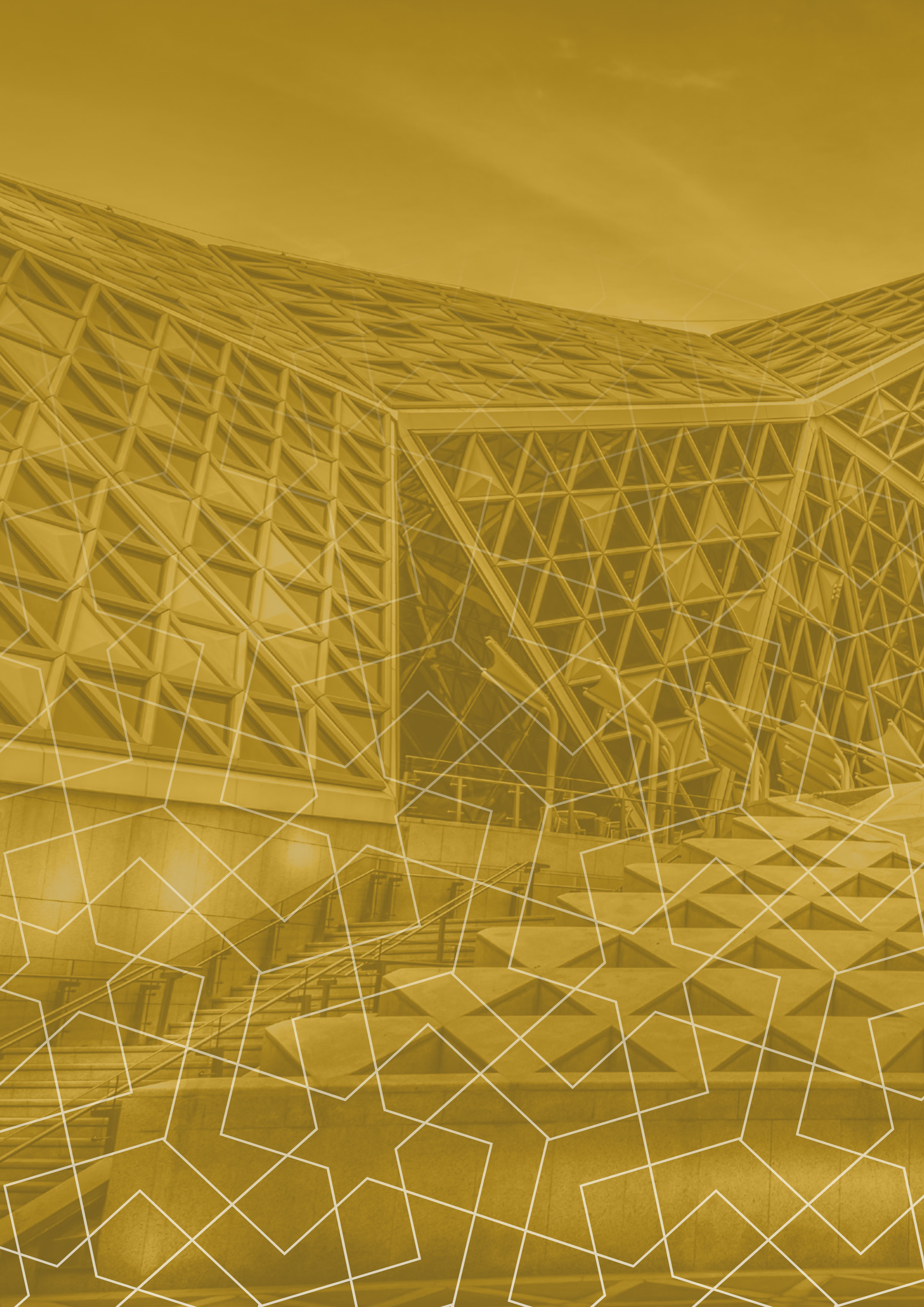
ISLAMIC FINANCIAL SERVICES BOARD

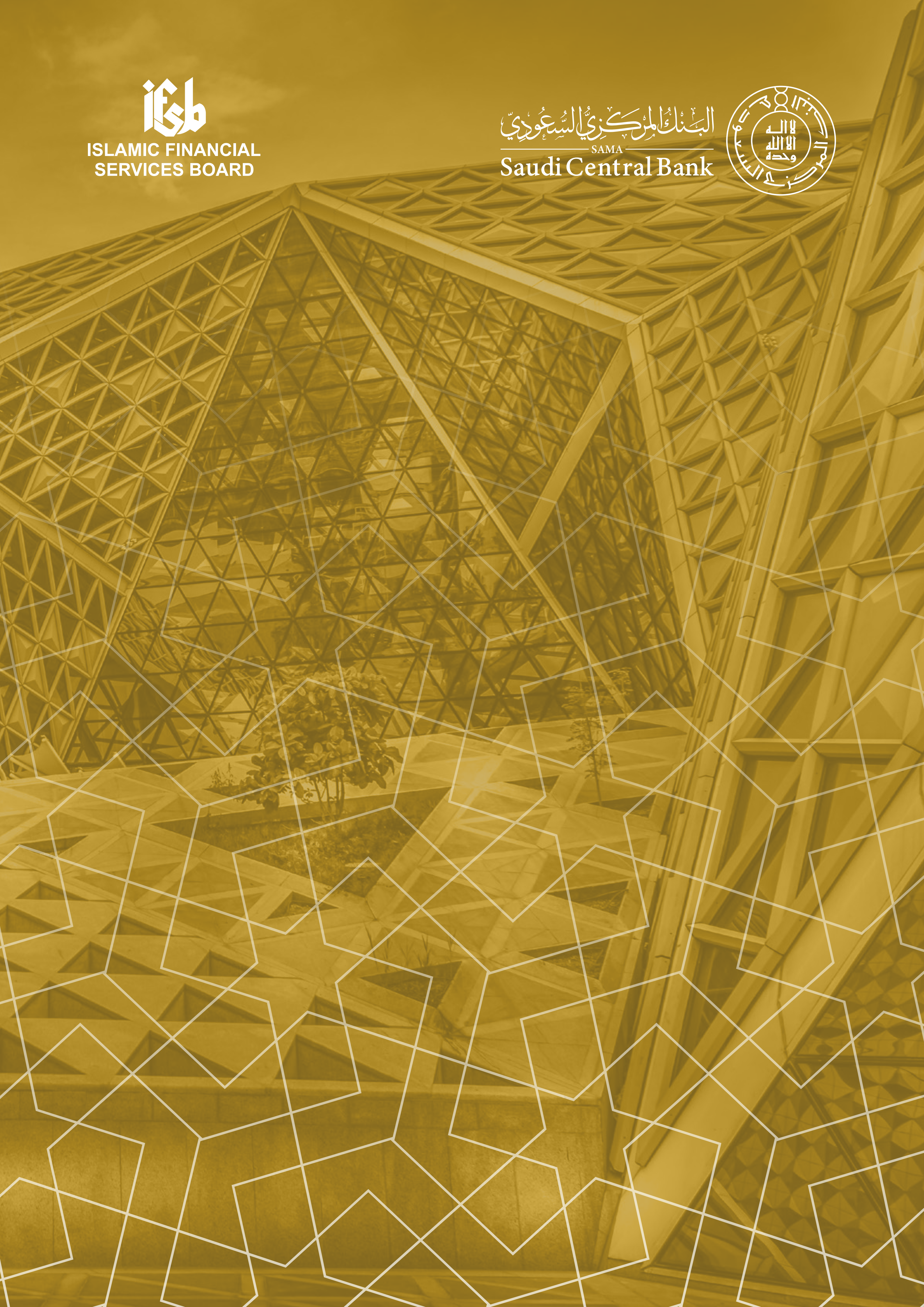
البنك المركزي السعودي
SAMA
Saudi Central Bank

EXCELLENCE AND LEADERSHIP

SAUDI ARABIA ISLAMIC FINANCE REPORT

2021





ISLAMIC FINANCIAL
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FOREWORD

Fahad Almubarak
Governor / Saudi Central Bank

It gives me great pleasure to present the Saudi Arabia Islamic Finance Report "Excellence and Leadership", demonstrating our continued commitment to support the growth and development of the Kingdom's Islamic finance industry. This report is launched in conjunction with the IFSB 2021 Summit, themed ''Islamic Finance and Digital Transformation: Balancing Innovation and Resilience''.

This report provides an overview of the Islamic finance landscape in Saudi Arabia, in addition to analysis and insights into the development of its constituent sectors, including Islamic banking, insurance, Islamic capital markets, Waqf and Islamic FinTech. The Saudi government has embarked on Vision 2030, setting out long-term development priorities to move towards a diversified and sustainable economy.

To supplement this, the Financial Sector Development Program (FSDP) was designed to develop the financial sector supporting the development of the country's future economic prospects.

The Islamic finance industry plays a vital role in this transformation, supporting economic initiatives targeting the development of the private sector and small and medium enterprises (SMEs). The Saudi Central Bank has focused resources and attention to ensuring a sound and stable financial system in the Kingdom. As a result, our Islamic finance industry has demonstrated remarkable resilience, asset growth and diversity despite global economic uncertainty and volatility in financial markets due to the Covid-19 pandemic.

