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Charting the rise of Shari'a-compliant financing in Saudi Arabia

- **Two thirds of bank financing is Shari'a-compliant**
- **Shari'a-compliant financing is growing at 14% per year**

It seems that every week a consulting firm produces a new headline number for the growth in Islamic assets worldwide. But such numbers are often hard to understand – or believe.

How exactly does one calculate the volume of Shari'a-compliant assets in the global financial system when the distinction between fully Shari'a-compliant institutions and conventional firms that operate Islamic windows is increasingly blurred? And what do these headline numbers include? Do they refer only to banking assets and liabilities, or do they include investments by Islamic insurance firms and money held by fund managers?

Yet it is possible to generate reliable statistics on size and growth in the Shari'a-compliant finance industry if one searches with clear criteria and, of course, if one knows where to look.

Fortuitously, one of the best places to accurately chart growth in Shari'a-compliant banking is Saudi Arabia – the Middle East's largest economy and (by most measures) its biggest banking system.

Financial reporting by Saudi domestic commercial banks is consistent from year to year – enabling us to track multi-year trends; and it is reasonably consistent from bank to bank – enabling us not only to make some comparisons between banks but also to calculate aggregate figures for the system as a whole.

Saudi banks disclose Shari'a financing under "Net Loans"

In the note to the "Net Loans" figure published in their financial statements, all conventional Saudi banks include a line in which they quantify the amount of Shari'a-compliant financing contained within the total net loans figure.

Which Shari'a-compliant instruments do Saudi banks use?

Some Saudi banks disclose the Shari'a-compliant products that they use to extend credit-like facilities to their clients.

Unsurprisingly, the most commonly-cited instrument is murabaha – all the banks that disclose their products state that they use murabaha.

Murabaha is a sale and repurchase agreement whereby the bank buys goods that its client wants to own and re-sells those goods to the client, delivering immediately, but receiving payment after delay. Murabaha is typically a short-term instrument, but, as Table 4 shows, the move towards Shari'a-compliant financing in Saudi Arabia has not been accompanied by a shortening of the maturity profile of banks' lending. Longer-term murabaha is possible.

Several banks also cite ijara as one of the shari'a-complaint structures they use. Ijara is effectively the same as a conventional lease.

Other instruments cited include istisna' – a structure whereby the bank agrees to buy manufactured goods or constructed assets from a client over the medium or long term. Effectively, the bank is funding the manufacture or construction of goods. Since a bank does not want to hold such goods, it generally enters into a parallel contract with another client who agrees to buy the goods from the bank (for a conventional parallel, think of an "off-take agreement").

Several Saudi banks also state that they employ tawarruq – an instrument through which banks can supply working capital to their clients (in contrast, say, to murabaha where a bank finances the purchase of specific goods).

Islamic scholars frown upon tawarruq, although much depends on the precise form that the Shari'a contract takes, and also the intent of the bank in deploying it. A distinction is made between tawarruq and "organised tawarruq", which is also known as "commodity murabaha." Simple tawarruq is deemed to comprise two genuine and separate economic transactions, whereas "organised tawarruq" is seen as a ruse entailing, in effect, a single transaction between a bank and its client and containing no genuine economic activity. ■

