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Distr.
LIMITED
ID/WG.465/6(SPEC.)
6 March 1987
ENGLISH

United Nations Industrial Development Organization

Workshop on Industrial Financing Activities
of Islamic Banks

Vienna, Austria, 16-20 June 1986

THE ISLAMIC DEVELOPMENT BANK:
INVESTMENT PROFILE AND ITS EFFORTS IN DEVELOPING FINANCIAL INSTRUMENTS
IN ACCORDANCE WITH SHARIAH*

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** Islamic Development Bank.

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INTRODUCTION

The main purpose of this paper is the introduction of IDB, its objectives, and its overall financing operations on one hand; and a presentation of its recent efforts in the field of resource mobilization on the other hand. The Bank has been briefly introduced in Section II of this paper.

The emphasis of IDB in the first decade of its operations was on ways and means of investing and placing its funds which would foster economic and social development of its member countries. Hence, IDB has successfully initiated and pioneered a number of financing modes which are in conformity with Shariah. These modes include equity participation, leasing, loans, instalment sales, foreign trade financing, and technical assistance. Section III of this paper presents - very briefly - IDB's operations - by mode and by sector - since its inception.

IDB in this past decade had relied almost entirely on subscribed capital to meet the needs of its member countries. However, the projection of the resource position of IDB taking into consideration - among other things - the operations plan of the Bank shows clearly a resource gap by the year 1409H(1989). IDB, therefore, has embarked on serious efforts to develop other ways and means for resource mobilization. These efforts have been directed toward the development of Islamic financial instruments and setting the ground for an Islamic secondary market. A summary of these efforts is presented in Section IV of the paper.

II. THE ISLAMIC DEVELOPMENT BANK (IDB) AT A GLANCE

The Islamic Development Bank (IDB) is an international financial institution established in pursuance of the Declaration of Intent issued by a Conference of Finance Ministers of Muslim Countries held in Jeddah in Zil Qadah 1393H, corresponding to December 1973. The Bank formally opened on 15 Shawal 1395H, corresponding to 20th October 1975. The aim and purpose of the Bank are to foster economic development and social progress of member countries and Muslim communities in non-member countries individually as well as jointly, in accordance with the principles of Shariah.

The authorized capital of the Bank is two billion Islamic Dinars, divided into 200,000 shares having a par value of 10,000 Islamic Dinars each. The value of the Islamic Dinar, which is a unit of account in the Bank, is equivalent to one SDR (Special Drawing Right) of the International Monetary Fund. The subscribed capital of the Bank is now 1,952.07 million Islamic Dinars payable in freely convertible currency acceptable to the Bank.

The main functions of the Bank are to participate in equity capital and grant loans for productive projects and enterprises, besides providing financial assistance to member countries in other forms for economic and social development. The Bank is also required to establish and operate special funds for specific purposes, including a fund for assistance to Muslim communities in non-member countries, in addition to setting up trust funds.

The Bank is authorized to accept deposits and to raise funds in any other manner compatible with Shariah. It is also charged with the responsibility of assisting in the promotion of foreign trade, especially in capital goods, among member countries; providing technical assistance to member countries; extending training facilities for personnel engaged in development activities; and undertaking research for enabling the economic, financial, and banking activities in Muslim countries to conform to Shariah.

The present membership of the Bank consists of 43 countries. The basic condition for membership is that the prospective member country should be a member of the Organization of the Islamic Conference and be willing to accept such terms and conditions as may be decided upon by the Board of Governors of the Bank.

III. THE FINANCING OPERATIONS OF THE BANK DURING THE LAST DECADE

The operations of the Bank include Ordinary Operations (comprising Project Financing and Technical Assistance), Foreign Trade Financing Operations and operations financed out of the Special Assistance Account. The operations and projects approved by the Bank since the start of its activities in 1396H(1976) up to the end of 1405H (1985) both by type of financing and by sector are depicted in Table 1 and 2 respectively. The data contained in these tables for the Ordinary Operations of the Bank are represented graphically in Figure 1 and 2.