I am pleased to say that the Saudi Central Bank has taken a forward-thinking and dynamic approach in the development of the FinTech ecosystem. We have worked on introducing modern and efficient regulations to support a safe, state-of-the-art, FinTech ecosystem to make the Kingdom a leading international FinTech hub. We have also established a regulatory sandbox that enables financial institutions and FinTechs alike to test their innovative products in a safe space, promoting innovation culture and establishing integrated connections in the financial services sector. In this context, the Saudi Central Bank and the Capital Market Authority jointly launched the "Saudi Fintech" initiative to stimulate the financial services technology sector and to promote its role in social and economic development.

I hope the information and data analysis in this report will guide you through the Islamic finance landscape in Saudi Arabia. In the coming years, you will continue to observe contributions from Saudi Arabia as a key international player in supporting the growth, development, and distinction of the global Islamic finance industry.

EXECUTIVE SUMMARY

Saudi Arabia is undergoing tremendous changes across almost all sectors of its economy and society, driven by Vision 2030 that was released in 2016. As part of that transformational roadmap, whose goal is to diversify the Saudi economy away from reliance on oil, Islamic finance is identified as an important supporting component of the Kingdom's economic and financial systems.

Saudi Arabia's financial industry landscape is made up of major components that include banking, insurance, finance companies, Sukūk, investment funds, and Waqf.

The Saudi Islamic finance industry is the largest globally by asset size. The major components of the industry totaled $842 billion by the end of 2020. Industry assets grew despite the economic fallout and financial market volatility that ensued as the Covid-19 pandemic emerged. This remarkable growth was boosted by a surge in Sharīʿah-compliant financing, serving as evidence of the Islamic finance industry's resilience.

