Islamic Banking and Finance in North Africa

Past Development and Future Potential

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Past Development and Future Potential

This report was prepared by Rodney Wilson (Consultant, ORNA) under the supervision of Vincent Castel (Principal Program Coordinator, ORNA) with support from Paula Ximena Mejia (Consultant, ORNA) and overall guidance from Jacob Kolster (Director, ORNA) and Nono Matondo-Fundani (Director, ORNB). The following are thanked for their contribution: Olivier Eweck (Division Manager, FRTY4), Diabaté Alassane (Principal Country Economist, ORNB), Rokhaya Diallo-Diop (Senior Portfolio Officer, OPSM), Malek Bouzgarrou (Senior Economist, ORNB), Stephan Mulema (Senior Financial Analyst, FTRY), Yasser Ahmad (CPO, ORNA), Emanuele Santi (Senior Economist, ORNA), Ji Eun Choi (Economist, ORNA), Kaouther Abderrahim (Conultant, ORNA), Saoussen Ben Romdhane (Consultant, ORNA).

Glossary

Fatwa: ruling by a scholar of Islamic jurisprudence such as those serving on the shari'ah boards of Islamic financial institutions

Fiqh: Islamic jurisprudence

Gharar: legal uncertainty such as contractual ambiguity which could result in one of the parties to a contract exploiting the other

Hadith: sayings and deeds of the Prophet including when he was asked to provide a ruling on disputes

Halal: permissible under Islamic law by being shari'ah compliant

Ijara: an operational leasing contract where the owner responsibilities justifies the payment of rent

Ijtihad: the interpretation by a trained scholar, such as those serving on the shari'ah boards of Islamic financial institutions, of how shari'ah should be applied in new circumstances. This would apply, for example, to the consideration of what forms of activity are not permissible in complex modern financial markets. The interpretation involves examining the teaching of the Quran and the Hadith, as well as the study of fiqh, but previous fatwa are not necessarily relevant to changed conditions

Istisna'a: a sale contract that requires the manufacture of a good or the construction of a facility to exact specifications that are stipulated before the work commences. The financier, usually an investment bank, pays the raw material and wage costs of the supplier or contractor. On completion after the contractor is paid the bank is reimbursed, the amount including an agreed pre-determined profit margin. This type of contract is often used for project finance

Masir: game of chance involving gambling. Activities such as spread betting in financial markets are prohibited under shari'ah as they are regarded as addictive and contribute nothing to society or an economy

Murabaha: a sale contract whereby an Islamic financial institution sells a good to a client who makes deferred payments including a profit mark-up. The Islamic financial institution may have already acquired the good, or may acquire the good from the supplier on behalf of the client once the contract is signed

Mudaraba: a partnership contract between an investor, the rab al-maal, and a business manager, the mudarib, which provides for profit sharing, with the rab al-maal receiving a return on their financial investment while the mudarib receives a share of the profit assessed on the basis of the value of their effort. The rab al-mal is sometimes regarded as a "sleeping" partner as they do not get directly involved in business decisions after the initial contract is signed. Only the rab al-maal has a liability for any losses, as they are the sole provider of the capital. If there is no profit or a loss the mudarib will not r eceive any remuneration, but they have no further liability provided they are not negligent in their duties as defined in the original contract

Musharaka: a partnership contract between investors whereby they obtain pre-determined shares in any profits generated. The partners take an active role in management, the extent of that activity being defined in the contract. If some partners agree to play a more active role than others, they may receive an enhanced profit share. Any losses are apportioned according to the capital contributions, as these indicate the capacity to take a hit

Qard hasan: an interest free loan, the only type of loan agreement permissibly under shari'ah. Although Islamic financial institutions cannot profit from the loan, they may levy a set-up fee and an annual management levy to cover administrative expenses. Such finance is only available to existing clients and is often used to ensure that those in financial difficulties can continue to honour existing financial commitments. It can also be provided as a stand-by facility to maintain third party creditor confidence

Riba: an addition to the principal of a loan, which is usually equated with interest. Riba is explicitly prohibited in the Quran (2:275; 3:130; 4:161 and 30:39) because it is viewed as exploitative

Salam: an advance payment in full for a commodity for delivery at a future date. This contract was originally used for the financing of agricultural production with the advance payment being used by farmers to cover labour, seed, irrigation and other costs during planting and cultivation while benefiting from a fixed price on harvesting. As the payment is made in advance it is usually less than the expected spot price at the time of delivery. Today salam is used to finance the production of many commodities and is no longer confined to agricultural output. It is similar to a forward contract

Shari'ah: Islamic law based on the Divine guidance provided by the Quran and the Sunnah, the practices or "way" of the Prophet during his life. This includes the Hadith, the narration of the Prophets rulings. For example Imam Sahih Bukhari, one of the most respected early followers of Islam narrated what the Prophet ruled on loans, payment of loans, freezing of property and bankruptcy (Book 41)

Sukuk: certificates of ownership or rights in tangible assets such as those being used as backing for an Islamic bond or floating rate note

Takaful: an Islamic alternative to a conventional insurance contract involving risk sharing by the participants rather than risk transfers. The collected funds are jointly owned by the participants as in a mutual company but are used to cover individual losses

Wakala: an agency contract which provides for the appointment of a wakil or agent to manage the financial assets of a person, family or business which continues to own the asset. The wakil is paid a pre-determined fixed fee rather than sharing in any profits generated by the assets as with a mudarib

Zakat: obligatory alms paid annual by Muslims according to the value of their wealth. The amount is usually calculated as one fortieth of the value of financial assets and excludes wealth in owner occupied properties. Payment is viewed as one of the Five Pillars of Islam. Corporations, including Islamic banks, as well as individuals, have an obligation to pay zakat. The proceeds are used for charitable purposes to help the poor and needy with much of the expenditure devoted to health care and education for the underprivileged.

Islamic Banking and Finance in North Africa

Executive Summary

The aim of this report is to assess the state of Islamic banking in North Africa, examine why it has failed to take-off and consider its future potential and how it can contribute to the economic development. The rationale for Islamic finance is explained and its essential features described. Once *shari'ah* compliant financing facilities become available, funds that otherwise might not be available can be harnessed for both commercial and development projects. In addition to diversifying funding sources, Islamic finance can ensure better monitoring of how funds are deployed, improving the effectiveness of financial intermediation.

A detailed survey is provided of the historical development and current state of Islamic banking in those countries classified as being in North Africa as defined by the African Development Bank (AfDB), namely Egypt, Libya, Tunisia, Algeria, Morocco and Mauritania. There are Islamic banks currently operating in all these states apart from Libya and Morocco, but they account for only a minute proportion of total bank deposits and total bank assets. Egypt has the longest history of Islamic banking and finance, dating from the 1960s, yet even there the industry is very underdeveloped compared to the countries of the Gulf Co-operation Council (GCC) and Malaysia.

There is a substantial need for project finance in North Africa given the poor state of much of the region's infrastructure. Existing Islamic project financing covering 24 schemes in North Africa worth over $US 2.4 billion has already been approved. Construction has started on most of these projects. Many of the schemes involve *istisna'a*, a *shari'ah* based funding method for projects which has a proven track record of success. Shorter term Islamic debt financing has also beenprovided to North African countries, mainly involving *murabaha* and *ijara*, with 28 deals worth over $US 5.3 billion.

At present although there has been some capital market development in North Africa, with stock markets in Egypt, Morocco and Tunisia, there has been only limited issuance of, and no trading in, Islamic sukuk securities. So far there have been four *sukuk* issuances worth a total of $US 250 million, all in Egypt. The potential for both sovereign and corporate *sukuk* will be considered as these could attract investment funds from the GCC and could provide a useful instrument for the liquid holdings of Islamic banks operating in North Africa, as well as takaful funds once the Islamic insurance industry in North Africa becomes more developed.

In addition to Islamic banking, *takaful* and collaborative development assistance which is shari'ah compliant, there are also opportunities for Islamic mutual funds or unit trusts. There are already some mutual funds marketed to GCC investors which invest in the emerging markets of North Africa, but they are of very limited size. Within Egypt nine Islamic funds have been registered with the total amount of investment exceeding $US 175 million. There is also one Tunisian Islamic fund, but no capital has been raised to date. Both Islamic mutual funds that provide portfolio investment in listed stock and foreign directinvestment can contribute to the private sector development needed to expand employment opportunities for young people completing their secondary or university education in North Africa.

Islamic private equity investment and venture capital finance also has a role to play. There is limited experience with this in the GCC, and even less in North Africa, an area where there is considerable scope for small scale industries and family enterprises to seek equity finance. *Musharaka* structures involving partnership agreements can be utilised for such financing which involve the establishment of special purpose vehicles for the duration of the funding. An advantage of this approach is that it is not only *shari'ah* based, but a means of ensuring that families do not loose control of the enterprises they own and manage, as is often the case with conventional private equity and venture capital finance which is injected directly into the business.

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1. Introduction

The aggregate figures for *shari'ah* compliant assets are impressive, exceeding $US 1 trillion world-wide, with annual growth exceeding 10 percent, even during the financial crisis of 2008. Disaggregation however reveals numerous weaknesses and challenges, not least overdependence of Islamic banking and finance on a limited range of markets, and its relative underdevelopment in the markets of the more populous Muslim countries. The largest Islamic bank in the world in terms of assets is Bank Melli of Iran, where all the banks operate in compliance with *shari'ah* under the 1983 Law on Usury Free Banking. However sanctions by the United States and the European Union on Iran have adversely affected the development of the banking sector.

Elsewhere it is domestic political factors that have often been unhelpful for Islamic banking development, especially in North Africa where Islamic banking was seen by some as being associated with banned Islamist political movements. It is too early to say what impact Arab people's power will have on Islamic finance following the overthrow of the autocratic regimes of Presidents Mubarak and Ben Ali, but the legitimising of Islamic political movements in Egypt and Tunisia could be viewed as very encouraging developments from the perspective of Islamic finance.

From the 1970s onwards it was the GCC countries that witnessed the most rapid growth of Islamic finance following the establishment of Dubai Islamic Bank in 1975 and Kuwait Finance House in 1977. Over adecade earlier in 1963 it had been Egypt that was the centre for the first modern Islamic financing experiment when the Mit Ghamr Savings Bank was started, a *shari'ah* compliant credit union in which members would place *qard hasan* deposits in exchange for the right to interest free loans. Over 358,000 accounts were opened in Mit Ghamr by 1970, clearly indicating its outstanding success in appealing to the Egyptian rural masses.[1] This early experiment was closed down by the authorities who preferred to see a state controlled banking system with finance allocated in a manner consistent with government development priorities rather than through uncontrolled local initiatives which had the potential to emerge as alternative centres of economic power, especially if the process of capital accumulation was influenced by Islamic ideals.[2]

The author has written other papers on the development of Islamic finance in the GCC[3] and more recently a paper comparing the Islamic banking experiences of Iran and the Arabian Peninsula.[4] The demonstrations in Bahrain have implications for its role as an Islamic banking centre, with the potential for significant capital flight if the unrest continues, a considerable challenge given the island's meagre resources.[5] Rather than speculate on possible negative scenarios the aim here is to take a longer term view, dealing with the countries at the core of the Arab World rather than the periphery.

[1] *Elias Kazarian, Finance and Economic Development: Islamic Banking in Egypt, Lund Economic Studies, 45, 1991, p. 146.*
[2] Monzer Kahf, "Islamic banks: the rise of a new power alliance of wealth and shari'ah scholarship", in Clement Henry and Rodney Wilson, (editors), The Politics of Islamic Finance, Edinburgh University Press, 2004, p. 19.
[3] Rodney Wilson, The Development of Islamic Finance in the GCC, Centre for the Study of Global Governance, London School of Economics, London, 2009.
[4] Rodney Wilson, Étatisme versus Market Driven Islamic Banking: The Experiences of Iran and the Arabian Peninsula Compared, Georgetown University School of Foreign Service in Qatar, Doha, 2010.
[5] Reed Stevenson, "Bahrain unrest may have regional financial impact", Reuters, 16th February 2011.

This paper therefore focuses on the more populous Arab countries of North Africa, where arguably Islamic banking has greater potential, especially if at least some of the popular forces unleashed campaign for a different type of financial system that supports entrepreneurial effort and creates employment opportunities, particularly for the young whose needs were too often neglected by the ancient regimes.

The model of expanding state patronage through employment creation in public services may still work in the less populated oil and gas rich states of the Gulf, but it cannot work in an economy of a country such as Egypt with a population exceeding 84 million and government finances which are increasingly constrained by what can be raised through the tax system. Clearly a different type of economic system is required, private sector dominated and internationally competitive. Islamic finance can thrive in such a system, as most of the successful Islamic banks are privately owned or stock market listed companies focused on providing dividends for their investors. There is a proven market demand for Islamic financial services which do not require government patronage, but simply a regulatory level playing field where they can compete on equal terms with conventional banks.

