Global Islamic Bankers' Survey 2018

Evaluating Future Impacts: Strategic Thinking, Branding and Financial Technologies

May 2018





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About The General Council for Islamic Banks and Financial Institutions (CIBAFI)

CIBAFI is an international organisation established in 2001 and headquartered in the Kingdom of Bahrain. CIBAFI is affiliated with the Organisation of Islamic Cooperation (OIC).

CIBAFI represents the Islamic financial services industry globally, defending and promoting its role, consolidating co-operation among its members, and with other institutions with similar interests and objectives.

With over 120 members from 33 jurisdictions, representing market players, international intergovernmental organisations, professional firms, and industry associations, CIBAFI is recognised as a key piece in the international architecture of Islamic finance.

In its mission to support Islamic financial services industry by being the leading industry's voice in advocating regulatory, financial and economic policies that are in the broad interest of our members and that foster the development of the Islamic financial services industry and sound industry practice, CIBAFI is guided by its Strategic Objectives, which are 1) Policy, Regulatory Advocacy, 2) Research and Publications, 3) Awareness and Information Sharing and 4) Professional Development.

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Acronyms

1.	OIC	Organisation of Islamic Cooperation
2.	GCC	Gulf Cooperation Council
3.	IT	Information Technology
4.	CEO	Chief Executive Officer
5.	IFIs	Islamic Financial Institutions
6.	ABC technologies	Artificial intelligence, Blockchain and Clood
7.	SME	Small and Medium Enterprises
8.	CBR	Correspondent Banking Relationships
9.	Al	Artificial Intelligence
10.	RM	Relationship Manager
11.	AML	Anti-Money Laundering
12.	CFT	Combating the Financing of Terrorism
13.	FTT	Foregin Telegraphic Transfers
14.	KPI	Key performance Indicator
15.	VBI	Value-based Intermediation
16.	Fintech	Financial Technology
17.	P2P	Peer to peer
18.	JV	Joint Venture
19.	CFO	Chief Financial Officer
20.	CIO	Chief Information Officer
21.	СТО	Chief Techonology Officer
22.	СМО	Chief Marketing Officer



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Statement by the Secretary General

Welcome to the third annual CIBAFI Global Islamic Bankers' Survey. We hope this edition will be welcomed by the industry both as a useful measurement for the progress of the Islamic finance sector and as a starting point for discussions on how to overcome obstacles to future growth.

As you will see the theme of our survey this year looks broadly at strategic thinking within the Islamic finance sector. We manage to paint – for the first time ever – an accurate picture of where strategic thinking fits within the complex matrix of decision making within Islamic banks and financial institutions.

The growing presence of new technology as a main pillar of the business of Islamic banking & finance has shown to be both a blessing and a threat. It is a blessing because technology makes it much easier for banks to respond to changing customer demands, but a threat because not responding to the changes of new business model brought by financial technologies may cost the survival of the financial sector as we know it today.

It is also worth mentioning that this is the biggest survey we have ever had, with responses of 103 CEOs from 31 countries included in the analysis. We hope that this helps demonstrate the growing strength of the industry as well as the growing importance of the annual CIBAFI Global Islamic Bankers' Survey.

The overall picture of the industry that emerges from the survey is that of a sector that is becoming increasingly confident and looking forward to a steady growth. Islamic bankers, on the whole, believe that the Islamic finance sector will grow faster than the conventional sector now that the world economy is shifting up a gear. Readers can track growth metrics from year to year as the survey compares data from previous surveys side by side with this year's.

Equally interesting is the perception that the Islamic finance industry is seeing uneven growth with some geographies witnessing more rapid growth in some areas than others.

The result is a fascinating read, and we hope that this year's survey will be welcomed as warmly as those of previous years.

> Abdelilah Belatik Secretary General

Acknowledgements

The Secretariat would like to offer its sincere thanks to its member and non-member banks and financial institutions who took part in the survey and provided their valuable inputs.

Additionally, we would like to express our gratitude to the individuals who have contributed in making the publication a success. We would like to appreciate Dr. Abdurrahman Yazici, Aziza Yarlaeva, Dr. Mahmoud Al-Homsi, and May Arshi from CIBAFI Secretariat; and Paul Macnamara, Ken Dorph and Peter Casey, CIBAFI consultants for their contribution and efforts in different phases of production of this report. We are also thankful to Syed Ahmed, Andrew Cunningham, Darien Analytics and Dr. Adam Ng for providing valuable feedback and comments to the survey over the course of its preparation.

CIBAFI would also like to express its appreciation to AI Baraka Türk Participation Bank, Jordan Islamic Bank (JIB) and Safa Bank of Palestine for their financial support in developing this report.

We trust that this publication will provide valuable insights to the Islamic Bankers around the globe in measuring the pulse of the Islamic financial industry, taking it towards the path of success.

Abdelilah Belatik Secretary General







Executive Summary

This year's CIBAFI Global Islamic Bankers' Survey is unique since it takes in consideration the position of the industry as the world's economy seems to finally be emerging from the shadow cast by the global financial crisis.

After a long spell of calm, volatility is back in the world's stock markets. Wage growth in many developed markets is accelerating, and a transition is underway in which buoyant global growth causes inflation to replace stagnation as investors' biggest fear.

For the first time since the CIBAFI survey was inaugurated, the world's economy is showing signs of improvement, buoyed by a synchronised acceleration in America, Europe, and Asia.

After years in which investors could rely on central banks for support, the safety net of loose monetary policy is slowly being dismantled. At the time of writing, America's Federal Reserve has already raised interest rates six times since late 2015, with future increase expected.

In such an environment, there could be no better time to undertake a survey with the theme: "Evaluating Future Impacts: Strategic Thinking, Branding and Financial Technologies" and the results of the survey make for fascinating reading.

The responses that CIBAFI received demonstrate a remarkable clarity in the thinking of the leaders of the Islamic finance sector. Remarkable clarity to where the opportunities lie as well as where the pitfalls are.

Irrespective of geography, industry leaders were increasingly bullish about the prospects for the Islamic banking sector in their jurisdiction – and indeed they showed significant levels of confidence in the banking and finance sectors overall.

Alongside their optimism, leaders demonstrated that they were acutely aware of the growing risk of their technological systems being compromised – by malware, spyware, hacking, and so on as their IT systems become more complex and more interconnected.

An equally new set of risks was identified this year in the survey as well as solutions to mitigate them in the area of de-risking risk. In essence, this means taking much closer charge of correspondent banking relationships, monitoring them more closely and closing them down if their risk profile looked too high. These forms of risks were perceived much higher in markets that might be viewed as feeder markets for the main markets of the GCC and Malaysia than they were in the main markets themselves.

Nevertheless, the overarching conclusion was that most Islamic banks expect to perform significantly better than conventional banks in their jurisdiction in the future. The caveat is that, while the banks are optimistic about their ability to outperform other banks in their markets, they do not expect all of that outperformance to be manifested in better revenue growth in the next 12 months. Additionally, the revenue growth is expected to be different across different geographical locations.

Another fascinating outcome of the survey was the demonstration that the concerns which banks harbour have shifted to being very micro-focused on the institutions themselves, rather than macro-focused concerns about the business environment. This could be taken as a positive development that the banks are no longer preoccupied with the economy as a whole and the future price of oil – leaving them with more energy to focus on institutional matters like risk management and business growth.

More specifically, the issue that was shown to be of greatest concern to Islamic banks in the survey was that of shareholders' value and expectations, which perhaps demonstrate that shareholders recognize that the economy had stabilised and they were focused now more on profits and growth.

Further useful insights into the thinking of industry leaders are provided in the survey in the form of the risk dashboard, which serves as a temperature guide for the biggest risks facing both Islamic banks and the sector as a whole.

This year, the Islamic banks surveyed identified the biggest risk as being technology risk and IT security, followed by credit default risk and liquidity risk. These are three quite separate areas of risk which, taken together, demonstrate how acutely aware the banks are of the different threats to their growth and survival.

Awareness of technology risk and IT security risk is only to be expected in an industry that is paddling furiously in the wake of the tsunami of Fintech that threatens to overwhelm most financial institutions. It is not only the scope of the change happening in Fintech that banks find overwhelming, but the speed of change. Security measures that were put in place at the start of the year may no longer be adequate just six months later.

But nothing showed how different geographies were affected by risk in different ways more plainly than the issue of de-risking risk. 70% of Islamic banks in the GCC indicated that they had experienced "no significant change" in business because of de-risking. However, 70% of Islamic banks in West, Central and South Asia, as well as 80% of banks in Sub-Saharan Africa indicated that they had seen either significant or some decline and in North Africa, over 66% of banks indicated that they had seen 'significant decline.' This is an area that will bear close study in future surveys.

And what of strategic thinking, branding, and financial technologies? Overall, Islamic banks appear to acknowledge the importance of strategic thinking, with over one-third (36%), indicating that they discuss it at every board meeting. For 55% of banks, the longest time frame considered while building this strategy is between three and five years.

In terms of strategy, it was encouraging to see that the survey indicated that boards were becoming more proactive in setting agendas. Meanwhile, it is clear that middle management within Islamic banks is playing an increasingly significant role in both strategy formation and implementation.

IFIs' corporate strategy typically involves gathering input from a wide range of sources, but according to the survey, by far the most important input was that of the bank's own financial projections. It also became clear that strategies focusing on external and internal process changes were a great driver of strategic thinking, and that very often, the implementation of the new strategy was typically driven from the top down by the CEO.

Innovation was most evident within IFIs in their development of new products, as well as in payment and customer interface solutions.

The survey also had some intriguing insights on how Islamic banks see branding. It became clear that the three core areas where Islamic banks felt they could differentiate themselves was through their products, the Islamic nature of their business, and their performance.

However, this does not mean that branding was an effortless exercise for all banks. In particular, some regions, most notably Southeast Asia, found branding to be a real challenge. In contrast, some respondents in GCC felt that the strongest branding message IFIs could give was to promote their Shariah credentials.

Many IFIs felt that the competition within their own market made it very difficult to develop real depth to their brand, and there was an overall opinion that more money needs to be spent on branding. This perhaps acknowledges that the market has reached a level of sophistication that requires far more emphasis on branding initiatives to help individual banks differentiate themselves from the competition.

Looking to the future, IFIs noted that the bank's brand was their biggest asset, while excellence in customer service would grow in importance as the banks try to build more equity in their brands.

As an objective measure, over half of the respondents to the survey described the potential to innovate newer financial solutions by the Islamic banking industry in the next three years as being 'somewhat high,' which gives some sense of how the industry's leaders view their capacity for change.

It is not surprising to see that over 40% of industry leaders think their institution has put Fintech and digital transformation at the forefront of their strategic planning decisions and judged it to be 'highly important.'

Many respondents regarded Fintech as a challenge, with the single biggest concern being the barriers to the adoption of new technologies. Cyber security, budget constraints, and lack of skilled staff are all core concerns that make Islamic banks wary of adopting new technologies.

Some banks were worried about whether their legacy systems were robust enough, while in contrast, a significant number of IFIs remained quite confident that their IT systems could cope.

Most Islamic banks were aware of new technological developments such as robo advisers, but some remained sceptical of their value, believing that such technologies might impact the quality of their service.

Some IFIs indicated that they were launching technology departments to cope with digital change, while others were forming JVs with Fintechs – or buying up Fintechs – to be in a better position to face the future. Equally interesting, almost 45% of leaders said that they planned to increase or launch digital branches in the next couple of years.

The Islamic financial industry, which has seen little change since 1975, is suddenly undergoing enormous shifts that can be challenging for IFIs to mitigate. This year's CIBAFI survey unearthed an enormous amount of data that will help IFIs around the world to benchmark themselves against their peers, as well as alert them to the sorts of risks, opportunities, and developments they can expect to come across in the next 12 months.

The pages that follow show that the IFIs that will be best positioned to thrive in the future will be those that nurture and encourage strategic thinking and innovation as core values. The future is bright, but it is a Fintech-driven future where strategic awareness is the biggest asset.



CIBAFI's Global Islamic Bankers' Survey

This is the third CIBAFI Global Islamic Bankers' Survey, which builds upon the results of this year in addition to the knowledge gathered by the two preceding surveys in 2015 and 2016.

The theme of the survey this year was "Evaluating Future Impacts: Strategic Thinking, Branding and Financial Technologies" This follows on from previous years' themes of "Responsible Business Practices" and "Risk Perception, Growth Drivers and Beyond."

A Comprehensive Survey

In quantitative terms, the survey was a great success and we received 103 responses from 31 countries, offering a truly comprehensive picture of an industry at its peak. This compares to 86 responses from 29 countries in the 2016 survey, and 83 responses from 35 countries in the 2015 survey.

The aim of the survey is to present practitioners' perspectives globally on the emerging trends of the Islamic banking industry.

This year, the survey comprised three main areas:

- The CIBAFI Confidence Index
- The CIBAFI Risk Dashboard
- Strategic Thinking, Branding and Financial Technologies

CIBAFI's hope is that the results of the survey will provide Islamic financial institutions with a starting point for in-depth technical research on strategic thinking.

Survey Methodology

CIBAFI Secretariat sent the questionnaires to the CEO offices of CIBAFI's member and non-member Islamic banks, with the final responses received in February 2018. The survey, therefore, reflects the views of the Islamic banking community towards the end of 2017 and start of 2018.

Like previous years, questions were asked relating both to confidence and risk, allowing readers to see how their attitudes have changed and developed over time.

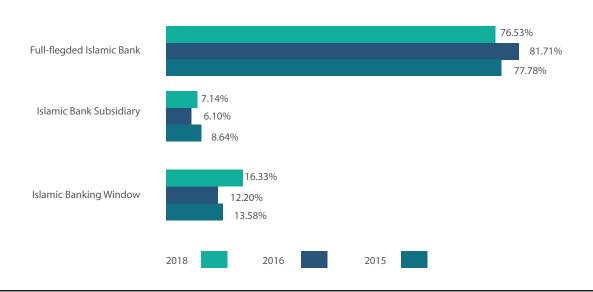
All parts of the survey comprised both "closed" and "open-ended" questions. The open-ended questions were intended to enable industry leaders to express their views in the most effective and detailed way.

This year, around 77% of the responders to this year's survey were fully-fledged Islamic banks, 7% were Islamic bank subsidiaries, with the remaining 16% being made up of Islamic banking windows of conventional banks.

This year, we received 103 responses from 31 countries, offering a truly comprehensive picture of an industry at its peak.

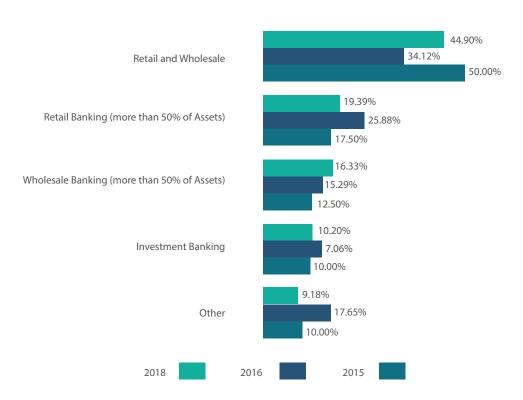
Figure 1. Global Banking Operation

Some Top Line Results



Retail and wholesale banking made up the bulk of the activity for 45% of respondents – with a further 20% indicating that retail banking accounted for more than 50% of assets and about 16% indicating that wholesale banking accounted for more than 50% of assets. 10% of respondents indicated their core business to be in investment banking while a further 9% had other type of activities as their core business.

Figure 2. Global Core Business



Growth in the Size of Islamic Banks

Meanwhile, overall 50% of respondents indicated that the size of the total Islamic assets of their institution was less than US\$1bn, 30% said that they had assets between US\$1bn and US\$5bn, 5% said they had assets between US\$5bn and US\$10bn and 15% stated that they had assets of over US\$10bn.

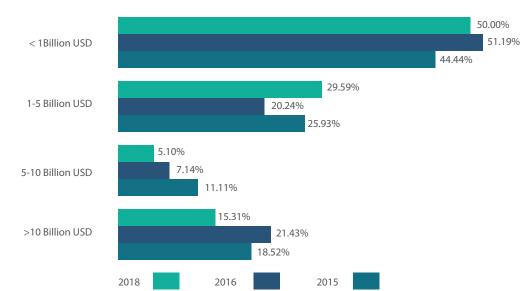


Figure 3. Size of total Islamic assets

Table 1. Respondents by Regions and Countries

Group	Region	Countries from which banks responded	Number of banks in this group that respond
Group 1	GCC	Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, UAE	29
Group 2	Middle East ex-GCC	Egypt, Iran, Iraq, Jordan, Palestine, Syria, Yemen	15
Group 3	Southeast Asia	Malaysia, Philippines	8
Group 4	West, Central, and South Asia	Afghanistan, Bangladesh, Kazakhstan, Maldives, Pakistan, Sri Lanka	12
Group 5	North Africa	Algeria, Sudan, Tunisia	28
Group 6	Sub-Saharan Africa	Djibouti, Mauritania, Nigeria, South Africa	6
Group 7	Europe	Germany, Turkey, UK	5
Total number of countries and banks		31 Countries	103 Islamic Banks



An Optimistic Outlook

This is the third time that CIBAFI has undertaken an exhaustive survey of the Islamic banking industry in order to produce the CIBAFI Islamic Banking Confidence Index. The results give a snapshot of Islamic bankers' confidence in the Islamic banking industry in their respective jurisdictions during the closing months of 2017 and start of 2018.

Part I CIBAFI Islamic Banking Confidence Index

The headline results reflect moderate optimism in the banking sector as a whole and more pronounced optimism in the Islamic banking sector. The backdrop of a burgeoning global economy lends some support for this growing sense of confidence as measured by the index.

To put these results in context, a score of 2.00 is classed as 'pessimistic,' 3.00 is classed as 'fairly optimistic,' and 4.00 ranks as 'very optimistic.'

The headline results reflect moderate optimism in the banking sector as a whole and more pronounced optimism in the Islamic banking sector.

Bankers Feeling Positive About the Future of the Sector

In response to the first question in this section, 'How optimistic are you about the future of banking in your jurisdiction in 2018?' Islamic banks globally showed a confidence level of 3.56. This shows significant improvement from the corresponding results from CIBAFI's previous surveys, which in 2016 showed a confidence level of 3.32 and in 2015 showed a confidence level of 3.46.

The geographic breakdown of responses shows that Islamic banks in the GCC demonstrate a level of confidence closest to the global average, at 3.52 (compared to 3.38 in 2016 and 3.47 in 2015).

Islamic banks in the Middle East ex-GCC were, once again, substantially less confident about the future than GCC-based banks, but significantly more confident than last year, showing a score of 3.42 (compared to 3.09 in 2016 and 3.38 in 2015).

The real surprise, however, came from Islamic banks in Southeast Asia, which showed an

overall confidence level of 3.38 for this year – coming back from a figure of 2.85 in 2016 and 3.14 in 2015.

As before, Islamic banks in West, Central, and South Asia, North Africa, Sub-Saharan Africa, and Europe were significantly more optimistic than the average.

Confidence levels rose in all areas, with Europe rising for the first time since the CIBAFI survey began, now at 3.60 compared with 3.33 in the two earlier surveys.

West, Central, and South Asia showed a continual rise: from 3.12 in 2015, to 3.31 in 2016, to the current standing of 3.67. The North African region rebounded from a drop in confidence, from a high of 3.86 in 2015, sliding to 3.54 in 2016, now rising again to settle at 3.63.

Sub-Saharan Africa shot up to become the most confident region, at 3.80, after hovering around 3.50.

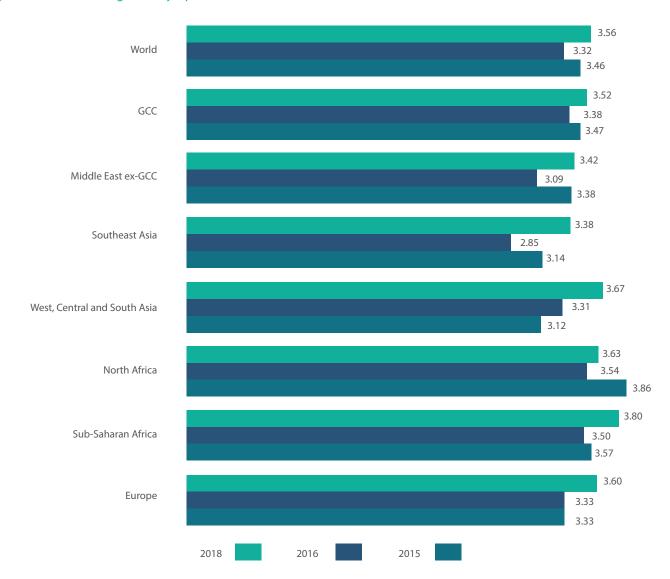


Figure 4. Overall Banking Industry Optimism Level

Even Greater Confidence in Islamic Banking

A similar uplift in confidence was witnessed in response to the question, 'How optimistic are you about the future of Islamic banking industry in your jurisdiction in 2018?'

Islamic banks globally showed a confidence level of 3.78, compared to their confidence level for the banking sector as a whole, as we have just seen, 3.56. The figure of 3.78 also shows significant improvement from the corresponding figure from CIBAFI's previous surveys, which in 2016 showed a confidence level of 3.54 and in 2015 showed a confidence level of 3.64.

If we bear in mind that a score of 4.00 ranks as "very optimistic," then we can see that the growth prospects for the Islamic banking sector are expected to be optimistic, according to the main players themselves. This overall improvement in optimism could be reflective of the improving global economy as a whole – although we might expect Islamic banks to manifest concerns whether the recovery is sustainable.

Data for Islamic banks' confidence in the GCC was based on trend and mirrored the global picture quite closely with an overall confidence level of 3.75 (compared to 3.50 in 2016 and 3.57 in 2015). This is partly explained by the fact that the GCC was the most responsive geographic area for this survey, with 29 of the 103 banks that completed the survey.

As we might expect from the overall observation of the data for the banking sector, Islamic banks in the Middle East ex-GCC were significantly less confident about the future than GCC-based banks, but significantly more confident than last year, showing a score of 3.55 (compared to 3.36 in 2016 and 3.38 in 2015). While the Middle East ex-GCC is still witnessing some political turmoil, it may also be taking longer for the global economic uptick to permeate through to all levels of business. Taken together, these two factors could be suppressing the overall optimism for the sector.