The Kingdom's Islamic banking sector is the largest globally among dual banking jurisdictions. Islamic banking assets reached $544 billion, around 65% of the major components of Islamic finance assets in 2020. The dominant Islamic banking sector came into the pandemic with high capital and liquidity buffers, which was further propped up by the government's extraordinary stimulus and policy measures that helped mitigate the severe impact of the Covid-19 pandemic.

Notably, the 17% surge in Saudi Arabia's Islamic banking assets in 2020 was driven by Sharīʿah-compliant financing that was largely based on the retail business line, especially residential mortgages. In accordance with the Real Estate Finance Law, home financing must be Sharīʿah compliant.

Meanwhile, the Saudi Sukūk market made up 19% of the major components of Islamic finance assets, with the value of outstanding Sukūk reaching $157.5 billion in 2020. The Sukūk market had grown threefold between 2016 and 2020, making the Saudi Sukūk market the second largest globally, in terms of new and outstanding issuances. The Kingdom was also the largest issuer of sovereign Sukūk and the third largest issuer of corporate Sukūk globally. Sukūk issued by Saudi-based entities increased from $5 billion in 2016 to $36 billion in 2020, boosted by Saudi sovereign issuances in the domestic market as part of the government's 'Sukūk Issuance Program', which was launched in 2017 to diversify state budget funding.

Publicly-listed investment funds in Saudi Arabia are almost entirely Sharīʿah-compliant (95%) with AuM valued at $53 billion in 2020, making up the largest Islamic funds market globally. Islamic funds maintained a firm footing with significant growth of 33% in 2020, despite heightened volatility in global financial markets due to the Covid-19 pandemic. Around 67% of Sharīʿah-compliant AuM were invested in money market funds.

Saudi Arabia is home to the world's largest Islamic insurance market, accounting for more than 40% of global Takāful contributions in 2020. Gross written premiums reached a total of $10 billion by 2020, up 5% from $9.8 billion in 2016. The medical line dominates the insurance business in Saudi Arabia, making up 59% of total premiums in 2020. A consolidation drive in the Saudi insurance sector started in 2020 and will be propagated by a planned increase in minimum capital.

Utilizing Islamic financial resources to create a more impactful non-profit sector is one of the Vision 2030 objectives, setting a target to boost the size of the Waqf sector to $93 billion and increase the contribution of the non-profit sector to 5% of GDP by 2030. The assets of the overall Waqf sector are estimated to be worth $63 billion in 2020. These assets included $4 billion in Waqf assets overseen by GAA, which grew by 323% since 2018. However, the main challenge facing the Waqf sector is its high concentration in real estate investment, which calls for sectoral diversification. Mandated with developing current and new Waqf structures, GAA issued a licensing framework for Waqf investment funds in 2018, which are listed Sharī'ah-compliant mutual funds. By H1 2021, eight Waqf investment funds were approved by GAA and CMA with AuM of $104 million.

The overall FinTech sector in Saudi Arabia is thriving, as the number of FinTechs in the Kingdom increased from 60 in 2020 to 82 in 2021. Saudi Arabia is the largest Islamic FinTech market globally, valued at $18 billion in 2020 and projected to reach $48 billion by 2025, based on estimated transaction volume. While some FinTech segments, like payments, have gained traction in Saudi Arabia, others such as digital banking remain relatively less utilized. Meem, the region's first digital bank, was launched in the Kingdom in 2014 and offers retail Islamic banking services online. In June 2021, SAMA approved the licensing of two standalone digital banks: STC Pay and Saudi Digital Bank.

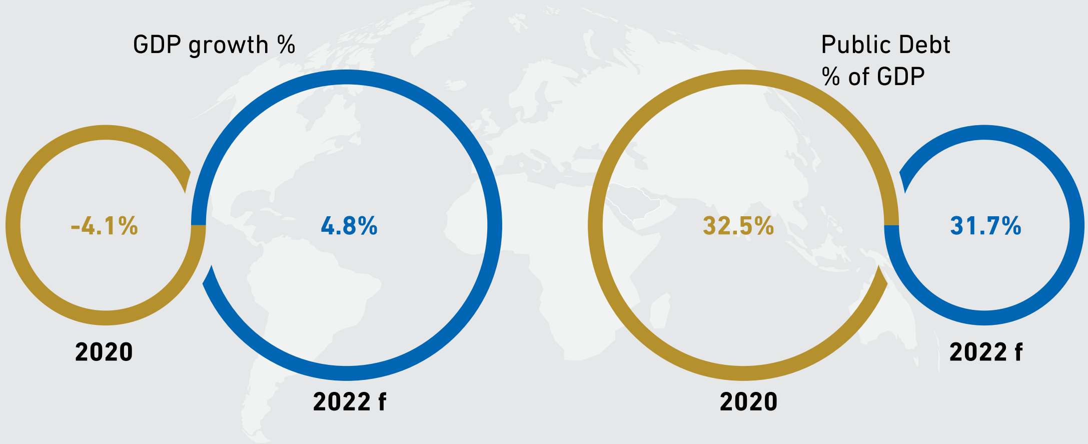
Islamic finance is poised to play a significant role in achieving the objectives and targets of Saudi Arabia's Vision 2030, which, along with the FSDP, will transform both the supply and demand sides in Islamic finance. Increased government expenditure on infrastructure will increase demand for the use of Islamic financial instruments, while on the supply side, the growth in Islamic capital markets will attract higher foreign investment to the Kingdom. Moreover, the development of the broader private sector, through increasing access to finance for MSMEs and the proliferation of domestic FinTechs, will help channeling funds throughout the economy more efficiently, while also developing the digital infrastructure of Saudi Arabia.