(a) Ordinary Operations

As seen in Table 1, the Ordinary Operations constitute 27.20 percent of total financing approved by the Bank during the last ten years of its existence. Within Ordinary Operations, project financing amounted to ID 1,288.28 million (US\$ 1,441.35 million) and accounted for 97.48 percent which included 37.30 percent loans, 19.68 percent equity participation, 34.96 percent leasing, 4.99 percent instalment sales, and 0.55 percent profit-sharing.

In addition to providing assistance for project financing, the Bank also extends technical assistance either in the form of loan or grant (not exceeding ID 150,000), or a combination of both. This is primarily intended for feasibility studies, preliminary and detailed designs, and consultancy services, as well as procurement of research and training equipment during the execution phase of a project. Technical assistance during the decade amounted to

TABLE 1 : OPERATIONS APPROVED PER YEAR BY TYPE OF FINANCING
UP TO THE END OF 1405H

PARTICULARS	(ID million)														TOTAL ^a									
	1390H	1397H	1398H	1399H	1400H	1401H	1402H	1403H	1404H	1405H	1406H	1407H	1408H	1409H	1410H	1405H	1406H							
	No. Amount	No. Amount	No. Amount	No. Amount	No. Amount	No. Amount	No. Amount	No. Amount	No. Amount	No. Amount	No. Amount	No. Amount	No. Amount	No. Amount	No. Amount	No. Amount	No. Amount							
OPERATIONS:																								
Loan	1	6.00	11	55.41	5	25.46	6	33.74	9	52.60	6	28.12	9	40.03	11	73.45	12 ^b	71.46	15	98.62 ^b	85	492.97		
Equity	1	7.45	0	30.23	5	29.36	0	39.79	10	39.04	10	45.98	0	28.70	5 ^a	15.61	1	6.00	4	9.07 ^b	60	260.03		
Lending	-	-	1	5.22	1	10.00	2	16.25	5	36.47	3	30.69	0	73.53	10 ^b	86.43	12 ^b	125.27	9	92.10 ^b	50	462.04		
Installment Sale	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	7	65.90	7	65.90
Profit-Sharing	-	-	-	-	-	1	4.27	-	-	-	-	-	-	-	-	1	3.06	-	-	-	-	-	2	7.30
Technical Assistance	-	-	3	0.84	3	0.82	5	1.37	3	3.38	10	6.83	0	4.44	12	5.99	7	2.98	13	6.63	64	30.25		
Total Ordinary Operations	2	13.45	23	99.70	15	69.91	21	91.14	27	131.57	29	111.62	33	154.70	38	184.54	32	205.70	48	373.11	260	1,321.53		
Foreign Trade Financing Operations	-	-	5	43.61	14	177.44	25	262.45	33	352.67	32	370.24	28	359.77	28	480.61	47	714.31	38	648.21	250	3,379.31		
Special Guarantee Account	-	-	-	-	-	-	1	0.71	7	8.46	9	5.33	0	9.25	7	7.85	14	62.65	11	63.90	57	158.15		
GRAND TOTAL	2	13.45	28	143.31	29	197.35	47	354.30	67	492.70	70	487.19	69	523.72	73	673.09	93	982.66	97	1,405.22	575	4,899.99		

^a Includes projects for which two types of financing were approved. ^b Totals may not add due to rounding.

TABLE 2 : PROJECTS APPROVED PER YEAR BY SECTOR
UP TO THE END OF 1405H

SECTOR	(ID million)										
	1396H	1397H	1398H	1399H	1400H	1401H	1402H	1403H	1404H	1405H	TOTAL
AGRICULTURE	-	11.12	13.00	1.70	14.67	27.08	5.50	6.17	23.99	80.25	183.48
INDUSTRY & MINING	7.45	38.93	32.96	47.75	59.98	60.07	59.29	45.20	79.42	118.70	549.75
TRANSPORT AND COMMUNICATIONS	-	44.27	-	24.18	21.83	23.22	33.63	75.35	34.43	7.28	264.19
PUBLIC UTILITIES	6.00	-	19.68	9.41	22.17	-	34.26	8.27	26.00	28.13	153.92
SOCIAL SERVICES	-	5.39	-	5.04	12.91	-	5.00	39.34	41.36	35.48	144.52
OTHER	-	-	4.27	3.05	-	4.23	0.09	10.21	0.48	3.28	25.61
TOTAL	13.45	99.70	69.91	91.14	131.57	114.62	137.78	184.54	205.70	273.11	1,321.53