The confidence levels of Islamic banks in Southeast Asia showed an overall level of 3.63 for the year – up from 3.43 in 2016 and 3.57 in 2015. As we have observed in the past, overall, Southeast Asia tends to be less optimistic than the GCC, so the strong 3.63 seems to indicate that the sector has a healthy view of the prospects for the next 12 months.

Once again, Islamic banks in other groups were significantly more optimistic than the average. While it is difficult to be precise when discussing such a broad geographic spectrum, it seems more than likely that these areas, as relatively new markets for Islamic finance, are aware of the fact that they are still at the starting stage of their growth trajectory, and therefore have more room for growth than more established Islamic finance markets.

West, Central, and South Asia, for instance, showed a level of confidence at 3.83 (compared to 3.77 in 2016 and 3.62 in 2015).

North Africa showed a level of confidence at 3.85 (compared to 3.60 in 2016 and 4.00 in 2015).

In line with the confidence levels expressed for the banking sector as a whole, Sub-Saharan Africa showed itself to be the most confident market anywhere on Earth, with a level of confidence at 4.20 (compared to 3.67 in 2016 and 3.71 in 2015). It bears repeating that a score of 4.00 ranks as "very optimistic," which would indicate Islamic banks in Sub-Saharan Africa are expecting 2018 to be a very good year indeed. Once again, this could hint at the fact that financially, Sub-Saharan Africa is seen as the most likely future growth market for Islamic finance and the greenest pasture for space to grow. The players there have already identified growth avenues in terms of retail Islamic banking services, as well as Islamic capital market (Sukuk) opportunities.

Europe showed a remarkable level of confidence of 3.80, shooting up from 3.50 in 2016 and 2015.

Sub-Saharan Africa showed itself to be the most confident market anywhere on Earth, with a level of confidence at 4.20

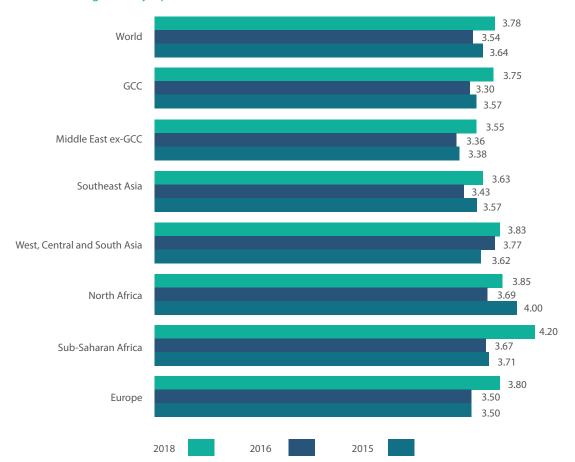


Figure 5. Islamic Banking Industry Optimism Level

Restrained Confidence over Revenue Growth

The next question posed in the survey was, "What is your expectation on the revenue growth of your institution relative to conventional banks in the year 2018 within your jurisdiction?"

Overall responses to this question showed a marginally more muted response compared to the previous question, with a confidence score of 3.51. However, for context, this shows a substantial improvement from last year: The confidence score in 2016 showed 3.28 and 3.40 for 2015.

The fact that banks are both predicting growth and failing to predict increased revenues is

not necessarily a paradox. More likely, this acknowledges the fact that Islamic banks expect their business growth to be robust, but they are still in the "investment for the future" stage of growth, meaning increased revenues will flow through in the following years after investment spending has had time to facilitate growth. Indeed, this could be a sign that Islamic banks have acquired healthy scepticism about what the growth dynamics of their businesses are, as well as how to plan future revenue growth to avoid financial crisis.

Interesting Geographic Variations Emerge

A breakdown by geographical region reveals greater divide, with some regions demonstrating great confidence and others indicating low levels of confidence.

The net takeaway from this is that most Islamic banks expect to perform significantly better than conventional banks in their jurisdiction, but they do not expect all of that outperformance to be manifested in better revenue growth in the next 12 months – and the revenue growth is projected to be uneven across different geographical locations.

In regional terms, Islamic banks in the GCC showed a confidence level of 3.48 for the revenue growth of their institution relative to conventional banks for the year (compared to 3.16 in 2016 and 3.43 in 2015). Once again, this shows a substantial improvement on last year and marginally ahead of 2015.

Islamic banks in the Middle East ex-GCC were, again, a little less confident about revenue growth in comparison to conventional banks than GCC-based banks but were still significantly more confident than the year before, showing a score of 3.42 and this compares to 3.27 in 2016 and 3.25 in 2015.

The confidence levels of Islamic banks in Southeast Asia in terms of revenue growth showed an overall level of 3.50 for the year – up from 3.00 in 2016 and 3.29 in 2015.

Islamic banks in West, Central, and South Asia showed a confidence level in terms of revenue growth compared to conventional banks of 3.33 (compared to 3.23 in 2016 and 3.25 in 2015). As we have seen in the data above, these geographical locations have shown to be slightly more optimistic than the global average in other areas – so it is remarkable that these

locations should prove to be substantially less optimistic in this particular metric.

Put another way, Islamic banks in West, Central, and South Asia tend to be more optimistic than banks in other geographical locations about the outlook of Islamic banking and banking in general, but not when it comes to their revenue growth projections compared to conventional banks.

North Africa showed a very high level of confidence at 3.82 (compared to 3.58 in 2016 and 3.91 in 2015). It is a figure that is entirely consistent with this region's overall levels of optimism for the future.

Sub-Saharan Africa, on the other hand, provides a surprising opinion on this matter of revenue growth. As we know, this region showed itself to be the most confident market with a level of confidence of 4.20, a score that is "very optimistic" in terms of the future of Islamic banking in the region. However, when asked about their confidence in competing with conventional banks in terms of revenue growth for the year, these Islamic banks showed a score of only 2.80 (in line with 2.60 in 2016 and 3.00 in 2015). It is perhaps worth reminding ourselves that a score of 2.00 is described as "pessimistic."

Sub-Saharan Africa is widely viewed as a growth region, so it could follow that all banks are optimistic. However, it seems that banks do not expect the gap between Islamic and conventional institutions to close. It appears they are expecting growth will benefit all banks, but not Islamic banks in particular.

More predictably, Europe showed a level of confidence of 3.60 (compared to 3.67 in 2016 and 3.33 in 2015).



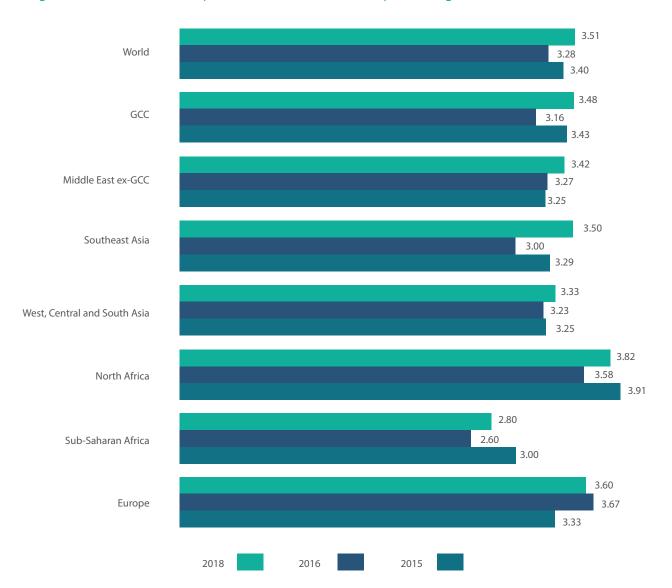


Figure 6. Revenue Growth Expectation - Confidence in Outperforming Conventional Peers

The Biggest Concerns Faced by Islamic Banks

The third section of the confidence index looks in granular detail at the sorts of issues that are of greatest concern to the decision-makers in the C-suite of most Islamic banks. We asked the bankers to score their institution's main concerns regarding various issues and challenges over the next 1-3 years.

This year's results show clearly that the concerns that banks harbour have shifted to being very micro-focused on the institutions themselves rather than macro-focused on the business environment.

We gave the banks a list of 23 challenges and asked them to assign a score of between 1.00 and 5.00 to each challenge, with 1.00 indicating that the bank did not consider the issue important, and 5.00 indicating that the bank considered it as extremely important.

This year's results show clearly that the concerns that banks harbour have shifted to being very microfocused on the institutions themselves rather than macro-focused on the business environment.

We rounded the section off by asking banks to give details about the two biggest challenges from the list and to give some insights concerning how they were dealing with them.

Concerns over Shareholders' Value and Expectations

The issue that was of greatest concern to Islamic banks was that of shareholders' value and expectations, with a staggering score of 4.35; while the area of least concern was that of competition from conventional financial institutions, with a score of 3.36. This would suggest that banks expect the economic rebound to benefit them in the years ahead, whereas they still do not consider conventional banks to be their biggest threat.

As the economy improves, it seems likely that shareholders will expect to see a corresponding improvement on their return on equity, thus putting the shareholders' value and expectations at the forefront.

For context, in 2016, the area of least concern was competition from conventional financial institutions, with a score of 3.27; the area of greatest concern was the macro-economic environment, with a score of 4.31. In 2015, the issue of greatest concern was that of shareholders' value and expectations, with a score of 4.33; the area of least concern was that of back office operations, with a score of 3.39.

It seems possible that the uncertain macro-economic picture that dominated 2016 caused banks to temporarily take their eye off their greatest enduring concern, which is creating and maintaining value for the shareholders of the bank.

Technology Concerns Moving Front and Centre

Of equal note this year is the rise of concerns over Islamic banks' IT systems, with a score of 4.30, making it the second biggest concern (in 2016 and 2015, IT ranked only at the seventh and eighth biggest worries, respectively). It is unclear whether this represents a long-term strategic apprehension about the impact on business structures of new ABC technologies (artificial intelligence, blockchain, and cloud), or shorter-term concerns about cyber security and ageing systems. Later questions consider some of these issues in more detail.

These concerns are perhaps reinforced by growing distress over compliance (anti-money laundering, counterterrorist financing, and so on) which now ranks as the third biggest worry, with a score of 4.30; it is closely followed by risk management, which is the fourth biggest concern at a score of 4.28.

Both compliance and risk management featured far less prominently in both 2016 and 2015.

Concerns Over the Economy as a Whole are in Decline

The most recent survey shows that Islamic banks are less concerned about the macro-economic environment than they were last year. This perhaps reflects the fact that most traumatic effects of the global financial crisis of 2007 have been consigned to the past, and growth is once again on the agenda.

Concern about the macro-economic environment is still present, as it was still the fifth biggest worry that banks had, with a score of 4.27, but is has been overtaken by worries about the health of each institution.

When we take a look at general macro worries such as political uncertainty (the fourteenth biggest worry with a score of 3.97), regulations concerning Islamic finance (the fifteenth biggest worry with a score of 3.86), and Islamic financial market infrastructure (the second least worrisome subject with a score of 3.64), these have largely been eclipsed by concerns facing each bank individually.



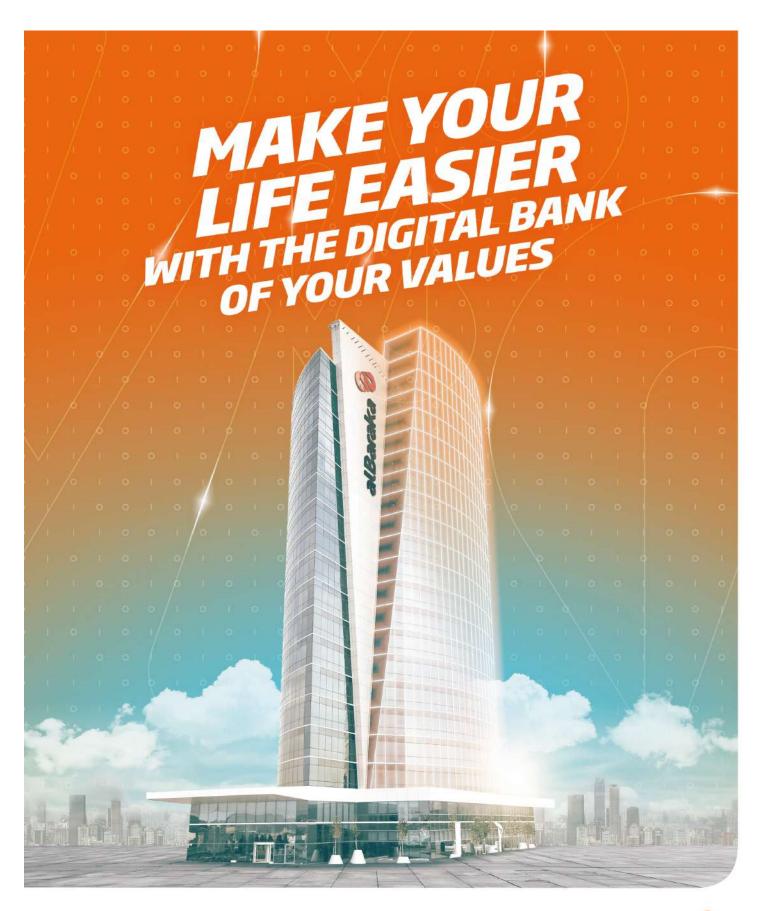
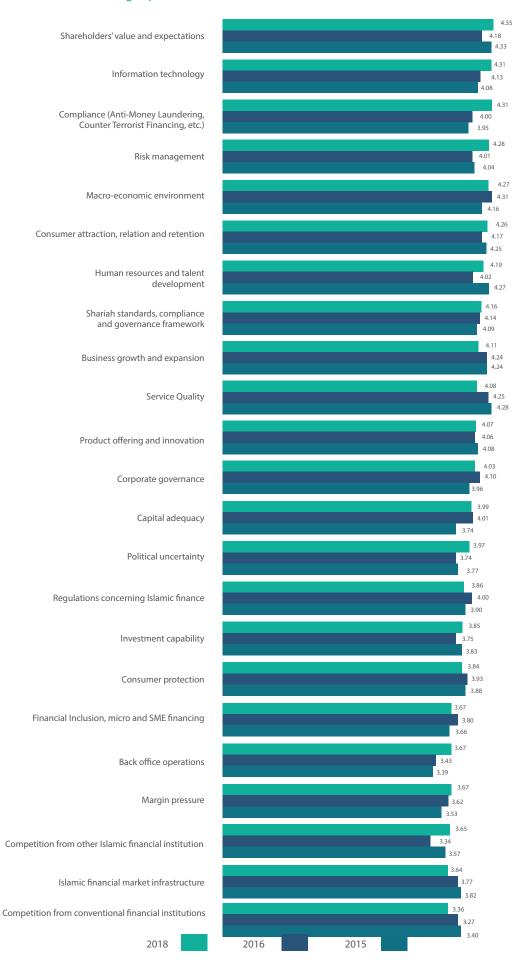






Figure 7. Global Islamic Banking Top Concerns



Regional Variations

As we have come to expect, not all geographic regions responded homogenously, and therefore there are marked differences from region to region over which topics are of greatest concern for the future.

Islamic banks in the GCC, for instance, indicate that their greatest concern in the next few years is risk management and macro-economic environment, both tied with a score of 4.21, closely followed by shareholders' value and expectations at 4.18. They were least concerned about financial inclusion, micro and SME financing, with a score of 3.32.

In sharp contrast to this, Islamic banks in the Middle East ex-GCC are most concerned with political uncertainty, with a score of 4.50, reflecting the region's worries about regional tensions, including unrest in Syria and Yemen. Information technology is their second biggest concern, followed by risk management. They were least concerned about margin pressure, with a score of 3.25.

The Middle East ex-GCC are most concerned with political uncertainty, reflecting the region's worries about regional tensions.

Islamic banks in Southeast Asia show that they have high levels of concern about risk management, consumer attraction, relation and retention, and shareholders' value and expectations, which were all ranked equally at 4.63. There was also high concern for product offerings and innovation, information technology, and compliance (AML/CTF), which all scored at 4.50. They were least concerned about political uncertainty, with a score of 3.63.

Institutions in West, Central, and South Asia indicate that their three biggest concerns are information technology (4.50); human resources and talent development (4.42); and a tie between business growth and expansion; and consumer attraction, relation, and retention (both 4.25). All of these could be firmly classified as "growth" concerns, and this perhaps hints at the fact that the Central and South Asian regions are undergoing a sharp growth phase to catch up with the Islamic finance story in the rest of Asia. They were least concerned about competition from other Islamic financial institutions, with a score of 3.17.

North African IFIs showed the greatest concern over the macro-economic environment, with a score of 4.69, and this was followed closely by equal concern over capital adequacy, compliance, and shareholders' value and expectations, which were rated at 4.62. Corporate and consumer-related concerns both scored quite highly as well, both at 4.58. However, they were least concerned about competition from conventional financial institutions, with a score of 2.70.

Islamic banks in Sub-Saharan Africa, on the other hand, show extreme concern about business challenges as shareholders' value and expectations (5.00), followed by consumer protection (4.75), and corporate governance, growth and expansion, and consumer attraction, relation and retention all tying at 4.50. These are precisely the sorts of concerns that we might expect from conventional banks in Sub-Saharan Africa to be focused on, and this might give some insight into how well Islamic banks are integrated into the financial landscape in Sub-Saharan Africa. They were least concerned about investment capability, with a score of 3.25.

Finally, Islamic banks in Europe were most concerned about IT, with a score of 4.40, while their second biggest worries were equally Shariah standards and compliance (anti-money laundering, counter terrorist financing, etc.), both showing at 4.20. They were least concerned about back office operations, with a score of 3.20.

Table 2. Major concerns of Islamic Banks across regions

	Geographical breakdown of top concerns*	
Group	Top Concerns	Score
Group 1 GCC	 Risk management Macro-economic environment Shareholders' value and expectations 	4.21 4.21 4.18
Group 2 Middle East ex-GCC	Political uncertaintyInformation technologyRisk management	4.50 4.42 4.25
Group 3 Southeast Asia	 Risk management Consumer attraction, relation and retention Shareholders' value and expectations 	4.63 4.63 4.63
Group 4 West, Central, and South Asia	 Information technology Human resources and talent development Business growth and expansion Consumer attraction, relation and retention 	4.50 4.42 4.25 4.25
Group 5 North Africa	 Macro-economic environment Capital adequacy Compliance (Anti-Money Laundering, Counter Terrorist Financing, etc.) Shareholders' value and expectations 	4.69 4.62 4.62
Group 6 Sub-Saharan Africa	 Shareholders' value and expectations Consumer protection Corporate governance Business growth and expansion Consumer attraction, relation and retention 	5.00 4.75 4.50 4.50 4.50
Group 7 Europe	 Information technology Shariah standards, compliance, and governance framework Compliance (Anti-Money Laundering, Counter Terrorist Financing, etc.) 	4.40 4.20 4.20
Global	 Shareholders' value and expectations Information technology Compliance (Anti-Money Laundering, Counter Terrorist Financing, etc.) 	4.35 4.31 4.31

^{*}For every group, the top three risks are identified, including all risks with the same score, even if that means that more than three are listed in total.

The Two Main Concerns Facing IFIs and Strategic Initiatives to Overcome Them

In order to extract maximum value from the wisdom and experience of the Islamic finance sector leaders, survey participants were then asked to describe the two main concerns facing their institutions from the list, then outline their institution's strategic initiatives to overcome them in the next 1-3 years.

Banks in the GCC Showed Acute Awareness of All Threats

As we might expect, IFIs in the very competitive GCC market had some fascinating insights to share, but the main takeaway was that every single concern identified was of major significance to one bank or another.

One leading banker, for instance, pointed out the two biggest concerns as being margin pressure and shareholders' value and expectations. "Both are correlated, as the firm needs to reach a number of performance targets to satisfy the shareholders' expectations." The bank's response to these concerns was, "To invest in a number of sectors such as infrastructure, education, etc. that can generate favourable profits and yields."

Another banker identified capital adequacy and the inclusion of technological products as being the two major concerns, and explained that the bank had, "a plan to increase capital [and] a company was established to develop technological banking services."

Still, other IFIs in the GCC were more focused on product offering and innovation coupled with consumer attraction and retention.

One Saudi-based bank was more concerned about the quality of domestic oversight of the sector and identified governmental and administrative risk as being the two biggest concerns, with the "central bank's administration and its standards for regulation of Islamic financial institutions." Another Saudi bank pointed out "human resources talent and the global economic and political climate" as being the two biggest concerns of the bank.

Macro-Economic Concerns Dominate in the Middle East ex-GCC

IFIs in the Middle East ex-GCC provided equally useful insights, with one leading Egyptian bank pointing out, "this market has been subjected since the beginning of 2011 to severe pressures affecting macro-economic indicators, so the working environment of the Egyptian economy and society is a major challenge to the bank." Another bank emphasized that "Competition with traditional banking represents the largest side of banking activities within the domestic market and benefits from competitive advantages in the areas of business and its activities, especially with respect to innovative services and products."

The same types of concern were echoed by a major Jordanian bank, which stated that "The macro-economic environment and the geopolitical conditions in the region pose a major challenge to the banking environment in general and to our bank's business in particular, which requires matching liquidity and profitability, trying to improve risk management and study opportunities away from carrying more risks."

Everyday Pressures Coming to Bear on Islamic Banks

Taken together, these two comments provide the perfect example of the sorts of real life pressures that IFIs are faced with every day in order to meet shareholders' expectations.

Additionally, one Syrian bank pointed to political uncertainty and strategic initiatives as being their biggest concerns. "The impact of political uncertainty is reflected at the start of the reconstruction process in Syria, accompanied by an increase in financing portfolio size and the effect of this increase on the bank's profit. It is also reflected in the currency exchange rate. The effect of this factor on the profit of the bank, which includes unrealized profits/ losses affect the value of the equity and the profitability of the share if it is realized." The partial solution to alleviating these concerns involved conducting "a market study to identify the sectors in which the expansion should be undertaken," according to this banker.