2. Why Islamic Finance?

There are clear contradictions between Islamic teaching and the systems of financial intermediation that have developed over the last three centuries. In particular loans based on interest are a key component of modern banking practice, but in Islamic teaching the receipt of *riba*, the addition to the principal of a loan, is viewed as exploitative.[6] Simply making money from lending is unacceptable, rather the first Islamic financial principle is that returns have to be related to effort. Wages and salaries are justified through work, profits are legitimate returns for taking commercial risks and rents are an entitlement resulting from ownership responsibilities. Interest earnings do not fall within any of these categories.

Islamic teaching recognises that financial risk is inevitable, as there have always been business cycles and those involved in commercial activity, including investors, often make mistakes. A second Islamic principle is that commercial risks are better shared to avoid placing excessive risks on one of the parties. Much stress is placed on solidarity or brotherhood, sharing each others' burdens. Most Islamic financial contracts provide for risk sharing, with ownership responsibilities being borne by those providing finance to justify their returns. Risk should not be taken for its own sake, as with gambling, *masir* being prohibited,[7] but rather should serve a productive and social purpose.

A third Islamic financial principle is the avoidance of contractual uncertainty, which can result in one of the parties being exploited by the other. Such practices constitute *gharar,* which Islamic teaching as set out in the *Hadith,* the sayings and deeds of the Prophet, explicitly forbids.[8] Verbal agreements are viewed as unsatisfactory as they often result in disputes as the parties may forget the exact details of the undertakings given. Written contracts are preferable but misleading wording is dishonest and clear and transparent contracts are important if there is to be confidence by all the signatories.[9] Those who have signed valid contracts are expected to honour their contractual obligations.[10]

2.1 Islamic Financial Contracts

There is a wide choice of Islamic financial contract with each serving a particular purpose and ensuring that there are equitable provisions for all the signatories. The financier or investor retains responsibility for how the finance is used limiting the discretion of the beneficiary, the aim being to retain a measure of control so that the funding is not used immorally. The contractual responsibilities of the parties limit the possibility of corruption which thrives in an environment where there is ambiguity and uncertainty. Islamic financial contracts are designed to ensure that a high level of trust is maintained between the parties thus reducing long term transactions costs and more than offsetting the additional set up expenses associated with ensuring *shari'ah* compliance.

In the event of disputes between contracting parties, it is national courts that will hear the case, not *shari'ah* courts whose remit is confined to family and inheritance matters in most jurisdictions, including all the countries of North Africa. Usually the contract will specify the governing authority in the event of disputes. This often includes English law authorities such as the Dubai International Financial Centre (DIFC) which has its own courts[11] and arbitration centre.[12] Its laws include provisions for special purpose companies such as those that administer Islamic securities (sukuk) issuance. To be fit for purpose, Islamic financial contracts are usually drafted by commercial law firms, with leading international firms heavily involved such as Norton Rose[13] and Simmons and Simmons.[14]

To ensure *shari'ah* compliance Islamic financial institutions appoint a board of at least three *shari'ah* scholars who read over all the contracts and suggest changes as necessary before providing their endorsement through a fatwa or ruling.[15] In some jurisdictions, such as Malaysia, Pakistan or the Sudan, Central Banks appoint their own national boards, but this is not the practice anywhere in the Arab World where there is no national systems for *shari'ah* compliance. This privatisation of *shari'ah* compliance inevitable often results in variations in the standards being adopted by different Islamic financial institutions, even within the same jurisdiction. However although the lack of standardisation is often criticised, it results in healthy debate, and clients are of course free to change the Islamic financial institution they use if they are unconvinced about the validity of the *fatwa*.

In practice the most frequently used contracts offered by Islamic banks are remarkably similar. For trade finance *murabaha* is usually offered, with the bank purchasing the stock or inventory on behalf of the client and reselling it to the client for a higher price which includes a profit margin. As the bank owns the inventory until it is sold it bears ownership risk, and if the goods resold are defective, the client could potentially sue the bank. Hence purchase risks are shared, justifying the bank's profit.[16] Usually such contracts run for up to a year although longer periods are sometimes offered, with the client purchasing through a series of monthly deferred payments. Variations in the contracts largely reflect the needs and circumstances of the clients, rather than *shari'ah* considerations.

Ijara or leasing contracts are increasingly offered by Islamic banks, with the bank having ownership of an asset for the duration of the contract and the client paying rent.[17] The bank has ownership responsibilities and in the case of real estate or equipment will have to pay for the maintenance and insurance. Financing leases which transfer all risks to the client are not permissible under *shari'ah*, rather *ijara* corresponds to an operating lease where risks are shared.

Islamic banks also provide partnership financing through *mudaraba* and *musharaka* contracts.[18] With *mudaraba* only the bank provides finance the other partner, the entrepreneur or business manager, providing their time and effort. Profits are shared, but the bank as financier is responsible for any losses, the justification being that if the business is in difficulties the manager will not receive any remuneration, and as they had no capital to contribute initially, it would be unduly harsh to make them liable for losses. In contrast with *musharaka* contracts, which represent a type of joint venture, all investors share in both profits and losses. Not surprisingly

6 Qur'an, 2:275-280; 3:130; 4:161.
7 Qur'an, 2:219; 5:90-91
8 Abdul-Rahim Al-Saati, "The permissible gharar (risk) in classical Islamic jurisprudence", Journal of King Abdulaziz University, Islamic Economics, Volume 16, Number 2, pp. 3-19.
9 Qur'an, 2:282-283
10 Qur'an, 5:1; 16:91; 17:34.

11 http://difccourts.complinet.com/
12 http://www.difcarbitration.com/
13 http://www.nortonrose.com/expertise/banking/islamicfinance/expertise4585.aspx?lang=en-gb
14 http://www.simmons-simmons.com/index.cfm?fuseaction=service_industry.display_left&page=3243&hsf=islamic%20finance
15 Rodney Wilson, "Shari'ah Governance for Islamic Financial Institutions", International Shari'ah Research Academy Journal of Islamic Finance, Vol. 1, Issue 1, 2009, pp. 59-75.
16 Sunil Kumar, "Risk management in murabaha", New Horizon, London, April 2008.
17 Angelo M. Venardos, Current Issues in Islamic and Finance: Resilience and Stability in the Present System, World Scientific Publishing, Singapore, 2010, p. 292.
18 Muhammad Nejatullah Siddiqi, Partnership and Profit Sharing in Islamic Law, Islamic Foundation, Leicester, 1989.

musharaka contracts are preferred by Islamic banks for financing, mudaraba contracts being mostly used for deposits.

2.2 Benefits From Islamic Banking

Development

There has been much debate over whether the growth of financial intermediation facilitates economic development or if banks expand as a consequence of economic development. Most Islamic banking is retail, largely catering for the needs of those in salaried employment, providing payment facilities and personal finance for vehicles and housing.[19] Such retail banking can be regarded as a consequence of economic development and the emergence of a relatively affluent middle class, rather than being focused on development projects. In other words Islamic retail banking contributes to "demand" side activity in the economy, but is less relevant to the "supply" side investment that development finance seeks to assist. Of greater relevance for the latter are the IDB and Islamic investment banks which can arrange funding for development projects through *sukuk* issuance and syndicated finance.

Islamic banking can contribute to the growth of financial intermediation if it attracts those unwilling to use conventional banks involved in *riba* transactions. In practice however many of its retail clients already had bank accounts, and therefore the Islamic banks are serving as a substitute for their conventional counterparts rather than harnessing new funds. Indeed many of those with Islamic bank deposits continue to have accounts with conventional banks, the attraction of the Islamic banks being that they may provide additional access to credit. In short although religious belief can be one reason why clients use Islamic banks, financial factors are also important. Islamic finance is far from being the exclusive domain of the pious.

From a North African perspective the merit of Islamic banking is that it can attract deposits from outside the region, especially remittances from expatriates working in the countries comprising the Gulf Cooperation Council (GCC). There have been millions of expatriates from Egypt and to a lesser extent the Maghreb counties working in Saudi Arabia and the Gulf during the last four decades. Although there has been a decline in migration of labour taking lowly paid menial jobs in construction, there are increasing numbers of professionals such as doctors and lawyers working in the GCC, who all have bank accounts. Rather than making cash transfers through exchange bureau, remittances are increasingly sent through banking channels, especially from Islamic banks in the GCC to *shari'ah* compliant correspondent banks in North Africa.

Islamic banking can strengthen mutually beneficial financial links between North Africa and other regions of the Muslim World and promote economic integration. As much of the paid up capital for the Islamic banks already operating in North Africa was raised in the GCC, this represented an inflow of foreign direct investment. As GCC markets are limited by small populations many Islamic financial institutions based there are looking to expand into other markets by establishing subsidiaries and joint ventures. Often because of trans-Arab World media advertising there is already potential client brand awareness of particular Islamic banks. Hence new entrants into North African markets can take advantage of an at least partly informed market. An interesting expansion model is that of Kuwait Finance House which now has more branches in Turkey than in its home market, but as yet no branches in North Africa.[20] Similarly Dubai Islamic Bank has a growing branch network in Pakistan, while Qatar Islamic Bank has subsidiaries in Kuala Lumpur, Beirut and London, and in 2010 it signed a Memorandum of Understanding with Banque Populaire Caisse d'Epargne,

[19] Rodney Wilson, "The growth of Islamic banking and product development among Islamic retail banks", in Sohail Jaffer, (ed.) Islamic Retail Banking and Finance: Global Challenges and Opportunities, Euromoney Books, London, 2005, pp. 18-28.
[20] Rodney Wilson, "Strategic choices for Islamic banks in service provision for home and overseas markets" in Sohail Jaffer, (ed.), Islamic Investment Banking: Emerging Trends, Developments and Opportunities, Euromoney Books, London, 2010, pp. 33-46.

France's second largest banking group, in order to gain access to the French retail banking and the small to medium-size business markets.

There is considerable potential for Islamic micro finance in North Africa given the relatively low levels of income and lack of regular secure employment for much of the population. Most people do not have bank accounts and have no collateral to offer for bank financing. Traditionally it was moneylenders and pawnbrokers who provided finance for the poor, but the terms were often exploitative reflecting the weak bargaining position of those seeking funding. Chronic indebtedness often resulted with recipients paying more in interest than the amount of funding they actually borrowed. Of course the high money lending charges reflects the risks involved and the costs of administering a large number of small loans. Islamic micro finance can mitigate these challenges as it usually involves the creation of credit unions where the participants provide financing to each other through *qard hasan* loans, the only permissible form of lending under *shari'ah*, as no interest is charged. As members of the unions believe if they default they will be letting down their fellow believers, there is a strong incentive to honour all obligations.[21]

In order to attract members, an initial grant to establish the fund from which members can draw is needed. A condition for interest free loans is that members must place deposits, usually for very small amounts, in the fund. This not only provides resources, but also ensures members have a sense of ownership commitment. Funding costs are minimal, as depositors do not get a return, only an entitlement to future loans. Service charges are levied for loans to cover administrative costs and make the institutions self sustaining. This type of Islamic micro financing scheme operates at Hodeibah in Yemen and Jabal al-Hoss in Syria, and much larger schemes are run by Islamic cooperative banks such as Bank Rakyat in Indonesia.[22] There is much experience from which North African countries can learn if proposals are presented for similar schemes to overcome financial exclusion and promote employment creation through the development of small businesses.[23]

2.3 Criticisms of Islamic Finance

Despite over four decades of experience of Islamic banking and finance, the industry has its critics, both Muslim and non-Muslim. There is still debate over the fundamental issues, not least whether the interest paid and received by modern banks actually constitutes *riba*.[24] It is argued that the prohibition of *riba* was relevant to traditional societies where money lenders often charged exorbitant interest, but it is not applicable in contemporary circumstances. Many argue that if interest charges are moderate and kept down by competition, they are not exploitative.

Furthermore the financing charges imposed by Islamic banks are often higher than those of conventional banks, resulting in a perception that Islamic finance is expensive. There are of course shari'ah compliance costs and the legal fees for structuring the products add to overheads. In addition as the market for Islamic finance is a differentiated segment of the overall financial market, there is less competition, with often only one or two banks dominating, whereas in conventional finance there are many competing institutions. Regulatory costs are also often higher for Islamic banks, as if they are obliged to hold conventional treasury bills as part of central bank liquidity requirements, they either have to forgo the interest returns, or accept them but

[21] Rodney Wilson "Making development assistance sustainable through Islamic microfinance", International Islamic University of Malaysia Journal of Economics and Management, Vol. 15, No. 2, 2007, pp. 197-218.
[22] Abdul Rahim Abdul Rahman, "Islamic microfinance: a missing component in Islamic banking", Kyoto Bulletin of Islamic Area Studies, Volume 1-2, 2007, pp. 38-53.
[23] International Development Law Organisation, Islamic Microfinance Report, Allen and Overy, London, 2009.
[24] Sheikh Yusuf Talal Delorenzo, "Introduction to understanding riba", in Abdulkader Thomas, (ed.), Interest in Islamic Economics, Routledge, London, 2006, pp. 1-9.