FIGURE : 1
ORDINARY OPERATIONS APPROVED 1396 -1405 H.
(BY TYPE OF FINANCING)

Amount in ID Million

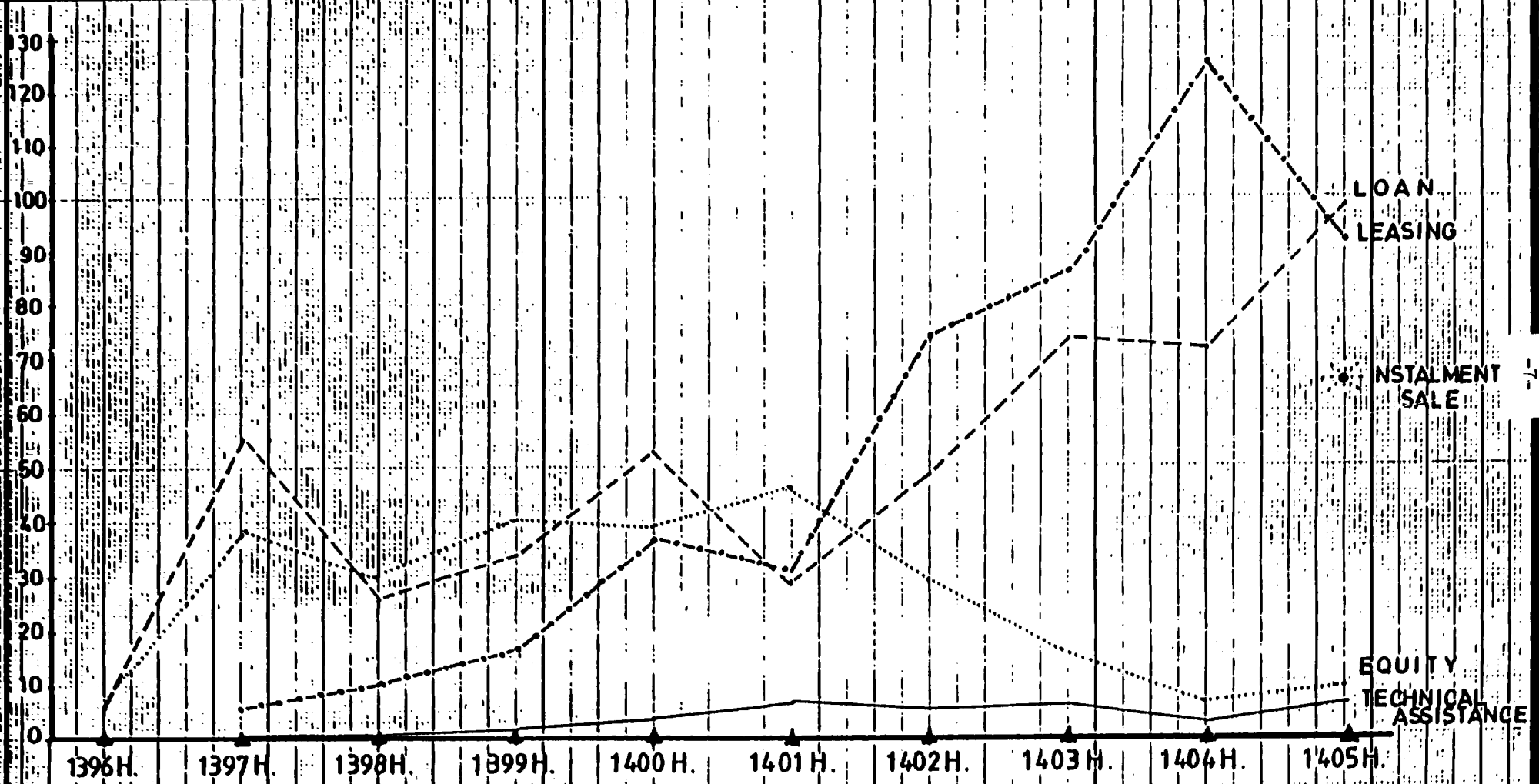
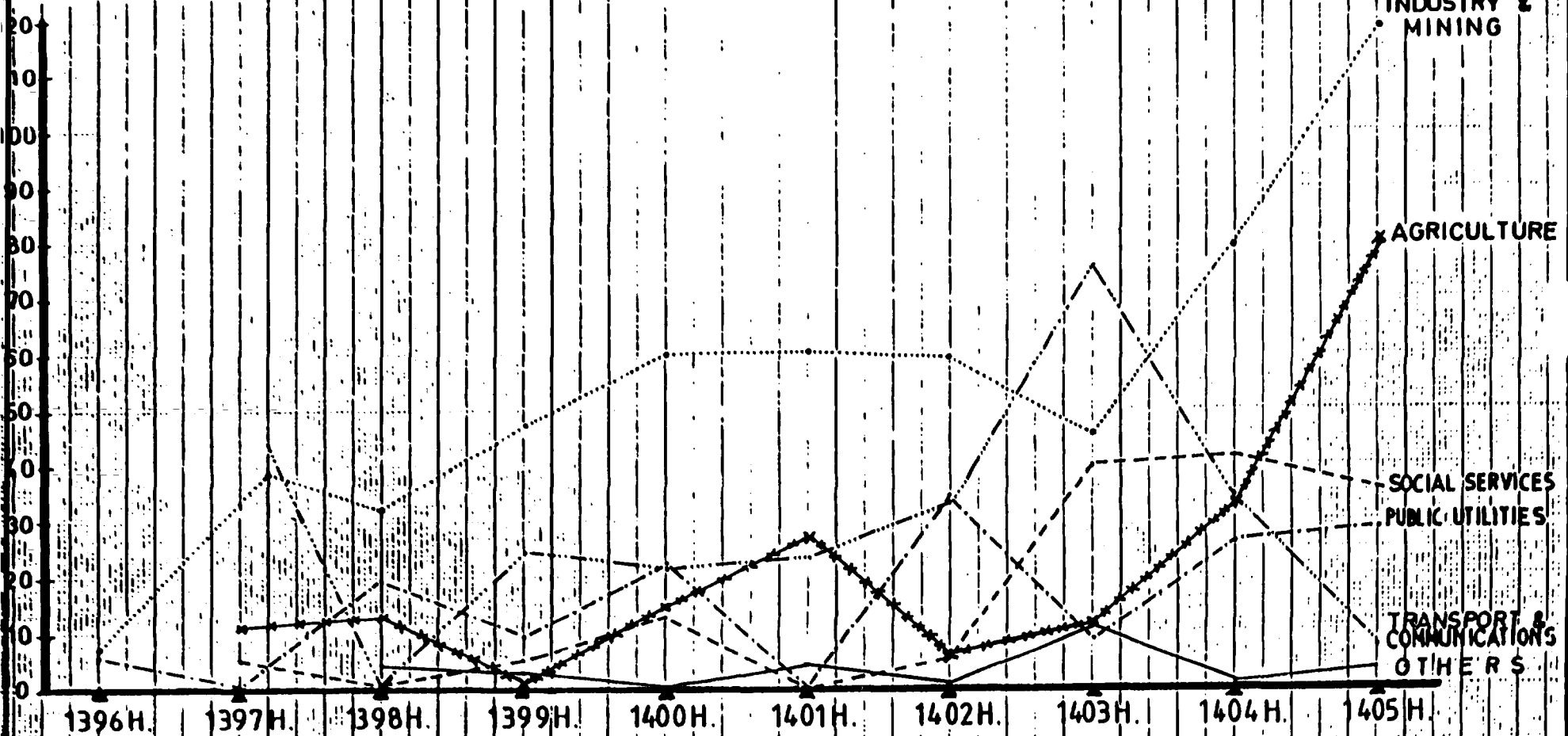


FIGURE 2

PROJECTS APPROVED 1396-1405H.

(BY TYPE OF SECTOR)

Amount in ID Million



ID33.25 million (US\$37.08 million) for 64 projects and accounted for 2.52 percent of total Ordinary Operations.