One Yemeni bank, on the other hand, was most concerned about regulations concerning Islamic finance, and went on to say that "many customers take advantage of the regulations concerning Islamic finance, which prohibits Islamic financial institutions from levying any penalty or charges for the late repayment of finances. The impact of this on an Islamic institution is extremely harmful."

Economic Uncertainty and the Rise of Fintech

IFIs in Southeast Asia voiced unique concerns of their own. One leading Malaysian bank was most concerned about "uncertainty in the global economy and the rise of Fintech," while another was most concerned about "human resources and talent development, as there is an acute shortage of professional Islamic bankers in the industry, hence staff retention is also a focus of HR initiatives."

One bank in the Philippines was most concerned about regulation concerning Islamic finance, and "has sought the help of the Philippine Congress (both Senate and House of Representatives) to pass a law or framework/regulation concerning Islamic banking and finance." It is co-operating with the central bank in this endeavour, which is actively sponsoring the bill.

One of Malaysia's smaller players was most concerned about margin pressure and went on to mention that "the presence of significantly larger competitors in the banking sector that dominate the industry, and the disruptions caused by smaller unregulated players in the form of Fintech and digital banking solutions have caused serious margin pressure on yields."

Service Quality and Business Growth

Islamic banks in West, Central, and South Asia were equally vocal in outlining their biggest worries, with one Pakistani bank pointing out service quality and business growth and expansion as the two main issues to be tackled. The bank states that their aim is for "each unit level to comply with the service quality standards and to be far better than the market competitors," and asserts that "This will ultimately help out in business growth by not only deepening the existing relationships but also multiplying the same...the strategy to achieve business growth is to be focusing on trade, retail, and SME business segments."

Meanwhile, a leading player in the Afghan market had this to say: "The political uncertainty remains as the significant cause of concern in Afghanistan, which triggers other ancillary factors towards law and order situation. [This] holds the prime challenge due to which only 9% of the total population is banked and the remaining huge audience has been kept out of the sphere of banking."

One Islamic bank in Kazakhstan highlighted the lack of public awareness of Islamic products as being the biggest concern. The bank proposed that the solution to the problem lies in PR and Islamic finance educational materials for the public, coupled with call centre and branch staff to explain products to interested individuals.

North Africa Focuses on Multiple Concerns

North Africa is always a fascinating Islamic financial market, and the survey responses confirm this. One leading Sudanese bank indicated that the greatest concern was the US political stance towards Sudan. "Not all foreign correspondents have responded with Sudanese banks optimally as they did before imposing the economic blockade in Sudan."

One bank in Algeria indicated that recently, it has had to completely rethink its approach. "In its overall strategy, the bank is making its activities highly flexible and increasingly diversified the bank's income. The bank also works in cooperation with the Islamic credit institutions located in the local arena to raise awareness of Islamic banking and the need for legal frameworks commensurate with the characteristics of Islamic banking."

Equally interesting, one Tunisian bank pointed to the incomplete legal frameworks for Islamic banks which "would undermine the competition existing between Islamic and conventional financial institutions." On a more macro level, "the economic climate in the country would threaten the profitability of banks and Islamic banks in particular."

One well-established bank in Sudan stated that "The macro-economic environment, in addition to the economic and financial embargo and the refusal of a number of countries and correspondents to deal with the country or the requirement to deal in specific currencies other than the dollar represent important obstacles. Therefore, in light of these difficulties, the bank is going to alternative countries and other banks, while innovating the approach of dealing with a basket of currencies other than the dollar and adopting a number of policies and hedging to ensure its continuity, thereby reducing potential risks." This seems to indicate that, despite the obstacles they're facing, Islamic banks in the North African market are ready to go to great lengths to overcome whatever stands in their way.

"Incomplete legal frameworks for Islamic banks in Tunisia would undermine the competition existing between Islamic and conventional financial institutions."

Keen Focus on Competition

The Sub-Saharan Africa market reveals some more conventional concerns, such as those highlighted by a leading Nigerian bank that considers "competition from other conventional banks due to the high potential interest rates of banks in the country" as the biggest worry. According to this bank, the situation "will be resolved by opening up many Islamic banks so that competition will be balanced in the next three years."

The major risk in Mauritania is quite the opposite, according to one local player: "Mauritania has witnessed intense competition due to the licensing of a group of Islamic banks and financial institutions in a relatively short period of time." The solution is "to change their strategies and review their investment plans so as to match the new competitive position based on their strengths such as market knowledge, long experience, geographical spread and a network of international correspondents."

One institution in South Africa points to capital adequacy as the major concern, suggesting "looking at Sukuk and other structures to increase capital and investments to ensure sustained growth of the bank," while one Djibouti-based bank said that back office operations were the biggest issue. "The back-office operations play a vital role in the bank's success; a well-crafted process flow, carefully designed risk policy and smooth credit operations hold extreme importance."

Another bank in the Djibouti market stressed that competition with conventional banks as the biggest concern, and posited their solution: "We are working on expanding our customer base, diversifying our products and training our employees, in addition to building relationships and opening accounts with correspondents abroad to facilitate and expand the base of commercial services and direct investment activities."

The Rest of the World Showed the Usual Mix of Concerns

IFIs in Europe showed a diverse but predictable range of concerns. One firm in Turkey focused on "the state-owned participation banks which entered [the market] lately and have been growing effectually; thus, there will be some benefits for the sector" as being one of the biggest concerns. Another firm points to "human value and information technology" as being the two biggest concerns, and goes on to say that "We want to move all of our processes to digital platforms to automate

our operational processes and utilize from the intellectual capital at maximum level."

Meanwhile, one participant bank from Germany stressed on the reputation of Islamic banking as being the biggest concern, expanding on the theme to say: "The most important challenge is to explain the system as an alternative to the conventional banking system."





Part II CIBAFI Islamic Banking Risk Dashboard

The CIBAFI Islamic Banker Risk Dashboard allows Islamic banks the chance to assign a score for the level of riskiness faced by their institution from a defined series of 20 types of risks that are possible within the next 1-3 years. The banks were asked to assign a score of 5.00 to indicate "extreme risk" and a score of 1.00 to indicate "no risk at all."

Since the CIBAFI Islamic Banker Risk Dashboard is intended to reflect the risk marketplace in which Islamic banks operate, it is necessary to fine-tune the dashboard from time to time in order to paint the most accurate picture possible. To that end, both "macro-economic risk" and "political risk" were excluded from this year's Risk Dashboard. Both of these risks are covered more fully in the preceding section of the survey, where they sit alongside other top concerns, leaving the Risk Dashboard to cover more day-to-day problems.

For similar reasons, "de-risking risk" has been added to the Risk Dashboard this year, since this is one of the important tasks faced by Islamic banks. As already outlined above, de-risking risk involves taking much closer charge of correspondent banking relationships, monitoring them more closely and closing them down if their risk profile looks too high.

The Rise of Technological Risks

This year, the Islamic banks identified the biggest risk as being technology/IT security (with a score of 3.38), followed by credit default risk (with a score of 3.37), and liquidity risk (with a score of 3.29).

A comparison with last year's result shows that liquidity risk has slipped from being the biggest perceived risk (at 3.39) to the third biggest risk this year.

Technology/IT security risk has been steadily increasing since 2015, now becoming the biggest perceived risk. It is perhaps not surprising that technology risk and IT security appear as strongly as a source of concern for Islamic banks – technology now affects virtually all aspects of a bank's business. The more entrenched technology becomes within a bank's systems, the more exposure the bank has to IT security risks like malware, hacking, and identity fraud.

That credit default risk featured so prominently this year is also not surprising for Islamic banks who witnessed the low or negative growth in some of their core markets – and in many instances, the identification of liquidity risk as the third major concern for banks can be seen as a corollary of this. Lower liquidity levels in predominantly oil-based economies at a time of low and constrained oil prices will naturally have a marked impact on the trading conditions of many banks.

De-Risking Risk Shows Great Importance

Interestingly, the newly introduced category of de-risking risk (closing of correspondent banking relationships) featured as the fifth biggest risk faced by Islamic banks with a score of 3.16. However, this global figure conceals some significant regional variations, such as appearing as only the seventeenth biggest risk in the GCC (with a score of 2.59), while it appears tied for the biggest risk for banks in the Middle East ex-GCC, (with a score of 3.50), likewise tied for first in West, Central, and South Asia, (with a score of 3.09), and second place in North Africa (with a score of 3.74).

De-risking risk appears tied for the biggest risk for banks in the Middle East ex-GCC, likewise tied for first in West, Central, and South Asia, and second place in North Africa.

Within banks in Southeast Asia, de-risking risk was one of the lowest perceived risks (with a score of 2.87).

Shariah Non-Compliance Risk is a Low Priority

It is heartening to see that Shariah non-compliance risk is featured as the second lowest concern that Islamic banks have. This can only indicate confidence in both the Shariah boards of the banks, as well as the overall systems of Shariah oversight within the different banking jurisdictions.

Again, not surprisingly, tax risk is of the least concern of most banks. This could be either because the tax systems in which they operate are simple, or because the banks find compliance to be well within their comfort zone.

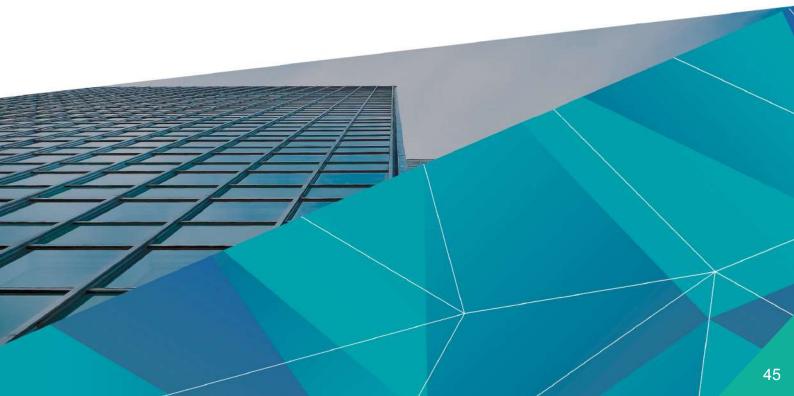
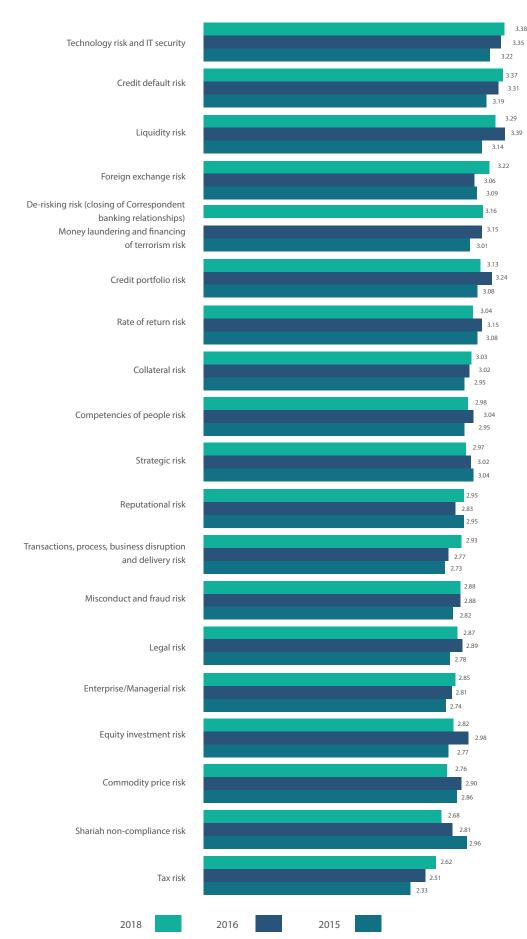


Figure 8. Islamic Banking Risk Dashboard



A Look at Different Geographical Locations in Depth

Islamic banks in the GCC were firm on the opinion that credit default risk was the biggest concern, with a score of 3.45. Credit portfolio risk was seen as the second biggest worry at 3.35, followed by technology/IT security risk at 3.28. They were least concerned about Shariah non-compliance risk (at 2.41) and commodity price risk (at 2.45).

Islamic banks in the Middle East ex-GCC were concerned with credit default risk and derisking risk, which both scored 3.50 and were the joint biggest concerns. Their next biggest concern was technology/IT security risk, with a score of 3.42. They were least concerned about Shariah non-compliance risk (at 2.25) and tax risk (at 2.33).

Islamic banks in Southeast Asia were mostly concerned about liquidity risk (3.75), and then by technology/IT security (3.50), though credit default risk was not far behind (3.38). The surprise came, however, in the areas in which they felt least threatened: de-risking risk, money laundering, financing of terrorism risk, and tax risk, all at 2.88.

This meant that Shariah non-compliance risk featured as the ninth biggest risk in Southeast Asia, whereas for most other regions was one of the least risky aspects of the Islamic banking business. This may hint at the tacit understanding that the differences in Shariah interpretation from the Gulf to Malaysia tend to work in favour of the Gulf and pose some small risk to banks in Southeast Asia that are wishing to perform on the global stage.

Foreign Exchange Risk Concerns in West, Central, and South Asia; and North Africa

Islamic banks in West, Central, and South Asia identified the biggest risks they faced as being foreign exchange risk and de-risking risk, both at 3.09. These were closely followed by competencies of people risk and tax risk, which are at 3.00. The Islamic banking sector has long suffered from lack of high-quality staff available for hire. It seems that West, Central, and South Asia feel this problem so acutely that the competencies of their people pose a significant risk to the health of the organisation. Once again, we see Islamic banks in this area indicating that Shariah compliance risk is their lowest priority concern at 2.09, closely followed by equity investment risk at 2.40.

Islamic banks in North Africa indicated that foreign exchange was their biggest worry, with a quite high score of 4.08, followed by de-risking risk at 3.74 and liquidity risk at 3.67. It is perhaps not surprising that Islamic banks in North Africa are concerned about foreign exchange risk, considering the spectre of inflation has long haunted the markets of North Africa. This has led to a dependence on foreign currencies, particularly the US dollar, in domestic, intraregion and international transactions. In addition, US sanctions on Sudan have largely prevented its banks from dealing with US dollar, forcing them to operate in a wider range of currencies for their international transactions. Their lowest areas of concern in terms of risk were tax risk at 2.65 and transactions, process, business disruption and delivery risk at 2.89.

Fraud and Strategic Risk

The picture of perceived risk for Islamic banks in Sub-Saharan Africa, however, could not be more different from their northern counterparts. Misconduct/fraud risk and strategic risk featured at the head of their list, both scoring 3.25. The high score of misconduct/fraud risk might give some indication of how Islamic banks in Sub-Saharan Africa perceive a weakness in the application of the rule of law in the financial services sector, and doubtlessly indicates that banks in the sector are particularly vigilant about any sort of financial crime.

Another fascinating feature of the Sub-Saharan Africa sector is that the banks gave an equal risk score of 3.00 to a wide range of risks: credit default risk; technology/IT security risk; transactions, process, business disruption and delivery risk; enterprise/managerial risk; reputational risk; money laundering / financing of terrorism risk; and de-risking risk.

Also included in this set was Shariah non-compliance risk, which perhaps indicates that the level of Shariah oversight at work in the sector in Sub-Saharan Africa is not considered to be as robust as that of banks in well-established Islamic finance markets, such as the GCC and Malaysia.

Reputational Risk is Seen to be of Importance

Finally, Islamic banks in Europe identified their biggest risk as a reputational risk at 4.00, followed by both technology/ IT security risk and Shariah non-compliance risk at 3.80.

The relatively high score of Shariah non-compliance risk from banks in Europe may come as something of a surprise. This may suggest that the banks have some concerns about how their Shariah decisions will be accepted in their jurisdictions.

Both tax risk and commodity price risk were both rated the lowest risks faced by these banks, at 2.60.

The relatively high score of Shariah non-compliance risk from banks in Europe may suggest that the banks have some concerns about how their Shariah decisions will be accepted in their jurisdictions.

Table 3. Geographical breakdown of top 3 risks

Group	Geographical breakdown of top 3 risks*	Score
Group 1 GCC	 Credit default risk Credit portfolio risk Technology risk and IT security 	3.45 3.35 3.28
Group 2 Middle East ex-GCC	 Credit default risk De-risking risk (closing of Correspondent banking relationships) Technology risk and IT security 	3.50 3.50 3.42
Group 3 Southeast Asia	 Liquidity risk Technology risk and IT security Credit default risk 	3.75 3.50 3.38
Group 4 West, Central, and South Asia	 Foreign exchange risk De-risking risk (closing of Correspondent banking relationships) Competencies of people risk Tax risk 	3.09 3.09 3.00 3.00
Group 5 North Africa	 Foreign exchange risk De-risking risk (closing of Correspondent banking relationships) Liquidity risk 	4.08 3.74 3.67
Group 6 Sub-Saharan Africa	 Misconduct and fraud risk Strageic risk Credit default risk Techonology risk and IT security Transaction, process, business disrepution and delivery risk Shariah non-compliance risk Enterprise/Managerial risk Reputational risk Money laundering and finanching of terrorism risk De-risking risk (closing of Correspondent banking relationship) 	3.25 3.25 3.00 3.00 3.00 3.00 3.00 3.00 3.00 3.0
Group 7 Europe	 Reputational risk Technology risk and IT security Shariah non-compliance risk 	4.00 3.80 3.80
Global	 Technology risk and IT security Credit default risk Liquidity risk 	3.38 3.37 3.29

^{*}For every group, the top three risks are identified, including all risks with the same score, even if that means that more than three are listed in total.



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De-Risking Risk in Depth

In order to fully explore the issue of de-risking risk, the survey posed a supplementary question in order to draw out more detail: "To what extent has the bank experienced a decline in correspondent banking relationships as a result of 'de-risking' over the last five years?"

Almost one-third of the respondents (32%) said that they had witnessed a "significant decline," while a further 22% indicated that they had experienced "some decline." A further third (36%) said that they had experienced "no significant change."

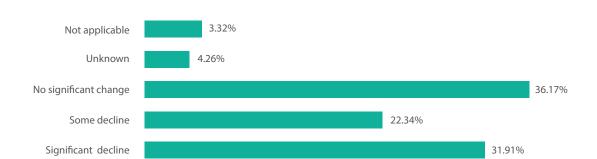


Figure 9. The decline in correspondent banking relationships (CBR)

More Significant Regional Variations

As we might expect, the breakdown of geographical location paints a more vivid picture. Among Islamic banks in the GCC, 70% indicated that they had experienced "no significant change" with the remaining balance split between "significant decline" and "some decline." As we will see, these figures tend to reinforce the image of GCC banks as being less vulnerable to the challenges of de-risking risk.

Islamic banks in the Middle East ex-GCC indicated that 50% of banks had experienced "no significant change," with the balance split between "significant decline" and "some decline." Meanwhile, Islamic banks in Southeast Asia also indicated that 50% of banks had experienced "no significant change" and 37% indicated "some decline," but none at all indicated a "significant decline."

In contrast, 70% of Islamic banks in West, Central, and South Asia, and 80% of banks in Sub-Saharan Africa, indicated that they had seen either significant or some decline. In North Africa, over 66% of banks indicated that they had seen "significant decline."

It seems clear that de-risking has had a crucial effect on banks in these areas, and this issue may be worthy of a study of its own in the coming years.

Finally, Islamic banks in Europe indicated that only 20% had seen some decline in the balance, while the rest stated that they had either seen no change or did not know whether there was a change.

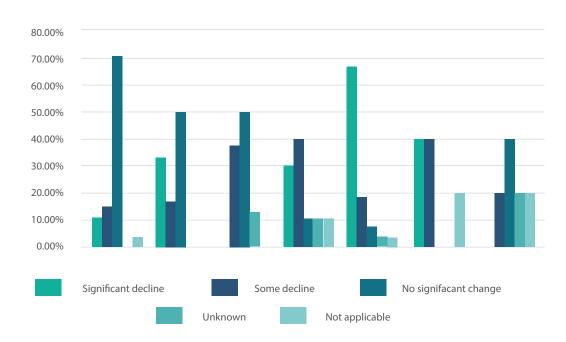


Figure 10. The decline in correspondent banking relationships (CBR) - Regional Breakdown

Effects of Closing Correspondent Banking Relationships to Business

The survey went on to probe further for details about how de-risking had affected the business face of the bank. It asked to what extent a given set of products and services had been affected within the institution as a result of the closing of correspondent banking relationships.

A score of 1.00 indicated "no affect at all," while a score of 5.00 indicated that the area of business had been "significantly affected."

On a global basis, the business line most affected by de-risking was trade finance/letters of credit/documentary collections, with an aggregate score of 3.02, followed closely by structured finance/foreign investments with a score of 2.98.

This would suggest that, although such business had been affected by de-risking, the net effect on the business was not so great that immediate action would need to be taken.

Indeed, each of the business lines was affected, more or less, in the intermediate realm between 2.50 and 3.00. This suggests that the effect of de-risking last year was gentle enough for the banks to be able to cope with the strain and prepare to take remedial steps in subsequent years.



The picture painted on a region-by-region basis was in line with what we might expect, given the responses to the preceding question.

Islamic banks in the GCC identified the business line most affected as being structured finance/foreign investments, but with a score of only 2.30. Overall, Islamic banks in the GCC seemed to be only moderately affected by de-risking, with scores across all business lines that ranged from 1.85 (cheque clearing) up to 2.30.

The situation for banks in the Middle East ex-GCC was a little more pronounced, but even so, the most affected (international wire transfers) had a score of only 3.17, and the least affected (cheque clearing) had a mere score of 2.25.

Southeast Asia's Islamic banks suggested that cash management services were the most affected by de-risking (at 3.14) and least affected was investment services (at 2.57), while West, Central, and South Asian banks indicated that international wire transfers were hit the hardest (at 3.40), followed by trade finance/letters of credit/documentary collections (at 3.10).

However, the picture changes quite dramatically when we look at North Africa. Five of the business lines of the Islamic banks operating there

have been significantly affected by de-risking – including trade finance/letters of credit/ documentary collections at 4.12, structured finance/foreign investments at 4.00, foreign exchange services at 3.96, cash management services at 3.96, and international wire transfers at 3.88. This is very much in line with the 66% of banks in North Africa that indicated that they had seen a 'significant decline' in business due to de-risking.