"purify" such financial gains by donating the interest to charitable causes.

There is also criticism of the *shari'ah* compliance processes and a questioning of the independence and integrity of the scholars who serve on the *shari'ah* boards.[25] As the shari'ah scholars are paid for the work they do by the banks they serve, there are issues of conflict of interest as it is alleged that they are unlikely to reject financial products proposed in such circumstances.[26] As some *shari'ah* scholars serve on the boards of many banks there is criticism that they don't spend sufficient time studying the issues and concern that confidentiality may be breached if the scholars are on the boards of rival institutions. In Malaysia these issues have been addressed with shari'ah scholars only authorised to serve on one board and an accreditation system whereby shari'ah scholars have to apply to the central bank for approval before they can be appointed to a shari'ah board.[27] There is no system comparable to this in the Arab World and none in North Africa. The Islamic Financial Services Board (IFSB), which advises on the regulation of Islamic banks, has provided guidelines on shari'ah compliance, but these are not mandatory.[28]

The original advocates of Islamic finance such as Mohammad Nejatullah Siddiqi often express disappointment that Islamic banks provide very little *mudaraba* finance, focusing instead on *murabaha* short term trade finance which merely replicates what conventional banks provide.[29] Furthermore the corporate ownership structures of Islamic and conventional banks are often identical, with the aim of the management being to maximise share value rather than focusing on other stakeholders, notably the investment *mudaraba* depositors.[30] As already indicated the early modern Islamic financial institutions were not-for-profit credit unions rather than listed companies. However commercial banks serving businesses and retail clients can coexist with co-operatives and other institutions serving the poor, and there are similar alternatives available for structuring Islamic financial institutions.

A criticism often heard is that there is a lack of product standardisation in Islamic finance and disagreement about what is *shari'ah* compliant which confuses many potential clients. There is no single authority for guidance, partly because Islam itself is a decentralised religion with different schools of jurisprudence. However differences result in debate and development, whereas standardisation and the imposition of inappropriate universal rules may hinder progress. International institutions have emerged to provide some consistency, notably the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), a standards setting body for financial reporting which most Islamic banks look to for guidance. The IFSB, as already mentioned, provides guidance for Islamic bank regulation which is followed in most jurisdictions in both the Islamic world and in Muslim minority countries. For shari'ah issues the opinions of the International Fiqh Academy are widely respected as it is an affiliate of the Organisation of the Islamic Conference (OIC) representing fifty six Muslim countries and provides *shari'ah* guidance for the Islamic Development Bank.

[25] Mahmoud A. El Gamal, Islamic Finance, Law, Economics and Practice, Cambridge University Press, 2006, pp. 175-189.
[26] Rodney Wilson, "Sharia Governance for Islamic Financial Institutions", International Shari'ah Research Aacdemy Journal of Islamic Finance, Vol. 1, Issue 1, 2009, pp. 59-75.
[27] Bank Negara Malaysia, Guidelines on the Governance of Shari'ah Committees for Islamic Financial Institutions, Kuala Lumpur, December 2004, pp. 5-9.
[28] Islamic Financial Services Board, (IFSB), Guiding Principles on Shari'ah Governance Systems for Institutions Offering Islamic Financial Services, Kuala Lumpur, 2009, pp. 7-21.
[29] Muhammad Nejatullah Siddiqi, Banking Without Interest, Islamic Foundation, Leicester, 1983, pp. 19-52.
[30] M. Umer Chapra and Habib Ahmed, Corporate Governance in Islamic Financial Institutions, Islamic Development Bank, Occasional Paper No. 6, Jeddah 2002, pp. 44-49.

3. Overview of Islamic Banking and Finance in North Africa

Islamic finance in North Africa is not only underdeveloped in comparison to the Gulf region and South East Asia, but also, perhaps surprisingly, now lags behind the development of the industry in the United Kingdom. As table 1 shows the rankings of the countries of North Africa in terms of shari'ah compliant assets are not even in the top 10, with Egypt, where Islamic finance is most developed, ranking only twelfth. In the Islamic Republic of Iran all banking has to conform to *shari'ah* under a law passed in 1983, hence its number one ranking which includes the assets of its entire banking system. In Saudi Arabia where conventional and Islamic banks compete and clients have a choice, the greatest share of total assets is accounted for by Islamic banks. Al Rajhi Bank, the market leader, is the largest stock market listed Islamic banks in the world, and second only to the Iranian state owned Bank Melli in terms of shari'ah compliant assets. Malaysia, despite having a significant non-Muslim population, has the world's third ranking in terms of shari'ah compliant assets, accounting for almost 30 percent of total bank assets.

As can be seen from the table the ranking of Islamic bank assets and their share of total assets is much lower in the Muslim states of the Mediterranean. Turkey has the highest ranking in terms of shari'ah compliant assets, although Egypt has a slightly higher share of total assets accounted for by Islamic banks. In Algeria and Tunisia the shares are only 1.1 and 2.2 percent respectively. Libya and Morocco are not included in the table as they do not yet have Islamic banks, and in the case of Mauritania there is little data, hence it is also excluded.

Faisal Islamic Bank of Egypt is the largest Islamic bank in North Africa as table 2 shows, but it remains a relatively small institution. The other banks cited in the table are all part of the Al Baraka Group, including Banque Al Wava Mauritania. There is clearly scope for new entrants into these markets, as at present there is a monopoly, and in Egypt's case a duopoly of Islamic banking provision which is not a conducive environment for product innovation and development. Competition could either come through new start-ups or by existing banks converting to becoming fully Islamic, as was the case when the National Bank of Sharjah became Sharjah Islamic Bank. They could come by locally funded initiatives or as a result of foreign direct investment by Islamic banks based elsewhere, most likely in the GCC. For comparative purposes the asset size of the leading conventional bank or banks in each market is shown. The assets of the National Bank of Egypt for example are over nine times greater than those of the Faisal Islamic Bank of Egypt. The small size of the Islamic banks in North Africa limits the potential for economies of scale and scope.

Table 1: The Position of North Africa in Shari'ah Compliant Asset Rankings

Rank	Country	Shari'ah compliant assets $US billion	Total assets $US billion	% of bank assets shari'ah compliant
1	Iran	315	315	100.0
2	Saudi Arabia	138	225	61.3
3	Malaysia	103	358	28.8
4	UAE	86	201	42.7
8	Turkey	22	520	4.3
12	Egypt	7	144	4.9
20	Algeria	1	90	1.1
23	Tunisia	0.8	36	2.2

Sources: The Banker, Top 500 Islamic Financial Institutions, FT Business, London, November 2010. Data on total bank assets is from the central banks of each country cited.

3.1 Why Islamic Banking is Underdeveloped in North Africa

There are three factors that account for the relative underdevelopment of Islamic banking in North Africa, firstly the limited development of retail banking generally, second the lack of knowledge of Islamic banking amongst potential clients and third, the absence of government support. The latter will be considered in more detail in the next section on legal and regulatory issues. It is worth stressing however that banking generally, and not just Islamic banking, is relatively less developed in North Africa as the figures for total bank assets in figure 1 showed.

Commercial banking rather than retail banking is dominant in North Africa with the banks serving government owned enterprises and the limited private sector. Retail banking serving the personal needs of the middle classes is much less developed than in the Gulf or Malaysia, partly reflecting the poorer economic status of the majority of the population. Yet in the Gulf and Malaysia it is the retail Islamic model which has proved so successful, with government employees and private sector managers having their salaries paid into personal bank accounts and seeking financing for housing and vehicle purchase. Islamic banks have become focused on this type of business, but the experience learnt in the Gulf is not easily transferable into the very different financial environment of North Africa.

The lack of knowledge of Islamic banking in North Africa is also an issue, partly because of limited marketing by the few Islamic banks that have been established. In the Gulf and Malaysia Islamic banks have a much higher public profile, not least because as primarily retail institutions they have to compete strongly with each other, as well as with conventional banks offering contracts based on interest payments and receipts. There is extensive coverage of Islamic banking developments in the media in the Gulf and Malaysia, but much less coverage in the countries of North Africa. In the case of the Maghreb countries there has also been more external focus on France where there is virtually no Islamic banking rather than the Gulf region or other more distant parts of the Islamic World where Islamic finance is more developed.

3.2 Legal and Regulatory Issues

In jurisdictions such as Iran[31] and Malaysia[32] there are specific Islamic banking laws, and in other jurisdictions such as Kuwait there have been separate provisions added to the banking law to cater for Islamic finance.[33] In most Arab jurisdictions Islamic finance is governed at the regulatory level, the Central Bank of Bahrain having the most comprehensive rulebook, devised as part of its effort to make the island an Islamic financial hub.

In North Africa there are no comprehensive Islamic banking laws apart from the limited provisions made in Egypt under law number 48 of 1977 which is discussed below in the country section. The licensing requirements for Islamic banks are identical to those for conventional banks in terms of capital requirements,

31 Law on Usury Free Banking, Iran, Tehran, 1983.
32 Islamic Banking Act of Malaysia, Kuala Lumpur, 1983
33 Central Bank of Kuwait, Legislation, Safat, 2004, Section 10.

liquidity ratios and financial reporting. These are not always helpful for Islamic banks however, as they are often at a disadvantage in relation to conventional banks with regard to regulatory requirements. Capital requirements are not a major problem and as Islamic banks all adhere to Basel II requirements, Basel III should not represent too much of an additional challenge.

Two specific problems that Islamic banks face in a conventional financial environment relate to liquidity management and trust laws. Islamic banks cannot hold treasury bills paying interest or accept interest payments on their deposits with central banks. This results in these institutions earning no returns on treasury holdings, while their conventional competitors gain from such holdings.

One solution is for governments to issue short term sovereign *sukuk* or Islamic securities which Islamic banks can legitimately hold and earn a modest return. Such *sukuk* are issued in Malaysia and Bahrain, and their issuance is being considered in other jurisdictions, but not yet in North Africa. The administration of sukuk payments and the ownership of the underlying asset normally requires a trust law of the type found in English Common Law jurisdictions, but not usually in the Civil Law jurisdictions which exist throughout the Arab World, unless special provision is made. This has been done in Bahrain, but in North Africa the issue has yet to be considered.

Table 2: Leading Islamic Banks in North Africa

Islamic Bank	Rank	Assets, $US million	Conventional leader	Assets, $US million
Faisal Islamic Bank of Egypt	43	5,087	National Bank of Egypt	46,380
Al Baraka Bank, Egypt	81	2,135	Banque Misr	28,899
Al Baraka Bank, Algeria	116	1,015	Crédit Populaire d' Algérie	6,856
Banque Al Wava Mauritania	118	992	Banque Mauritanienne pour le Commerce International	12,922
Al Baraka Bank, Tunisia	163	418	Banque International Arabe de Tunisie	4,719

Source: The Banker, Top 500 Islamic Financial Institutions, FT Business, London, November 2010 and The Banker, Top 1,000 World Banks, FT Business, London, July 2010.

4. Islamic Banking Activity in North Africa

This section provides a survey of Islamic banking on a country by country basis. Information on the individual banks, including in many cases their balance sheets, are provided in the appendices.

4.1 Egypt

As table 1 showed, although Islamic banking is less developed generally in North Africa than in the Gulf and Malaysia, it is Egypt that has the highest proportion of shari'ah compliant assets in relation to total bank assets, approaching the five percent level. It is also Egypt, as the most populous state in the region, where Islamic finance has the greatest potential. In addition, as mentioned in the introduction, it is Egypt which has the longest history of Islamic banking in the region dating from the 1960s, even if progress during more recent decades has been disappointing. For these reasons it is worth focusing on Egypt, not least because developments there in the aftermath of the popular uprising are likely to influence attitudes to Islamic finance elsewhere in North Africa. In this section overall developments in Islamic finance in Egypt are reviewed. In appendices A.1.1 to A.1.4 the activities of the major Islamic banks operating in Egypt are examined.