In the first five years, loans have been by far the largest mode of financing approved by the Bank. Starting from 1402H(1981), operations under lease types of financing (leasing and line of leasing) and instalment sales took the lead. For various reasons, equity participation has been declining. Profit-sharing has been used in only two projects. The improvement in technical assistance has continued to fall short of targets. These trends are shown in Figure 1.

In terms of sectoral distribution, as presented in Table 2, 41.60 percent of financing approved for the projects during the period under study went to the industrial and mining sector, 13.88 percent to the agricultural sector, 19.99 percent to the transport and communications sector, 11.65 percent to the public utilities sector, 10.94 percent to the social services sector, and 1.94 percent to others. Figure 2 portrays the trend of sectoral distribution.

(b) Foreign Trade Financing Operations (FTFO)

Foreign Trade Financing Operations of the Bank started in 1397H (1977). This is principally a placement operation designed to provide a means of investment for surplus funds of the Bank not immediately needed for its Ordinary Operations. This mode of financing provides member countries with the necessary financing facilities to import some essential commodities required in their development programmes and assists in the promotion of trade among member

countries. Since 1397H(1977), the Bank approved 250 FTFOs amounting to ID 3379.31 million equivalent to US\$ 3785.18 million (see Table 1). This represents about 70% of the total financing approved by the Bank.

(c) Special Operations

In addition to financing development projects and technical assistance, the Bank also finances some operations out of the Special Assistance Account. The main areas in which operations out of this account are financed includes extension of training facilities; provision of relief; promotion and furtherance of Islamic causes; and promotion of social welfare and economic uplift and provision of scholarships to Muslim communities in non-member countries.

Table 1 shows that the total amount approved by the Bank out of the Special Assistance Account since its inception in 1399H (1979) had reached ID 158.15 million (US\$ 163.68 million) for 57 operations by the end of 1405H (1985).

IV. EFFORTS OF IDB IN DEVELOPING FINANCIAL INSTRUMENTS BASED ON SHARIAH

Over the last year, the Islamic Development Bank has been working towards the development of financial instruments based on Shariah principles. These efforts have included preparing working papers, sponsoring and organizing bilateral and expert group meetings in various member countries. The outcome of these efforts has been a "Scheme for Financial Instruments Based on Shariah".

The Review Committee - composed of eminent economists - undertaking the task of evaluating IDB's performance in the last 10 years - in presenting the "Future Outlook" of the Bank - stressed the need for finalizing the development of appropriate financial instruments and the necessity of going to the market in order to raise the required resources. This Committee also endorsed the above Scheme and commended it to the attention of the Bank. Furthermore, the Committee proposed that . . . " a high level experts group could be constituted to undertake a comprehensive assessment of the resource prospects of the Bank and advise its management on the implementation of the above Scheme.

The same Scheme was presented to the 7th Islamic Banks meeting in Amman in March of 1986. It received full support from the leaders of Islamic Banks and they had decided to refer it to their Shariah scholars for final screening. Finally, the heads of Islamic Banks - in their very recent meeting in the headquarters of IDB in Jeddah on

26 May 1986 - decided to implement the above Scheme in establishing an investment portfolio jointly owned by IDB and other Islamic Banks to finance trade operations between Islamic countries.

This section covers the following points:

- (a) The salient features of the proposed Scheme (which is based on issuing specific-purpose certificates).
- (b) Some preliminary thoughts on ways of implementing the above Scheme.
- (c) The Islamic Certificate of Deposit (representing the general-type certificates).

(a) The Salient Features of a Proposed Scheme for Financial Instruments Based on Shariah

1. Shariah permits - in principle - the issuance, exchange, and circulation of certificates. In short, the issuance would be based on the Islamic concept of Mudarabah; whereas the principle of "offer/acceptance" would be the base for the transfer of ownership and circulation of certificates. Moreover, the certificates should be treated as regular "Shariah Contracts" defining the rights and responsibilities of the holders.
2. The certificates proposed in this Scheme are investment certificates assigned to a specific project or a group of projects in one basket (the projects in this case are chosen by the prospective investors).