Islamic social finance tools offer the government and local communities avenues to mobilize funds towards the economic empowerment of individuals and MSMEs most disadvantaged by the pandemic. Zakāh, Sadaqat, Qard Hasan, Waqf, Sukūk, and Sharī'ah-compliant microfinance and crowdfunding can be coordinated and integrated with national economic recovery and sustainable development policies.

A 2021 survey by Backbase and YouGov revealed that the growing consumer appetite for digital banking services in Saudi Arabia has been accelerated by the pandemic, where 88% of respondents became more likely to opt for digital banking services. Islamic financial institutions must now shift to leaner and more tech-centric business models, aligned with the evolving preferences of a young customer base. Supporting technologies such as artificial intelligence, big data and blockchain, SAMA established a regulatory sandbox to foster the development and innovation of these technologies.

Promoting further financial inclusion is a priority for Saudi Arabia, where 28% of adults were unbanked, compared to 31% globally. By 2017, 6.9 million individuals in the Kingdom were unbanked, according to World Bank's Global Findex. Only 58% of adult females and 50% of adults outside the labor force held bank accounts, making them the main targets for financial inclusion efforts. Islamic finance presents solutions to supplement efforts in promoting financial inclusion, such as disbursing funds through social finance tools. However, integrating social finance tools like Zakāh and Waqf into small-ticket financing or microfinance can also be an effective tool in promoting financial inclusion.

ECONOMIC OVERVIEW



FINANCIAL SECTOR DEVELOPMENT

Vision 2030 has specific targets to develop Saudi Arabia's financial sector and economy

- Place Saudi Arabia in top 15 global economies
- Increase FDI to 5.7% of GDP
- Place among top 10 countries on the WEF Global Competitiveness Index
- Increase non-oil exports to 50% of GDP
- Growing SME contribution to GDP to 35%

FSDP aims to shape the next stage of growth for Saudi Arabia's financial industry

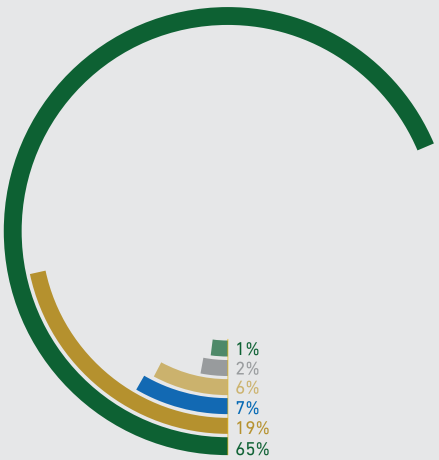
The FSDP has three key objectives:

- Enable financial institutions to support private sector growth
- Ensure the formation of an advanced capital market
- Promote and enable financial planning

ISLAMIC FINANCE LANDSCAPE 2020

Total assets of Islamic finance major components

$842 billion



Islamic banking
$544 billion
* Global ranking by size: 1

Cooperative Insurance
$10 billion
Global ranking by size: 1

Sukūk
$158 billion
Global ranking by size: 2

Islamic Investment Funds
$53 billion
Global ranking by size: 1

Non-bank financing
$14 billion

Waqf
$63 billion

ISLAMIC FINANCE REGULATION

Saudi Central Bank (SAMA)

Islamic banking
- Banking Control Law
- Sharī'ah Governance Framework for Local Banks
- Additional Licensing Guidelines and Criteria for Digital-Only Banks

Cooperative Insurance
- Cooperative Insurance Companies Control Law
- Insurance Market Code of Conduct regulation
- Rules of Forming and Managing Health Insurance Risk Pools through Brokers
- Rules of Insurance Products Approval
- Rules for Comprehensive Insurance of Motor Vehicles Financially Leased to Individuals
- Rules Governing Bancassurance Activities
- The Standard Policy of Inherent Defects Insurance (IDI)
- Actuarial Work Rules for Insurance
- Rules Governing Insurance Aggregation Activities

Non-bank financing
- Finance Companies Control Law
- Sharī'ah Governance Directive for Finance Companies
- Real Estate Finance Law
- Finance Lease Law
- Rules Regulating Consumer Microfinance Companies
- Rules for Engaging in Debt-based Crowdfunding

Capital Market Authority (CMA)

Sukūk
- Capital Market Law
- Rules on the Offer of Securities and Continuing Obligations

Islamic Investment Funds
- Investment Funds Regulations
- Real Estate Investment Funds Regulations

General Authority for Awqaf (GAA)

Waqf
- Law of the General Authority for Awqaf
- Instructions for Approval on Establishing Waqf Investment Funds