Following the demise of Mit Ghamr Savings Bank in 1971 the government established its own savings institution, Nasser Social Bank, but although it offered interest free loans subject to administrative and service charges, it was not specifically Islamic in terms of its ethos or products. In practice it became a source of soft loans for co-operatives and craft syndicates, largely a financing arm of the Ministry of Social Affairs. It is not regulated by the Central Bank of Egypt, being a hybrid government agency and credit union rather than a bank.

With the emergence of Islamic banking in the Gulf in the 1970s Egypt was viewed as a promising market for expansion, not least because of its large population and proven, if thwarted, interest in Islamic finance. Hence both the Faisal Islamic Bank and Al Baraka of Saudi Arabia were enthusiastic about establishing Islamic finance subsidiaries in Egypt, especially as many of the Egyptian expatriates working in Saudi Arabia and the Gulf were interested in placing remittances through exchange houses in Jeddah and Riyadh and elsewhere directly into Islamic banks in Egypt. The alternative of converting funds into Egyptian pounds and then depositing funds with Egypt's state owned banks was a less attractive alternative, not only because the state owned banks were not shari'ah compliant, but also because they provided a poor level of service.

In response to lobbying by advocates of Islamic finance law number 48 of 1977 was passed permitting the establishment of Islamic banks and their regulation by the Central Bank of Egypt. Both Prince Mohammed bin Faisal and Sheikh Saleh Abdullah Kamel, a wealthy Saudi business man and chairman of the Dallah al Baraka Group, proceeded to line up associates in Egypt to establish Islamic banks. The Faisal Islamic Bank of Egypt obtained a licence from the Central Bank of Egypt on 14th June 1979, shortly followed by Al Baraka Bank of Egypt which was awarded its licence on 8th May 1980. A significant amount of capital was raised in the Gulf for these banking ventures, with Prince Mohammed bin Faisal taking a 20.25 percent stake himself in the Faisal Bank, a financial inflow that seemed unaffected by the Arab financial boycott of Egypt following its peace treaty with Israel.[34] Just a few weeks later a wholly locally owned competitor was established, Al Watany Bank of Egypt, that received a licence on 26th May 1980.

Despite law number 48 being silent on specific Islamic issues, it provided autonomy from interference from government bodies apart from the Central Bank. Islamic banks, like their conventional counterparts, were required to maintain adequate cash to deposit ratios to cover likely liquidity requirements. However the Central Bank did not get involved in *shari'ah* compliance issues. Islamic banks were free to include provisions for *shari'ah* compliance in their own articles of association, with for example article 3 of the Faisal Islamic Bank's statutes referring to the prohibition of *riba* and the obligation to pay *zakat*.[35]

The absence of adequate legal and regulatory provision for Islamic finance created significant problems as voids soon get exploited. In addition to licensed banks, a number of Islamic investment companies were established in the 1980s, the largest of which was the Al-Rayyan Company. These were unregulated and functioned informally, but as they offered investors very high returns, they attracted large amounts of funds. Unfortunately their founders and managers were unable to identify high yielding investments, and they were soon tempted into using new funds deposited to enhance the pay-out to existing investors, a practice that was unsustainable, indeed morally dubious and not the type of behaviour which might be expected from institutions marketing themselves as Islamic.[36] Inevitably these companies collapsed, and as they were unregulated, the investors lost most of their funds, and there was no question of the Central Bank of Egypt becoming involved in any compensation arrangements. There is little doubt that this experience resulted in lasting damage to the reputation of Islamic finance in Egypt, and was unhelpful for the expansion of the licensed Islamic banks.[37]

Although there has been over three decades of Islamic banking experience in Egypt, the laws governing Islamic banking remain unsatisfactory. In particular law number 88 of 2003, the most recent version of the Banking Law, contains no provision for Islamic finance. Some of the articles are unhelpful, including article 40 governing interest rates, article 56 (e) on reserves that has no reference to *shari'ah* compliance, article 59 which provides for interest penalties if banks fail to meet liquidity requirements and article 87 providing for deposit protection. Investment *mudaraba* accounts cannot of course be guaranteed, as otherwise the profit returns for risk sharing would be undermined.

In practice the Central Bank of Egypt has adopted a flexible approach to the regulation of Islamic banking, although it has not been as closely involved in international regulatory debates in such an intense manner as the Central Bank of Bahrain or Bank Negara Malaysia, institutions that have done much to promote their own countries as international centres for Islamic finance. Egypt has no such ambitions, but the Central Bank is a full member of the Islamic Financial Services Board (IFSB), the Kuala Lumpur based organisation that advices on the regulation of Islamic finance and produces prudential standards. Furthermore on the 18th and 19th January 2011, just before the popular uprising, the Central Bank of Egypt hosted an IFSB Workshop at the Egyptian Banking Institute.

4.2 Tunisia

Tunisia has three Islamic banks, Al Baraka Tunisia, Noor Bank and Bank Zitouna. The first two are Gulf based but function in Tunisia as offshore institutions whereas Bank Zitouna was established in May 2010 as a local retail bank to serve the domestic market. Bank Zitouna aimed at establishing 20 branches in its first year of operations, but there are some questions about what can be achieved in the short run, as the bank was founded by Mohamed Sakher El Materi, the son in law of Tunisia's deposed President, Zine El Abidine Ben Ali.[38] Mohamed Sakher El Materi previously owned an Islamic radio station, Radio Zitouna, and Dar Al-Sabah, the largest private media group

[34] Gil Feiler, Economic Relations Between Egypt and the Gulf Oil States, 1967-2000: Petro Wealth and Patterns of Influence, Sussex Academic Press, Brighton, 2003, pp. 218-219.
[35] Ahmed Abdel Fattah El Ashker, The Islamic Business Enterprise, Croom Helm Books, London, 1987, pp. 115-116.
[36] Sami Zubaida, "The Politics of the Islamic investment companies in Egypt", British Society for Middle Eastern Studies Bulletin, Volume 17, Number 2, 1990, pp. 152-161.
[37] Charles Tripp, Islam and the Moral Economy: The Challenge of Capitalism, Cambridge University Press, 2006, p. 144.
[38] Mona Yahia, "Islamic bank a first for Tunisia", Magharebia, Tunis, 2nd June 2010.

in Tunisia; hence Bank Zitouna represented a further stage in the development of his business empire. The bank provides finance for real estate development, tourist buses, equipment and stock. Like other Islamic banks its financing methods include *murabaha, ijara, musharaka, mudaraba* and *istisna'a*.

4.3 Algeria

There are two Islamic banks in Algeria, Al Baraka Bank, part of the Al Baraka Group, whose affiliates in Egypt and Tunisia have already been discussed, and Al Salam Bank, an affiliate of Al Salam Bank of Bahrain. The Al Baraka Bank's presence in Algeria dates from 1991, but the Al Salam presence is more recent dating only from October 2008.[39] The Al Salam Bank was established in Algeria with a paid up capital of $US 100 million, but so far it has been largely involved in exploratory work identifying where the opportunities might be for Gulf investors in Algeria.

4.4 Morocco

There are no Islamic banks in Morocco and although the Islamic Development Bank and the Central Bank of Morocco, Bank Al-Maghrib, hosted a conference on Islamic finance in Casablanca in 1990, no local Islamic bank emerged as had happened at similar launch events elsewhere in the Islamic World. The banking laws of Morocco do not permit the type of direct investment activity undertaken by many Islamic banks and there is no provision for profit sharing with depositors or participatory finance.[40] Bank Al-Maghrib has observer status with the IFSB, but it has not applied for full membership and rarely sends representatives to Islamic finance conferences or seminars.

4.5 Libya

There is still no Islamic banking in Libya, although there have been moves to open up the largely state owned banking system in recent years, and prior to the 2011 popular uprising, Gumhouria Bank had declared its intention to establish an Islamic banking subsidiary. Although there is much uncertainty over the direction of economic and financial policy following the demise of the Gaddafi regime, it seems likely that it will move towards being a more liberal and open system which should favour the development of Islamic banking.

4.6 Mauritania

Mauritania is one of the poorest countries in the Islamic World whose population of just over 3 million have been adversely affected by drought in recent years. Most of its people do not use banks of any type, either conventional or Islamic. Al Baraka Bank however established an Islamic bank in Mauritania in 1985, with half of the initial capital subscribed by Al Baraka's Saudi Arabian shareholders, 10 percent of the capital subscribed by the Central Bank and the remaining 40 percent by businessmen from Mauritania.

[40] *Fathallah Oualalou, "Morocco explains difficulty to grant permission to Islamic bank installation", Arabic News, Rabat, 18th November 1998.*

5. Shari'ah Compliant Project Finance

Islamic retail banks such as those in North Africa reviewed in the previous section contribute to economic activity by boosting demand, but where there are supply constraints a different type of finance is needed. In North Africa supply constraints can only be overcome through substantial investment in infrastructure, but the region has lagged behind adjacent areas such as the GCC in recent decades which have much larger incomes from oil and gas exports. In this section existing *shari'ah* compliant project finance in North Africa is examined, as this has the potential to make a worthwhile contribution to the region's infrastructure development. Country data is used to illustrate the scale of Islamic project finance followed by a section providing an account of project finance in North Africa by the Jeddah based Islamic Development Bank (IDB).

It is worth noting that the appraisal process for Islamic project finance is the same as for conventional project finance, and as most of the funding is for infrastructure, energy and other types of development projects there are no issues of *shari'ah* non-compliance. The major difference between Islamic and conventional project finance is in the legal contracts governing the financing methods used.[41]

5.1 Islamic Project Finance in Egypt

As table 3 shows most of the financing in Egypt has involved *ijara* operating leases and murabaha. Of the five contracts listed for Egypt the IDB was the financier for the three *ijara* deals and the government the funding recipient. With the *ijara* contract for the Behna Power Plant for example the government of Egypt rents the facilities from the IDB from the fourth year after the project is completed and there will be a revenue stream from the sale of the electricity. The *ijara* rents are paid over a 15 year period to the IDB, after which the government of Egypt purchases the plant. The advantage of the IDB funding from an Egyptian perspective is this very long term before the credit expires and the stable and predictable servicing costs. Commercial funding would be for a shorter period and much more expensive.

Table 3: Islamic Project Finance in Egypt

Date	Project	Sector	Method	Amount $USm
10.01.2011	Saudi Al Batterjee	Hospital	Ijara	10.0
10.01.2011	Suez Steam Power	Energy	Ijara	60.0
08.09.2010	Benha Power Plant	Energy	Ijara	120.0
21.12.2009	ENPC Fertilizers	Manufacturing	Murabaha	15.0
11.10.2009	Abu Qir Power	Energy	Murabaha	73.8

Source: Islamic Finance Information Service, London, March 2011.

[41] *Syed Tariq Husain, "Project finance", in Simon Archer and Rifaat Ahmed Abdel Karim, (editors), Islamic Finance: Innovation and Growth, Euromoney Books, London, 2002, pp. 143-150; Michael J. T. McMillen, "Islamic Project Finance", in M. Kabir Hassan and Mervyn K. Lewis, (editors), Handbook of Islamic Banking, Edward Elgar, Cheltenham, 2007, pp. 200-239; Richard T. de Belder, "Commercial real estate and project financing", in Habiba Anwar, (editor), Islamic Finance: A Guide for International Business and Investment, GMB Publishing, London, 2008, pp. 75-82.*

The *mudaraba* funding for the Abu Qir Power plant was part of a syndicated financing deal for $US 183 million arranged by the Arab African International Bank with conventional loans being provided by the Banque du Caire, Egyptian Saudi Finance Bank, Al Watany and Egyptian Gulf Bank. The financing was provided to the West Delta Electricity Company to cover a three year financing gap. Work on the project commenced in 2007, but revenue from electricity sales will not start until 2012. The Islamic funding worth $US 73.8 million was provided by Faisal Islamic Bank of Egypt through a mudaraba facility whereby it provided partnership finance in return for a share of the profits accruing to the West Delta Electricity Company.

5.2 Islamic Project Finance in Tunisia and Morocco

There has also been significant Islamic project funding for infrastructure, energy and real estate developments in Tunisia and Morocco as table 4 shows, with three funding deals for Tunisia and six for Morocco. Most of the funding has involved istisna'a whereby the financier pays for the equipment, labour and suppliers for the project and receives the return of the capital advanced plus a pre-determined profit mark-up when the project is completed and revenue starts to accrue.

