

# Islamic financing in Russia: Still no common vision

Today, the problem of implementing Islamic financial instruments, as well as developing the Islamic banking system as a whole, is becoming increasingly significant in Russia, due to the extended economic sanctions and, as a result, instability in relations with western financial markets. **DMITRY CHURIN** and **KLIMENT NECHAEV** find out more.



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**Market insiders increasingly demand alternative forms of doing business. At the same time, the Islamic population in Russia is steadily increasing, and in the regions of the North Caucasus with a predominantly Muslim population, there is an increase in the number of outstanding debt in regular banks and in the number of insolvent individuals (the highest share of overdue debt, according to RIA Rating, is in the Republic of Ingushetia (23.9%), with high overdue payments also recorded in the Karachay-Cherkessia Republic, the Republic of Adygea and the Kabardino-Balkar Republic). The implementation of Islamic banking in the Russian financial market is seen as a potential approach to overcoming these negative trends.**

The range of companies providing financial services in accordance with Shariah rules is gradually expanding in Russia. These include not only non-core organizations (such as financial house Amal and the Lyariba-Finance organization, offering payment for consumer goods in installments, transport and express installments; and the financial house Masraf in Dagestan), the number of which is increasing, but also large-scale banking institutions.

Since 2015, the Moscow Industrial Bank (a cross-functional bank at the federal level with a wide regional network of branches, serving more than one and a half million private clients) has been offering customer debit cards that meet Shariah financial standards and

approved by the chairman of the Council of Muftis of Russia on the following conditions: there is no accrual of interest on these cards; invested funds are not used to finance activities prohibited by Shariah; invested funds are not used for risky operations; and the bank transfers money to an Islamic charity in the amount of 0.5-0.75% of purchases made with the card on a monthly basis.

In 2017, another high-street bank – Sovcombank (one of the five largest private banks in Russia in terms of assets, number of offices and territorial coverage) – within the framework of the Halva project (a card for the purchase of goods in installments up to 36 months without an initial payment, commissions and overpayments in partner stores) launched the issuance of the Halva Halal installment payment card corresponding to the norms of Islam and accompanied by Shariah control. Using this card, one can make purchases only in authorized Shariah stores, there is no accrual of interest on the balance of the client's own funds and if funds are debited in case of delays, such funds are sent through direct debit to a charity fund account. It is to be expected that in order to improve competition in the banking market, this experience will be adopted in the near future by other credit organizations, which would be a positive factor for the development of Islamic banking in Russia, particularly in overcoming the stereotype of it as an element of religious worship only.

Sberbank, the largest state bank in Russia, has also demonstrated consistent interest in introducing Islamic banking mechanisms. We should note that in 2017, Sberbank announced a transaction on the principles of Mudarabah, under the terms of which the bank provided funds to a large leasing company from Tatarstan. During the first Russian Islamic Economic Forum on the 27<sup>th</sup> February 2018, Behnam Gurbanzada, the advisor to the deputy chairman of the board of Sberbank, announced that

Sberbank is considering launching a pilot project to receive deposits from the public in accordance with Shariah rules in Tatarstan, Chechnya and Bashkiria.

Concurrently, an Islamic customer service window is being considered for Sberbank branches, where customers would be served based on the rules of partner banking, taking into account the requirements of Islam. There are plans to develop partner financing in the framework of the Sberbank leasing project, to implement successful transactions for Islamic financing with leasing companies.

On the 10<sup>th</sup>-12<sup>th</sup> May 2018, the 10<sup>th</sup> International Economic Summit 'Russia – Islamic world: KazanSummit' was held in Kazan, the largest Muslim city in Russia, where the Bank for Foreign Economic Activity (Vnesheconombank) and the IDB agreed to create a fund to support high-tech industries with a volume of US\$100 million – this shows the real, and not just declarative, nature of the intentions on cooperation in this area. According to Zamir Ikbal, the vice-president of the IDB, it is currently implementing about 56 projects in cooperation with Russia valued at more than US\$7 million. The IDB is also involved in the elaboration of the legal framework to implement Islamic banking.

Besides the named financial instruments, the Islamic equivalent of stock – Sukuk – has also caught the interest of Russian lawmakers and the business community. In 2018, the first Russian Islamic economic forum announced the introduction of a bill to the State Duma of the Russian Federation proposing to abolish restrictions on the issuance of bonds without a fixed income. The Sukuk-Invest company (Kazan, Tatarstan) carried out a trial issue of Sukuk bonds that meet Islamic standards and registered the issue with the Bank of Russia.

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The foregoing allows us to conclude that there are stable trends in the development of Islamic banking in Russia, with interest shown by business leaders and foreign partners in liquid financial assets, as well as customer demand for such banking services. These trends create conditions for the adaptation of Russian legislation to allow for the use of Islamic financial instruments.

However, despite the steady interest from the business community and private clients, there have not been any actual legislative changes in the area of Islamic banking regulation. There is no legal framework for the comprehensive and competitive functioning of Islamic banking institutions in Russia. After an unsuccessful attempt at regulation (in 2017, the State Duma Committee on the Financial Market recommended rejecting in the first reading Bill No 746023-6 'On amendments to Article 5 of Federal Law on banks and banking activities' which provided the opportunity for credit institutions to engage in trade activities for the implementation of principles of Islamic banking), a uniform representation of what should be the legal regulation of

Islamic banking in Russia has still not been formed.

Consequently, the main difficulties of Islamic banking implementation in Russia are caused by the following factors:

- Russian legislation is not adapted to the principles of Islamic finance, so market players are forced to use limited legal instruments provided by Russian civil law, which restrains their development and makes them uncompetitive on the scale of the non-Muslim market. It is also worth noting that beginning 2019, the value-added tax (VAT) rate will increase from 18% to 20%, which means an increase in the amount of tax payments for participants of the Islamic banking market, as the turnover of real assets is the basis of Islamic finance. Specifically, this can affect Murabahah transactions because such transactions involve a purchase of assets by a bank and the further sale to the client. This means that the VAT will need to be paid twice.
- There is a lack of a common vision of further development of Islamic

finance both among the state and market participants.

- There is a lack of qualified specialists in the field of Islamic economics and finance.
- There is a passive policy on the part of public authorities.
- There is low awareness of the public about the financial products of Islamic banking (according to a survey of the Bank of Russia conducted in four regions, 80% of respondents are unaware of Islamic banking).

Ultimately, it should be noted that the Russian banking system is becoming increasingly inclined to accepting Islamic financial instruments, and their introduction has the potential of creating advantages in both foreign and domestic financial markets. In order to ensure the real, effective and profitable use of Islamic banking instruments in Russia, it is necessary to continue the development of harmonious legislation in this area, taking into account the interests of Russian individuals and commercial organizations, as well as foreign partners interested in investing and cooperating in alternative financial transactions. ☺

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