*largest Islamic banking sector in a dual banking jurisdiction

FSDP ISLAMIC FINANCE STRATEGY 2030

2025 Commitments	Strategic Goals	Sub-goals	Examples of Initiatives
Islamic Finance Assets 22.5% of global Islamic finance assets 79.3% of GDP	**Governance** Enhance and develop the Islamic finance industry governance	Enhancing Sharī'ah governance structure and increasing transparency Reducing legal risks and cost of doing business Increasing efficiency and transparency	Regulating the work of Sharī'ah Committees at financial institutions Define the functions of Sharī'ah compliance at financial institutions Define the functions of oversight and internal Sharī'ah audit at financial institutions
Sharī'ah Governance 1.6 distinct Sharī'ah scholars per financial institution 23% Saudi scholars at selected international organizations	**International Positioning** Enhance Saudi Arabia's international position as the leader in Islamic finance	Driving recognition as a sector leader Enhancing sector capacity and superiority	Holding the Saudi international annual Islamic finance conference Launch of the King Salman International Award in Islamic Finance Activate Islamic financing sources in large Vision programs Study Launching an International Islamic Finance Saudi Center Launch Global Sharī'ah Compliant Indices
Research and Education More than 60 Islamic finance publications annually	**Education, R&D, and Innovation** Develop and enhance the educational and research institutions to support the growth of the sector	Enhancing workforce capabilities Increasing diversity of products/services through innovation	Develop higher education courses and programs in the Islamic finance field Support workers capabilities in the sector through training programs Activation of an Islamic Finance research and development center

KEY TRENDS IN ISLAMIC FINANCE

Supporting Covid-19 Recovery

Islamic finance tools that can support government pandemic recovery efforts

Zakāh + Sadaqat | Short-term
Qard Hasan + Islamic Microfinance + Islamic Crowdfunding | Medium-term
Waqf + Sukūk | Long-term

Digital Transformation

Backbase + YouGov Survey (2021)

88% | became more inclined to choose digital banking services post-Covid
32% | thought banks are weak in offering seamless access to online banking services

Key considerations for IFIs digital transformation

Robust online offering | branches only necessary for very complex transactions
Single platform | offers seamless customer experience comparable to e-commerce
Partnership with FinTechs | allows more focus on delivering customer experience

Financial Inclusion

Holding at least one bank account in Saudi Arabia

72% | adults
58% | women
50% | excluded form the workforce

*Global Findex Data 2017

Islamic finance tools to promote financial inclusion

Microfinance | financing products based on risk-sharing contracts
Social finance | Zakāh and Waqf
Hybrid | Zakāh or Waqf used to fund microfinance, cover operational cost and used as a guarantee

1. COUNTRY OVERVIEW

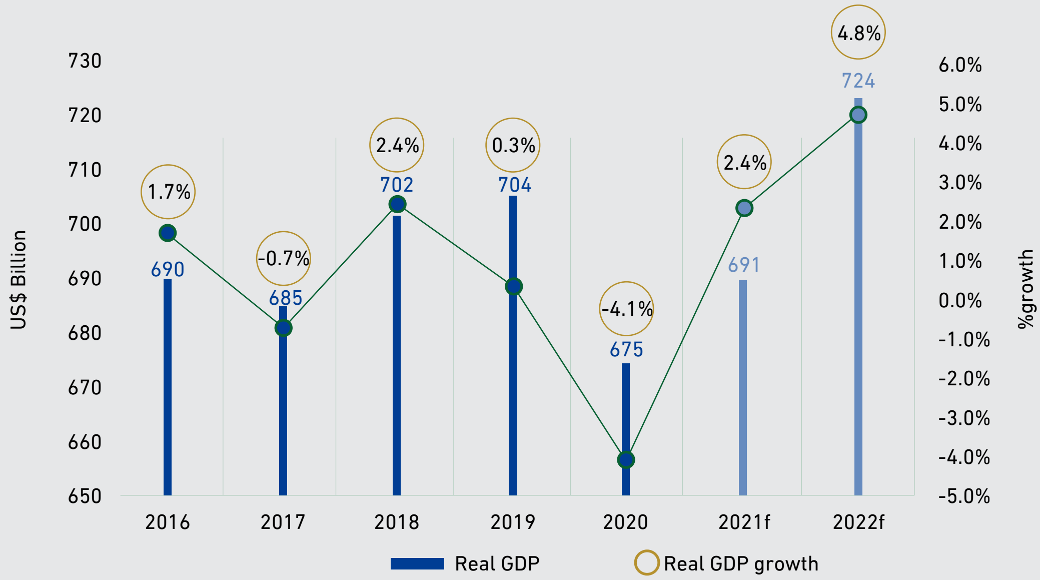
ECONOMIC OVERVIEW

Diversification amid growth recovery

The International Monetary Fund (IMF) has forecasted the global economy to grow by 6.0% in 2021 and a further 4.9% in 2022[1]. However, recoveries are diverging across countries due to varying levels of access to COVID-19 vaccines, with advanced economies expected to rebound faster than emerging economies.

Among emerging economies, Saudi Arabia is projected to grow by 2.4% in 2021 and 4.8% in 2022, rebounding from a contraction of 4.1% in 2020. The expected growth is supported by a domestic fiscal stimulus package equal to 2.7% of GDP, forecast current account surpluses and rising demand for oil.

CHART 1 – SAUDI ARABIA REAL GDP GROWTH 2016-2022F



Source: International Monetary Fund (IMF)

Private sector will drive future economic growth

By the end of 2020, the non-oil private sector accounted for 51% of Saudi Arabia's GDP (current prices), making it the main driver of economic growth in the Kingdom. The private sector maintained an average contribution to GDP of 50% during the first half of 2021. Although private sector real GDP contracted by 3.1% in 2020, it saw a remarkable recovery during the first half of 2021, with year-on-year growth of 11.1% from Q2 2020 to Q2 2021.