3. The investment certificate is by itself a financial claim on the total assets of the project.

The project may take one of the following forms:

- (i) Permanent equity participation;
- (ii) Declining participation;
- (iii) Purchase/leasing of material, equipment, tools, etc. for subsequent leasing; and
- (iv) Short, medium, or long-term financing of trade (based on the concept of Murabaha).

4. The project financed by these instruments should have an autonomy; i.e., identifiable legal and accounting entity to be kept separate from the other assets and liabilities of the Bank. This entity would take the form of a "Trust, a "Fund", or a "Corporation". The experts prefer the first two forms if they comply with the rules and regulations of the Bank. The experts are also of the opinion that IDB should undertake an in-depth study to identify the most appropriate form and mechanism of this Trust or Fund.

5. The role of the Bank in using the funds acquired is the role of a "Restricted Mudarib". In other words, the relationship between the Bank and the certificate-holders is not a creditor/debtor relationship, but rather a relationship between the "owner" of capital and the "Trustee". Therefore, the accounts kept for these projects are not part of the Bank's regular accounts.

6. IDB could delegate part of its functions as a "Mudarib" to other financial institutions - mainly other Islamic Banks - against a compensation to be deducted from IDB's share as a "Mudarib".
7. Because of the absence of an "Islamic Financial Market" and the various restrictions in the existing "Securities Markets" in most IDB's member countries, the Scheme advocates the use of a "self-liquidating system". IDB could, for example, indicate with each issuance its willingness (subject to certain conditions) to repurchase the certificates presented to it after a specific date (normally the closing day of the initial subscription).
8. The prices - according to the above Scheme - could be determined in the following manner:
 - (a) During the period of the initial subscription and before the actual operations, the price is determined as the "par value" of the certificate; and
 - (b) After the above period, IDB would set up a price periodically (the interval between any two periods should not exceed three months). The price is based on the financial position of the project and conditions of supply and demand.
9. If its liquidity permits, IDB would buy and sell the certificates as per these prices. However, it should be emphasized here that this situation is temporary and will cease to exist upon the trading of

certificates in existing securities markets in member countries, or the establishment of an "Islamic Financial Market".

10. In accordance with Shariah, IDB would be held responsible for two issues:
 - (a) To ensure that the information provided in relation to the project is accurate; and
 - (b) To ascertain that the analysis in the feasibility study has been conducted in conformity with the generally accepted principles.
11. This does not mean that IDB is responsible for the "return" estimated in the feasibility study as the project could even lose all its investment due to reasons beyond the control of the "Mucarib". In fact, the Bank is held responsible if it is proven, beyond any doubt, that it intentionally concealed essential information from prospective subscribers or conveyed false data to them.
12. The above responsibility requires IDB to include in the "Prospectus" all the major information related to the issuance. In addition, the full economic feasibility study of the project (or projects) concerned should be made available to the prospective investors.
13. Since Shariah permits the concept of "Cooperative Insurance", IDB may establish a "Cooperative Insurance Fund" to cover investment risks of those projects

using the certificates to mobilize funds. The resources of this Fund are composed of :

- (i) A predetermined portion of the actualized profits of all the projects using the certificates to accumulate funds as donations;
- (ii) Donations from the IDB; and
- (iii) Return on the investment (according to Shariah) of the liquid funds of the Fund.

14. IDB (the Mudarib) is authorized to use the resources of this Fund to cover any loss and restore the original capital invested. It is suggested, therefore, that IDB takes steps to lay down rules and regulations governing the use of resources from this Fund .

15. In accordance with the "Mudarabah Contract" between the Bank and the "owner of capital", the profits at the end of the financial period could be distributed in the following manner:

- (a) A percentage to IDB representing its share as Mudarib ;

- (b) A percentage to owners of certificates (IDB is usually one of them); and

- (c) A percentage to the "Cooperative Insurance Fund".

16. In case IDB opts for issuing certificates to finance "declining participation" projects, then a percentage of profits should be directed towards the "amortization" of part of the investment certificates. Here, too, IDB would be required to set up rules and regulations for each case based on its own merits.

However, a basic principle - from an Islamic point of view - is the necessity of amortizing a "unified proportion" of the ownership of each subscriber (no lottery approach is allowed.)