Table 4: Islamic Project Finance in Tunisia and Morocco

Date	Project	Sector	Method	Amount $USm
11.10.2011	Tunisia Financial Harbour	Real estate	Islamic finance	3000.0
09.08.2010	Jorf Lasfar port expansion, Morocco	Infrastructure	Istisna'a	150.0
09.08.2010	Rural electrification, Morocco	Energy	Istisna'a	65.6
14.12.2009	Irrigation development, Tunisia	Infrastructure	Istisna'a	12.3
08.11.2009	Al-Quneitrah housing, Morocco	Real estate	Islamic finance	53.5
21.05.2009	Al-Quneitrah power station, Morocco	Energy	Islamic finance	200.0
24.03.2009	Tunisian Indian fertilizers	Manufacturing	Istisna'a and ijara	150.0
08.10.2007	Mohammedia gas turbine plant, Morocco	Energy	Istisna'a	189.0
24.06.2005	Marrakech-Agadir highway, Morocco	Infrastructure	Istisna'a	106.2

Source: Islamic Finance Information Service, London, March 2011.

The largest project is the Tunisian Financial Harbour modelled on the Bahrain Financial Harbour. The site is in Raoued, a suburb of Tunis, which is to serve as the first offshore banking and financial centre for North Africa. The ambitious scheme aims to create 16,000 jobs and accommodate a permanent population of 110,000 residents.[42] The Islamic financing is being provided for the real estate development by Gulf Finance House, a Bahrain based investment bank which was founded in 1999 to provide shari'ah compliant services. Work has already started on the development the eventual aim being to attract European Union North African business worth $US 15 billion.

5.4 Islamic Development Bank activity in North Africa

The IDB is considered separately in this section because of its importance as the major provider of shari'ah compliant project finance. It has been providing shari'ah compliant financial assistance to its 56 member states since 1976, which include all the countries of North Africa. Although Saudi Arabia is the largest financial contributor to the IDB accounting for over one quarter of its paid up capital the North African countries are also significant contributors as table 6 shows, with Libya being the largest contributor in the region.

Table 5: Islamic Project Finance in Mauritania

Date	Project	Sector	Method	Amount $USm
01.03.2011	Water distribution	Infrastructure	Islamic finance	13.0
01.03.2011	Cardiac centre	Hospital	Islamic finance	17.8
05.10.2010	MoroccoKiffa-Kankossa road	Infrastructure	Islamic finance	15.0
05.10.2010	Aftouti Elchagui water supply project 1	Infrastructure	Istisna'a	14.1
05.10.2010	Aftouti Elchagui water supply project 2	Infrastructure	Istisna'a	13.6
09.08.2010	Vocational literacy programme	Education	Islamic finance	6.2
31.01.2010	Nouakchott University campus	Education	Islamic finance	9.4
19.08.2009	National Mineral Industry	Mining	Ijara	108.0

Source: Islamic Finance Information Service, London, March 2011.

5.3 Islamic Project Finance in Mauritania

Although there is little Islamic banking in Mauritania, there have been seven Islamic project finance schemes by the IDB as table 5 shows with two based on istisna'a structures and one involving ijara. The total value of the projects is less than $US 200 million, the largest project being for mineral development involving iron ore. The aim is to recapitalise the state owned Société Nationale Industrielle et Minière which exploits iron ore in the northern town of Zouerate.

IDB data provides a comparative perspective across the North African region. Table 7 shows the total project and trade financing received by the countries of North Africa from the IDB. There has also been some technical assistance and special assistance to deal with emergencies which is included in the total.

As the table shows Morocco was the largest single beneficiary in the region from IDB project and trade finance, as well as in overall funding, despite being a

[42] *Leah Hyslop, "First offshore financial centre in North Africa opened", Daily Telegraph, 19th October 2010, London.*

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Table 6: North African IDB Contributions

	Number of shares	Called up capital, million ID	Callable capital, million ID	Total ID	Percent of total
Algeria	45,922	124,260	334,960	459,220	2.87
Egypt	127,867	346,000	932,670	1,278,670	7.99
Libya	147,824	400,000	1,078,240	1,478,240	9.24
Mauritania	977	4,920	4,850	9,770	0.06
Morocco	9,169	24,810	66,880	91,690	0.57
Tunisia	1,955	9,850	9,700	19,550	0.12

Source: IDB, Annual Report, Jeddah 1430 H (2009-2010)
Note: 1 Islamic Dinar (ID) = 1 Special Drawing Right of the IMF = $US 1.57 = €1.14

relatively minor contributor to the IDB, and well behind Libya, Egypt and even Algeria. Funding is of course decided on the merits of the financing applications rather than in relation to member's contributions, and one of the reasons for Morocco's success has been its ability to submit coherent funding applications based on sound business plans with realistic cost and revenue projections. Recent projects financed include the Kenitra Power Plant Project aimed at adding an additional 300 MW to the existing electricity power supply system. The funding was worth ID 126 million and was structured as an instalment sale. The second project approved in Morocco in 2009 was for a water supply expansion project for rural communities in Taza Province. This aimed to augment the supply of drinking water for the southern districts of Fez city and adjacent rural villages by improving the pipelines from two existing dams to eliminate wasteful seepage. This project was mostly through an *istisna'a* facility worth ID 26.48 million, the preferred *shari'ah* compliant method for project finance.

The IDB has cooperated with many other international funding organisations, including the World Bank, since the 1970s. Often development finance can be most effective when several agencies are involved and costs are shared. Although the IDB is committed to the provision of *shari'ah* compliant funding, it can cooperate with conventional institutions providing interest based loans, provided these are not funded from IDB resources. Funding segregation must be maintained, but this does not preclude sharing the costs of project appraisal and progress monitoring.

Table 7: IDB Funding for North African Member States, 1976-2009

	Number of projects	Project finance ID million	Number of trade deals	Trade finance ID million	Total financing ID million
Algeria	40	446.9	188	1,490	1,944.4
Egypt	42	554.2	113	1,380.2	1,938.3
Libya	17	282.2	10	230.0	517.5
Mauritania	52	302.6	7	77.2	406.1
Morocco	57	1,073.5	114	1,670.0	2,685.6
Tunisia	50	555.7	160	803.9	1,364.6

Source: IDB, Annual Report, Jeddah 1430 H (2009-2010)
Note: 1 Islamic Dinar (ID) = 1 Special Drawing Right of the IMF = $US 1.57 = €1.14

6. Potential for Islamic Capital Market Instruments

Project finance can also be raised through *sukuk* issuance. *Sukuk* are traded or potentially tradable securities often referred to as Islamic bonds,[43] although those with variable returns are more similar to floating rate notes rather than fixed return instruments.[44] The distinctive feature of *sukuk* is that they must be asset backed as trading in debt securities is not permitted under shari'ah. When *sukuk* are traded what is being bought and sold is a right to the underlying asset. Investors in *sukuk* cannot receive interest, but rather permissible returns such as rents in the case of *ijara sukuk* or profit shares in the case of *mudaraba* or *musharaka sukuk*.

Most *sukuk* trading occurs in Malaysia[45] with some over the counter deals in the GCC, but in North Africa *sukuk* issuance is confined to Egypt where there has been no trading so far. As table 8 shows all of the *sukuk* issuance in Egypt to date has been structured using *ijara*, which results in investors receiving a variable rental linked to inter-bank lending rates.[46]

The *sukuk* funding has been for three year periods with the Al Baraka *sukuk* US dollar denominated. Following the re-branding of Al *Baraka* in Egypt the *sukuk* was to re-structure the bank's balance sheet and increase its resources to finance expansion. The Al-Tawfeek *sukuk* were organised by the Commercial International Bank of Egypt, the leading local private investment bank. Al-Tawfeek is the largest leasing company in Egypt, with 297 contracts on its books worth LE 599 million. The *sukuk* were to raise funds in Egyptian pounds for equipment purchases. Investors in the sukuk receive

Table 8: Egyptian Sukuk Issuance

Date	Issuer	Currency	Type	Amount, $US
01.11.2010	Al Baraka	$US	Ijara	150.0
10.07.2010	Al-Tawfeek	LE	Ijara	53.0
06.10.2010	Al-Tawfeek	LE	Ijara	40.6
10.06.2010	Al-Tawfeek	LE	Ijara	6.8

Source: Islamic Finance Information Service, London, March 2011.

43 *Mughees Shaukat, "The ultimate guide to sukuk", Global Islamic Finance, March 2011, pp, 12-20.*
44 *Rodney Wilson, "Innovation in the structuring of Islamic sukuk securities", Humanomics: The International Journal of Systems and Ethics, Volume 24, Number 3, 2008, pp. 170-181; Rodney Wilson, "Overview of the sukuk market", in Nathif J. Adam and Abdulkader Thomas, (editors), Islamic Bonds: Your Guide to Issuing, Structuring and Investing in Sukuk, Euromoney Books, London, 2004, pp. 3-17.*
45 *Zainal Hasfi Hashim, "The Malaysian sukuk market", in Sohail Jaffar, (editor), Islamic Investment Banking: Emerging Trends, Developments and Opportunities, Euromoney Books, London, 2010, pp. 93-103.*
46 *Shabnam Mokhtar and Abdulkader Thomas, "Ijara sukuk", in Abdulkader Thomas, (editor), Sukuk, Sweet and Maxwell Asia and Thompson Reuters, Selangor, Malaysia, 2009, pp. 145-160.*

monthly returns which are the equivalent of a 10 percent annual return over a 36 month period.[47] The *sukuk* are rated AA by the Middle East Rating and Investors Service (MERIS) which is partly owned by Moodys,[48] and are regarded as a safe investment given the business success of the Al-Tawfeek Company.

Egypt has the most highly developed debt market for treasury bills and bonds worth over $US 80 billion which until the recent popular uprising was attractive for raising both government and private funding because of the relatively low pricing. The former government's commitment to lowering the budget deficit and the high degree of liquidity in the Egyptian banking system helped the market. Of course the situation dramatically changed after the popular uprising with foreign investors pulling out.[49] Nevertheless when the political situation stabilises confidence should return, and this could help the development of *sukuk* issuance which tends to be linked to bond market development.

Trading in bonds is undertaken on the Casablanca stock market, with government bonds accounting for most of the issuance, both in local currency and in Euros. Domestic borrowing accounts for around three quarters of Moroccan government debt, but on 5th October 2010 there was a sale of new 10 year bonds worth €1 billion with HSBC and Barclays Capital acting as arrangers. The bonds yielded 4.5 percent, enough to attract an oversubscription, with 57 percent of the bond investors from Europe.[50]

Tunisian bonds, mainly representing sovereign debt, are traded on the Tunis stock exchange, with most being held by local investors, including the banks, as is the case in Morocco. The largest sovereign bond is a ten year issuance for €600 million which matures in 2020. Following the revolution in January Moody's lowered Tunisia's foreign debt rating to Baa3, constraining the raising of funds on the market.

As the new government in Tunisia will need to raise substantial funds in order to stimulate the economy, diversification of funding sources may be necessary. To attract investment from Islamic financial institutions based in the GCC and elsewhere in the Islamic World, *sukuk* issuance could be helpful, not least as they can contribute to capital market development.[52] This also applies to Morocco which has already attracted substantial foreign direct investment from the GCC, mainly for real estate and tourist projects. Issuing Euro denominated sovereign *sukuk* could be attractive to GCC based Islamic financial institutions seeking to diversify away from US dollar holdings. *Ijara sukuk* would probable prove the most straightforward structure, as it is the type of *sukuk* which is favoured by GCC investors. For any issuance to be successful and priced attractively, it would need to be favourably rated. This would be dependent on the future political stability of Tunisia.

6.1 Shari'ah Compliant Managed Funds

There has been over three decades of experience of *shari'ah* compliant managed funds, which started in Saudi Arabia but soon spread to other GCC countries as well as Malaysia which has become a major Islamic fund management centre. Most of the funds invest in the equity of listed companies, but some invest in real estate developments and others in traded commodities. There are also *sukuk* funds which hold a portfolio of *sukuk* investments, the shari'ah compliant equivalent of a corporate bond fund.

In the case of equity based Islamic managed funds the companies in which the funds are invested are screened

[47] *Data from the Islamic Finance Information Service, London, March 2011.*
[48] *http://www.merisratings.com/*
[49] *Robin Wigglesworth, "Egypt faces bleak outlook on debt", Financial Times, London, 9th March 2011.*
[50] *Alaa Shahine and Ahmed Namatalla, "Morocco €1 billion bond sale aims to diversify borrowing", Bloomberg, New York, 29th September 2010.*
[51] *Jihen Laghmari, Alaa Shahine and Ola Galal, "Tunisian coalition to meet for first time to discuss proposed amnesty law", Bloomberg, New York, 20th January 2011.*
[52] *Salman Syed Ali, Islamic Capital Market Products: Developments and Challenges, Islamic Development Bank, Islamic Research and Training Institute, Occasional Paper Number 9, Jeddah, 2005, pp. 47-48.*

to ensure they are *shari'ah* compliant.[53] There are both sector and financial screens which are widely recognised. Investing in a *riba* base bank is not permitted for example, nor is investment in the food processing of *haram* meat products such as pork, or casinos which encourage gambling.[54] The financial screens relate to corporate leverage, as although it is recognised that most listed companies will have conventional debt liabilities, if these exceed one third of the asset value or market capitalisation of the company, this is regarded as excessively risky, encouraging speculative investment.[55] Speculation and excessive risk taking for monetary gain is forbidden in Islam.