Banks in Sub-Saharan Africa had seen no such declines in their business due to derisking. Their most affected business line was trade finance/letters of credit/documentary collections, but with a score of only 3.00. This seems to run contrary to a picture of 80% of banks in Sub-Saharan Africa indicating that they had seen either significant or some decline in their business due to de-risking, suggesting that further analysis could be warranted in subsequent years.

Islamic banks in Europe were the most relaxed of all regions in terms of the effects of de-risking on the businesses. These banks gave a straight score of 2.00 for all business lines except trade finance/letters of credit/documentary collections, which nudged up to 2.20.

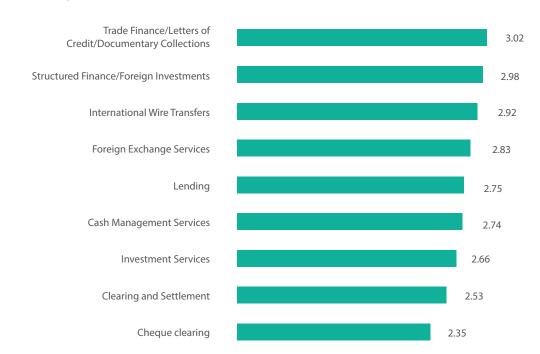


Figure 11. De-Risking Effects on Products and Services

De-Risking and the Closure of Correspondent Relationships Pose a Systemic Risk

In 2015, a World Bank survey of jurisdictions and banks commissioned by the Financial Stability Board confirmed that roughly half of the emerging market and developing economy jurisdictions surveyed had experienced a decline in correspondent banking services.

The withdrawal was not on a global scale, but in some countries, the trend was flagged as a concern that could lead to banks relying on a narrow range of providers. If withdrawals continued, the report concluded that this has the potential to rise to a systemic issue for the regions affected, as well as to drive some payment flows underground, which would make it harder for authorities to prevent financial crime and the financing of terrorist activity.



Top Two Risks Faced by IFIs – and Steps Taken to Mitigate Those Risks

The CIBAFI Risk Dashboard also included a write in section in which survey respondents were asked to describe the top two risks that their institution was facing and to describe the initiatives it was taking to mitigate them in the next 1-3 years.

GCC Banks Identified Almost Every Single Risk as Being of a High Importance

For some banks in Bahrain, IT was the single biggest worry. While one bank pointed to the "risks of technology and information technology," it revealed that "We have contracted to buy a modern technological system to keep pace with the development of operations in the bank."

A neighbouring bank echoed this sentiment, saying, "Technology is getting obsolete due to rapid changes in customer expectations. The IT security risk is also increasing with the increase in the use of technology. The bank has charted an ambitious plan for updating and maintaining technology to ensure best service delivery with high economies of scale. State-of-the-art security

"Technology is getting obsolete due to rapid changes in customer expectations and the IT security risk is also increasing with the increase in the use of technology."

infrastructure is being implemented to ensure that IT security risk is properly monitored and mitigated."

Other banks, including one bank in Oman, highlighted a different set of risks. "Keeping in view the prevalent macro-economic conditions, the top two risks are the credit portfolio risk and credit default risk." The solution they have implemented: "The bank is following a cautious approach in terms of providing financing to new clients and also keeping a strong focus on the quality of the existing portfolio."

One bank in Saudi Arabia had an even more macro view of the risk horizon, identifying "transactions, process, business disruption and delivery risk" as being the major worries. "Due to the financial market crisis that started in 2008, potential investors are not investing in even good projects." The bank stated they were tackling these risks by, "diversifying business segments by providing corporate advisory services to its clients."



Banks in the Middle East Ex-GCC Had an Equally Wide Set of Risk Worries

One leading player in Egypt pointed to strategic risk as being their greatest worry. "The wide variety of banking services offered by competitors in addition to the high rates of return offered by conventional banks on their savings, especially in recent periods, threatens the share of our bank in the Egyptian market."

In order to tackle this risk head-on, "The bank has already started implementing a time plan to reduce the focus of the investment wallet and increase its diversity to include more SMEs and to serve the objectives of the state plan in this area and work to improve macro-economic indicators."

Meanwhile, in Jordan, one bank identified both problem and solution: "In light of the economic conditions experienced by the region, these conditions will reflect on the risk of increasing the ratio of non-performing loans and thus increase the default risk and its impact on profitability. This requires greater caution in providing funds and financing and matching liquidity, profitability and guarantees."

Southeast Asian IFIs Focused on IT

Banks in Southeast Asia were also consumed with worries over IT risk. One bank in Malaysia summed it up by saying that "Technology risk and IT security is imminent as we take on our digitalization strategic building block. Forces of change such as automation, the emergence of Fintech and online marketplace and Al call for an emerging risk to the bank. The bank plans to partner with Fintech to deliver new technologies and delivery speed."

One survey respondent in the Philippines expressed domestic worries instead, with one bank identifying legal and regulatory risk as being the biggest worry. "The law does not address key issues relative to the regulation of Islamic banking [in the Philippines]. For example, tax neutrality for Islamic products and conventional products, resulting in higher cost for Islamic products."

De-Risking Risk is Paramount for IFIs in West, Central, and South Asia

Banks in West, Central, and South Asia were most worried about de-risking risk, with one bank in Afghanistan saying that "The entire banking industry in Afghanistan has been confronting the risk of the closure of correspondent banking relationship, which has been negatively impacting the growth and profitability of the banks." The bank was taking remedial action to combat this: "The bank's management is vigorously communicating with other banks worldwide to get the lines of correspondent banking and the subject has been held as the top priority."

One bank in Kazakhstan, on the other hand, stated that they were concerned about IT risks specifically related to legacy equipment. The bank expressed concern about the business continuity of bank systems, as well as the safety of the bank's systems from external attacks.

North Africa Shows More Concern on Traditional Matters

Banks in North Africa were worried about more predictable issues. Most players in Sudan pointed to foreign exchange rate risk and the risk of volatility in international and domestic prices as being most worrisome. One bank described it as "The deterioration of the exchange rate is the big problem and so to mitigate it, most institutions tend to turn liquidity into assets."

Meanwhile, banks in Sub-Saharan Africa had a range of concerns, extending from Nigerians' concerns on the risk of non-compliance to South African banks worries about liquidity risk and technology/IT security risk: "The bank is looking at developing a robust cyber resilience framework that meets best standards and is able to proactively mitigate this risk."

Foreign Exchange Risk Looms Large to the Rest of the World

Europe's concerns were also as expected. A bank in Turkey cited foreign exchange risk concerns, with their proposed solution being to encourage the central bank to adjust its policy stance accordingly.

One bank from Germany made an interesting point when it said that "Islamic banking leadership requires a good understanding of today's real needs of retail and corporate customers. They should be productive and creative to find alternative Islamic products and services; thus, Islamic banking products and services should be attractive to everybody."

What the World's IFIs Had to Say About De-Risking Risk

In another write-in question, banks were asked if there were any other ways in which their bank had been affected by de-risking and what the institution was doing to mitigate its effects.

GCC and Southeast Asian Islamic Banks Show Concern over Systemic Risk

In the GCC, one bank in Bahrain emphasized systemic risk when it said that "The impact of de-risking and withdrawal in general at the banking industry is that it could damage not only financial stability but also economic growth and financial inclusion, which would have a negative impact on the banking system."

"The impact of de-risking and withdrawal could damage not only financial stability but also economic growth and financial inclusion."

This same bank was going to great lengths to mitigate such risks, and was taking the following steps: "Establish new correspondent banking relationships in main currencies in different jurisdictions... Approaching major international correspondent banks and counterparts outlining that the (bank) would make the correspondent banking relationships with our counterparts rewarding from risk and profitability perspective... Consider establishing an alliance with reputable banking groups with geographic diversification."

In Southeast Asia, one of the leading Malaysian banks echoed the worries expressed by the Bahrain banks above. It stated that "One of the most prominent impacts of de-risking would be how it may impede financial inclusion strategies. SMEs, enterprises, businesses are dependent on correspondent banking services as well as that of trade finance."

One Kuwaiti bank had an equally root-and-branch approach, saying that "It has forced us to revisit each relationship and if it was an open, but unused relationship (i.e. dormant Nostro, RMA, counterparty), it was closed or sent to the RM to re-activate the relationship. Therefore, the abovementioned decline is in the number of relationships maintained as open as we now only want active relationships."

Procedural Matters Concern Banks in the Middle East ex-GCC

Banks in the Middle East ex-GCC had other procedural concerns with de-risking as one bank in Jordan described it that "Over-use of procedures of knowing your customer to maintain a good relationship with correspondent banks may lead to the loss of part of the business with some customers, both in the banking operations received or issued, due to the strengthening of the banking procedures related to compliance with AML/CFT locally, regionally or globally."

Quite a different set of issues affect banks in West, Central and South Asia, with one Afghan bank saying that "Foreign telegraphic transfers (FTT) are the main affected area and due to de-risking, the bank has lost some major portion of its deposits because the bank was not able to entertain the requests for FTTs."

For some banks in North Africa, de-risking risk is nothing new. As one Sudanese bank described it: "Because of the US sanctions imposed on Sudan and the impact of this on the banking sector in Sudan, there was a complete closure of correspondent banking relations for more than 20 years. But thank God in October 2017, the sanctions were lifted. This affects the return and normalization of banking relations of correspondent banks with Sudanese banks."

One bank in Algeria made a different, but related point when it said that "All banks in Algeria are concerned about macroeconomic and political risks. One of the most important activities affected (by this bank as a result of de-risking) is lending in general. Credit operations have been tightened to ensure that some high-risk sectors are avoided and are constantly seeking diversification."

Tunisian banks saw yet more issues around the same central theme that "The closure of some currency accounts in a small part of the foreign correspondent banks was reflected in the conversion and investment operations. This situation was quickly corrected and was dealt with by resorting to other correspondent banks."

Banks in the other geographical locations had no substantial additions to make to these responses.







Part III Strategic Thinking, Innovation and Branding

Corporate strategy is an important element in setting a clear direction for the institution and allowing it to achieve its goals and objectives efficiently. This section evaluates the aspects of corporate strategies of Islamic Financial Institutions (IFIs), including how they are being implemented and to what extent stakeholders are involved in their development.

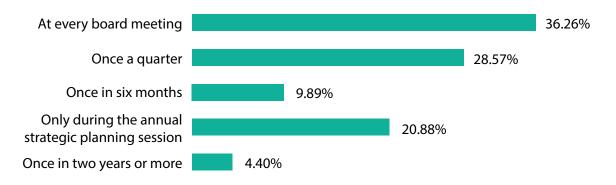


The Board of Directors is Taking a More Proactive Role

Financial institutions globally are under pressure to improve their governance and especially the oversight role of the board of directors, particularly in strategy and risk management. Banks increasingly have board-level strategy and risk committees to remain apprised of trends, both globally and within the bank, to enable specific oversight of strategic and risk concerns. These committees increasingly have members with specialized knowledge, often independent, who can help professionally critique bank direction.

The concern over governance has risen as well within the Islamic banking market, as reflected by the 2017 "Corporate Governance Practices in Islamic Banks" jointly published by CIBAFI and the World Bank Group. The responses to the CIBAFI survey also reflect these trends. When asked the frequency with which boards meet to discuss corporate strategy, almost two-thirds (65%) cited that their bank discussed strategy explicitly at least quarterly, with the majority discussing it at every board meeting.

Figure 12. The Frequency of Board of Directors discussions on Corporate Strategy



Longer Time Horizons are more preferable in Building Corporate Strategy

Most banks see strategy as a longer-term commitment, with over half (55%) viewing strategy within a three- to five-year horizon, and a small portion (5%) with a scope of over five years. Most groups cluster towards the middle definition of strategy, of three to five years, but respondents from the GCC, Southeast Asia and West, Central, and South Asia tended to have a somewhat shorter-term horizon than those from the Middle East ex-GCC and Europe.

Most groups cluster towards the middle definition of strategy, of three to five years

Figure 13. Longest time horizon considered while building the Corporate Strategy

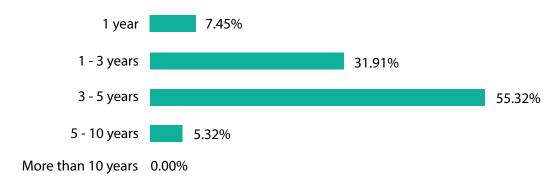
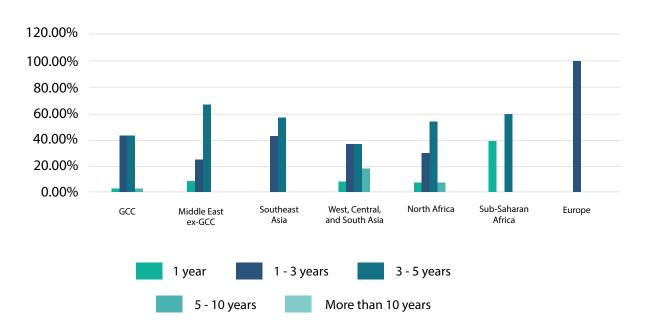


Figure 14. Longest time horizon considered while building the Corporate Strategy - Regional Breakdown



The Strategy is a Bank-Wide Responsibility

Although the boards are increasingly taking a leading role in strategy formation, in most well-run banks, strategic planning and execution are infused throughout management, often with a specialization in certain areas. Typically, the Chief Executive Officer is most involved in strategy formulation, and is responsible for its execution. Unsurprisingly, the survey revealed this same trend among Islamic banks. In most regions, the CEO was cited as most responsible for strategy, but in Southeast Asia and Sub-Saharan Africa, the board was given equal power. North Africa was the only region where the board's role was ranked as higher than the CEO.





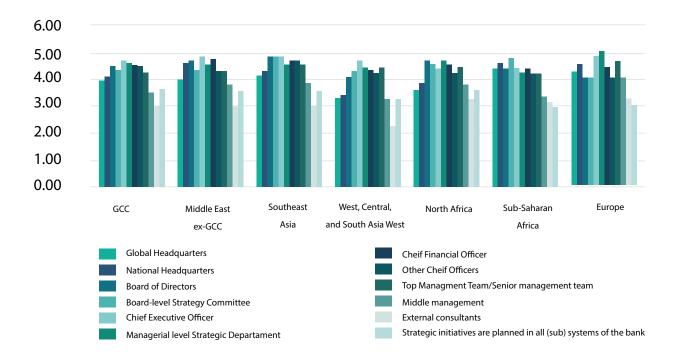


Figure 16. Department/Stakeholders involved in Strategic Thinking - Regional Breakdown

Divisions, Departments, and Middle Managements are an Important Part of Strategic Thinking

Middle management was cited as also playing a role in strategy formation and implementation, with responses ranging between 3 and 4 ("important"). Several banks felt that involving managers in the strategic implementation was critical. A Bahraini bank remarked that in their bank, "Department heads are involved in strategy making to increase participation and ownership."

Another Bahraini bank also made efforts in including middle managers, "The middle management team upwards is involved in the strategic planning process. Even the selected junior employees [chosen] for the career progression plan are part of this strategic process." At the same time, in a Qatari bank, "Management holds an annual strategic meeting where all divisions/departments are invited to take part and present their strategic plans and goals, which is then used to form the basis for the bank's overall strategy." A

Malaysian bank went so far as to hold retreats to incorporate middle management participation: "A Strategic Brainstorming Retreat is held annually where the CEO, senior management team, heads of divisions and second liners (C-1) are grouped together to brainstorm strategies in moving forward."

Involving middle management in the strategic formation was a theme at most banks. According to one Egyptian bank, "The different sectors and departments of the Bank are involved in the strategic planning process by setting their own objectives, studying them, discussing them."

At one Omani bank, senior management drives strategy, but lower level managers must still be included in the implementation: "Middle management is also involved in the process of budgeting, planning and reporting for their respective departments."

Linking Staff to the Strategy and its Implementation

Another Omani bank observed how the successful use of the bank's performance management system naturally incorporated staff into the implementation of the strategy, "The Bank has a well-defined performance management framework in place, which is linked to the key performance indicators of an employee. The Key Performance Indicator (KPI) of the employee is linked to the strategy

"The bank gives the opportunity for departments "to participate in setting their strategic plans to be in line with the whole bank's strategic plan."

of the Bank with a specific focus on the individual's role and responsibility. In this way, employees are engaged in the execution of strategy." A Jordanian bank made a similar observation on how performance management serves as a feedback loop to the strategic management process since the bank holds "regular strategic meetings to discuss strategic planning progress, their KPI's, and any challenges." The bank gives the opportunity for departments "to participate in setting their strategic plans to be in line with the whole bank's strategic plan."

A South African bank also shared how it uses performance management to engage staff in the execution of the bank's strategy: "The strategy is being cascaded down from an executive level into mini action plans in which every staff is involved in making contributions towards meeting the bank's strategic objectives."

Several banks noted that regular, internal meetings were one mechanism to ensure strategic coherence. A Kuwaiti banker observed that "First and foremost, senior management meet regularly with the parent company to ensure continued alignment on strategic issues and transfer of knowledge in key areas."

A Palestinian bank remarked that to foment strategic thinking among their staff, they hold "specialized workshops in strategic planning, with the participation of specialists in this field."

Several banks mentioned training multiple levels of staff to introduce and instil strategic approaches. A Pakistani respondent described how and why this happens in their bank: "The key top management undergoes leadership training such as balance scorecard, goal setting, etc. to keep them attuned to the jargon so that when the yearly strategic goals are developed, they are guided and bring in the right strategic mind-set to drive the bank towards better customer satisfaction & shareholders' value."

Many banks felt that sharing the strategic vision, including responsibility for its formulation and implementation, helps to create a sense of shared destiny among the bank employees. An Algerian bank offered that the bank "seeks to spread the culture of strategic thinking by expanding participation and taking decisions. The dissemination of this culture requires a comprehensive program involving the majority of stakeholders in the bank through workshops and participation of all in setting the future vision and mission of the institution." In a similar vein, a Malaysian bank noted that brainstorming sessions for all staff levels along with team-building activities not only helped strengthen strategy formation, but also helped "to instil the spirit of meeting the same objective for everyone."

The Management Has Some Independence from the BOD

When asked to what degree the bank's functional areas had independence from the board over resource allocation, responses varied considerably. Generally speaking, budgeting and investments were assigned greater autonomy, reflecting their typically independent decision-making within certain defined parameters, whereas strategic planning and political negotiations were viewed as more under board supervision.

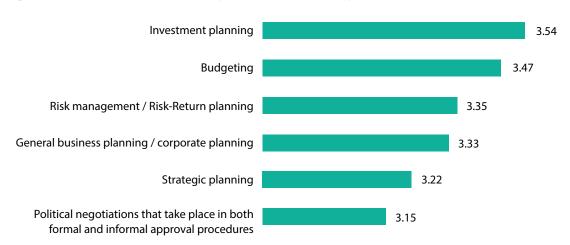


Figure 17. Level of administrative independence of functions/processes

The Corporate Strategy Has Diverse Inputs and Outputs

Respondents viewed strategic planning process inputs, such as competitive actions and customer expectations, as important to build a strategic direction. However, the respondents ranked the bank's own financial projections, along with macro-economic trends, as leading the pack. All were ranked as very important except analysts' expectations. The prioritization among inputs did not differ dramatically by regions.

Figure 18. Important Inputs in developing the Corporate Strategy

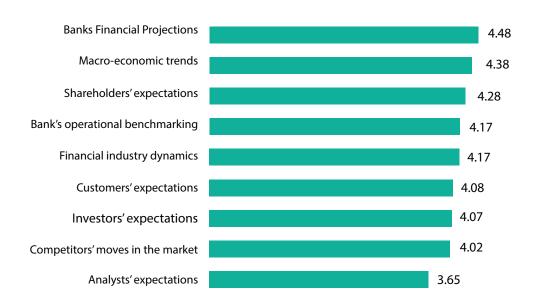
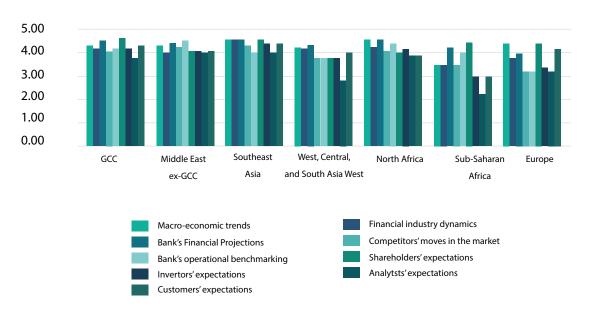


Figure 19. Important Inputs in developing the Corporate Strategy - Regional Breakdown



The development of the corporate strategy is expected to yield several key results. The two that were ranked most important, both breaking through level 4, were the related objectives of entering new markets and acquiring new businesses, which are both high risk and high reward strategic decisions. Just below these two in importance were ranked two internal objectives: redesigning key processes and driving performance transformation, ranking just below 4 ('very important'). All initiatives were ranked important, but the one considered least was the exit of markets, a rarer consideration in any case for most banks.

Figure 20. Important Outputs from the Corporate Strategy development



5.00 4.50 4.00 3.50 3.00 2.50 2.00 1.50 1.00 0.50 0.00 GCC Middle East South East North Africa West, Central Sub-Saharan Europe ex-GCC & South Asia West Africa Asia Divesting assets/liabilities Acquiring new business Making major changes in organic capital expenditures across the corporate portfolio Entering major/new markets Redesigning key processes Exiting major markets Making major shifts in talent across corporate portfolio Restructuring the back Customer experience driven strategies Driving performance transformation Making changes in operating expenditures across the corporate portfolio

Figure 21. Important Outputs from the Corporate Strategy development – Regional Breakdown

An institution's leadership is extremely important in defining the future course, not only for itself, but also for the overall success of the Islamic financial industry. This section aims to evaluate Strategic Leadership aspects of Islamic financial institutions.



