



Features And Challenges of Islamic Finance Development in Russia

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Abstract: Since the end of the XX century Islamic finance demonstrates high potential of growth globally. The share of Russia in global Islamic finance remain low, though Russia has a potential. The objective of the article is to study Islamic financial market of Russia, its specific features and challenges that Islamic financial institutions face. The article analyses development of Islamic finance since 1997, defines market players, existing products and services. Islamic finance development in Russia is characterised by distinctive features. It lacks legal frame, publicity, official support, etc. Challenges that Russian Islamic financial institutions are facing also studied by authors.

Keywords: Islamic finance, Russia, factors of development of Islamic finance, challenges of development of Islamic finance, Islamic finance in Russia.

JEL Classifications: G23, G21

1. Introduction

Islamic finance is rapidly becoming globally widespread. Currently Islamic financial institutions are represented in around 50 countries of all over the world. However, the share of Islamic finance in the global financial system is only 1%.

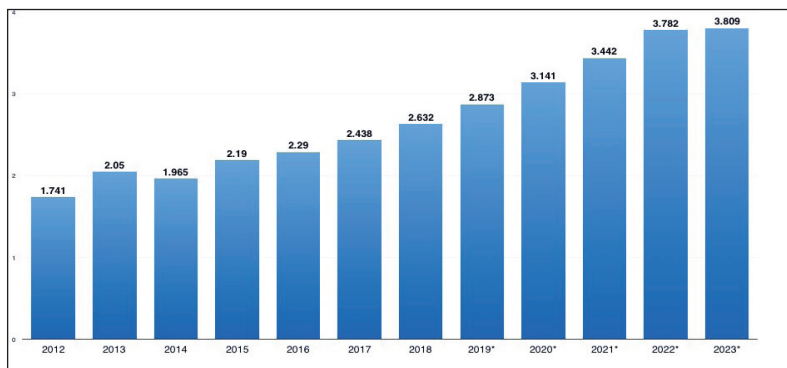


Fig.1. Global Islamic Finance Assets (\$ trillion)

Source: compiled by the authors using Thomson Reuters, 'Islamic finance development report 2018', (25 November 2018), p.14

* Forecast



It is worth to mention, that the global Islamic finance market is no longer a monopoly of Islamic countries. Over the past decade, the Islamic financial system has been actively developing in non-Muslim countries, where Islamic banks are created, insurance companies and funds are opened, and Islamic securities are issued. Islamic assets have increased from \$1.7 trillion in 2012 to \$2.6 trillions in 2018. Thomson Reuters estimated that the market for Islamic finance services is going to reach \$3.8 trillion by 2023. Global assets of Islamic finance grew by an average of 7.1% annually during the period 2012-17 (Fig.1).

The Middle East and Southeast Asia dominate the Islamic finance market (Fig.2). Islamic finance is becoming an integral part of the financial markets of different non-Muslim countries - the UK (which ranks 17th in the Islamic Finance Country Index), the USA (21th place), Switzerland (28), South Africa (28), Canada (33), Thailand (34), Australia (37), Germany (40), France (45), and etc.

Russia made first efforts to develop Islamic finance more than 20 years ago. Despite the growing assets the share of Russia in global Islamic finance is still minimal – around 0.002%. Though position of Russian Islamic finance market is improved in the Islamic Finance Country Index from 46 in 2018 to 38 in 2019.