In North Africa Islamic funds are confined to Egypt with the exception of one fund offered in Tunisia. As table 9 shows there are nine funds available in Egypt the earliest being an equity fund offered by the Faisal Islamic Bank to its clients in 2004.

The Faisal Fund is managed by EGF Hermes, the Egyptian Investment Bank which is listed on the Cairo and London stock exchanges.[56] It has extensive experience with asset management and a strong team of analysts specialising in Arab and Middle Eastern markets. Such outsourcing of the management of Islamic funds is very common, the input of the Faisal Bank being to provide the *shari'ah* compliance and the marketing to their clients. The fund is open ended with no subscription fee, but a 0.25 percent redemption charge. The fund has performed well with investors more than doubling their money over the period from 2005 to 2007. During the global financial crisis of 2008 the fund suffered a 35.1 percent decline, half of which has subsequently been recovered. Major holdings include Orascom Construction, Orascom Telecom, Ezz Steel and the Palm Hills residential development outside Cairo.

The Al Baraka Fund which was launched in 2006 is also managed by EGF Hermes with a similar range of investments and performance as the Faisal Fund. The Bashayer Fund, the largest in Egypt as table 9 shows, is also offered by Al Baraka Bank but managed by Al Ahly Mutual Funds which is an affiliate of the National Bank of Egypt. Its investment portfolio includes Abu Kier Fertilizers, Mobinil, the leading Egyptian mobile telephone company, Alexandria Iron and Steel, Misr Benisuef Cement and Asec Mining. The Banque Misr Fund is discussed in Appendix A.1.4 where the Islamic operations of the bank are covered. It is managed by the H.C. Securities and Investment Company, a small asset management specialist firm based in Cairo. Its performance has been inferior to the other funds with a 64 percent decline in its value during 2008.

It is evident that Egyptian investors have a varied range of Islamic funds to choose from, and the poor performance during the global financial crisis of 2008 did not deter the launch of new funds, with three funds established during 2010. This bodes well for the future when economic activity in Egypt picks up once a newly elected President and government are in place.

The sole Islamic mutual fund in Tunisia, FCP Valeurs Al Kaouther, was launched by Amen Bank in September 2010 in collaboration with Tunisie Valeurs, a local asset management company.[57] The fund is open ended and classified as a low risk and balanced with a minimum of 50 percent of total investments placed in companies listed on the Tunisian stock exchange, a maximum of 30 percent in monetary placements and 20 percent held as liquidity.[58] The launch capital was 10 percent subscribed by the IDB, with 20 percent by Bechir

[53] *Rodney Wilson, "Screening criteria for Islamic equity funds", in Sohail Jaffer, (editor), Islamic Asset Management: Forming the Future for Shari'ah Compliant Investment Strategies", Euromoney Books, London, 2004, pp. 35-45.*
[54] *For an example of the screening criteria see the Scottish Widows Investment Partners Islamic funds website: http://www.swip.com/advisers/FundsinFocus/swip-islamic-global-equity-fund/Pages/shariah-finance-principles.aspx. In Malaysia the screens only apply to sectors, not leverage. See Securities Commission, Regulations of the Securities Commission Advisory Board, Kuala Lumpur, 2006, Second edition, pp. 144-149.*
[55] *Guide to the Dow Jones Islamic Market Index, New York, December 2010, p. 5: http://www.djindexes.com/mdsidx/downloads/rulebooks/Dow_Jones_Islamic_Market_Indexes_Rulebook.pdf*
[56] *http://www.efg-hermes.com/English/AboutUs.aspx?PageID=41&h=h1*
[57] *https://www.tunisievaleurs.com.tn/indexssl.asp*

Tamarza and 20 percent by Omar Benzina, and a further 10 percent subscribed by Bank Zitouna, the Tunisian Islamic bank. So far it is too early to assess performance, which has been adversely affected by the uprising, but the longer term prospects are potentially promising, although constrained by the small size and restricted stock selection available in the Tunisian stock market.

Table 9: Egyptian Managed Funds

Date	Name	Asset type	Currency	Fund size, $US
17.10.2010	Al Hayat	Equities	LE	15.9
10.08.2010	Al Baraka	Mixed	LE	10.0
10.02.2010	Bashayer	Equities	LE	50.4
18.03.2007	Al Mudaraba	Equities	LE	N/A
08.02.2007	Sanabel	Equities	LE	12.8
24.10.2006	Banque Misr	Equities	LE	34.8
25.09.2006	Al Aman	Equities	LE	9.1
01.06.2006	Al Baraka	Equities	LE	22.9
01.12.2004	Faisal Islamic	Equities	LE	47.9

Source: Islamic Finance Information Service, London, March 2011.

[58] *FCP Valeurs Al Kaother, Prospectus d'Emission, Tunis, September 2010.*

7. Private Equity and Venture Capital Using Musharaka

The private equity and venture capital industry is in its infancy in North Africa and there are no Islamic private equity funds available to investors comparable to those offered in the GCC and Malaysia.[59] At present much of the industry is confined to Egypt, but there is clearly considerable potential elsewhere in North Africa and there has been some activity in Morocco and Tunisia where there is a demand for equity finance.[60]

7.1 Private Equity Investment in Egypt

The leading private equity investment company in Egypt is Citadel Capital which was established in 2004. It has invested itself and attracted investment worth $2.5 billion into 19 funds. It employs 66 people including 38 investment analysts, and its geographical focus is on Egypt and investment opportunities throughout Africa.[61] Its investments are mainly in energy and manufacturing ventures, but it has a holding in Wafra Agriculture of the Sudan. Its energy investments are mostly in exploration companies such as ASCOM Geology and Mining, the National Petroleum Company, NORP Energy and Nile Valley Petroleum.

EGF Hermes also has a private equity division which has raised $US 2.2 billion for investment in 9 funds. These are focused on Egypt and the wider Middle East and North Africa region, but there has been no investment in North Africa beyond Egypt. Although there has been investment in energy ventures, the largest single fund, Horus III, invests in technology companies with a committed investment of $US 575 million.[62] The companies the fund invests in include Ridgewood, a desalination venture operating in South Sinai and the Red Sea, Wadi El Nil, a specialist cement company and Dyetex, an Egyptian manufacturer of ready made clothing mainly destined for the European market.

7.2 Private Equity Investment in Morocco

In Morocco Fons Mediterrània Capital, the private equity division of Riva Y Garcia, has been financed by the European Investment Bank and Spanish partners. Since 2009 six investments have been undertaken including funding for a Moroccan company producing flowers and ornamental plants, JP Industrie, a Moroccan building supply firm and BITAKA, a Tunisian mobile phone company.[63] Emerging Capital Partners, a Washington based private equity firm with a focus on Africa, has offices in Casablanca and Tunis. It has partnered with Truffle Capital, an energy investment specialist, and Attijari Invest, the private equity affiliate of Morocco's Attijariwafa Bank, to acquire Compagnie Minière de Touissit, a lead producer and exporter. The investment was worth €38.3 million, but it was a one off deal which does not provide a flow of private equity capital comparable to the deals in Egypt.[64]

7.3 Shariah Compliant Private Equity

Although the private equity investment funds offered by Citadel Capital and EGF Hermes are not formally *shari'ah* compliant, as they have not been approved by a *shari'ah* board, in practice most, if not all, of the companies in which investments have been placed are engaged in activities that can be considered to be permissible or *halal*. Rather than converting existing funds which are already fully subscribed to being shari'ah compliant it may be preferable to launch new funds which are designated as Islamic to attract wider investment.

Most of the existing Islamic private equity funds are structured using conventional contracts but eliminate all references to riba and spell out the screening criteria used to ensure *shari'ah* compliance. A more radical but ultimately more rewarding way forward may be to draft contracts based on Islamic financing methods. *Mudaraba* and *wakala* contracts can be used for Islamic private equity finance, with the investors sharing in profits and losses under the former but having sole liability for losses. Under *wakala* contracts the investors receive all the profits, with the wakil or agent being paid a fee.[65] *Musharaka* contracts, a type of joint venture arrangement, are also possible, with the investors sharing the profits and losses collectively for the duration of the project.

[59] *Rodney Wilson, "Shariah compliant private equity finance", in Sohail Jaffer, (editor), Islamic Wealth Management: A Catalyst for Global Change and Innovation, Euromoney Books, London, 2009, pp. 399-412.*
[60] *Tom Pfeiller, "Private equity takes growing role in North Africa", Reuters, 25th October 2009.*
[61] *http://www.citadelcapital.com/investor-relations/key-information/*
[62] *http://www.efg-hermes.com/English/Services.aspx?PageID=234&expandable=3&subexpandable=0&li=18*
[63] *www.mediterraniafcr.com/en/119.html*
[64] *www.ecpinvestments.com/news/1514.xml*

[65] *Mohamad Nedal Alchaar, "Private equity investment through Islamic finance", in Chézard Ameer, (editor), Islamic Alternative Investments: A Guide to Managing and Investing in Shariah Compliant Private Equity, Real Estate and Hedge Funds, Private Equity International Publications, London, 2008, pp. 51-54..*

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8. Conclusions

There is substantial scope for Islamic banking and finance in North Africa. It can potentially contribute to a more inclusive type of development that brings social cohesion by supporting the equitable distribution of risk and returns between suppliers and users of funds.

Additionally, Islamic banks are able to provide a wider variety of contracts than their conventional counterparts tailored to particular financing needs. There have been over four decades of innovation with modern Islamic financial contracts, a process referred to under Islamic law as ijtihad, and the dialogue between scholars of fiqh, commercial lawyers and finance professionals has produced a wide range of financial solutions which can be designated as shari'ah compliant. In other words far from being a throw-back to a period when financial intermediation was underdeveloped, the advocates and supporters of Islamic finance have contributed to the development of financial contracts that can serve many purposes in modern economies. Islamic banking should not be viewed as a panacea for development challenges, although it could play a useful role in regions such as North Africa.

Moreover, as far as North Africa is concerned Islamic finance has only had a very limited impact to date. The survey of Islamic banking in the region showed that despite the pioneering efforts of institutions such as the Al Baraka Bank since the 1970s, Islamic finance remained on the margins of the financial systems.

However, a potential advantage of Islamic banks is that they can harness funds from the pious who do not want to deal with interest based banks. This may account for some of the deposits in Islamic banks in North Africa, but arguably of greater significance is their ability to raise funds in the GCC, both from their sponsors, and from expatriates from North Africa working in the GCC. The mobilization of these funds would allow for the diversification of sources of foreign investment in the region. Meanwhile, such investments would allow for North Africa's accelerated development whilst reducing its dependence on its current principal economic partners.

Appendices: Case Studies of Islamic Banks in North Africa

A.1 Egypt

A.1.1 Faisal Islamic Bank of Egypt

As the longest established commercial Islamic bank in Egypt, it is appropriate to first examine the activities of the Faisal Islamic Bank of Egypt. It does not figure in the top ten ranking of Egypt's banks, but it has a network of 14 branches and its assets are worth around LE 27.7 billion (€3.46 billion). Over 70 percent of its funding comes from what it describes as savings pools, most of which comprise investment accounts placed on a *mudaraba* basis whereby the depositors share in the bank's profit rather than earning an interest based return. There are around LE 50 million of current account deposits with the bank which earn no return but can be withdrawn on demand rather than being subject to periods of notice. However as the inflation rate in Egypt exceeded 16 percent in 2010 and rose to 18.6 percent in 2011, the opportunity cost of leaving funds in deposits not earning a return is high, and hence it is not surprising that such deposits have diminished as a proportion of total deposits.

In addition to accepting deposits in Egyptian pounds the Faisal Bank accepts deposits in foreign currencies, notably Euros, Sterling, Saudi Riyals and United States dollars. The returns paid on these deposits are in line with the conventional interest rates for each currency, and are only a fraction of the rates paid on investment deposits in Egyptian pounds. Nevertheless because of expectations that the Egyptian pound will continue to depreciate, many Egyptian expatriates in the Gulf or Europe prefer to maintain deposits in harder currencies.