Expansion is the Feature of Leaders' Strategic Thinking

The tendency of focusing on expansion was expressed also when respondents were asked to cite any strategic moves that senior management had taken in the past two years. The strategic review, a normal cyclical process, was named first. But the launch of a new business or product, acquisition of a new customer class and geographic expansion were especially cited among the top experiences. This focus on innovation and expansion ranked high across all geographical locations, but in the GCC cost reduction was also high, in fact, beating out the expansionist initiatives and perhaps reflecting the greater focus on keeping expenses

The launch of a new business or product, acquisition of a new customer class and geographic expansion were especially cited among the top experiences.

down in the tighter economic environment of today's GCC. Cost reduction was also relatively high in Southeast Asia. The only regions which registered any significant focus on mergers and acquisitions were the GCC and West, Central, and South Asia.

Regional differences among strategic outputs overall were not dramatic, however, in Sub-Saharan Africa, Europe, the GCC, and especially Southeast Asia, respondents considered strategies driven by customer experience more critical than those surrounding entering new markets, with organization changes and human talent shifts ranking as somewhat important at around 3.5.

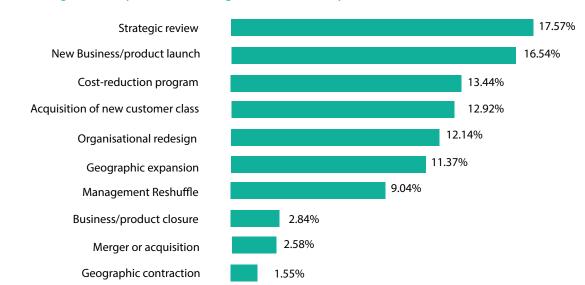


Figure 22. Strategic moves by the senior management in the last 2 years

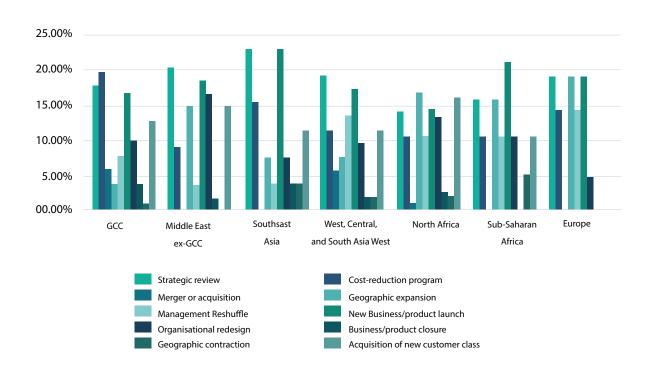


Figure 23. Strategic moves by the senior management in the last 2 years - Regional Breakdown

Long-Term Objectives and Short-Term Issues are Key Dimensions for Strategic Thinking

Strategies focusing on external and internal process changes were generally ranked as a greater driver of strategic thinking. Acting as a catalyst for organizational change ranked dead last among leadership dimensions. This was true for each region as well, with the exception of Sub-Saharan Africa, where it was ranked in the middle.



Figure 24. Ranking of Leadership Dimensions for Strategic thinking (1: most important and 7: least important)

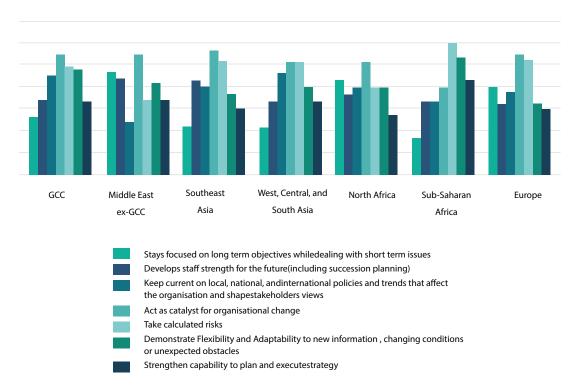


Figure 25. Leadership Dimensions for Strategic thinking - Regional Breakdown

While short-term objectives were still on the banks' radar, leadership dimensions for banks' strategic thinking was largely focused on long-term objectives. However, this was not uniform across all regions. Several regions, especially North Africa, ranked the desire to strengthen the bank's capacity to plan and execute the strategy as a prime driver.

The CEO and Top Management Drive Strategic Implementation

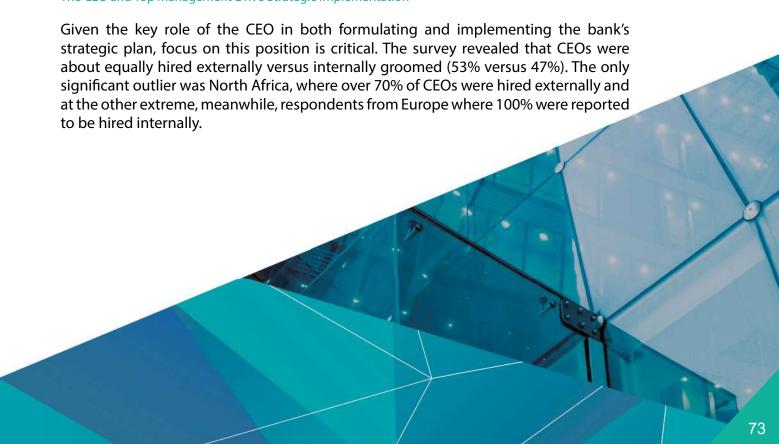


Figure 26. CEO Hired

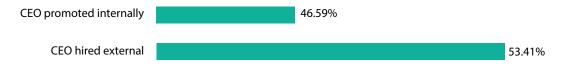
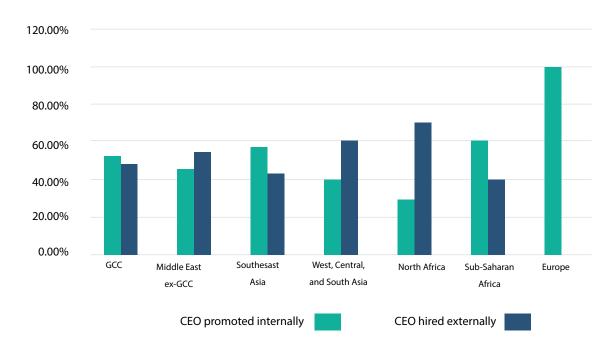


Figure 27. CEO Hired - Regional Breakdown



The great majority of CEOs are between forty and sixty, over 70%, but interestingly, the Middle East ex-GCC skewed older, with over 40% of CEOs passing 60. At the other extreme, Southeast Asia was more comfortable with younger leadership: Most CEOs were under 50, with 14% in their 30s, and none were over 60.



Below 30 years 0.00%
30 to 40 years 2.17%

Figure 28. Age Group of the Chief Executive Officer

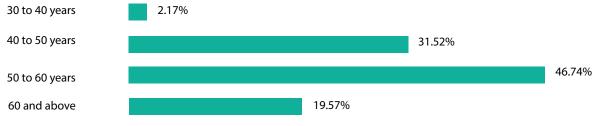
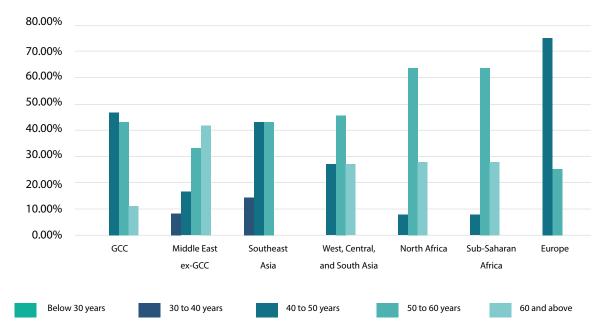


Figure 29. Age Group of the Chief Executive Officer - Regional Breakdown



When asked on the approximate percentage of different categories that make up the senior management cadre, 80 % of respondents reported less than 10% of foreigners within their institutions. This was true among most regions, with the exception of GCC where about 44% of respondents reported that foreigners represent more than 20% within the management, which is perhaps not very surprising, given the GCC reliance on foreign labour. Similarly, half of the respondents (51%) indicated that women represent less than 10% of the senior management composition, while the other half indicating more than 20% of women. On the other hand, 44% of respondents reported more than 20% of young professionals (below 35 years) within the senior management

When looking at the regional breakdown of responses, West, Central and South Asia reported the highest percentage of women within the high-level management, where 30% of respondents reported more than 40% of women. Also interestingly, the highest proportion of respondents between the regions indicating more than 40% of young professionals within the senior management cadre was found in the Middle East ex-GCC (36%). (For a regional breakdown of responses, please refer to appendix 2)



Figure 30. Senior management cadre Composition

Innovation and Financial Engineering

Innovation is considered a key factor for the future growth of the Islamic financial industry. This section measures innovation capabilities of institutions regarding their products, services, business models, and business processes.

Innovation Supports Strategic Change

Respondents were overall optimistic about the capacity of the Islamic banking industry to innovate financial solutions in the medium term (three years). More than half (52%) said this likelihood of innovation was somewhat high, while another fifth (21%) considered it as very high. The most pessimistic region was Sub-Saharan Africa, where more than half felt that such innovation was unlikely.

Figure 31. Potential to innovate newer financial solutions by the Islamic banking industry in the next three years

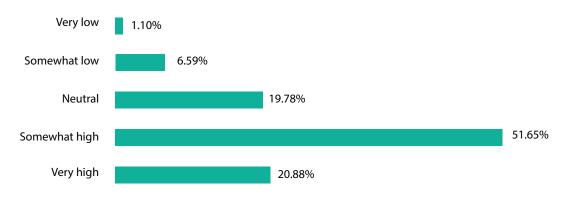
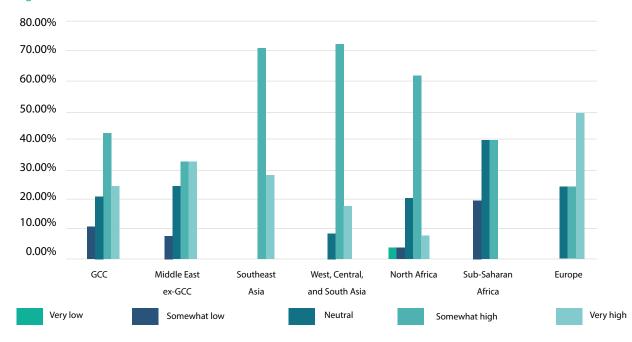


Figure 32. Potential to innovate newer financial solutions by the Islamic banking industry in the next three years - Regional Breakdown



Shariah-Compliant Product Innovation is Most Needed in the Next Three Years

As for the types of innovations expected, products were seen as most likely to see new forms, with payment and customer interface solutions close behind. Many respondents cited the need for further innovation of Shariah-compliant products to keep up with the changing global financial environment. A Malaysian respondent mentioned the need for "highly qualified Islamic bankers to create more innovative products to meet customers' requirements that comply with Shariah principles."

Several respondents noted this need for greater innovation in products that on one hand maintain Shariah compliance while keeping abreast of developments in the broader financial markets. A Mauritanian respondent cited the need for, "a greater effort in the field of innovation to provide financial services and products distinct from the prevailing products in the recent practices of Islamic banks, which focus mostly on Murabahah operations."

Product innovation was seen as not just including twists on the existing product lines, but greater entry into whole product classes, away from traditional financing. One banker from Turkey noted, "about 80% of [the Islamic market] is interest-free banking; then Sukuk comes later in a volume over 300 billion dollars. However, interest-free financing is not just about these products. In terms of interest-free finance, other fields such as capital market products, Islamic funds, and microfinance are other important areas of Islamic finance."

A few banks pointed out the challenges to product innovation in a Shariah-compliant context, and how that can lead to competitive disadvantages. A Malaysian bank pointed out that the conventional banks were putting pressure on Islamic banks by launching sophisticated and innovative products that are hard to match within the context of Shariah. The respondent observed, for example, that conventional banks can issue deposit products to manage the net interest margin while adhering to the liquidity requirement, but that Islamic banks "are curbed under the IFSA [Islamic Financial Services Act] to have limited deposits and instead to pursue Investment Accounts which do not offer similar benefits to normal deposits."

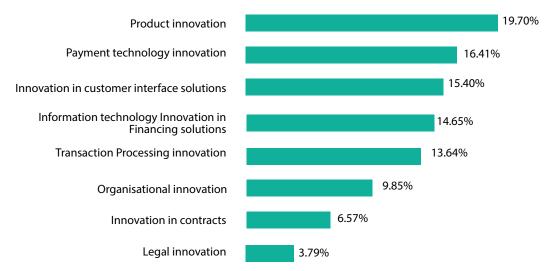
A Malaysian bank pointed out that the conventional banks were putting pressure on Islamic banks by launching sophisticated and innovative products that are hard to match within the context of Shariah

A bank in Tunisia shared a similar observation in the difficulty of adapting to the specificities of Islamic products and "the absence of some operations in the Islamic banking sector, such as account statements and projection processes."

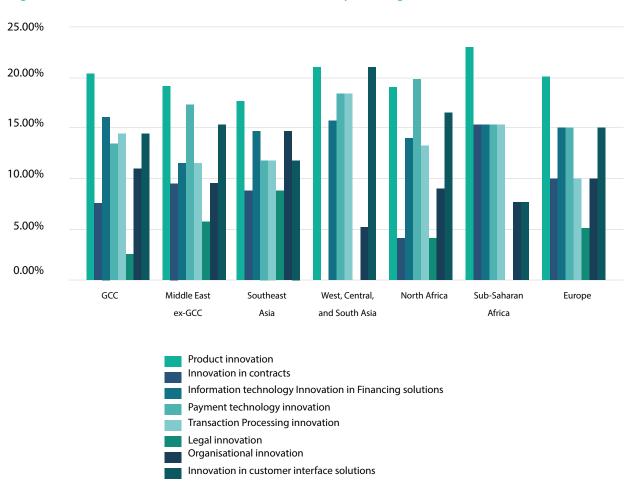
Innovation was also seen as a tool in other areas beyond products, but somewhat less critically. The stodgy world of legal and contractual relations was seen as least subject to innovation, with fewer than 10% seeing any headway. Similarly, the organizational structure was seen as resistant to change. This ranking held fairly fast among regions.

Some banks expressed the desire to formalize innovation as an explicit process. One bank in Bahrain declared that it was in the process of "establishment of an innovation management system."

Figure 33. Areas of Innovation to invest in over the next three years



Figur34. Areas of Innovation to invest in over the next three years - Regional Breakdown



The Cost and Benefit of Innovation

As to budgeting for innovations, more than a quarter (29%) did not know what percentage of the total bank budget was dedicated to innovations. This is not wholly surprising since breaking out innovations as an independent item is still a relatively new approach in financial institutions. Of those who knew, estimates varied widely, from more than 8% (25% of respondents, which is surprising) to less than 1%, estimated by about 10% of respondents.

Figure 35. Institution's Budget Allocation towards Innovation Activities

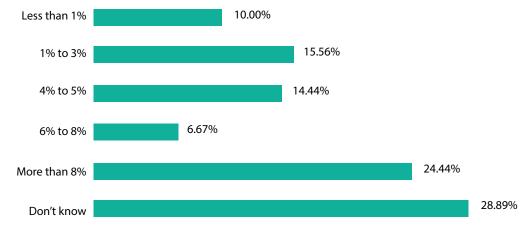
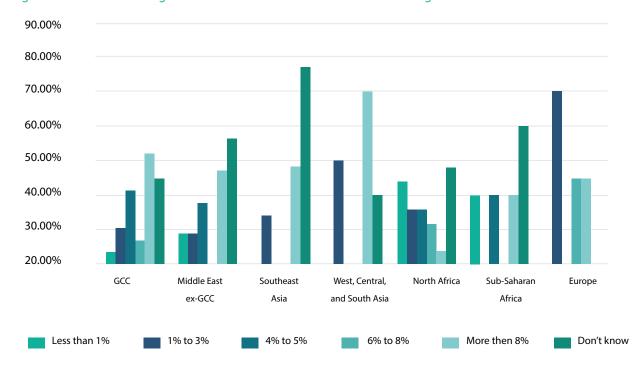


Figure 36. Institution's Budget Allocation towards Innovation Activities - Regional Breakdown



About a third of respondents said that innovation was budgeted via the technological area, the most common response, with strategy ranked second at about 30%. This varied slightly by region, with Southeast Asia and Sub-Saharan respondents more likely to budget innovation within the strategy area. A bit below 10% said that innovation was not explicitly budgeted at all. The region where this non-budgeting was most common was in North Africa, where almost 18% answered thusly.



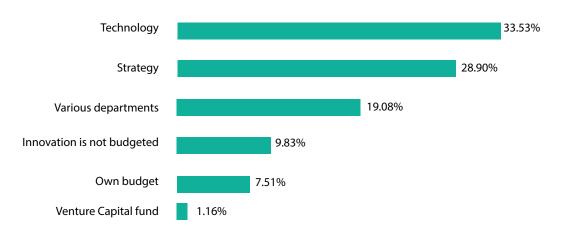
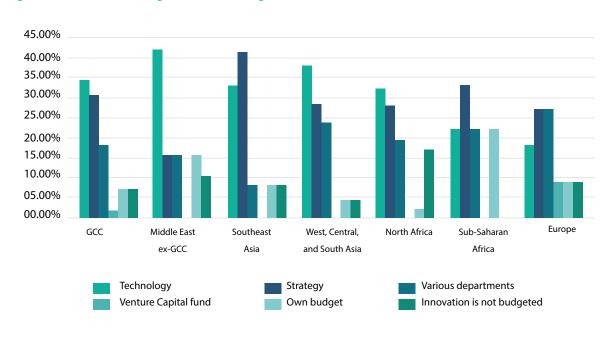


Figure 38. Innovation's Budget Allocation - Regional Breakdown



Generally speaking, respondents did not believe that revenues derived from innovated products played a significant role in overall income, with most (48%) saying that less than 10% came from products developed within the past three years, and over 10% of respondents saying none at all. The Middle East ex-GCC and Southeast Asia seemed to benefit the most from newly developed products, with most respondents in Southeast Asia, particularly (over 80%) ascribing more than 10% of revenue to new products.

The Middle East ex-GCC and Southeast Asia seemed to benefit the most from newly developed products

Figure 39. Percentage of the company's revenue from innovated products introduced in the last three years

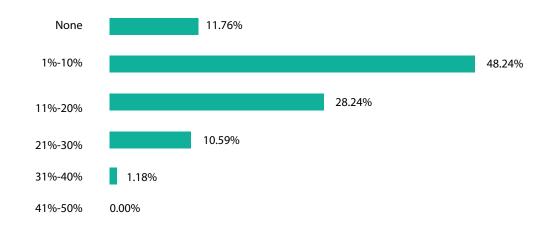
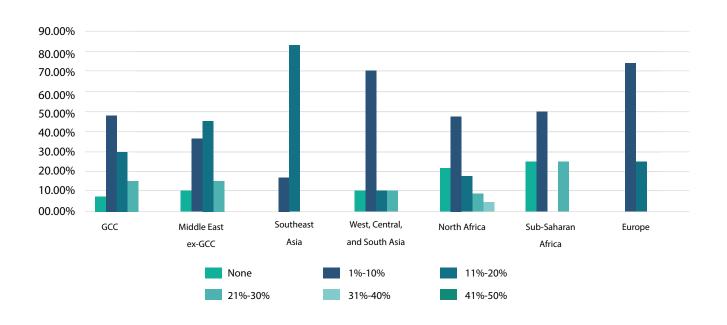


Figure 40. Percentage of the company's revenue from innovated products introduced in the last three years - Regional Breakdown



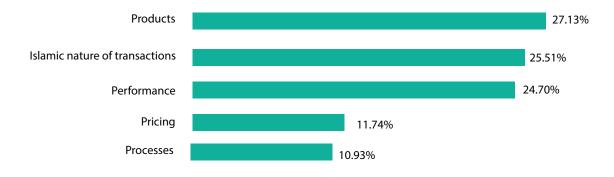
With an increasing acceptance of Islamic financial propositions in recent years, branding of Islamic financial institutions is expected to be an important consideration among stakeholders in the industry. This section evaluates Islamic financial institutions' strategies and approaches towards branding itself, as well as towards its products and services in its endeavour to attract new customers and increase awareness among its existing ones.

Islamic Banks Have Diverse Branding Strategies

Respondents tended to believe that branding for Islamic banks should be based primarily on three key components: Products, the Islamic nature of their business, and performance. Other characteristics such as pricing were considered less critical and this tendency is held for all regions.

Branding for Islamic banks should be based primarily on three key components: Products, the Islamic nature of their business, and performance.

Figure 41. Metrics on which Islamic financial institutions should base their branding strategy



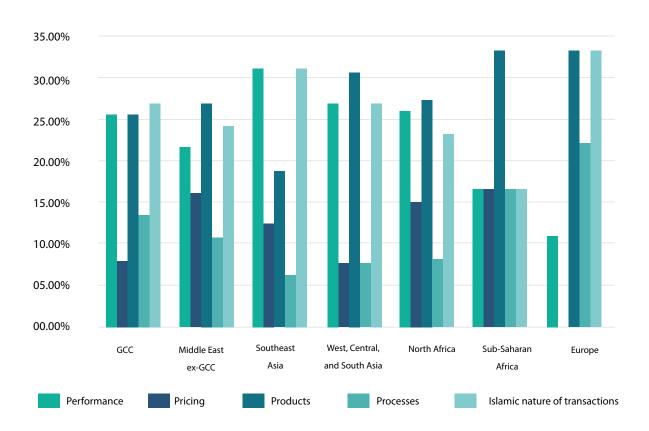


Figure 42. Metrics on which Islamic financial institutions should base their branding strategy - Regional Breakdown

Most institutions (about two-thirds) responded that they did not find promoting their brand as an Islamic bank particularly challenging, stating it is either not challenging at all, slightly challenging, or neutral. However, when broken down by region, differences arose. The majority of banks in Southeast Asia; West, Central, and South Asia; and Europe found branding to be challenging or extremely challenging. For many of these banks, they may not be located in Muslim-majority nations, therefore likely facing an adverse branding environment. These challenges may also be ascribed to political or cultural hurdles. Moreover, Islamic banking has a much longer history in regions where challenges were perceived as low, such as the GCC. In these regions, explicit branding as an Islamic bank is not viewed as an issue in itself.

