

Islamic financing in Russia: Prospects and barriers

Russian banks and companies are constrained at the moment with regards to their access to western financial markets due to US and European sanctions brought on by the Ukrainian crisis, and alternative markets are actively sought. One such market could be the market of Islamic financing. According to official statistics, about 25 million Muslims live in Russia. The populations of some of the regions, such as Tatarstan, Bashkiria, Dagestan, Chechnya and Ingushetia, are almost fully Muslim. DMITRY CHURIN and KLIMENT NECHAEV explore.



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Tatarstan is the most developed of the Muslim regions and it is assumed that it will become the capital of Islamic banking in Russia. It is here that the development of Islamic finance institutes has been under discussion for several years already at the KazanSummit international forum.

In March 2015, a legislative bill was introduced in the Russian State Duma, proposing to amend Russia's banking law. The amendments would allow banking operations based on Islamic law, which are not allowed currently. The Duma declined the bill, and later a working group was formed by the Bank of Russia to study the possibilities for introducing Islamic banking in Russia, and in 2016 the group prepared a roadmap to develop partnership banking. In March 2017, another legislative bill was declined by the Duma.

Based on the roadmap, an announcement was made on the creation of the first Islamic bank in Russia, the Partner Banking Center working within Tatfondbank and Tatagroprombank. The center proposed financing for individuals for purchasing automobiles and real estate, opening and closing bank accounts, debit cards and various types of wire transfers. Businesses could use the services of cashier settlements, conversions, letters of credit and currency control. Project financing was also announced. However, within less than a year, both

banks lost their licenses and the center ceased its activity.

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Currently, the working group is preparing a new legislative bill. However, there is no information as to its content or when it might be ready.

Even though there are no regulations governing Islamic banking, currently there are several companies in Russia that provide Islamic banking services such as:

- The BKS Fund Khalal Mutual Investment Fund, investing only in securities allowed by Islam
- Amal Financial House, offering financing under the Murabahah principle
- Tatarstan International Investment Company, offering investment consulting services, and
- LaRiba Finance Trust Partnership, offering financing on the Murabahah and Mudarabah principles.

At the same time, none of these organizations are banks and none offer traditional banking services. Such companies strive to work under

the Shariah principles, using the legal instruments provided under the Russian civil law. However, this approach restricts their development and makes them uncompetitive within the non-Muslim market.

Sberbank, the largest Russian state bank, has shown interest in Islamic financing. In 2017, Sberbank announced a pilot Mudarabah transaction, where the bank provided funds to a large Tatarstan leasing company. No information is available on the contracting party or the details of the deal which was over a year in the making. The only thing known is that the deal was certified in compliance with AAOIFI standards by the Shariah Review Bureau, a consulting partner for Sberbank and in line with Shariah norms.

That said, Mudarabah is not the only Islamic financing instrument that Sberbank could offer in the future. According to Sberbank officials, the bank plans to develop Musharakah, Mudarabah and Murabahah financings.

However, no further details are available at the moment. Vnesheconombank, the Russian state development and investment bank, has also officially announced its interest in attracting investment based on Islamic financing, but has not provided any specific information on its further projects or plans.

At present, the main gaps between Russian law and Islamic banking principles are the following:

- Unlike a regular bank, Islamic financial institutes undertake deals with real assets rather than money. Under Russian law, asset deals are subject to a VAT of 18%.
- A Russian credit organization using Murabahah has tax obligations

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different from traditional ones. In a sale and purchase operation, tax must be paid on the entire contractual amount, irrespective of whether the buyer fulfills his payment obligations. Such a system poses serious risks to financial organizations.

- Persons making a bank deposit pay interest tax only when the rate exceeds 14%, while in Islamic (and any other) investment companies, income tax is paid on all income.
- Russian banking law forbids banks to engage in trade. Therefore, if a bank works in Islamic financing, it must accept assets on its balance sheet which are non-core for a credit institution. Record-keeping and realization of such assets are made rather difficult.
- The key feature in Islamic financing is that profit and risk are shared by the financial organization and its investors. In this connection, Islamic financial institutions are unable to guarantee a return of the principal investment amount. Banking law requires the bank to return the principal in full in any event.

To summarize, we should note that the Russian legislation does not currently provide banks with a possibility to fully comply in their operations with Islamic financing principles. Organizations that already provide certain Islamic banking services are severely limited in their activity and are hardly competitive. Therefore, even though there is public interest and several organizations already offer certain Islamic banking services, their actual implementation and economical attractiveness in Russia are overly complex due to the absence of special legal regulations.

For Islamic banking to actually work in Russia, a comprehensive reform of banking and tax law is needed. If these measures are taken, new serious players acting on Islamic financing principles will certainly appear in the Russian financing market.

However, at this very moment, there is no joint understanding of what this reform will be like and when it will be implemented. ☹

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IFN US Forum 2017 will be the preeminent event for Islamic finance opportunities in the western hemisphere, as the forum returns for its third installation.

The US features pockets of possibilities for the Shariah compliant investment sector to flourish, especially since the financial crisis almost a decade ago highlighted the growing need for greater transparency in financial transactions among large financial institutions. IFN US Forum will offer delegates access and insight into efforts being taken by industry players and market makers within the US in developing Islamic financial products, as well as the lucrative opportunities for domestic and foreign investors interested in making Shariah compliant investments into the country.

The forum will bring together key industry players, asset and fund managers and financial intermediaries in the US in another exciting IFN-led event, as they discuss the Shariah compliant landscape, ranging from innovative real estate deals to agriculture and livestock investments.

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