TABLE 1: SHARI'A-COMPLIANT FACILITIES AS PERCENTAGE OF NET LOANS

		Shari'a-compliant facilities % net loans	Shari'a-compliant facilities ($mn)	Total net loans ($mn)	Total assets ($mn)	Total assets (SRmn)
National Commercial Bank	2013	66.1	33,107	50,050	100,608	377,280
	2012	63.8	27,794	43,594	92,085	345,320
	2011	59.8	21,591	36,077	80,320	301,198
	2010	55.8	18,676	33,493	75,299	282,372
	2009	57.2	17,113	29,909	68,654	257,452
	2008	56.1	16,135	28,776	59,147	221,802
Al-Rajhi	2013	100.0	49,817	49,817	74,632	279,871
	2012	100.0	45,851	45,851	71,302	267,383
	2011	100.0	37,417	37,417	58,862	220,731
	2010	100.0	32,017	32,017	49,291	184,841
	2009	100.0	29,906	29,906	45,528	170,730
	2008	100.0	37,514	37,514	43,566	163,373
Riyad Bank	2013	48.7	17,043	34,984	54,732	205,246
	2012	48.4	15,151	31,326	50,715	190,181
	2011	46.5	14,018	30,126	48,237	180,887
	2010	44.7	12,634	28,276	46,282	173,556
	2009	41.9	11,913	28,404	47,040	176,399
	2008	42.0	10,809	25,715	42,574	159,653
Samba Financial Group	2013	48.3	14,625	30,255	54,677	205,037
	2012	44.6	12,205	27,368	52,552	197,069
	2011	40.2	9,545	23,763	51,406	192,774
	2010	36.8	7,865	21,400	49,978	187,416
	2009	31.8	7,126	22,439	49,471	185,518
	2008	24.3	6,351	26,173	47,704	178,891
Saudi British Bank	2013	74.1	20,981	28,297	47,281	177,302
	2012	67.1	17,203	25,626	41,774	156,652
	2011	65.1	14,722	22,616	36,975	138,658
	2010	47.2	9,340	19,799	33,433	125,373
	2009	50.5	10,285	20,369	33,823	126,838
	2008	46.8	10,018	21,397	35,110	131,661
Saudi Fransi Bank	2013	56.1	16,652	29,682	45,349	170,057
	2012	51.8	14,211	27,409	42,074	157,777
	2011	48.4	11,926	24,620	37,461	140,480
	2010	41.1	8,866	21,594	32,858	123,218
	2009	38.9	8,125	20,884	32,153	120,572
	2008	32.9	7,102	21,564	33,564	125,865
Arab National Bank	2013	59.7	14,080	23,588	36,783	137,935
	2012	57.1	13,147	23,021	36,437	136,639
	2011	54.5	10,587	19,425	31,353	117,574
	2010	51.2	9,040	17,654	30,943	116,035
	2009	47.7	8,507	17,816	29,413	110,297
	2008	44.9	8,933	19,899	32,349	121,307
Saudi Investment Bank	2013	48.9	6,201	12,685	21,465	80,495
	2012	44.8	4,069	9,080	15,751	59,067
	2011	42.4	3,064	7,230	13,852	51,946
	2010	35.5	2,931	8,267	13,731	51,491
	2009	31.7	2,520	7,943	13,373	50,148
	2008	27.8	2,191	7,882	14,292	53,596
Saudi Hollandi Bank	2013	45.3	6,485	14,307	21,458	80,468
	2012	44.8	5,413	12,074	18,268	68,506
	2011	36.6	3,653	9,976	15,253	57,197
	2010	38.7	3,613	9,344	14,369	53,882
	2009	31.8	3,053	9,606	15,763	59,110
	2008	29.4	2,982	10,138	16,383	61,436
Alinma Bank	2013	100.0	11,980	11,980	16,800	63,001
	2012	100.0	9,917	9,917	14,404	54,014
	2011	100.0	6,736	6,736	9,809	36,783
	2010	100.0	4,158	4,158	7,080	26,549
	2009	100.0	297	297	4,615	17,306
	2008	100.0	685	685	4,148	15,556
Bank AlJazira	2013	100.0	9,332	9,332	15,994	59,976
	2012	100.0	7,973	7,973	13,542	50,781
	2011	100.0	6,215	6,215	10,373	38,898
	2010	100.0	4,988	4,988	8,805	33,018
	2009	100.0	4,134	4,134	7,994	29,977
	2008	100.0	4,035	4,035	7,339	27,520
Bank al Bilad	2013	100.0	6,244	6,244	9,686	36,323
	2012	100.0	4,868	4,868	7,941	29,778
	2011	100.0	3,675	3,675	7,394	27,727
	2010	100.0	3,277	3,277	5,631	21,117
	2009	100.0	2,937	2,937	4,643	17,411
	2008	100.0	2,207	2,207	4,281	16,052

Source for all data: Bank Reports Saudi Riyals have been converted to dollars at a rate of $1= SR3.75

TABLE 2: AGGREGATE FIGURES FOR SAUDI BANKS

		Shari'a-compliant facilities % net loans	Shari'a-compliant facilities ($mn)	Total net loans ($mn)	Total assets ($mn)	Total assets (SRmn)
Figures for all 12 Saudi banks	2013	68.6	206,548	301,221	499,464	1,872,991
	2012	66.3	177,802	268,107	456,845	1,713,167
	2011	62.8	143,150	227,877	401,294	1,504,853
	2010	57.5	117,406	204,267	367,698	1,378,868
	2009	54.4	105,915	194,644	352,469	1,321,758
	2008	52.9	108,964	205,984	340,457	1,276,712
Figures for the 8 conventional banks	2013	57.7	129,176	223,848	382,352	1,433,820
	2012	54.7	109,194	199,499	349,656	1,311,211
	2011	51.3	89,107	173,834	314,857	1,180,714
	2010	45.7	72,966	159,827	296,891	1,113,343
	2009	43.6	68,641	157,369	289,689	1,086,334
	2008	39.9	64,523	161,542	281,123	1,054,211

For example, National Commercial Bank's end-2013 financial statements say, "Loans and advances, net, include financing products in compliance with Shari'a rules mainly Murabaha, Tayseer and Ijara amounting to SR124,151 million (2012: SR 104,229 million.)" Since National Commercial Bank's total net loans at the end of 2013 was SR187,687 million we can calculate that 66% of the banks loan portfolio was Shari'a-compliant at the end of 2013.