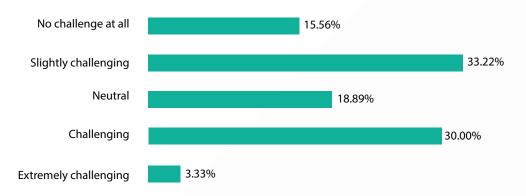


Figure 43. The extent to which institutions faces challenges in promoting the Islamic bank brand

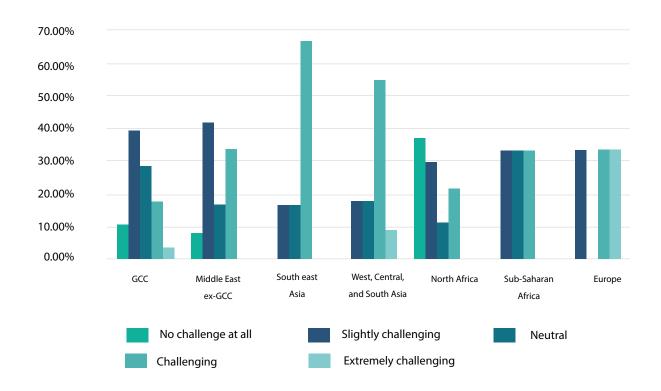


Figure 44. The extent to which institutions faces challenges in promoting the Islamic bank brand - Regional Breakdown

Given the unique niche of Islamic institutions, branding as Shariah-compliant was viewed as a key component of any Islamic bank's branding strategy. A Qatari respondent emphasized this link between the bank's impeccable Shariah compliance reputation and its branding: "Branding strategy for Islamic institutions is about providing products and services by strictly following the inherent principles that are embedded in Islamic banking. This include among others, the requirement of ethical conduct in doing business, the risk sharing principle and the availability of credit primarily for the purchase of real goods and services."

A Saudi bank was straightforward in its views towards the Shariah-compliant aspect of its business model in branding, saying that "Islamic values play a vital role in developing branding strategies."

A few banks noted how being Shariah compliant can definitely change the branding approach, thereby further cementing Shariah compliance in the client mind-set. A Pakistani bank observed that "The branding guidelines provided by the Shariah Board include certain Islamic principles such as exclusion of human faces in advertisements etc. challenges the branding/marketing team. However, due to these conditions, the ads/branding campaigns have improved the 'authenticity' level in customer's mind-set for the brand."

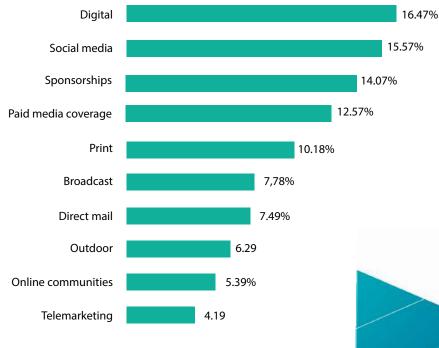
A Greater Attention to Digital and Social Media in Promoting Branding

Respondents shared a broad range of channels that their banks used to reach the public. Unsurprisingly, given global trends, digital and social media led the pack, with over 15% citing they implement both. More traditional channels such as sponsorships, paid ads and print still remained important, with more than 10% citing them as integral methods. Regional differences in channel utilization tended to reflect the stage of digital evolution of the banks' individual society. For example, respondents from Sub-Saharan Africa give more importance to print and broadcast channels than digital, while GCC banks, with their extremely high internet penetration, strongly favoured social media and digital means to reach the public.

Some banks saw the push towards digital solutions as a core aspect of their image and branding. A Kuwait bank declared that one of their leading objectives was "positioning our brand as a world-class pioneer of the Islamic digital economy."

Respondents from Sub-Saharan Africa give more importance to print and broadcast channels, while GCC banks strongly favoured social media and digital means to reach the public

Figure 45. The most effective brand building mediums to deliver messages to target audiences



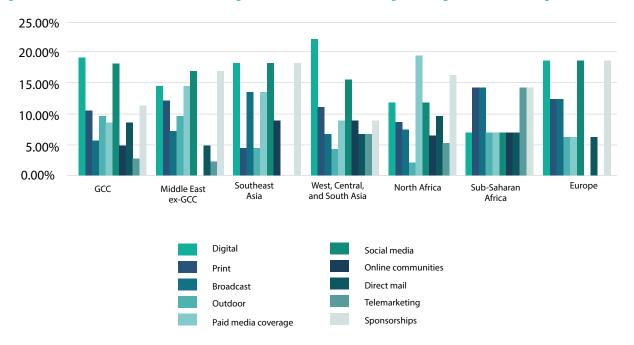


Figure 46. The most effective brand building mediums to deliver messages to target audiences - Regional Breakdown

Branding Strategies Vary Based on Religious Backgrounds in Different Jurisdictions

When asked whether the bank considered different cultural or religious backgrounds important while devising marketing and branding strategies, respondents overwhelmingly said yes. Some areas, such as Southeast Asia and Sub-Saharan Africa, said that this was highly important, perhaps reflecting the high cultural and religious diversity in their regions.

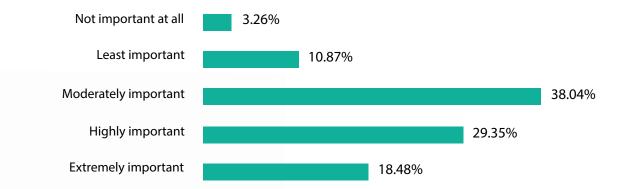


Figure 47. The Consideration of Different Backgrounds in Devising Marketing and Branding Strategies

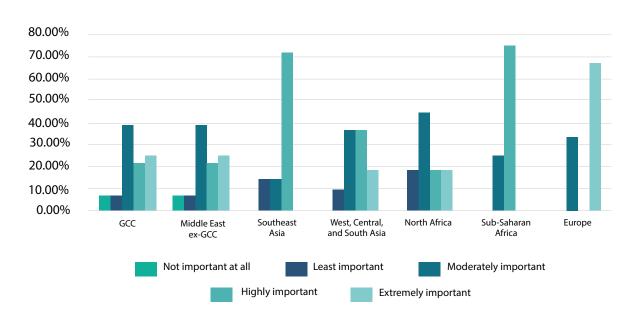
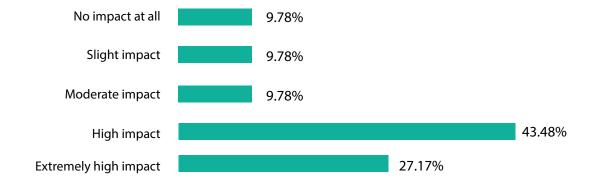


Figure 48. The Consideration of Different Backgrounds in Devising Marketing and Branding Strategies - Regional Breakdown

All respondents also stated that the marketing of Shariah-compliant products and services impact the institution's brand strategy. This was even more pronounced in areas which were newer in Islamic finance and outside Muslim-majority regions, such as in West, Central, and South Asia, Sub-Saharan Africa, and Europe. The two areas citing the least impact, where only about half the respondents said that the impact was high or extremely high, were the Middle East ex-GCC and North Africa.

All respondents stated that the marketing of Shariah-compliant products and services impact the institution's brand strategy.

Figure 49. Impact of Marketing of Shariah compliant Products and Services on the institution's brand strategy



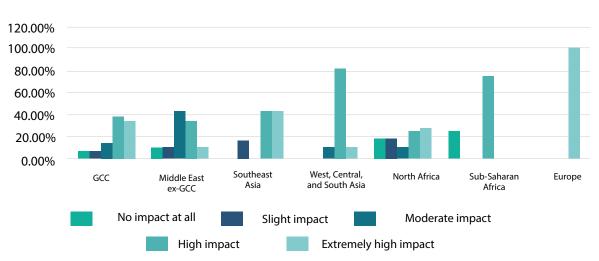


Figure 50. Impact of Marketing of Shariah compliant Products and Services on the institution's brand strategy - Regional Breakdown

Competition and Lack of Expenditure are Top Challenges in Developing Brands

The surveyed banks saw several key challenges in developing their brands. Chief among them was competition with other banks, which inevitably uses all the branding efforts and causes the never-ending trial of the insufficient budget. The prevalence of this issue was observed broadly across all regions. Measuring the effectiveness of branding efforts, a perennial challenge for all marketing departments was also viewed as a key challenge. Some regions regarded certain challenges as more critical for their regions, for example, respondents from the non-GCC countries viewed articulating the relevance of Sharia-compliant branding as very important, given the newer markets in those regions compared with, for example the GCC. Similarly, the non-GCC group saw achieving board of directors buy-in a serious challenge, possibly reflecting greater caution in those regions.

Some respondents noted specific methodologies to ensure better success in implementing branding strategies throughout the organization. One Malaysian bank has identified value-based intermediation (VBI) techniques whose "roles and ownership can benefit from a reiteration engagement to also include co-workers of middle management and below." Such an approach raises understanding of the subject and encourages a "smoother trail of branding in projecting the Bank's image."

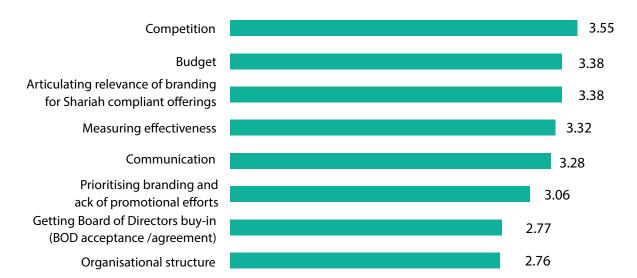
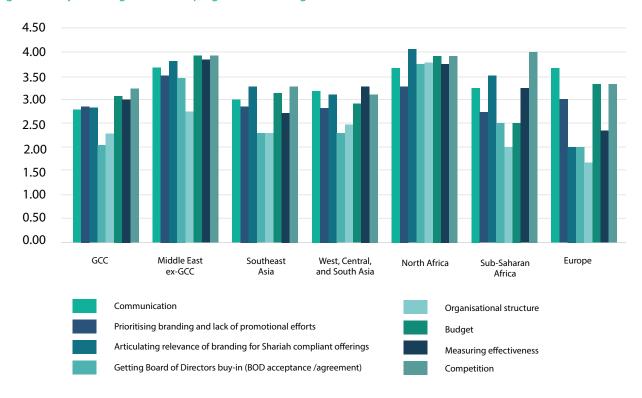


Figure 51. Key Challenges in Developing the Brand





Bank Staff and Employees Play a Vital Role in Branding

Respondents cited a broad range of brand dimensions of relatively similar importance, but one stood out in particular. Building brand loyalty, including supporting the brand name and a reputation for service quality, was considered the most critical with an overall average higher than 4.2 ("very important"). The second most cited dimension was the bank's staff themselves. Employees are the first and foremost brand ambassadors, and respondents universally recognized their significance.



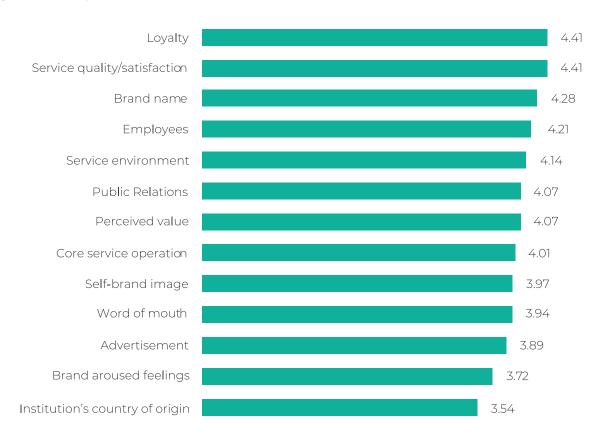
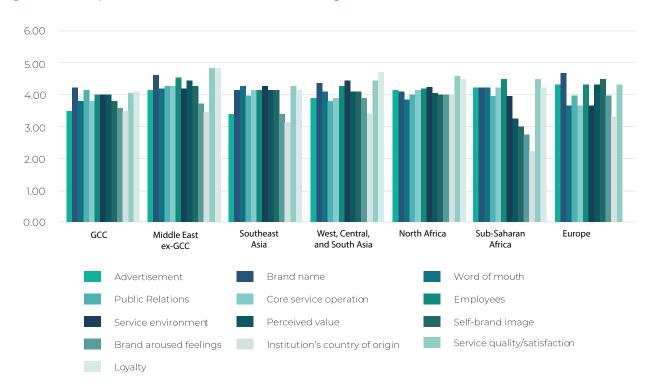


Figure 54. The Importance of Service Brand Dimensions - Regional Breakdown



Banks often cited their own competitive niches as helping to establish branding. A Kuwait bank noted that they had "a competitive brand advantage in providing strong security for its customer deposits" and that leveraging this advantage was a key leadership component. Similarly, another Kuwaiti bank observed how its development of a competitive advantage and new business model helped further establish a brand since the bank was "a pioneer in seeking vertical integration opportunities through our investment banking activities which has not only led to a steady stream of newly-created customers for the market (through real estate development projects for example), but a great deal of brand recognition that will outlast these initiatives themselves."

The Bank's Reputation is its Most Important Asset

Respondents were asked about a series of components that build a corporate reputation. Virtually all were considered important. The respondent banks appear to be aware of the building blocks that maintain their reputation and are keen to preserve them.

At the top of the list was the bank's reputation as Shariah compliant and its overall ethical standing. Unsurprisingly, as the raisons d'être for most clients of an Islamic bank, these two aspects of reputation must be unimpeachable. As one Bahraini banker puts it, "Branding strategies for an Islamic financial institution are, in essence, almost identical to those of any

ethical and morally responsible institution in the finance industry. Islamic financial institutions, for example, must build their brand strategies on honesty, transparency and integrity – as would any ethical and responsible institution in any industry."

As an Omani banker stated succinctly, "Islamic Banking and ethics go hand in hand when it comes to the overall branding strategies. Any brand that offers Shariah-Compliant products must, therefore, have full commitment to have high ethical standards."

This emphasis on ethical standards that are naturally associated with an Islamic bank can be incorporated into the branding strategy in a broader sense, for instance, in affirming the bank's transparency. One bank from Turkey uses this approach: We ground our branding strategy on our motto "The Right Way." Transparency is one of our most important main pillars in shaping our branding strategy. It is given that terms, rates and stipulations in contracts made with [the bank] remain as agreed and costs of services and products are stated clearly."

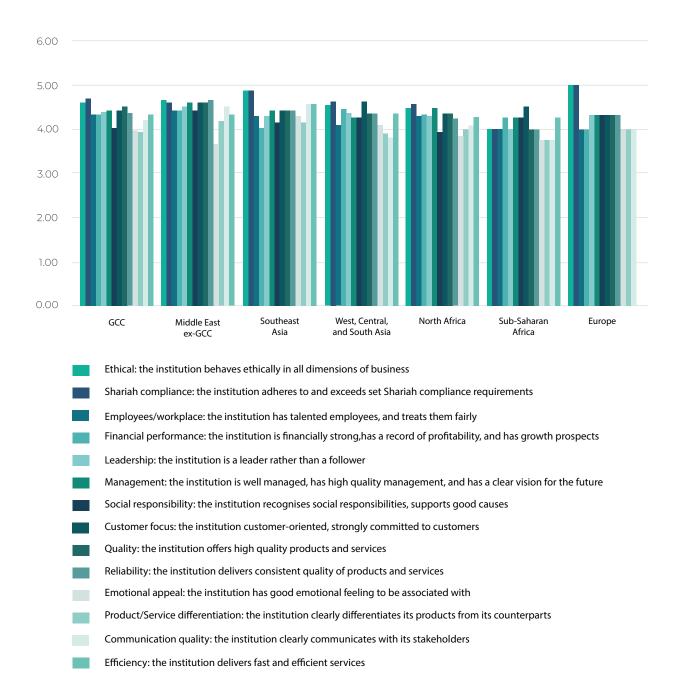
The bank's customer focus, the quality of its management, and the quality of its products and services all also emerged as critical components of a solid reputation, all being rated as very to extremely important (4.3). The components that ranked as least important include the bank's emotional appeal and its product/service differentiation, which were still ranked just below 4.0 (though still considered "very important.")







Figure 56. The Importance of Corporate Reputation in Reputation Measurement - Regional Breakdown



Strong customer relationships considered one of the key components for the overall and long-term success of the institution. Providing superior services and fair treatment to customers will not only enhance profitability, but also build trust and boost customers' engagement. This section attempts to look into institutions' strategies towards building and maintaining strong customer relationships, as well as their initiatives for consumer protection.

Customer Relationships and Evolving Servicing Strategies

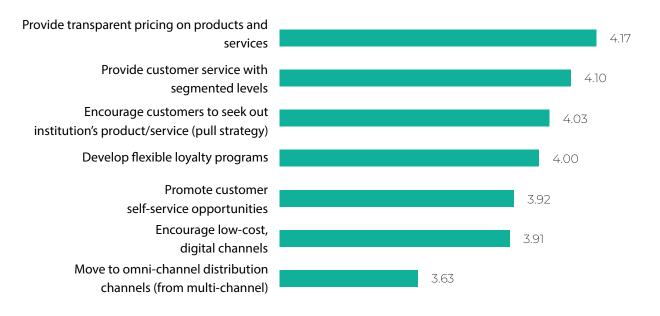
Banks Use a Variety of Customer Service Strategies

Respondents stated that they have invested in a broad array of customer service and retention strategies. Most agreed that the varieties of strategies suggested were important, but overall prioritization varied considerably by region.

When questioned on a range of customer-focused strategies, respondents ranked most of the choices offered as important, but the rankings varied considerably based on regions. The most popular strategy was price transparency, ranked first in the Middle East ex-GCC, North Africa, and Sub-Saharan Africa. The GCC respondents tended to prioritize a pull strategy, encouraging customers to seek out their banks' products. In Southeast Asia, respondents leaned towards flexible loyalty programs. Meanwhile, banks in Europe region sought to encourage low-cost digital channels to reach customers.

The GCC respondents tended to prioritize a pull strategy, encouraging customers to seek out their banks' products.

Figure 57. Adoption of Strategies to Enhance Customer Relationships and Servicing Strategies



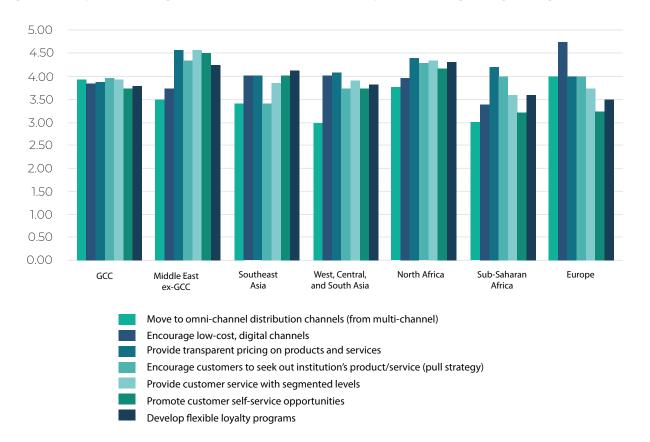


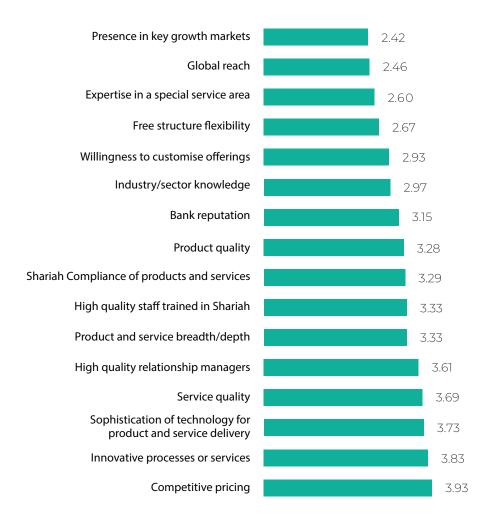
Figure 58. Adoption of Strategies to Enhance Customer Relationships and Servicing Strategies - Regional Breakdown

When asked to select five key factors to develop strong customer and service relationships, respondents overall ranked presence in key growth markets and global reach as the top two factors. However, choices varied by region. The GCC placed the bank's reputation and its service and product quality immediately after presence in key growth markets. However, for Southeast Asia and Sub-Saharan Africa industry, knowledge, innovation, and the flexibility of the fee structure were at the top of the list. The fee structure was also highest ranked in the Middle

East ex-GCC and in Europe, but customization was also a high priority in both.

A South African bank observed that to maintain good customer service, it was necessary to invest in: "Staff training to ensure transparency with customers and good customer service and awareness of various platforms consumers can use to complain and managing complains through executive interventions" as well as reaching out to measure impact through surveys and follow-ups.

Figure 59. Ranking of the Top 5 factors in the Development of Quality Customer and Service Relationships (1: most important and 5: least important)



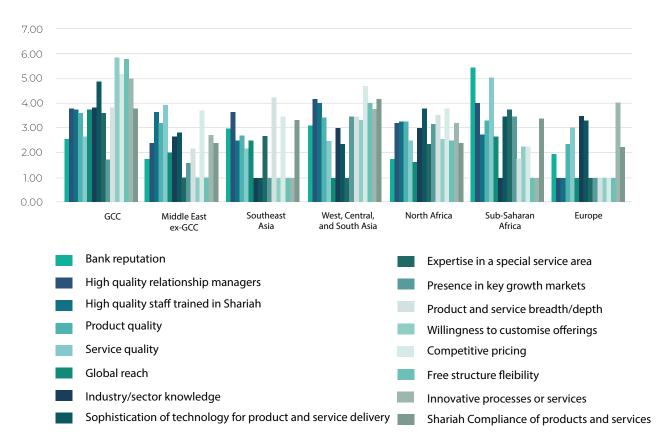


Figure 60. Ranking of the Top 5 factors in the Development of Quality Customer and Service Relationships (1: most important and 5: least important) - Regional Breakdown

User Friendly Mobile Applications are a Key Factor for Satisfaction and Loyalty

A final question on building customer loyalty focused on those activities employed to build customer satisfaction and loyalty. For this question, consistency was considered much more important among regions, with customer convenience investments at the forefront: tools such as user-friendly payment methods and mobile and online banking.

