuk and takaful regulations (drafts of which have already been circulated amongst key market players for comment). The Government and banks also need to focus on building a local talent pool of Islamic finance professionals to carry the industry forward. Most importantly perhaps though is that the CBO should implement regulations and guidelines relating to profit and loss distribution and liquidity management of Islamic banks as this is the core of the Islamic banking industry. As of the date, the CBO has aimed to address this by setting up a task force to develop and suggest new sharia-compliant liquidity management tools such as short-term sukuks or Islamic repurchase agreements.

Another key difference in the Islamic finance industry in Oman and other GCC countries is that the IBRF contains a whole-sale prohibition on the use of commodity murabaha transactions or tawarruq. Given the lack of effective liquidity management tools available to Islamic banks currently, the regulator may want to consider whether tawarruq should be permitted on a case-by-case basis with such restrictions as are necessary relating to use of proceeds to ensure they are not used in a manner contrary to 69/2012 principles.

The Islamic finance industry is in an exciting phase of development and is expected to continue to grow over the years to come. The key to growth will be the development of innovative products to address the industry's liquidity issues, nurturing of consumer confidence and talent and creation of awareness between the public and Government departments of the products offered and the benefits available to parties under Islamic finance transactions.

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