17. The success of a scheme for mobilizing funds through the market would require the following additional measures from IDB:

- Encouraging Islamic Banks in member countries to open their own windows for dealing with financial instruments based on Shariah. These windows could perform various functions such as underwriting, promotion, brokerage, etc.
- Building channels of communication with a number of investment banks, unit trusts, and brokerage houses to secure their technical assistance for the implementation of the various phases of the Scheme.
- Getting in touch with the securities markets in member countries to secure their cooperation with IDB.
- Establishing a "Consultation Group" comprising representatives of Islamic Banks, member states, money markets, and investment banks and companies for providing necessary guidance in this field on a regular basis.
- Establishing a "Shariah Control Board" for overseeing and monitoring the transactions with a view to ensuring that they are in accordance with Shariah.

(b) Some Preliminary Thoughts on the Implementation of the Proposed Scheme

The Management of IDB has taken a conscientious decision to start experimenting the proposed Scheme by grouping a number of profit-yielding equity projects currently existing in the portfolio of IDB and issuing marketable securities in order to mobilize additional resources for the Bank. Furthermore, a follow-up committee and a working group from IDB and other Islamic Banks have been formed for the implementation of the proposed Scheme in financing trade among Islamic countries.

IDB is considering various alternatives for this implementation such as:

i) The Establishment of a Unit Trust, or an Investment Trust (Mutual Funds);

1- As practiced in the UK and the U.S.A.

2- As practiced in some of IDB's member countries.

Some of IDB's member countries have introduced Unit Trusts and Investment Trusts in order to mobilize savings of small investors and channel them into appropriate investments. Pakistan has been a leading country in this regard and the experiences of the two major Trusts (National Investment Trust and Investment Corporation of Pakistan) are under careful investigation by IDB. Malaysia is another member country which has successfully introduced Unit Trusts and IDB is also studying with interest the experience of the major ones such as Amanah Saham Mara Berhad and the National Unit Trust (ASNB).

ii) The Establishment of a Limited Liability Company, or a Corporation

This is a special form of Investment Trusts. IDB is

carefully examining the study of the Al-Baraka Group for establishing a limited liability company with an open-end capital. Two types of shares are involved here namely, participation shares and management shares. A separate company could be established for each mode of financing.

(c) The Islamic Certificate of Deposit (ICD)

Finally, IDB is considering issuing an Islamic Certificate of Deposit. It may be noticed that the options presented in the previous section pertain to the proposed Scheme for Islamic Financial Instruments which requires a separate legal and financial entity either in the form of a Trust (Unit, Investment, or a consideration of both), or in the form of a separate company. However, this option is under IDB's investigation in case - for any reasons - a separate entity is not attainable.

According to this option, IDB could issue general-type certificates whereby the shareholder does not show the specific investment in which his funds are placed. It is the responsibility of IDB - as a general Mudarib - to direct the funds to the instrument which is deemed necessary. The distribution of profits will take place at the end of specified financial period in accordance with the actual profits of the investments in which the funds have been placed. The subscriber will be informed - if desired by him - the whereabouts of his fund. IDB is currently studying various issues related to these certificates such as their liquidity, pricing, maturity, tradeability . . . etc.

V. CONCLUSION

This paper has covered the experience of IDB in financing operations during the last decade. Furthermore, it has briefly presented the Bank's recent efforts in the area of resource mobilization. IDB has gone a long way in the area of developing modes of financing which conform to Shariah. However, in the area of developing financial instruments based on Shariah, IDB has taken a leading role and embarked on-with the assistance of other Islamic Banks - serious search to come up with an appropriate scheme. The initial signs are very encouraging and it will not be long before the market for the Islamic financial instruments is developed. Such a development will pave the way for mobilizing resources from savers, especially the small ones and will open the door for more cooperation among the Islamic financial institutions; and between Islamic financial institutions on one hand and conventional financial institutions on the other hand.

Needless to say that the development of financial instruments based entirely on Islamic Shariah is not an easy task but not-at the same time-formidable. IDB is determined to continue its efforts and work harder in this area in order to achieve its objectives and better serve the Islamic nation.