In March 2021, the Saudi Crown Prince launched the 'Shareek' program, a $1.3 trillion private sector investment program, which is part of a wider $7.2 trillion program that will be carried out over the next 10 years. Aramco and Saudi Basic Industries Corp (SABIC) will be contributing 60% of the program's investments.

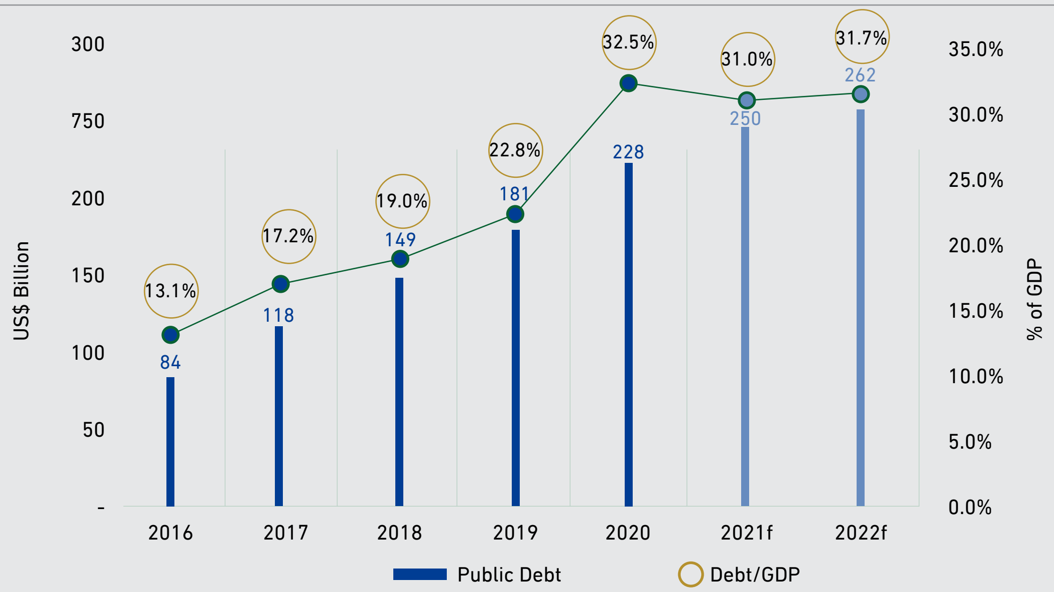
This initiative aims to increase the private sector's contribution to GDP to 65% by 2030 and enhance the cooperation and partnership between the public and private sectors, while creating hundreds of thousands of new jobs. Moreover, the government will also offer support to the private sector, including soft loans from Saudi development institutions and tax incentives at free zones, in line with World Trade Organization guidelines.

Public debt increases more than twofold, but remains below G20 average

IMF data shows that Saudi Arabia's debt as a percentage of GDP rose significantly, from 13.1% in 2016 to an estimated 32.5% in 2020. Despite this increase, it remains relatively low compared to the G20 average of 72.9% and is the second lowest among all G20 nations in 2020. As at the end of 2020, Saudi Arabia's total outstanding direct indebtedness amounted to $227.6 billion (SAR 853.5 billion)[2], of which 37% was borrowed through the Sukūk market[3].

1. IMF World Economic Outlook (July 2021)
2. National Debt Management Center Statistics
3. Refinitiv Sukūk database

CHART 2 – PUBLIC DEBT OF SAUDI ARABIA 2016-2022F

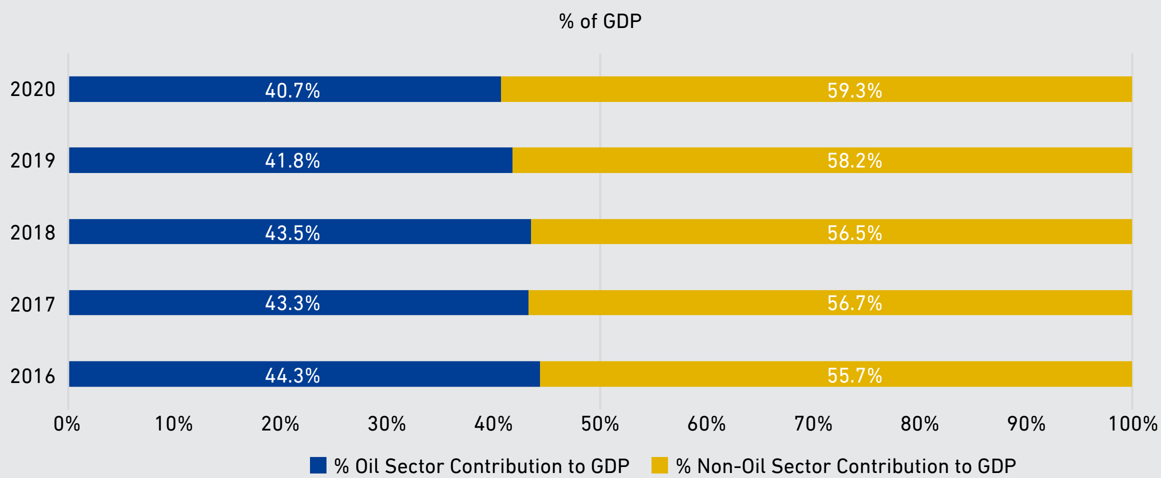


Source: International Monetary Fund (IMF)

Collectively, these indicators point to challenging headwinds amid a delicate post-pandemic recovery, while oil demand has picked up, the global public health crisis remains uncertain. Saudi Arabia has made efforts to diversify its economy, and the estimated GDP during the second quarter of 2021 indicates an annual increase of about 1.5%, driven largely by a growth of 10.1% in the non-oil sector[4].