However, Faisal Bank has had more success in attracting deposits than with the deployment of funds. One challenge has been that by accepting foreign currency deposits, it has to hedge foreign exchange risk by placing funds in Euros and US dollars in other banks rather than financing commercial activities in Egypt. Hence on 31st December 2009 LE 14.8 billion, over half its assets, represented deposits with other banks and only LE 5.5 billion was advanced to customers. The funds placed with other banks had to be used in a *shari'ah* compliant manner, an assurance which the Bank of Credit and Commerce International (BCCI) offered.[66] The Faisal Bank became heavily involved with BCCI during the 1980s, but when BCCI was liquidated under orders from the High Court in London on 14th January 1992 because of false accounting, the Faisal Bank faced the possibility of catastrophic losses. Over time as the affairs of BCCI have been wound down and legitimate assets sold, the Faisal Bank has received a series of dividend payments, but as at 31st December 2009 LE 272 million was still outstanding, 17 years after the BCCI liquidation.[67]

In many respects the Faisal Bank has acted as an investment company rather than a bank as it has established and participated in a wide range of companies both in Egypt and abroad. Table A.1 shows the sectors and amounts of the investment. Many of these holdings have been long term, some dating from the 1980s, but one issue is whether a relatively small bank has the management skill set to oversee and monitor effectively such a wide range of geographically dispersed investments. The Faisal Bank's profits amounted to LE 123 million in 2009, a rise from LE 85 million in 2008, but the return on assets was

[66] *For a profile of BCCI see Rodney Wilson, Banking and Finance in the Arab Middle East, Macmillan, London, 1983, pp. 64-69.*
[67] *Faisal Islamic Bank of Egypt, Annual Report, Cairo, 2009, note 8.*

Table A.1: Faisal Islamic Group Companies

Sector	Number	LE million
Agro-livestock	2	95
Industrial	19	1.201
Pharmaceuticals	4	142
Investment	4	5
Foreign trade	3	25
Residential housing	5	220
Financial institutions	17	1.270
Information technology	6	202
Others	9	235
Total	69	5.314

Source: Faisal Islamic Bank, Annual Report, Cairo, 2009.

a mere 0.48 percent, just over one tenth of the percentage returns of Al Rajhi Bank of Saudi Arabia, the world's largest listed Islamic bank.[68]

A.1.2 Al Baraka Bank Egypt

The Egyptian subsidiary of Bahrain based Al Baraka Bank has as long a presence as the Faisal Bank in the Egyptian market, with a network of 24 branches, larger than that of its rival. Its assets and liabilities amount to LE 13 billion, with customer deposits worth just under LE 11.5 billion. Al Baraka re-branded its operations in 2009 and it now designates itself as a retail bank. Hence an increasing amount of its financing is for its domestic customer base covering housing finance, durable goods purchase and vehicle finance. Although deposits are accepted in Euros and United States dollars, most deposits and financing are Egyptian pound denominated.

Table A.2 provides a breakdown of Al Baraka Bank financing with over LE 5 billion provided for customer financing through murabaha, mudaraba and musharaka, with the former being largely used for vehicle and durable goods financing, while musharaka partnership financing is used for residential and commercial mortgages. Almost LE 4 billion was deposited with other banks, largely the counterpart of the US dollar and Euro deposits.

Al Baraka's operations resulted in profits before tax of LE 94 million in the year to 30th September 2009 rising to LE 108 million for the year to 30th September 2010. The return on assets was a mere 0.45.[69] Al Baraka increased its returns on financing from LE 61.7 million in the year to 30th September 2009 to LE 67.4 million for the year to 30th September 2010, but the cost of its funding also rose from LE 41 million to almost LE

[68] *The Banker, Top 500 Islamic Financial Institutions, Financial Times Business, London, November 2010, pp. 34-35.*
[69] *Ibid.*

48 million.[70] This squeezed the bank's margins, and it was only by increasing fee income that the profitability could be modestly boosted. In other words although Al Baraka Bank in Egypt is growing, and it does not have the inherited problems of the Faisal Bank, the rate of growth is modest and the scale of business and profitability in relation to its fairly extensive branch network seems low.

A.1.3 Al Watani Bank

Unlike the Faisal Bank and Al Baraka, Al Watani is primarily a conventional bank, but it offers Islamic deposit facilities and shari'ah compliant funding. It was originally established in 1980 as a private bank geared towards financing the growing private sector in Egypt, but in 2007 it was taken over by National Bank of Kuwait (NBK), the leading bank in its home country, with an extensive international network of subsidiaries. Since the take-over NBK has invested significantly in Al Watani Bank, expanding its network to 36 branches by the end of 2010, and introducing advanced information technology systems that enable its Egyptian clients to enjoy the same excellent customer friendly on-line services that are available in Kuwait. Some of the clients are the families of Egyptians working in Kuwait, but most are middle class Egyptians working in their own country.

Al Watani Bank offers demand deposits, designated Islamic "safe" accounts, with withdrawals made from ATMs and cheque books and on-line payment facilities. No returns are payable on these accounts, but for savings investment accounts are offered on a mudaraba basis whereby the client shares in the bank's profit rather than earning interest. These are offered in Egyptian pounds to anyone over the age of 21. For higher returns clients can invest in three year certificates of deposit on which a quarterly income is paid, usually into the client's demand deposit account, although the returns can be re-invested in further three year certificates. These are comparable to conventional certificates of deposit, but the income is based on a profit share rather than on interest. There is no secondary market in the Islamic certificates, which are usually held to maturity.

For Islamic financing Al Watani Bank offers personal murabaha and vehicle murabaha. For both forms of financing clients must be employed, aged from 25 to 60

Table A.2: Al Baraka Egypt Assets

Asset	LE million, 30/9/2010	LE million, 30/92009
Cash and CBE balances	1,218	1,071
Due from banks	3,810	3,249
TBs & Government securities	749	727
Investments with banks	474	725
Murabaha, mudaraba & musharaka	5,062	4,422
Available for sale	74	100
Maturing	1,255	917
Other	370	351
Fixed assets	85	59

Source: Al Baraka, Balance Sheet, Cairo, 30/9/2010.

[70] *Al Baraka, Balance Sheet, Cairo, 30/9/2010.*

on the maturity of the financing and have a minimum annual gross salary of LE 18,000. A guarantor is required. For the personal murabaha the minimum amount is LE 10,000 and the maximum LE 200,000 with the financing period from 6 months to 5 years. For the vehicle murabaha a sum of up to 85 percent of the car value can be approved, the minimum being LE 25,000 and the maximum LE 250,000.[71] The minimum repayments period is 6 months for the vehicle finance and the maximum is 6 years. Car finance is provided both to employed clients who have their salaries transferred to accounts in Al Watani and self employed clients deemed creditworthy. With the vehicle murabaha the bank purchases the car on behalf of the client who then pays fixed instalments plus a mark-up to make the transaction profitable for the bank. These instalments cover the client's purchase of the vehicle from the bank, as it is the client who takes ultimate ownership. With personal murabaha the bank purchases a commodity on behalf of the client who then also acquires ownership through the deferred instalment payments. However in this case the bank organises the sale of the commodity to a third party, who makes a payment which is credited to the client's account. Hence the client obtains cash on terms which are similar to those with a personal loan.

In the Al Watani audited accounts Islamic deposits and shari'ah compliant financing is not categorised separately from the conventional deposits and loans. This is simply a financial reporting issue, and does not imply that there is any co-mingling of Islamic and interest based funds. Customer deposits rose from LE 13 billion in 2008 to almost LE 15 billion in 2009, but it is unclear what proportion comprised Islamic deposits. Total liabilities and assets rose from LE 13.2 billion to LE 14.8 billion over the same period, with loans, presumably conventional, rising from LE 6.1 million to LE 6.3 million.[72] However "for sale" investments rose from LE 972 million to LE 2.8 billion, this referring to the murabaha purchases, indicating that the Islamic business of the bank is growing faster than the conventional business.

Al Watani Bank offers musharaka partnership financing to its corporate clients as well as murabaha, with the latter covering letters of credit as well as direct trade financing. The musharaka is for longer periods, but has not yet been used for housing finance in Egypt, its main application by Islamic banks in the Gulf, Malaysia and the United Kingdom.

A.1.4 Islamic branches of Egypt's state banks

Egypt's state owned banks established Islamic subsidiaries during the 1980s with the National Bank of Egypt having a single designated Islamic branch at 92 Tahrir Street in Dokki, an upmarket central Cairo neighbourhood, and Bank Misr, Egypt's olderst bank, having a network of 32 designated Islamic branches throughout Egypt. Bank Misr was the first state owned bank to take the initiative in Islamic finance and all its shari'ah compliant business is supervised by the head of the Fatwa Committee at Al-Azhar University, the oldest centre of Islamic scholarship in the world. Funds are segregated but there are no separate published accounts for the bank's shari'ah compliant business. Therefore the amounts of Islamic deposits and finance are not disclosed, although they are likely to account for a significant proportion of the bank's assets and liabilities.

The Islamic branches accept deposits in Egyptian pounds and United States dollars, and offer certificates of deposit in both currencies. Bank Misr also offers an Islamic fund which invests in shari'ah compliant equities, including companies listed on the Cairo Stock Exchange. The Misr Fund IV was launched on 24th October 2006 with an initial capital of LE 200 million, of which LE 10 million was subscribed by Bank Misr itself as seed funding to boost confidence.[73] The management fee is 0.45 percent of the net asset value plus a bank fee of 0.5 percent. There is also a performance fee of 7.5 percent of annual net profits if these exceed 10 percent or the average return on Bank Misr Islamic deposits plus 3 percent. These fees seem

[71] *www.alwatany.net/islamicbanking/retail/morabaha/morabaha_en_gb.aspx*
[72] *Al Watani Bank, Annual Report, Cairo, 2009.*
[73] *www.banquemisr.com/sites/EngBM/Pages/ElHassan.aspx*

reasonable and in line with other Islamic funds elsewhere. Around 75 percent of the funds are invested in equity with 17 percent in time deposits and 7 percent in cash. Bank Misr has three conventional funds and the experience in managing these has been helpful for the Islamic fund.

Investors enjoyed a 47 percent capital gain in 2007, but this was followed by a loss of 64 percent in 2008 when the Cairo Stock Exchange slumped because of the global financial crisis. Since then prices have revived, but it remains to be seen what the impact of the popular uprising of 2011 will be.

A.2 Tunisia

A.2.1 Al Baraka Tunisia

The aim of Tunisia's offshore banks is to attract deposits from Tunisian expatriates, usually in US dollars, and to a lesser extent attract deposits from western expatriates living in or frequently visiting Tunisia. Al *Baraka* Bank was focused primarily on the former, and was established in 1983 after receiving an offshore banking licence. It was originally called Beit Ettamwil Saoudi Tounsi (BEST) Bank before the entire Al *Baraka* Group was re-branded with the same logo internationally. Initially there was significant political opposition to the establishment of an Islamic bank, not least because of President Bourguiba's concern over Islamist groups, but others did not want to turn away Gulf capital and the investment opportunities it might bring.[74] Consequently in 1985 as a result of an amendment to the offshore legislation Al Baraka Bank was allowed to conduct onshore banking business provided its deposits did not exceed one percent of the total within the Tunisian banking system, a somewhat severe constraint on expansion possibilities.

Al Baraka Tunisia has four branches in Tunis in addition to its head office, two branches in Sfax and one branch in Sousse. Accounts are offered in Tunisian Dinar and United States dollars, with savings deposits as well as investment accounts subject to periods of notice for withdrawals of three months, six months and one year. As the deposits have a *mudaraba* structure, depositors share in the bank's profits, with the highest returns for those subject to one year's notice. Returns on deposits in Tunisian Dinars are higher than those on US dollar deposits reflecting Tunisia's inflation, although this fell from 5 percent in 2009 to 3.5 percent in 2010, but it is expected to rise again in 2011.

Despite the constraints under which it operates Al Baraka Tunisia has managed to attract customer deposits of almost $400 million as table A.3 shows. There are significant inter-bank transactions, including with other banks in the Al Baraka group. Client receivables, mainly from *murabaha*, continue to increase, as have holdings of securities, usually in the form of *sukuk*.

Table A.3: Al Baraka Tunisia Financial Statement, US $ million

Item	2009	2008
Customer deposits	395.6	369.7
Deposits from banks	36.5	13.6
Bank balances	132.0	131.4
Client receivables	229.8	227.9
Trading securities	134.6	81.7
Investment securities	6.9	7.2
Fixed Assets	5.2	4.3
Total assets	523.3	461.3

Source: Al Baraka Bank, Annual Report, Tunis, 2009.