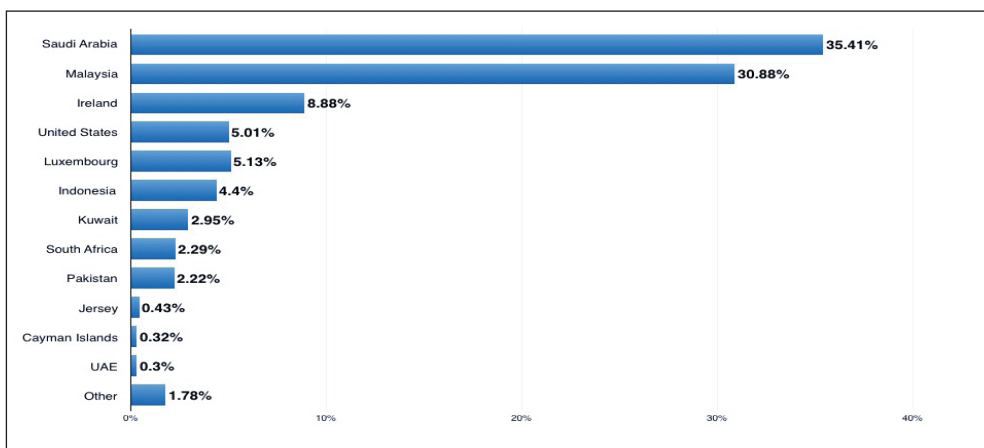


Fig.2. Distribution of Global Islamic Fund Assets in 2018, by Domicile

Source: compiled by the authors using Thomson Reuters, 'Islamic finance development report 2018', and Islamic Financial Services Industry. Stability Report 2019 URL: <https://www.ifsb.org/sec03.php#REPORTS>

Interest in Islamic finance in Russia is determined by both economic and cultural factors. Muslim population (from 10 to 15% of total population), availability of Sharia experts and Islamic schools from one side and dozens of implemented initiatives and projects, appearance of new big player in the Islamic financial market, efforts to lobby introduction of Islamic finance regulation on the other show potential of improving the level of Islamic finance development in Russia. Not all projects and initiatives were successful in Russia besides to other different challenges, but all added to the maturity of the Russian Islamic finance development.

The Islamic finance issue in modern Russian science is receiving increasing attention. Moreover, most of the researches are focused mainly on the study of the relationship of moral values and economic activity, the comparison of Islamic and traditional economic models.



The theoretical foundations of the Islamic economy are reflected in the works of Bekkin R. The possibilities of introducing various Islamic finance instruments in Russian realities are devoted to the work of M. Yandiev (2016), Musaeva R. and Magomedova Yu. (2018), Chokaeva B. (2015), Zaripov (2016).

The distinctive features of Islamic business and transactions are analysed in the research of Kalimullina (2020). A number of studies are devoted to the analysis of regional features of the practice of Islamic finance in Russia, in particular, in regions with a predominant or significant Muslim population: the Volga region (Tatarstan, Bashkortostan) and the Caucasus (Chechnya, Dagestan and others). Various aspects of the Islamic securities market are devoted to the works of Vakhitov (2014).

2. Methodology and Data

The article provides quantitative and qualitative analysis of the development and specifics and challenges of Islamic finance in Russia. The methodology of the paper is based on the principles of formal logic, systemic analysis, and the inter-disciplinary approach to the studied problem. The data were analysed with the help of statistical and content analysis.

The authors of the current paper also use the method of observation and the results of on-line conversations with some representatives of the banking and business community and government structures of Russia. To conduct the research publications, statistics and reports of the information and analytical agencies, articles from Russian magazines and newspapers, as well as scientific papers of Russian scholars specializing in development of Islamic finance in Russia were used.

3. Development of Islamic Finance in Russia

The difficult pathway of Islamic finance development in Russia dates back to 1997, when Badr-Forte Bank, licensed by the Central Bank of the Russian Federation in 1991, started to apply Islamic financing technologies. The Bank's Charter enshrined the right to use Islamic economic technologies that do not contradict the Russian banking legislation (Zhuravlev, 2004). In 2006, as a result of an audit by the Central Bank, the bank's activities were suspended, then the bank was fined, and thereafter lost its license (Bekkin, 2010).

The Badr-Forte Bank is not the only that ceased to exist. In Nizhny Novgorod and Ufa, the branches of the Ellipse Vostok Capital Bank, working according to Sharia standards, offering transactions of Ijara, Murabaha, etc. were closed due to the bank's resolution in 2013.

It should be noted that until 2014 in Dagestan there were also mainly small banks operating according to the principle of Islamic banking, but they did not survive the recovery policy initiated by the Central Bank. Bank Express and AF Bank in Dagestan and Bashkortostan were also closed and reorganized, as well as the Moscow Industrial Bank, which all issued Islamic payment cards. Sharia banking services were provided by a branch of Tatagroprombank until its license was revoked in 2017. Sovcombank stopped issuing payment cards based on qard hasan by internal decision.