Four of the 12 domestic Saudi commercial banks conduct all of their operations in line with the Shari'a. In their case, 100% of their loan portfolios is Shari'a-compliant.

Saudi British Bank shows the highest proportion of Shari'a-compliant financing

Statistics on individual banks are given in Table 1. Apart from the four wholly Shari'a-compliant banks, Saudi British Bank shows the highest proportion of Shari'a-compliant financing – 74% of its loans and advances. National Commercial Bank (NCB) is second, with 66% and Arab National Bank third with 60%.

At the end of 2013, the aggregate amount of Shari'a-compliant financing by the eight conventional banks represented 58% of their aggregate net loans, compared to 40% at the end of 2008. The average percentage shown by these eight banks as 56%, compared to 38% at the end of 2008.

Taking the domestic commercial banking market as a whole – all 12 banks – Shari'a-compliant lending amounted to $207bn (converting from Saudi Riyals to Dollars at $1 = SR3.75). This represented 69% of the 12 banks' net loans. (See Table 2.)

Shari'a-compliant financing has been growing at 14% per year

What is most striking about the statistics is the rate at which Shari'a-compliant facilities have been growing. In the five years to the end of 2013, the compound average growth rate (CAGR) of Shari'a-compliant facilities within Saudi banks' loan portfolios was 14%. The CAGR for the eight conventional banks was 15%. (See Table 3.)

Since the end of 2008, conventional loans extended by Saudi banks have fallen in absolute terms – from $97bn to $95bn.

In simple terms, according to the statistics, all net new bank lending since 2008 has been Shari'a-compliant.

This extra-ordinary development raises questions about what the expansion of Shari'a-compliant financing actually entails. Do we really believe that since 2008 Saudi borrowers – everyone from the largest corporate customer to the smallest consumer creditor – have changed their mind-set and (in the case of corporates) their treasury function and now think only in terms of Shari'a-compliant finance?

Certainly, there has been an increase in the general awareness of how Shari'a-compliant financial instruments work – this can be seen throughout the GCC both within banks and among bank

TABLE 3: COMPOUND AVERAGE GROWTH RATES, 2008-2013

	Shari'a-compliant facilities	Conventional loans	Total net loans	Total assets
All 12 Saudi banks	13.6	-0.5	7.9	8.0
Eight conventional Saudi banks	14.9	-0.5	6.7	6.3

TABLE 4: SAUDI BANK CREDIT CLASSIFIED BY MATURITY

	Short term	Medium term	Long term
End 2013	54	19	27
End 2008	64	14	22

Source for data: Percentages are calculated from figures in the Quarterly Statistical Bulletins of the Saudi Arabia Monetary Agency.

TABLE 5: BANK CREDIT CLASSIFIED BY ECONOMIC ACTIVITY

	Commerce	Manufacturing	Building & Construction	Consumer Loans	Real Estate
End 2013	21	12	7	30	10
End 2008	24	11	7	23	7*

* End 2009, not End 2008

Source for data: Tables in the Quarterly Statistical Bulletins of the Saudi Arabia Monetary Agency. Note that since several tables have been used as sources, it is possible that there is double counting within the percentages. That is, it is possible (though not certain) that some real estate loans are also included under "Building & Construction."

TABLE 6: PERCENTAGE OF TIME DEPOSITS THAT ARE STRUCTURED TO BE SHARI'A-COMPLIANT

Riyad Bank	End 2013	40
	End 2008	26
Samba Financial Group	End 2013	26
	End 2008	32
Saudi Fransi Bank	End 2013	48
	End 2008	26
Saudi Hollandi Bank	End 2013	48
	End 2008	36

Saudi British Bank discloses the total amount of its Shari'a-compliant customers deposits without specifying what type of deposits they are. At the end of 2013, 54% of its customer deposits were in Shari'a-compliant structures, compared to 43% at the end of 2008.

Samba Financial Group showed a ratio of 38% at the end of 2012.

Source for data: Banks' Financial Statements customers. There is far more Shari'a-compliant expertise in the GCC now than there was just a few years ago.

Eighty per cent of new bank licenses awarded in the GCC over the last 10 years have been for the establishment of Islamic banks.