[74] *Robert P. Parks, "Aiyyu Bank Islami? The marginalization of Tunisia's BEST Bank", in Clement Henry and Rodney Wilson, (editors), The Politics of Islamic Finance, Edinburgh University Press, 2004, pp. 240-263.*

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Al Baraka Bank Tunisia profits fell modestly from $19.47 million in 2008 to $19.43 million in 2009 and the profits paid to depositors was reduced from $10.4 million to $9.1 million. Net income increased slightly, and the overall return on assets was 1.96, higher than the return on assets for Al Baraka Bank in Egypt.[75] The Al Baraka Bank of Tunisia has been remarkably transparent in its *shari'ah* reporting. In the 2009 Annual Report, the Chairman of the *Shari'ah* Board, *Abdulelah Sabbahi*, drew attention to income from the Tunisian *Saudia* Leasing Company which derived from interest and was not *shari'ah* compliant. This income was used for assistance to *Quranic* Schools rather than contributing to the banks profits.[76]

A.2.2 Noor Bank Tunisia

The third Islamic bank in Tunisia, Noor Bank,[77] is an institution based in Dubai that was established in 2007, with branches in the other Emirates including Abu Dhabi and *Sharjah*.[78] The representative office in Tunis was opened in 2008, and is managed from Dubai. Noor Bank was unfortunate in being launched just before the global financial crisis which made it more difficult to raise capital. However it was fortunate in not being too exposed to the Dubai real estate bubble. It has however yet to make a profit, and it remains small in comparison to long established institutions such as Dubai Islamic Bank, with its assets worth less than one third of the latter's. As far as Tunisia is concerned its policy is "wait and see".[79] It intends to maintain its representative office, but not establish a full presence until the economy moves forward. The main potential is in the Tunisian tourist and leisure industry which interests Dubai based developers. There has already been investment worth over $US 2.2 billion from the UAE into Tunisia, but future investment will depend on the revival of Tunisia's tourism sector.

Overall it is evident that there is considerable potential for Islamic finance in Tunisia and the association of the family interests of the old regime with Bank *Zitouna* should not damage the reputation and image of Islamic banking in the country. Links between Tunisia and the Gulf will inevitably become more significant in the longer run, and Islamic finance can be part of these links. However, much will depend on the future growth of the Tunisian economy, and the ability of its new government to provide a favourable environment for private sector investment. Islamic banks can facilitate investment, but they will not be the drivers.

[75] *The Banker, Top 500 Islamic Financial Institutions, Financial Times Business, London, November 2010, pp. 36-38.*
[76] *Al Baraka Bank, Annual Report, Tunis, 2009, p. 15.10, pp. 36-38.*
[77] *Noor in Arabic means the light.*
[78] *www.noorbank.com/ae/english/index.aspx*
[79] *Babu Das Augustine, "Noor Islamic Bank to revive regional ambitions", Gulf News, Dubai, 21st February 2011.*

A.3 Algeria

A.3.1 Al Salam Bank

The Al Salama financial group was founded in Sudan in 2005, but soon moved to Bahrain which was viewed as a more promising location for fund raising. The Bank's initial public offering was for over $US 7 billion, the largest in the history of Bahrain, resulting in a listing on the Bahrain market in April 2006, to be soon followed by a listing on the Dubai Financial Market in March 2008. Its major investors include *Amlak* Finance, Dubai Holdings, Dubai Investment Group, *Emaar* Properties and Global Investment House. Unfortunately these investors all lost significant amounts because of the Dubai real estate crash, and in the case of *Amlak*, a mortgage company, virtual bankruptcy resulted, although it is currently in the process of being restructured to prevent its collapse. Clearly the prospects for raising funding through *shari'ah* compliant investment in Algeria for the immediate future or even the medium term look problematic given the financial constraints faced by potential investors.

A.3.2 Al Baraka Bank Algeria

New entrants are usually more risk averse than established banks such as Al Baraka. It has a much more significant presence than Al Salam Bank with twenty branches throughout Algeria and a further six in the course of being established. Indeed its operations are more extensive than that of Al Baraka in Tunisia, reflecting the much larger size of the country. Table A.4 shows the major balance sheet items with a substantial and growing amount of investment deposits on a *mudaraba* basis, increasing demand deposits and a high level of receivables mostly accounted for by *murabaha*.

Al Baraka in Algeria has a high return on its assets exceeding 8.15 percent but with the inflation rate almost 6 percent and currency depreciation, this is less impressive than it seems. Al Baraka in Algeria is larger in terms of assets than Al Baraka in Tunisia, but smaller than Al Baraka in Egypt. It remains on the margins of the banking industry in Algeria having only a fraction of the assets of the major conventional banks such as Banque Nationale d'Algérie, Crédit Populaire d'Algérie or Caisse d'Épargne et de Prévoyance. Analysts have criticised Al Baraka Algeria's excessive reliance on murabaha, accounting for over 80 percent of financing and its bad debts, although this has improved in recent years.[80] In 2005 the bank had 65,000 customers, but this has to be viewed in the context of Algeria's population which exceeds 34 million.

Table A.3: Al Baraka Tunisia Financial Statement, US $ million

Item	2008	2007
Deposits with central bank	11.6	12.7
Receivables	48.7	35.5
Total assets	72.5	56.2
Demand deposits	12.7	10.6
Investment deposits	39.8	34.3
Other liabilities	7.0	5.3

Source: Al Baraka Algeria, Annual Report, Algiers, 2008.
Note: €1 = 99.95 Algerian Dinar; $US 1 = Algerian Dinar 72.75.

[80] *Abdelhafid Benamraoui, "Islamic banking: the case of Algeria", International Journal of Islamic and Middle Eastern Finance and Management, Volume 1, Number 2, 2008, pp. 113-131.*

A.4 Morocco

Although opinions are divided on the merits of Islamic finance in Morocco, and some see it as a political issue, there is an increasing popular awareness of Islamic banking developments elsewhere. Hence for some, including Morocco's conventional bankers, Islamic banking is starting to be viewed as a business proposition rather than associated with the political realm.

Resistance to conventional interest based banking has also resulted in the growth of informal and unregulated Islamic financial intermediation, and there has been concern that these institutions could be used for money laundering or even terrorist funding. There are also worries that investors in these institutions could be mislead, as was the case with the Al-Rayyan Company in Egypt, which would potentially not only result in depositors being exploited, but could cause systemic damage to the whole financial system.

As a response to these concerns Bank Al-Maghrib examined possible options for the development of Islamic banking from 2005 onwards. In March 2007 as a result of the deliberations the Governor of Bank Al-Maghrib, Abdellatif Jouahri, announced that the most widely used Islamic financing products would be permitted in Morocco, notably murabaha trade finance, ijara leasing and musharaka for joint ventures.[81] The Governor made it clear that no specialist Islamic banks would be given licences, but rather these products could be offered by the existing commercial banks. Abdellatif Jouahri also argued that as 53 percent of bank deposits in Morocco were in current accounts which earned no interest, there was no need to introduce designated Islamic deposit facilities. This however overlooks the issue of co-mingling of funds, notably using non-interest bearing deposits to finance lending with interest, the normal practice for commercial banks which most Islamic scholars do not permit.

The measures were nevertheless welcomed by Saadeddin Othmani, the Secretary General of the Islamic Justice and Development Party, the Islamist Party in the Moroccan Parliament which had long supported Islamic finance. The take up of the products by the public has been slow however, not least because there has been no marketing of Islamic financing facilities by the commercial banks in Morocco and the products are expensive.[82] Some argue that the commercial banks do not want to undermine demand for their conventional loans, and therefore the *murabaha* has been offered for very short periods, with a tighter repayments schedule than most clients would like. Pricing has been made unattractive by the imposition of 20 percent value added tax (VAT) on *ijara* and 10 percent VAT on *murabaha*, whereas commercial loans are exempt from VAT.[83] The authorities argue that as murabaha involves a purchase and sale it must be subject to tax, and *ijara* also involves a purchase and subsequent rent payments.

The only attempt to market an Islamic financial product in Morocco to date has been by *Wafasalaf*, a consumer finance company, which specialises in car leasing and home improvement financing. Its *Taksit* Auto financing is structured on a murabaha basis with *Wafasalaf* acquiring the vehicle and reselling it to the client who makes deferred repayments plus a mark-up to generate a profit for *Wafasalaf*.[84] This type of financing has recently been extended to cover household items such as televisions and furnishings and kitchen equipment such as freezers. Despite these tentative advances, it is evident that the expansion of Islamic finance in Morocco will be a show process.

[81] *Mawassi Lahcen, "Morocco permits commercial banks to market Islamic banking products", Magharebia, Tunis, 23rd March 2007.*
[82] *Sarah Touahri, "Islamic banking products spark interest in Morocco", Magharebia, Tunis, 21st July 2007.*
[83] *Staff writer, "Islamic banking in the Magreb", The North African Journal, Tunis, 21st February 2009.*
[84] *www.wafasalaf.ma/Pages/CreditAutomobile.aspx*

A.5 Libya

Previous surveys of attitudes towards Islamic banking in Libya have revealed considerable popular support, even if the respondents were not fully conversant with the services offered given the lack of experience with murabaha, ijara and other forms of Islamic finance in Libya. The first study, by Amal Kumati, involved fieldwork in Libya during 2006, including both Benghazi and Tripoli, with popular support for Islamic banking evident in both areas.[85] Interviews at the Central Bank revealed an interest in Islamic finance even though the bank was not a member, or even an observer, at the IFSB.

A second larger survey by Alsadek Gait in 2008 involved 385 retail customers, 296 businesses and 134 bank staff to ascertain their opinions on Islamic finance.[86]Not surprisingly religion was the major motivational factor, but the study also revealed that awareness of Islamic financing products available in other jurisdictions, age and socio-economic status also influenced attitudes. There was more support amongst the young, the better educated and the more widely travelled.

Two recent developments indicate that Islamic banking may well emerge in Libya sooner rather than later. Firstly in 2010 the Central Bank of Libya invited bids from foreign banks for joint ventures as part of moves to open up the Libyan banking system. The aim was to provide a wider range of banking services at more competitive prices to help the Libyan economy. Three European banks, Unicredito SpA, HSBC and Standard Chartered were short listed, together with three Arab banks, Qatar Islamic Bank, Mashreq Bank and Emirates NBD (National Bank of Dubai).[87] All these institutions prepared licence bids by June 2010 and these are being evaluated by the Central Bank. If Qatar Islamic Bank receives an operating licence this could be highly significant as the bank already has subsidiaries in London and owns Arab Finance House in Beirut and Asia Finance House in Kuala Lumpur, both dedicated Islamic banks with a focus on asset management.

The second initiative in January 2011 was by Gumhouria Bank, the second largest bank in Libya with assets worth $US 6.46 billion, 5,800 employees and 142 branches. It merged in 2008 with the Al Ummah Bank. Gumhouria Bank is planning to establish a subsidiary that will offer Islamic financial products, and convert seven of its branches to supply these products exclusively. Staff training will also be required, as well as a marketing campaign to attract customers, both those who already use the bank's conventional services and new clients, including those with other banks and young people opening their first bank account. Although these developments may be delayed by the disruption caused by the February 2011 popular uprising and its aftermath, the momentum has been established that should see Gumhouria Bank providing Islamic financial services, with possibly competition from the planned Libyan venture of Qatar Islamic Bank. Discussions have already taken place between the commercial banks and the Libyan Central Banks regarding the regulation of Islamic finance and these are expected to continue once the situation in Libya improves.[88]

[85] *Amal Kumati, Commercial Banking in Libya and the Potential for Islamic Banking, PhD Thesis, Durham University, United Kingdom, 2008.*
[86] *Alsadek Hesain Abdelsalam Gait, Libyan Attitudes Towards Islamic Methods of Finance: An Empirical Analysis of Retail Consumers, Business Firms and Banks, PhD Thesis, Griffith University, Australia, 2009.*
[87] *Lamine Ghanmi, "Libya picks banks qualified for licence bids, Reuters, London, April 19th 2010.*
[88] *Staff writer, "Islamic finance moves slowly into North Africa", Tripoli Post, 22nd February 2011.*

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A.6 Mauritania

Al Baraka has three branches, two in the capital Nouakchott, and one in *Tevragh-Zeina*.[89] The bank's assets are worth $US 992 million,[90] and it provides retail and commercial banking services. It is branded locally as Banque Al Wava, and has not been subject to the Al Baraka Groups re-branding.

The bank's return on assets was a mere 0.01 percent and its profits less than $US 100 million in 2007. There have still been no financial reports for 2008 or 2009. Much of the bank's business is handling remittances from Mauitanians working abroad, and it participates in the MoneyGram network. It also provides a debit card and cheque facilities to those with current accounts. Although the Central Bank owns a small stake in Banque Al Wava and serves as regulator there are no specific legal or regulatory provisions in Mauritania for Islamic banking and the Central Bank is not a member of the IFSB.

[89] *www.bamis.mr*
[90] *The Banker, Top 500 Islamic Financial Institutions, Financial Times Business, London, November 2010, pp. 59.*