The move away from a dependence on oil towards diversifying the economic base is gaining momentum. Saudi Arabia is one of the world's largest oil producers and is on pace to further diversify its economic base. In 2020, the oil sector's contribution to real GDP was 40.7%, compared to 44.3% in 2016. While some of this change can be attributed to the lower oil prices in 2020, credit must also go to the active efforts in weaning the economy away from the oil sector.

CHART 3 – OIL VS. NON-OIL SECTORS CONTRIBUTION TO REAL GDP 2016-2020



Source: Saudi Arabia's General Authority for Statistics (GASTAT)

4. General Authority for Statistics (GASTAT), Press Release: Gross Domestic Product Second Quarter of 2021

Saudi Arabia's Vision 2030 focuses on the diversification of the economic base by developing specific non-oil sectors, such as renewable energy, tourism, the digital economy, transportation, and logistics. The development of these and other sectors will be achieved through both government investment and international capital inflows.

Vision 2030 helps lead the way

Vision 2030 was announced in April 2016 to help steer Saudi Arabia's economic and social transformation. The Vision's main goal is a thriving economy built on a vibrant society and delivered by an ambitious nation. It has six overarching objectives, including growing and diversifying the economy and increasing employment. These objectives feed into one of 14 Vision Realization Programs, e.g., the Financial Sector Development Program (FSDP), which helps with the measurement and implementation of the various objectives. The strategic considerations of the FSDP are:

- Financial stability;
- Introduction of sophisticated capital market products;
- Digitization; and
- Financing Small to medium enterprises (SMEs).

Vision 2030 as a master plan has resulted in preliminary improvements in Saudi Arabia's global economic standing, as measured by various independent global rankings. In 2020, Saudi Arabia was ranked 18th among G20 economies, excluding the European Union, in terms of GDP at current prices, according to IMF data. Saudi Arabia ranked 32nd in the World Competitiveness Index 2021, including being ranked 24th globally for Government Efficiency and 26th for Business Efficiency.

Saudi Arabia was ranked second among the G20 digital risers by the European Center for Digital Competitiveness in its 2021 Digital Riser Report. The Kingdom also ranked first among the G20 for its digital ecosystem and third in terms of digital mindset.

While there is considerable room for improvement, some of Vision 2030's aspirational themes are already starting to bear fruit for Saudi Arabia's performance on tangible world indicators, highlighting a strengthening economic position at the global level.

Vision 2030 has specific targets to develop Saudi Arabia's financial sector and economy. Some of these Vision-level KPIs relating to financial and economic development include:

- Propelling Saudi Arabia into the top 15 global economies;
- Increasing foreign direct investments (FDI) from 3.8% to the international standard of 5.7% of GDP;
- Breaking into the top 10 countries on the World Economic Forum (WEF) Global Competitiveness Index;
- Raising the share of non-oil exports by increasing non-oil GDP from 16% to 50%; and
- Growing SMEs' contribution to GDP from 20% to 35%.

For these goals to be achieved, it is crucial at a systemic level for stakeholders to continue building on their existing strong work in partnership with tangible initiatives to advance progress and momentum.

Policies supporting post-pandemic recovery

Saudi policymaking also focuses on providing support for post-pandemic recovery. The Saudi government moved swiftly in early 2020 to help communities worst-hit by the pandemic. By March 2020, the government had introduced a stimulus package of $32 billion (SAR 120 billion). By November, these packages were collectively worth close to $61 billion, with several focused on the private sector, such as exemptions and postponing of government dues ($18.6 billion/ SAR 69.7 billion), and a wage subsidy of 60% for Saudi employees in the private sector. Additionally, 12 Saudi banks supported the health endowment fund with $42.8 million (SAR 160.7 million).

Moreover, in June 2020, Saudi Central Bank (SAMA) injected $13.3 billion (SAR 50 billion) into the banking sector to enhance banking liquidity and allocated another $13.3 billion (SAR 50 billion) to support the private sector, which includes: MSME financing support and measures of the Deferred Payments Program, the Guaranteed Financing Program, and the Loan Guarantee Program, in addition to supporting fees of POS and E-commerce. The Capital Market Authority (CMA) also introduced several measures, such as extending statutory deadlines for companies and providing fee exemptions.

> **“SAUDI ARABIA'S VISION 2030 FOCUSES ON THE DIVERSIFICATION OF THE ECONOMIC BASE BY DEVELOPING SPECIFIC NON-OIL SECTORS”**

FINANCIAL INDUSTRY OVERVIEW

The financial services industry in Saudi Arabia is one of the cornerstones in fulfilling the Kingdom's aspirations for economic transformation and sustainable development. Developing the various sectors within the financial industry in line with international best practices and encouraging digital transformation and innovation will be key contributors to achieving Vision 2030's objectives.

The Saudi financial services industry is predominantly Sharī’ah-compliant considering not only the Kingdom's standing in the Islamic world, but also that several financial sectors are required by law to operate fully in compliance with Sharī’ah.

Saudi Arabia's financial services industry landscape is made up of the following major components that include banking, insurance, finance companies, Sukūk, investment funds, and Waqf.