In 2011, AK BARS Bank entered the international Islamic finance market and raised \$60 million syndicated Murabaha for a period of 1 year. The received funds were used to finance the infrastructure projects for the Universiade in Kazan in 2013. Today, the bank provides Islamic mortgages. In 2019, it launched the LALE Islamic Investment Fund, which consists of shares traded on the Moscow Exchange. Earlier, until 2014, the shares of one previously created Islamic investment fund were quoted on the Russian stock exchange ("BCS - Halal Fund"), but investors showed low interest in this product.



In 2016, Sberbank, the largest bank in Russia partially owned by the government (52,32%), created a working group to develop and implement Islamic finance products. In 2018, the bank announced the creation of an Islamic bank. Sberbank chose Tatarstan, Chechnya and Bashkortostan as pilot regions, where in the fall of 2020 services will be provided for individuals.

Sberbank has elaborated four offers for corporate clients in accordance with AAOIFI standards and the Russian laws. Sberbank also funded 3 projects and acquired a stake in the fintech project Payzakat using venture financing tools (Interview, 2020).

Sberbank's Sharia-compliant portfolio is estimated at 16 billion rubles. It was expected that before the end of 2019, the portfolio could grow by another 4-5 billion rubles. This refers to direct financing contracts, deals on grain supplies to the Middle-Eastern countries, documentary deals in the interests of Russian metal producers together with the Islamic Development Bank in Turkmenistan.

The creation of financial and investment companies with various lines of business in accordance with Sharia principles continued in Russia. Of the many attempts, several proved successful. 2011 was the starting point for the launch of the unique Islamic financial company Amal, which provides a wide range of financial services in accordance with Islamic principles. Today the company operates in 85 Russian regions.

The trust partnership "LaRiba-Finance", established in 2011 in Dagestan, is engaged in financing, investment, and consulting.

In 2012, the Tatarstan International Investment Company (TMIK) established CJSC Eurasian Leasing Company. The technical partner of this TMIC project is the Bahraini company Ijara Management Company, a subsidiary of the Islamic Corporation for the Development of the Private Sector (ICD). The main goal of the Eurasian Leasing Company (ELC) is to promote Ijara in Russia.

In Chechnya, Barakat microcredit company was established in 2011. Islamic financial company FinCity and the Sheikh Zayed Fund providing Islamic financing have been operating since 2017.

In Tatarstan, in 2018, the noteworthy Housing Traditions project (housing savings cooperative) was launched.

In the North Caucasus region, there are also a number of small firms offering Islamic microfinance.

Russian market has registered Sukuk issuance. The first sukuk issue in 2006 was carried out by the Russian bank GLOBEX. The issue of sukuk was non-public, therefore neither the volume, nor profitability, nor other parameters of the transaction are known.

The next sukuk issue was in 2017. The Sukuk-invest company from Tatarstan for the first time in Russia issued RUB1 million of Sukuk maturing in 62 days. This issue was of a technical nature and aimed at working out the procedure for issuing Sukuk.

Earlier attempts were also made to issue Sukuk (VTB-Capital in 2009, Safinat in 2010, the Republic of Tatarstan in 2011 and 2013), but these issues did not take place.

Several efforts have been made to open Takaful companies in Russia, but today there are none among them.

Despite that fact that not all projects and initiatives were successful and brought practical results, an infrastructure is being formed to promote the development of Islamic finance in Russia.

In 1998, the Russian Islamic University was established in Kazan, the capital of the Republic of Tatarstan. The bachelor's program "Theology" includes the discipline "Fundamentals of Islamic



Economics". At the master's level the course "Financial and Legal Relations in Modern Islamic Law" is being implemented. Other programs also offer courses in Islamic Economics, Business Etiquette, and Arab Economies. Islamic Economics and Law are among key research areas of the University.

In 2008, The University opened Russian Center for Islamic Economics and Finance together with the Islamic Development Bank (Kingdom of Saudi Arabia) and Kuala Lumpur Business School (Malaysia). The Center offers short courses and provides consulting services.