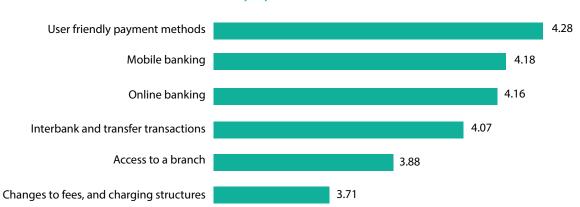


Figure 61. Activities to Increase Customer Satisfaction/Loyalty

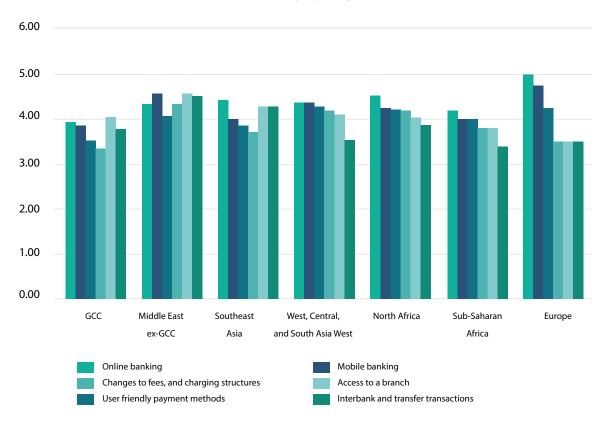


Figure 62. Activities to Increase Customer Satisfaction/Loyalty - Regional Breakdown



The rise of Fintech is expected to make radical shifts in the way financial transactions are carried out. Thus, Fintech might be seen as both a challenge and an opportunity to the financial services industry at the same time. This part explores and measures the Islamic banks' level of readiness to adopt financial technology and digital transformation and examines to what extent Islamic banks plan to embrace the technology.

It is worth emphasising that the CIBAFI survey can only provide a snapshot of the current time, given the speed at which the Fintech sector is moving. There are always new areas that will require further study in the future.

One of the big questions facing Islamic banks today in terms of survival is: "What is the predictive power of your best estimate?" Some Islamic banks are using technology to answer it, and many forward-thinking banks, both conventional and Islamic, are turning to big data and analytics to survive and to grow their businesses today.

The future success of Islamic banking lies in working the technology to their advantage. Future CIBAFI surveys will aim to solicit the views of Islamic banks in adopting technologies like ambient intelligence, predictive analysis, deep learning, machine learning, AI, the

Part IV. Fintech and Digital Transformation

internet of things, natural language processing, text mining, robotic process automation, and other products and processes that are still in development.

On a similar theme, future CIBAFI surveys will aim to explore the issue of the lack of legislation and standardisation covering the industry as one of the difficulties faced by Islamic banks in adopting new technologies. The regulators will be equally busy staying on top of this very fast developing sector.

The Rapidly Changing Financial Technology Landscape Represents a Challenge

The survey's respondents overwhelmingly view the rise of Fintech and digital transformation as key strategic challenges, with over 70% seeing these as highly or extremely important in formulating strategic decisions. As one South African bank views it, "Fintech is going to change the landscape and the operating model of banking. It will provide new ways of accessing and assessing our customers."

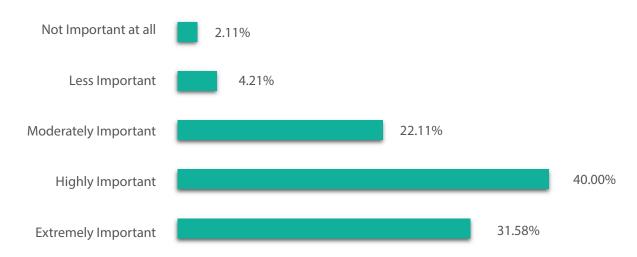


Figure 63. Importance of Fintech and Digital Transformation in Strategic Planning Decisions

When respondents spoke of innovation and investment in new ideas, technological change was often foremost on their minds. A Pakistani respondent explained that "Islamic financial institutions already have an innovative mind to deliver innovative product structures and services. Wrapping it with new-age technologies (digital and Fintech) would be a strategic fit for Islamic financial institutions, especially the newer institutions, which would not have legacy issues." A respondent from Algeria said that "Quality improvement can be achieved only by innovation and adoption of digital solutions required and keeping abreast of new developments."

Respondents also saw investing in new technologies as a necessary strategy as global customers grow accustomed to new advances. An Algerian bank noted that "The rapid spread and successes of Islamic banks on the ground have made them vulnerable to strong competition from riba-based banks at all levels, whether it is related to improving services, studying customer behaviour or taking advantage of modern technological

innovations and using them to increase, facilitate and improve service efficiency."

This theme of the inevitability of new technology adoption was repeated throughout the survey. A Kuwaiti respondent explained that "It was absolutely critical that we quickly get on board with technology so that there is a viable Shariah-compliant alternative to the solutions being rolled out by the conventional banks." A Jordanian bank said that "Fintech and digitalisation would be the next area of focus in the Islamic financial industry since they will have an impact on reducing operational costs and improving the level of banking services offered to customers."

Several respondents saw this as an opportunity for the industry. A Turkish bank remarked that "Islamic banking can focus on technological trends such as Islamic crowdfunding, Fintech collaboration, entrepreneurship and incubation centres. Creating new platforms and partnerships outside of the industry – especially with tech companies – can promote the power of Islamic banking."

Islamic Banks Face Obstacles in the Adoption of Technology

In terms of the obstacles preventing the banks from adopting new technologies, respondents generally agreed that cyber security was a key threat, ranking as very important (3.24). A leading Malaysian bank noted that "A number of cyber financial crimes that took place last year heightened the need for greater security in the global financial industry. We work closely with regulators to ensure that our system is secure and that our employees are well informed.

Data loss prevention measures were implemented to protect confidential customer data. Most fraudulent cases occur because confidential information is unwittingly divulged. Awareness among users is the key to the prevention of cybercrime. Initiatives such as personal risk management campaigns were launched to increase awareness among our customers. From a technical perspective, group technology constantly conducts rigorous tests to ensure that vulnerabilities in the bank's systems are quickly identified and resolved immediately."

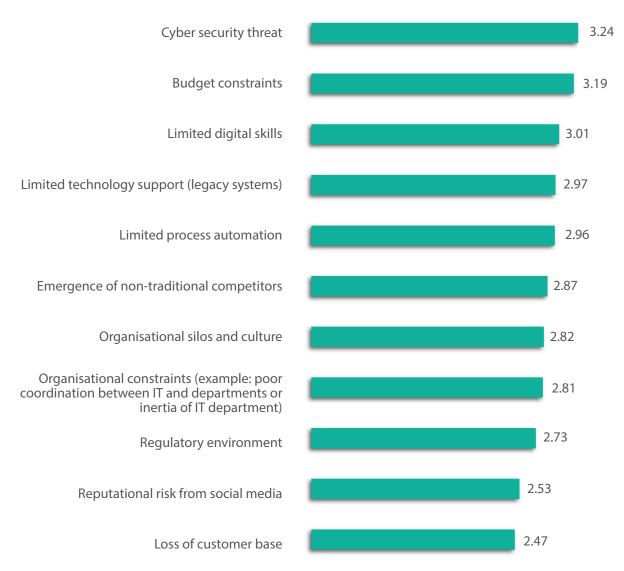
Rapid changes in technology typically create fear among late adopters for thinking that they will not be able to keep up with the security measures needed to maintain their integrity and safety, especially in the highly sensitive world of finance.

The other barriers ranked highly were internal hurdles that typically impede technological innovation: budget constraints, limited internal skills, and legacy systems. Regional responses were slightly different and Southeast Asia overall ranked the obstacles higher, including such risks as social media and the emergence of non-traditional competitors. This could reflect the more dynamic state of the financial sector in Southeast Asia due to its high investment in technology.

Europe ranked regulatory environment as one of the top obstacles. Some other banks from the Middle East ex-GCC indicated different obstacles in adopting new technology. A Syrian bank explained that "To highlight the difficulties faced by some countries and institutions as a result of the embargo and imposed sanctions, the country or the institution itself faces difficulties in the import and export of technology in general and financial technology in particular, from the point of application and pay the price of this technology to the exporting countries."

In terms of the obstacles preventing the banks from adopting new technologies, respondents generally agreed that cyber security was a key threat.

Figure 64. Factors preventing the adoption of technology



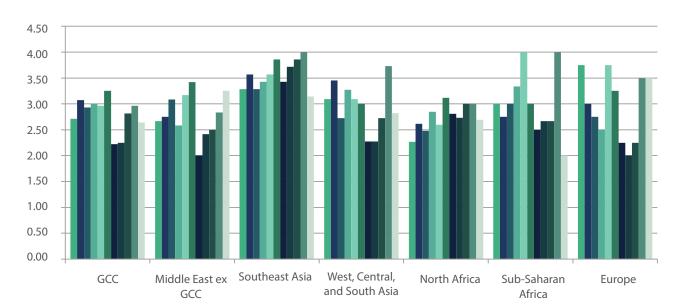


Figure 65. Factors preventing the adoption of technology - Regional Breakdown

- Regulatory environment
- Limited technology support (legacy systems)
- Organisational silos and culture
- Limited process automation
- Limited digital skills
- Cyber security threat
- Loss of customer base
- Reputational risk from social media
- Emergence of non-traditional competitors
- Budget constraints
- Organisational constraints (example: poor coordination between IT and departments or inertia of IT department

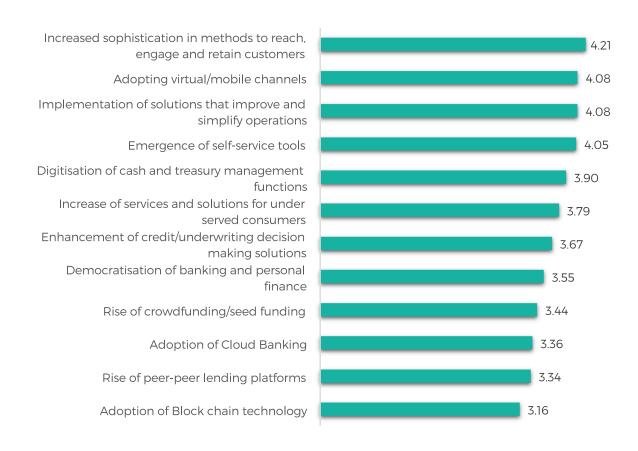
Customer Engagement and Interfacing is the Predicted Technology Trend in the Next Five Years

As for the adoption of new technologies, when asked to what degree technology trends would be important for the Islamic banking sector over the next five years, most respondents ranked all the suggested trends as important, but with special criticality assigned to technologies that interface with customers, including methods to reach, engage and retain customers as well as the adoption of new channels. Solutions to raise efficiency, such as in cash management, were also high on the list.

Technological innovations that ranked the lowest were those that concerned emerging technologies such as blockchain, peer-to-peer lending, and cloud banking. Europe was the exception, where they ranked as very important, perhaps reflecting the greater penetration of those technologies in the region. The results likewise showed that the relationship between technological investment and the priority given to the implementation of that technology followed the same patterns established above.

Special criticality was assigned to technologies that interface with customers, including methods to reach, engage and retain customers as well as the adoption of new channels.

Figure 66. Technology trends' importance for the Islamic banking sector over the next 5 years



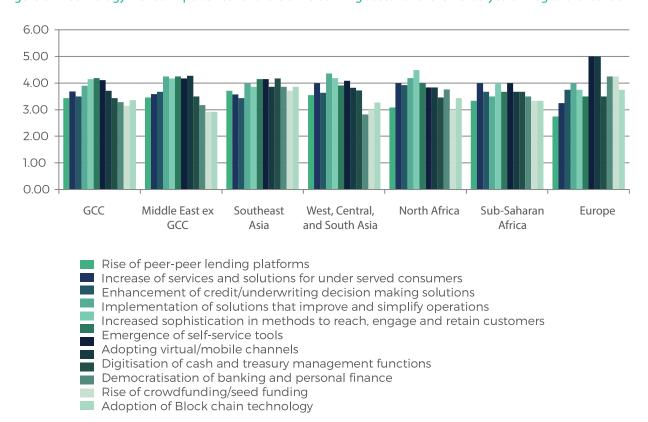


Figure 67. Technology Trends importance for the Islamic banking sector over the next 5 years - Regional Breakdown

Islamic Banks are Confident in Their Existing IT Systems

Generally speaking, respondents were satisfied that their existing IT systems could meet the demands of both customers and regulators. Very few defined themselves as extremely confident, perhaps not wanting to tempt fate, but over three-quarters (76%) expressed moderate or high confidence in their systems' capacity to serve the needed demands.

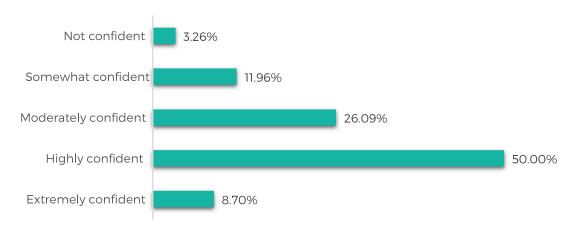
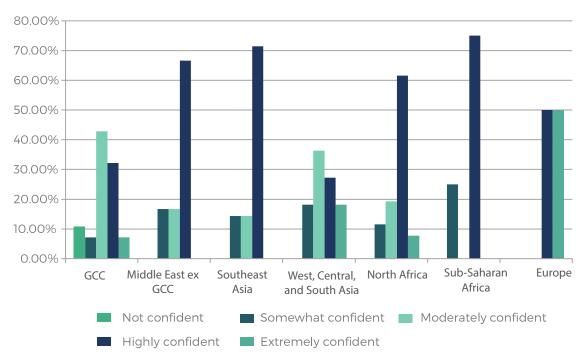


Figure 68. Confidence with the current IT systems in meeting the demands of customers and regulatory requirements

Figure 69. Confidence with the current IT systems in meeting the demands of customers and regulatory requirements - Regional Breakdown



Most Islamic Banks are Familiar with Automated Financial Advice

Respondents expressed a range of familiarity with some of the emergent technologies offered. When asked about their awareness of automated financial advice tools such a robo financial planners, over a quarter declared both familiarity and current or imminent usage (28%). At the other extreme, almost 16% had no knowledge of such tools.

Some respondents felt that the disruption caused by the new technologies could have a serious impact on the global financial sector in ways that we have not fully foreseen, and that the Islamic financial industry would not be immune. A Malaysian bank believed that imminent digital disturbances would encompass technologies such as seamless digital payments, blockchain, crypto-currencies, robo advisory, crowdfunding, and P2P lending. In view of this coming onslaught, "Islamic finance institutions are compelled to embrace digital banking in response to the digital disruptions."

"Islamic finance institutions are compelled to embrace digital banking in response to the digital disruptions."

There was not much regional variation when it came to knowledge of the emerging technologies, with the exception of the Middle East ex-GCC region, where familiarity was generally the lowest: a third of respondents expressed no familiarity at all with such concepts.



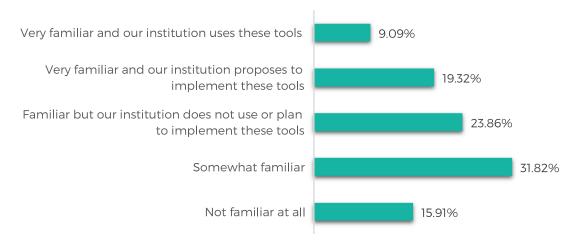
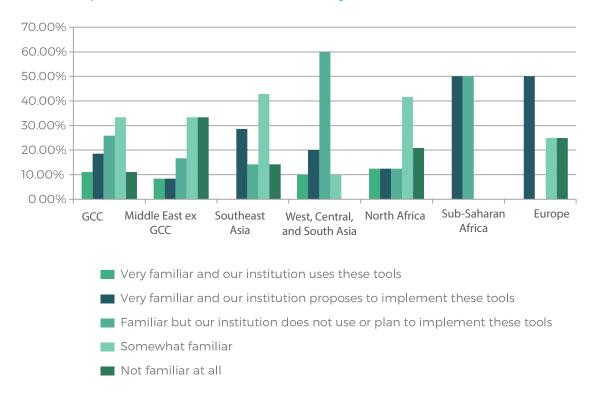


Figure 71. Familiarity with Automated Financial Advice Tools - Regional Breakdown



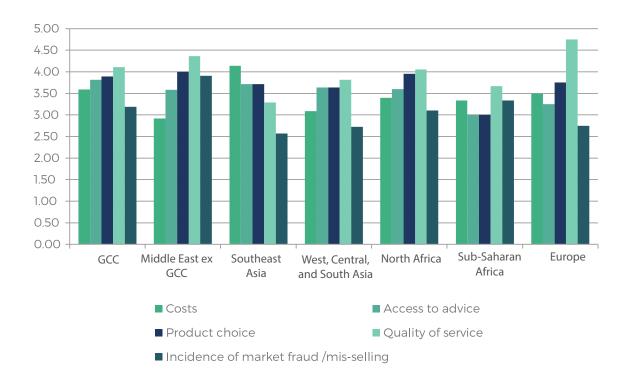
When asked about the impact of such technological innovations on their bank's business, most respondents cited customer-centred impacts such as service quality and product choice. A Sudanese bank expressed that "There is a great interest in the development of financial technology tools and digital remittances in order to keep abreast of rapid economic growth and find solutions to meet the requirements of customers for distinct and innovative products."

The least impact was thought to be market fraud. Several banks noted that technological innovations were critical to compete. One Bahraini-based bank, citing competitive pressure, noted that the bank was "on the way to fully automate all of our work processes."

Figure 72. Effects of the Availability of Automated Financial Advice Tools on Islamic Banks



Figure 73. Effects of the Availability of Automated Financial Advice Tools on Islamic Banks - Regional Breakdown



Fintech Solutions Have More Impact on Payments, Remittances, Compliance and Lending

As far as their own interaction with emerging financial technologies, the majority of respondents said that they dealt mainly with payments and remittances, with lending and compliance following. Indeed, the area of payments was the category most strongly associated with the concept of Fintech for many Islamic banks. As a Sudanese respondent said, "The term has evolved to include all technical innovations developed in the financial sector, which have witnessed real growth through the emergence and the evolution of the payment sector."

Some respondents predicted that the rise of Fintech solutions and alternative channels are fundamentally changing the banking environment and could have a hugely disruptive impact on financial systems generally. A Malaysian banker noted that "The presence of significantly larger competitors that dominate the industry and the disruptions caused by smaller unregulated players in the form of Fintech and digital banking solutions have caused serious margin pressure on vields."

A Bahraini respondent observed that "The rise of Fintech will witness an influx of start-ups in the crowdfunding and payment space and drive legacy banks to transform their operations and offerings in order to compete. Crowdfunding, P2P and payments platforms will be a major focus in the medium term."

Another Malaysian banker saw the rise of unregulated Fintech as a key long-term risk, stating that "The rise of Fintech and digital payment will make financial institutions redundant."

Fintech solutions have, according to the survey, so far had the least impact in the areas of capital markets and crowdfunding. This ranking was fairly consistent among regions, except that several regions which had invested more in emerging technologies to support lending. Among them were the Middle East ex-GCC banks, as well as banks in North Africa and Southeast Asia.

(For the sake of clarity, the gamification referred to below is intended to indicate the application of typical elements of game playing to other areas of business activity.)

The area of payments was the category most strongly associated with the concept of Fintech for many Islamic banks.

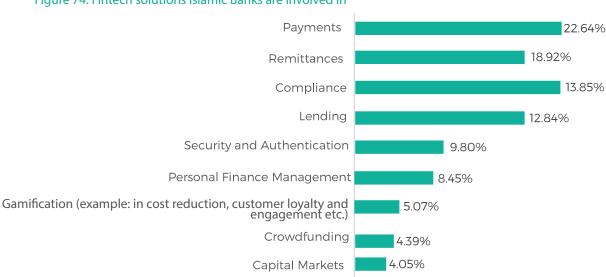
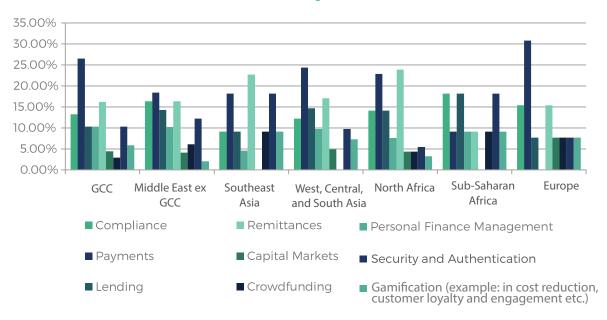


Figure 74. Fintech solutions Islamic Banks are involved in





Strong Variations Between Regions on the Relationship Between Islamic Banks and Fintech Companies

A significant portion of respondents said that their banks were engaged with Fintech companies, most commonly in joint partnerships (38%); however, almost a third of companies (31.71%) do not deal with Fintech companies at all, while a further 2.44% have not heard of them.

Regional variations were strong, with banks in Europe launching joint ventures or subsidiaries in Fintech, while in Sub-Saharan Africa and to some degree Southeast Asia, most banks do not deal with Fintech firms at all. However, this is beginning to change. One Malaysian bank declared that the bank now "plans to partner with Fintech to deliver new technologies and delivery speed. The bank is also considering the acquisition of solutions to enhance customer experience."

An Islamic bank domiciled in Bahrain shared that they were "a key partner in the Fintech ALGO initiative, which is tasked with bringing Fintech platforms and solutions to Bahrain for the benefit of the Islamic banking industry."

Another Islamic bank, also in Bahrain, noted that they had set up their own company "to develop technological banking services."