But Darien Analytics has long argued that three factors have underpinned the long-term growth of Islamic banking in the Middle East. The first is the long-term rise in Islamic sentiment in the region and the wider Islamic world. One way for people to express that Islamic sentiment is through the way they conduct their financial transactions. Secondly, Islamic finance has become more accessible, not only as a result of its increased availability, but also because the use of products such as murabaha and profit sharing investment accounts has become routine and as easy for clients to use as conventional products. Thirdly, improved Information Technology services enable banks to manage and deliver Shari'a-compliant products – which may have complex structures below the surface – easily, even when most of the bank's business is conducted on a conventional basis.

It seems clear that Saudi banks have been able to use Shari'a-compliant instruments to replicate the economic characteristics of conventional loans.

But the structure of bank lending has changed little

The broad structures of Saudi lending have changed little in recent years even as the form of credit facilities has moved heavily towards Shari'a-compliant lending.

In terms of the maturity of bank lending, the percentage of short-term facilities has fallen to 54% from 64% and the percentage of medium and long-term facilities has increased. (See Table 4 on previous page.)

As for the direction of lending, the five years to the end of 2013 saw an increase in real estate-lending and consumer lending – but that is consistent with broader social and economic trends in the GCC, and hard to attribute to an increase in Shari'a-compliant lending. (See Table 5 on previous page.)

It seems clear that Saudi banks have been adept at meeting their clients' existing financing needs through Shari'a-compliant financial products.

Saudi banks do hold Shari'a-compliant assets outside their loan portfolios. Most obviously, they hold Shari'a-compliant products as part of their investment portfolios. Although explicitly Shari'a-compliant investments such as sukuk are disclosed, it is reasonable to assume that some conventional investments would also qualify as Shari'a-compliant. Banks to not give a figure for total Shari'a-compliant investments. It is therefore not possible to calculate the percentage of banks' investment portfolios that are Shari'a-compliant. Similar challenges arise in respect of banks' interbank placements.

Shari'a-compliant time deposits have been growing rapidly too

It would be interesting conduct a comprehensive analysis of Saudi banks' deposits to see if there has been an increase in Shari'a-compliant funding to match the growth of Shari'a-compliant financing. Unfortunately, disclosure of Shari'a-compliant deposits is less strong, though some observations are possible.

Four of the eight conventional banks disclose figures for Shari'a-compliant time deposits. The four banks are Riyad, Samba Financial Group, Saudi Fransi and Saudi Hollandi.

Saudi Fransi and Saudi Hollandi had 48% of their time deposits in Shari'a-compliant structures at the end of 2013, compared to 40% at Riyad Bank and 26% at Samba Financial Group (though Samba's 2013 figure was, strangely, about 10 percentage points lower than in previous years.)

These figures do not represent the percentage of customers' deposits that are Shari'a-compliant. They simply show the percentage of time deposits that are Shari'a-compliant. Since conventional current accounts are economically similar to Shari'a-compliant current accounts (payable on demand, receiving no interest) it is reasonable to assume that a large proportion – perhaps 100% – of conventional banks' current accounts could be considered Shari'a-compliant. From that, one could conclude that the percentage of customers' deposits that are explicitly or implicitly Shari'a-compliant is greater than the percentages given above for time deposits.

Saudi British discloses the total amount of its Shari'a-compliant deposit accounts without specifying what type of account they are. At the end of 2013, 54% of the bank's customers deposits were Shari'a-compliant, compared to 43% at the end of 2008. ■

Islamic and Conventional Banks in Saudi Arabia

Al-Rajhi was licensed in 1987 and was the first Saudi bank to conduct all of its operations in line with the Shari'a. Two other banks have since been established to operate on a fully-Shari'a-compliant basis: Bank Albilad, which began operations in 2005 and AlInma Bank which began operations in 2008. Bank AlJazira was a conventional bank until 2007, when it made all its operations Shari'a-compliant.

Al-Rajhi is the second biggest bank in the Kingdom, when ranked by assets. The other three are the smallest three. Together these four accounted for 23% of the assets of the 12 Saudi domestic banks at the end of 2013, and 26% of the loans and advances. Al-Rajhi accounts for nearly two thirds of the total assets and loans of the four Islamic banks.

The Saudi Arabia Monetary Agency, the central bank and bank regulator, does not distinguish between conventional and Shari'a-compliant banks (unlike, say, the Central Bank of Kuwait, which designates Islamic banks in its listing of licensed banks). The four shari'a-compliant banks self-designate as Shari'a-compliant institutions in their audited financial statements. ■

Andrew Cunningham has spent more than 25 years writing, training and consulting on banking and finance, both in the Middle East and in Europe and the U.S.

Darien Analytics advises clients on international financial regulation, corporate governance and bank risk management, and has a particular focus on Middle Eastern and emerging markets, and Islamic finance. More analysis on Middle East finance can be seen on the website **www.darienmiddleeast.com**

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