There is no yet a possibility to get an academic higher education degree in Islamic Finance in Russia, but some universities offer short-term courses in Islamic Finance: Moscow International Higher School of Business (MIRBIS) together with the Council of Muftis of Russia; Plekhanov Russian University of Economics; Lomonosov Moscow State University.

As a special option course Islamic Finance is taught in a number of Russian universities: the Higher School of Economics, the Peoples' Friendship University of Russia (RUDN-University), Kazan Federal University and others.

International seminars and conferences on Islamic finance are held frequently in Russia. KAZANSUMMIT has become a recognized international platform. Sberbank supports and organize Islamic economic events.

The government of Russia began to study and discuss the possibility of regulating of Islamic finance. The Central Bank of Russia has created a partner banking Working group that is studying the issue of adapting Islamic banking to the Russian law. Bank of Russia began cooperation with the Islamic Development Bank. In 2017, the Bank of Russia presented the standards of accounting reporting and audit of Islamic financial institutions translated into Russian.

The State Duma also established an Expert Council on legislation in the field of partnership economics to develop regulation of Islamic finance.

Russia has already accumulated more than 20 years of experience in the development of Islamic finance. According to the estimates of one of the leading experts in the field of Islamic finance in Russia, Kalimullina M., the volume of assets of Islamic financial institutions in Russia at the end of 2019 amounted to \$78.4 million, the number of employees in the industry totaled at least 150 employees, and the total number of clients was about 40,000 (Kalimullina, 2020).

4. Features and Challenges of the Development of Islamic Finance in Russia

Despite the modest experience of Islamic financial market players, the development of Islamic finance in Russia is characterized by distinctive features.

The introduction of Islamic technologies and mechanisms was accompanied in Russia by secrecy and lack of publicity. Media coverage is provided for individual transactions and projects. As a result, it is difficult to assess the real level of development of the industry on the basis of scattered data. At the same time, the low level of public awareness about Islamic financial products puts in doubt the industry success (Bagdueva & Adzhieva, 2015).

The development of the Islamic financial system in Russia takes place with extreme caution and causes fears of the Islamization of the Russian society. Even the working groups of the Central Bank and the State Duma mentioned above were named as partnership ones, not Islamic.

The development of Islamic finance in Russia was accompanied by failed attempts: closing banks, financial and insurance companies, the specialized information and analytical portals. For example, in 2017, the Islamic Investment Center "Mudarib" (Dagestan) ceased operations.



In terms of the geography of Islamic finance the main activity is concentrated in the Republic of Tatarstan, in the Caucasus - Chechnya and Dagestan, and to a lesser extent in Bashkortostan. Today Kazan is the center for the development of Islamic finance in Russia, where many Islamic financial products were launched and Islamic financial institutions opened. Kazan also is a capital for international meetings, trainings, forums and conferences dedicated to the development of the Russian and Global Islamic financial system.

Important to notice that the Federal Government doesn't support Islamic financial industry. The general position of the regulators is both not to provide assistance and not to impede the development of Islamic finance. The management of the Bank of Russia is convinced that the current Russian legislation allows the use of Islamic financial instruments. Despite plans to turn Moscow into an international financial center, there is no official discussion on whether the development of Islamic finance in Russia is necessary or not. But official support for initiatives is shown at the regional level. For example, real support comes from the Government of Tatarstan and Chechnya.

The slow development of the Islamic finance industry is explained by legislative discrepancy and the lack of licensing of Islamic financial institutions. It also prevents large international Islamic banks penetrating the Russian market. In the banking sector, legislative restrictions relate to the requirement of a mandatory payment of a loan interest, a ban on investing borrowed funds in companies, and a ban on trade transactions (with the exception of precious metals).

When it comes to trade finance, double taxation is needed to be payed. Each transaction (the purchase of an asset and its sale) requires the payment of VAT, which leads to increase of the cost of the transaction compared to a conventional loan.

Islamic financial companies operate in existing organizational and legal forms, which limits the number of participants and capital turnover. Although several legislative proposals to develop Islamic finance were submitted to the State Duma, they were rejected. The State Duma Committee on Financial Markets has rejected a draft law to remove a moratorium on banks trade transactions (Mokina, 2017).