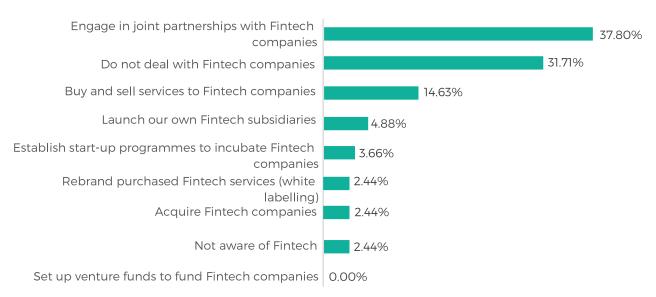
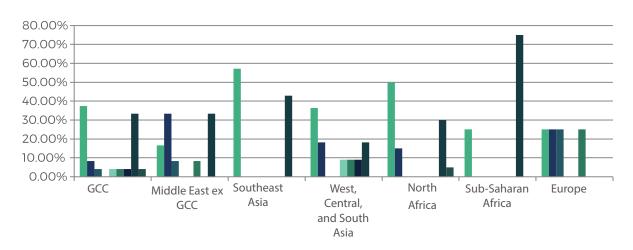


Figure 77. Islamic Banks dealing with Fintech companies - Regional Breakdown



- Engage in joint partnerships with Fintech companies
- Buy and sell services to Fintech companies
- Establish start-up programmes to incubate Fintech companies
- Set up venture funds to fund Fintech companies
- Rebrand purchased Fintech services (white labelling)
- Launch our own Fintech subsidiaries
- Acquire Fintech companies
- Do not deal with Fintech companies
- Not aware of Fintech

Customer Focus Areas are the Most Important in Developing Payment Services Technologies

When questioned about how important payment services would be for Islamic financial institutions in the coming five years, most respondents again emphasised a customer focus, giving high scores to robust tools to protect consumers' privacy, identity, and security; as well as digital wallet services. Among its most critical initiatives, one Bangladeshi bank cited a "combined centralised digital payment gateway."

Reflecting the lower interest in recently emerging technologies, blockchain-based and P2P payment solutions were considered least important.

Several respondents acknowledged the need to move towards a digital environment. One Omani bank said that "Readiness for digitisation of key functions based on latest technological innovations is one of the key success factors that Islamic banking leadership has to take into consideration for success in future."

At the same time, leaping into new technologies carries cultural risks. As a Bahraini banker noted: "Our bank's ambitious growth plans to rely on taking customers from our direct competitors. Our biggest challenge is one that faces the entire industry which is how to benefit from the developments of Fintech in a way which accesses new (younger) customers without alienating our current (older) customers."



Figure 78. The Importance of Areas of Payment Services for Islamic financial institutions in the next 3 years

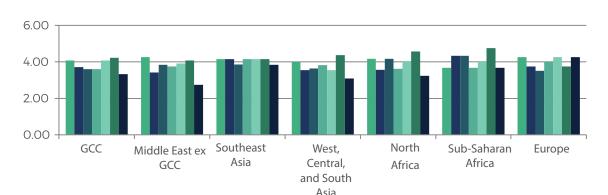


Figure 79. The Importance of Areas of Payment Services for Islamic financial institutions in the next 3 years - Regional Breakdown

- Digital wallet services
- Peer-to-peer payment solutions
- Value-added point-of-sale services
- Alternative retail-payment platforms
- ■International/cross-border money transfer solutions
- More robust tools and technologies to protect consumers' privacy, identity and security
- Block chain-based payments

Digital Branches are Within the Plan of Islamic Banks

About a third of respondents said their institutions would increase digital branches in the next couple of years. Of the remainder who had no experience yet, over 40% said that they were considering to do so. One Bahraini bank shared its plan to "implement a digital transformation strategy and Fintech launch to reach global investors." At the same time, the bank was planning to train and develop staff in Fintech.

A Turkish respondent shared these words: "Smart branches and reskilled branch staff will be important players in sales roles. It is not enough to introduce new digital channels and tools. Digital is an enabler of this transformation, not an end in itself."

One Omani bank also shared its views based on cost-benefit perspective, and said that "Digital branches are the new trend in the industry. However, at this juncture, it is important to assess the cost and benefits and then gradually move to digital branches. With alternate channels in place, the focus will be to increase delivery capabilities through alternate channels. Digital branches will reduce cost and improve the customer experience for which there is a plan for the bank to move and this is important for both Islamic and conventional banks."



Figure 80. Islamic Banks' Plans to increase/launch Digital Branches in the next 1-2 years

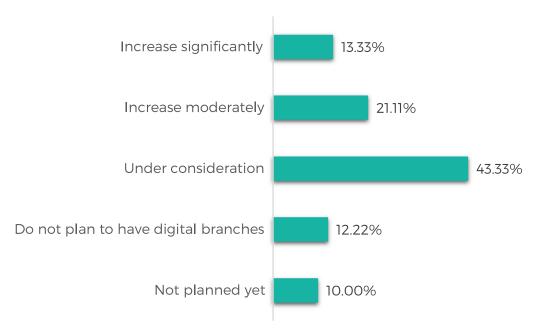
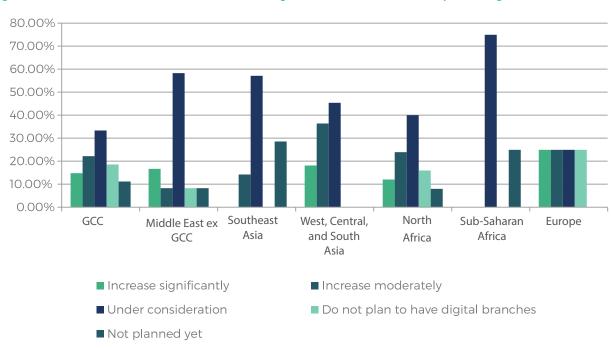


Figure 81. Islamic Banks' Plans to increase/launch Digital Branches in the next 1-2 years - Regional Breakdown



Other Global Insights on Fintech

Respondents shared some additional opinions and comments in regards to digital and financial technology.

Some respondents observed that Fintech should focus on what is appropriate in the local context. A Sudanese banker noted that "AML/CFT issues may be of greater importance to Islamic banks intending to use technical solutions, as most Islamic banks operate in countries that are more exposed to AML/CFT issues."

Bankers in those countries where Fintech has made more inroads tended to see it both as a threat and an opportunity. A Bahraini banker observed that "Fintech is fast becoming a major driver of change in the financial services space with initiatives that will substantially elevate the banking experience and improve banks and financial institutions' efficiency - which in turn will reduce costs and enhance stakeholders' value." Another bank from Kuwait highlighted that "the digital technology will be the key to attracting customers and sustaining profits."

Several respondents predicted that the onset of a growing digital revolution would transform financial services globally and Islamic finance with it. One bank from Turkey summed up its opinion with this view: "With the advantages of digital, it will be possible to customise our services and products. The customer decision journey has changed with digital technology and mobile devices. Banks are positioning themselves to create value using a range of approaches. Companies that can tap into the dreams of their customers will be leaders of the future. Digital shift is a cultural shift; collaboration provides a win-win."

Some respondents highlighted the issue of lack of legislation and standardisation as difficulties that face Islamic banks in adopting the new technologies. A Syrian bank indicated that "Our bank has started in a large way to be oriented towards the launch of a comprehensive e-payment system within an unclear area of legislation, causing some difficulties for the bank to activate the electronic self-service via dedicated platforms in branches or via electronic channels."

A Sudanese bank noted that "Islamic institutions cannot offer integrated solutions based on technology and may have many problems because of the need for them to share with another institution for the purpose of integration. Also, there is a lack of appropriate standards for Islamic financial products. In general, Islamic institutions will face an increase in the cost of technology application."

The Bahraini banker elaborated on the concept of this rapid technological innovation as an opportunity: "Fintech is all about financial inclusion, eliminating friction, improving efficacy and lowering costs. By embracing Fintech, financial service providers are able to offer clients the support they need to be more competitive. By leveraging technologies, banks can facilitate the creation of sustainable value for all stakeholders through cross-industry collaboration and by being more accessible to Muslims globally."

In the same context, one Nigerian bank highlighted the importance of Fintech in financial inclusion by saying that "In recent years, technology has been very useful in developing new and more innovative digital financial products that better meet the needs of people who do not have banking services and their specific circumstances, especially for people in rural and remote areas. The promotion of mobile money can be a starting point for the spread of vital digital financial services that benefit the lives of the poor."

Some respondents highlighted the issue of lack of legislation and standardisation as difficulties that face Islamic banks in adopting the new technologies.



CIBAFI Islamic Banking Confidence Index 2018

The confidence index showed moderate optimism in the banking sector as a whole and greater optimism in the Islamic banking sector. Islamic banks globally showed a confidence level this year that was higher than the corresponding results from CIBAFI's previous surveys and there was a similar uplift in confidence in response to the question, "How optimistic are you about the future of Islamic banking industry in your jurisdiction in 2018?"

IFIs were a little less sure about the prospects for their revenue growth, but this may be residual pessimism from the harsh economic climate over the past decade.

The survey showed that banks have shifted to become micro-focused on the institutions themselves, rather than macro-focused on the business environment. Their primary concern now is shareholders' value and expectations, followed by concerns about their IT systems, compliance, and risk management.

CIBAFI Islamic Banking Risk Dashboard 2018

The survey this year identified the biggest risks facing Islamic banks as being a technology risk and IT security. It seems likely that we might look back on this year's survey as the year that Islamic banks woke up to the potential upsides and downsides of the new wave of Fintech that is sweeping through financial services globally.

Credit default was also seen as a substantial risk, hardly surprising for a sector that has seen low or negative growth in some of its core markets. Liquidity risk was seen as the third major concern for IFIs.

Conclusions and Recommendations

The closing of correspondent banking relationships, or "de-risking risk," featured as the fifth biggest risk faced by Islamic banks this year, warranting close study in the coming years.

Strategic Thinking, Innovation, and Branding

The CIBAFI survey also uncovered valuable insights on the overall approach to strategy and innovation within Islamic banks.

The first and most encouraging outcome showed that the boards of directors within IFIs were taking a more proactive role in strategy and planning. Interestingly, over half of respondents viewed strategy over a three- to five-year horizon, and in many banks, strategic planning and execution is infused throughout the management tier.

Equally interesting was the finding that most typical inputs into the strategic planning process, like competitive actions and customer expectations, were seen as important to set a new strategic direction, such as entering new markets and acquiring new businesses.

Strategies focusing on external and internal process changes were generally ranked as being a greater driver of strategic thinking than strategies involving the human dimension of the bank. However, it became clear that the CEO and top management are very important in driving strategic implementation within Islamic banks.

The innovations that IFIs expected to see were mostly in the realm of new products, followed closely by new payment and customer interface solutions. Interestingly, the development of new Shariah-compliant products to keep up with the changing global financial environment was also seen as important.

The survey results showed that branding for IFIs should focus on products, the Islamic nature of their business, and past performance. Pricing was seen as being less important. Also noteworthy was the fact that around two-thirds of respondents said that they did not find promoting their brand as an Islamic bank challenging.

How do IFIs promote their brands? Digital and social media were the modern methods used by many banks, while more traditional channels like sponsorship and print advertising were also still seen as important.

The biggest challenge banks identified in developing their brands was competition with other banks. Reputation for service quality remains essential for developing and nurturing the brand message, and indeed, the bank's reputation is seen as its most important asset.

Fintech and Digital Transformation

The survey responses clearly showed that Fintech and digital transformation are important strategic challenges, with over 70% of the respondents seeing these as highly or extremely important in formulating strategic decisions.

IFIs have acknowledged the need to invest in new technologies as a defensive strategy to their market position as customers become used to new technological advances. New technology adoption is seen as inevitable, although banks see that there are still impediments to its adoption in the form of cyber security, budgetary constraints, legacy systems, and lack of qualified staff.

Technologies that interface with customers were seen as the most important, with blockchain, P2P lending, and cloud technology seen as the least important. Interestingly, many respondents were satisfied that their existing IT systems could meet the demands of both customers and regulators.

Most IFIs were aware of robo advisers and the opportunity they present, while a significant number were also planning to open more digital branches. Islamic banks that were particularly aware of the threat or opportunity presented by Fintech were either in discussion with Fintech and forming JVs with them or on occasions, were buying them up.

Recommendations

Strategic Thinking

The overwhelming impression given by survey respondents is that strategic thinking within Islamic banks is seen as an internal process that involves senior management accepting input from lower-ranking staff. External consultants featured the lowest ranking source of input amongst the stakeholders involved in strategic thinking (Figure 18).

With the acceleration of disruption in the financial services arena, it might be time for Islamic banks to take a leap from the playbook of conventional banks and start to solicit more strategic advice from outside parties as a core part of their strategy and planning process.

The Financial Times reported recently that the conventional banking sector's post-crisis consultancy spending had soared to \$200bn in 2016. The separate analysis suggested that this figure grew by over 8% in 2017, which would indicate that total spending last year on consultancy amounted to around \$216bn.

No comparable figures are available for the Islamic finance industry, but given the survey results, it seems safe to assume that the sector is distinctly underweight when it comes to spending on expert third party consultancy and advice.

The primary recommendation is that Islamic banks start to budget for greater spending on their strategic thinking inputs.

Innovation

Innovation is a skill set that is best hired rather than trained. Leading conventional banks and insurance companies are increasingly creating new roles within their C-suite with titles like 'chief innovation and transformation officer,' 'regional chief transformation officer,' 'chief transformation officer,' and so on.

What many of these roles have in common is that they are not internal hires, but rather the result of the extensive executive search. This is a position that is on par with the CFO, CIO, CTO and CMO, and the person who holds the role is responsible for making sure that the institution for which they work for is being innovative and agile in the face of digital disruption.

The primary recommendation is that Islamic banks look to create roles of this nature for themselves in order to ensure that the imperatives of innovation become ingrained in the DNA of the bank, and that their voice is heard in the boardroom.

Branding

The survey results indicated that Islamic banks are more than familiar with the nuances of effective branding. One way or another, the weaknesses in branding that most respondents identified boiled down to lack of expenditure. It can be hard to justify expenditure on intangibles like brand value when budgets are being tightened.

The primary recommendation is that Islamic banks review their levels of expenditure on branding as distinct from marketing in general, with an aim to increase their spending in this area.

The secondary recommendation is that Islamic banks pay very close attention to developing a digital branding strategy that is both measurable and flexible to the changing social and digital landscape.

Fintech

Fintech presents the greatest opportunity for Islamic banks, while also presenting the biggest threat. At this stage, it is impossible to say how cryptocurrencies, cloud technology, AI, and the like will affect the banking sector as a whole, but it seems certain that the effect will be profound. In such an environment, diligence is crucial.

The primary recommendation is that Islamic banks review their technological position on a frequent basis to ensure that they are adapting as nimbly as they can. There must be a tech-savvy expert who has the ear and the confidence of the CEO and who can advise wisely at all times.

Such a strategy will probably involve many pivots and there will doubtlessly be mistakes, but it is only by being adaptable and aware that Islamic banks will ensure that they ride the crest of the Fintech wave and don't get drowned by it.

Looking Ahead

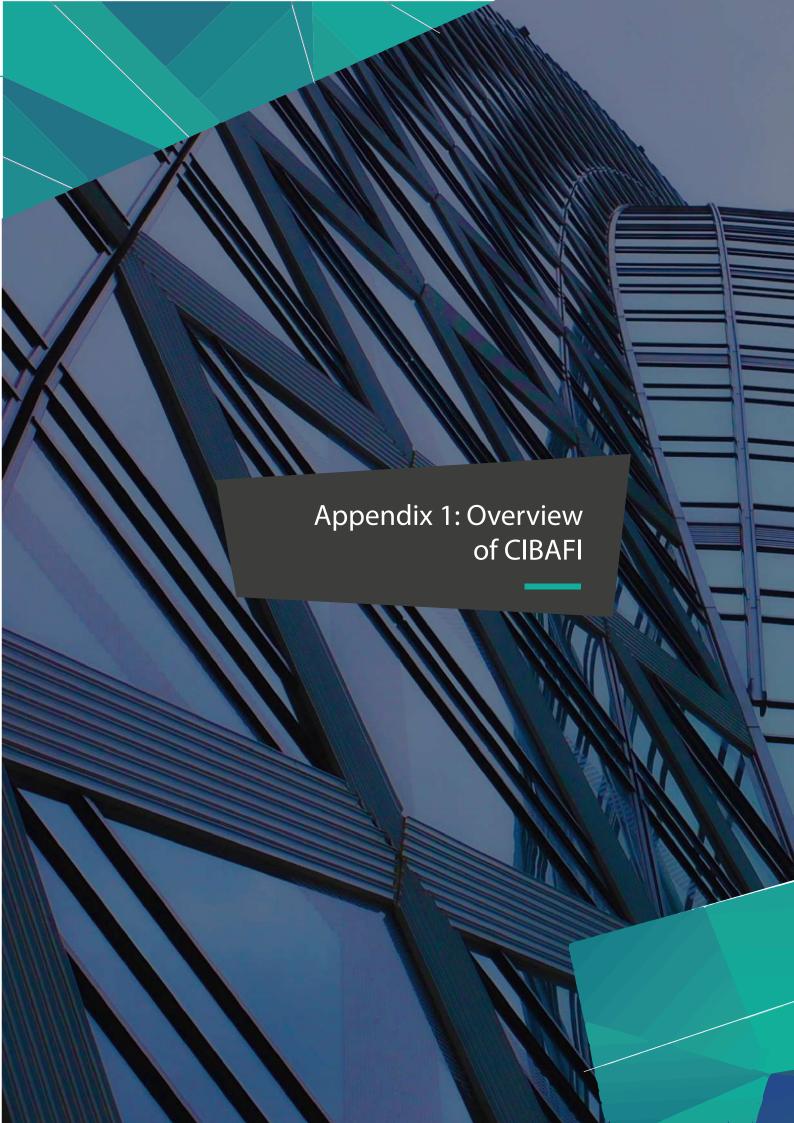
The Islamic banking industry has proven that it is more than capable of surviving in today's market.

However, it has yet to show that it is capable of real, sustained, and replicable success, or the global influence at a retail level that many believe it is capable of.

Millions already believe that Islamic banking is simply a better way of doing things. The challenge is to ensure that billions – not millions – hear that message.

This year's survey suggests that while the building blocks are now in place, it will take sustained effort and hard work to make it a reality. Making the building blocks into a robust and unassailable structure is where the hardest work will be.

This CIBAFI survey should be seen as a blueprint of where the building blocks should go, and what we can expect the completed structure will be in the future.



Appendix 1: Overview of CIBAFI

The General Council for Islamic Banks and Financial Institutions (CIBAFI) is a membership-based organisation, based in Bahrain that acts as the voice of the Islamic finance industry. CIBAFI was founded in 2001 by the Islamic Development Bank and other leading Islamic financial institutions. Today, it has over 120 members from over 33 countries and is proud to say that membership is increasing.

The Council is governed by a Board of Directors that is chaired by H.E. Shaikh Saleh Kamel, who is the Chairman of Al Baraka Banking Group. An Executive Committee of the Board is empowered to take certain decisions in between meetings of the full Board. The day-to-day management of CIBAFI's affairs is in the hands of the Secretariat, wich is led by the Secretary General, Mr. Abdelilah Belatik.

CIBAFI has a unique role in the global architecture of Islamic finance: it is the only member-based organisation that exists to promote the interests of Islamic finance practitioners whether they are banks, insurance companies, financial regulators, customers and the users of Islamic financial products, or others who encounter Islamic financial services in their professional or personal lives.

CIBAFI works with other organisations within the global architecture of Islamic finance. These organisations include the Islamic Financial Services Board (which sets regulatory standards), the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) (which sets accounting and other standards), and the International Islamic Financial Market (which sets standards and produces documentation for Shariah-compliant financial instruments). CIBAFI also works closely with global organisations such as the World Bank and the IMF, the Basel Committee on Banking Supervision, the International Accounting Standards Board (IASB) and the Institute of International Finance (IIF). It has a close relationship with the Islamic Development Bank and shares its objectives to promote and strengthen the Islamic Financial Industry.

CIBAFI's Strategic Plan for 2015 - 2018 identifies four Strategic Objectives:

1. Policy, Regulatory Advocacy

In an increasingly complex regulatory environment, new regulations are constantly being proposed and implemented for the financial industry. CIBAFI ensures that regulators and standard setters understand how the Islamic financial services industry will be affected by their proposals. For example, CIBAFI is a founding member of the IMF's External Advisory Group on Islamic Finance and a member of the International Accounting Standards Board's Consultative Group

on Shariah-compliant instruments and transactions. It solicited the views of its members recently on four Accounting Standards, one Auditing Standard and two Governance Standards being prepared by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI): Accounting Standard No. 30: "Impairment and Credit Losses", No. 31: "Investment Agency" (Al-Wakala Bi Al-Istithmar), among others, and made representations to the AAOIFI on behalf of its members. It also submitted recently the collective feedback of its members to the Basel Committee on Banking Supervision (BCBS) on three Consultative Documents: Simplified alternative to the standardised approach to market risk capital requirements; Sound Practices: Implications of fintech developments for banks and bank supervisors; and Stress Testing Principles.

2. Research and Publications

CIBAFI conducts research and produces publications on issues of interest to its members and which are relevant to the development of the Islamic finance industry. CIBAFI publishes every year its annual flagship report "CIBAFI Global Islamic Bankers' Survey" that provides insights on the Islamic banking industry and tracks its development year after year. CIBAFI also publishes a series of market related research that are conducted by CIBAFI or/and with its strategic partners in an initiative to increase its output of publications and research. Following this initiative, the Global Takaful Survey represents a market survey-based research that caters the needs of the market in providing in depth insights and prospects of the takaful industry. CIBAFI also publishes a newsletter ("InFocus") to keep members and others informed about CIBAFI activities and about significant developments in Islamic finance. In addition, CIBAFI also publishes a need-based periodical "Briefing", which are short and concise papers addressing emerging issues of the industry.

3. Awareness and Information Sharing

As the voice of the Islamic finance industry, CIBAFI plays an important role spreading awareness of the industry externally and facilitating the exchange of information and best practices within the industry. It has an annual gathering "Global Forum", where it addresses key themes of the year, and it also organises various regional events on its own and/or with our partners such as the Islamic Development Bank, World Bank, Union of Arab Banks and others. These events are usually hosted by a local regulator.

4. Professional Development

CIBAFI members have identified as one of their priorities the need to strengthen the talent pool within the Islamic finance industry. In response, CIBAFI offers 3 categories of professional development programmes: Executive Programmes for senior management and board level; Technical Workshops for mid-level staff of Islamic banks that are usually hosted by a regulator; and 16 professional certifications.

CIBAFI welcomes suggestions from members and non-members for ways in which it can strengthen the work that it does.