After the development and adoption of the Waqf Law in the Republic of Tatarstan, it was protested as inconsistent with Russian laws and, of course, repealed. An obstacle for growth of Islamic financial institutions is the lack of an arbitration mechanism based on Sharia principles, and differences in the mechanisms and approaches of Sharia governance in different financial institutions (Bekkin, 2014). The fact that Islamic financial initiatives in Russia are implemented mainly in the form of projects and as a result of the efforts of lobbyists (Kalimullina, 2020), seriously impedes the expansion of the Islamic financial business. Nevertheless, experience in Islamic finance was recorded in all major areas of the financial business: Islamic insurance, financing, investment funds, Sukuk issuance, payment cards, Islamic charitable foundations, etc.

So far, Islamic financial institutions have been able to develop through the launch of products whose circulation does not contradict Russian legislation. The activities of the financial companies are focused on raising public funds on an interest-free basis, opening investment accounts, and trade finance. Operations are carried out both with individuals and businesses.

Russia has already formed its own Sharia experts community, and the financial business no longer urgently needs international expertise. Projects are launched in the Russian market with the international support of the Islamic Development Bank, financial companies and regulators in Bahrain, Malaysia. Russian market players are also relying on the experience of Turkey, Saudi Arabia, Indonesia and others. Despite the development challenges faced, Islamic finance in Russia show an increase in financial assets (Fig.3)

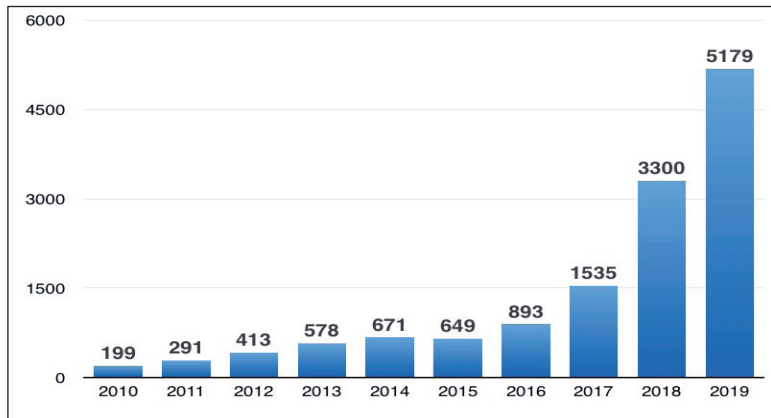


Fig.3. Islamic Finance Assets Growth in Russia, 2010–2019 mln RUR.

Source: Kalimullina M. (2020). Islamic finance in Russia: A market review and the legal environment. *Global Finance Journal*, 100534. Advance online publication. <https://doi.org/10.1016/j.gfj.2020.100534>

Over the past almost 2 decades, Islamic financial assets have grown 26 times – from 199 million rubles (US6 mln) to 5179 million rubles (US83.3 mln). The period of dynamic growth is 2015-2019, with the sharpest growth occurring in 2017-2019, when Sberbank increased its activity. The dynamics of assets, the history of development (the appearance and disappearance of financial companies), the launch of new initiatives and projects - all this allows us to predict that there will be continuous positive trend of the assets growth and diversification of the services offered that are in line with Islamic standards.

4. Conclusion

Islamic finance development is increasing all over the world. Countries that are not members of the OIC are leading in a number of areas. Russia, taking into account its geographical location and demographic features, can use the experience of countries where the development of Islamic finance is a harmonious continuation of cultural, ethical and religious norms, and countries that have decided to join the process of development of Islamic finance and adapt their legal environment.

Although some projects were not completely successful, lack of the state support, challenging financial system development in Russia, businessmen and financiers have shown strong will and adaptability to promote Islamic financial business.

Development of Islamic finance in Russia is based on separate private initiatives, the efforts of Sberbank, the largest player in the Russian banking sector, will lead to further increase of Islamic financial transactions, official support of legislative changes in favour of Islamic finance and the interest of other market players in Islamic business that will give rise to competition.

Competition, on the other hand, will become the driving force for the development of Islamic finance. Islamic financial players will compete with traditional banks and companies over time. The combination of the traditional and Islamic financial systems will have positive impact on the Russian financial market and consumers as a whole and hopefully will revive the market and add stability to the Russian financial system.



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