DIAGRAM 1 – MAJOR COMPONENTS OF SAUDI ARABIA'S FINANCIAL INDUSTRY LANDSCAPE 2020

$795 billion
Banking assets

$14 billion
Finance companies' assets

$56 billion
AuM of domestic investment funds

$10 billion
Gross written insurance premiums

$253 billion
Outstanding bonds and Sukūk

$63 billion
Waqf assets

Source: Saudi Central Bank, Capital Market Authority, General Authority for Awqaf, Refinitiv

The FSDP is one of the Vision 2030 Realization Programs, aiming to shape the next stage of growth for Saudi Arabia's financial industry.
The entities responsible for FSDP's implementation and oversight are the Ministry of Finance, Ministry of Investment, SAMA, CMA and the General Authority for Small and Medium Enterprises (Monshaat).

FSDP has three strategic pillars:
- To enable financial institutions (FIs) to support private sector growth;
- To ensure the formation of an advanced capital market; and
- To promote and enable financial planning.

The FSDP has also set out several commitments for 2025 to help measure the success of the implementation of the initiatives such as:

TABLE 1 – FSDP TARGETS FOR 2025

SEGMENT	TARGET
Banking Sector assets	$937 billion (SAR 3,515 billion)
Stock market capitalization (shares) as % of GDP	80.8%
SME's loans as % of bank loans	11%
Total Gross Written Premiums (GWP) to non-oil GDP	2.4%
Volume of debt instruments as a percentage of GDP	24.1%
Share of non-cash transactions	70%

Given the long-established linkages between Islamic finance and the Saudi economy, the FSDP's development of the wider financial sector will benefit Islamic finance in the Kingdom as well, since various aspects of the local economy use Islamic financial products and services. For example, according to data from Refinitiv, the Sukūk market has flourished and has become the second-largest globally in terms of new issuances and Sukūk outstanding. Saudi Arabia also ranks first in terms of sovereign issuances and third for corporate issuances globally.

Moreover, improving SMEs' access to finance and supporting nascent companies, such as Sharī'ah-compliant FinTechs, will help drive greater financial inclusion and access to finance, as well as reduce distributional inequity across the board. These are all themes Islamic finance seeks to support as well.

A secondary focal point for financial sector development is the support and growth of the Waqf sector in the Kingdom. Waqf in Saudi Arabia, a key pillar of Islamic social finance, consisted of $62.5 billion (SAR 234.4 billion) in assets in 2020. The regulatory authority – the General Authority for Awqaf (GAA) – registered over 600 endowments annually. Out of the total sector assets, Waqf assets overseen by GAA amounted to $4 billion in 2020, which grew by 323% since 2018.

Given its role in promoting sustainability in the non-profit sector, the continued growth of the Waqf sector in the Kingdom will undoubtedly help shape the success of the FSDP and achieve several of Vision 2030's overarching objectives more broadly.

“THE SAUDI FINANCIAL SERVICES INDUSTRY IS PREDOMINANTLY SHARĪ'AH-COMPLIANT CONSIDERING NOT ONLY THE KINGDOM'S STANDING IN THE ISLAMIC WORLD, BUT ALSO THAT SEVERAL FINANCIAL SECTORS ARE REQUIRED BY LAW TO OPERATE FULLY IN COMPLIANCE WITH SHARĪ'AH”

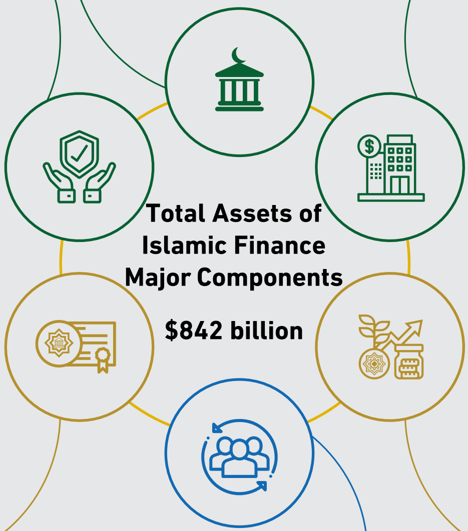
2.

ISLAMIC FINANCE LANDSCAPE

ISLAMIC FINANCE OVERVIEW

Saudi Arabia makes up the world's largest Islamic finance jurisdiction in terms of assets, boasting the world's largest Islamic banking, insurance, and Islamic investment fund sectors and the second largest Sukūk market. The major components of the Kingdom's Islamic finance industry are estimated at $842 billion by the end of 2020, boosted by remarkable growth in the Islamic banking, Islamic capital markets and non-bank financing sectors. Islamic banking is the largest sector within the Saudi Islamic finance industry with assets valued at $544.3 billion in 2020 where Sukūk worth $157.5 billion.

MAJOR COMPONENTS OF SAUDI ARABIA'S ISLAMIC FINANCIAL INDUSTRY LANDSCAPE 2020



Islamic Banking
Total Assets:
$544.3 billion

- Banking Control Law
- Sharīʿah Governance Framework for Local Banks
- Additional Licensing Guidelines and Criteria for Digital-only Banks

Cooperative Insurance
Gross Written Premiums:
$10.3 billion

- Cooperative Insurance Companies Control Law
- Insurance Market Code of Conduct regulation
- Rules of Forming and Managing Health Insurance Risk Pools through Brokers
- Rules of Insurance Products Approval
- Rules for Comprehensive Insurance of Motor Vehicles Financially Leased to Individuals
- Rules Governing Bancassurance Activities
- The Standard Policy of Inherent Defects Insurance (IDI)
- Actuarial Work Rules for Insurance
- Rules Governing Insurance Aggregation Activities

Non-bank Financing
Total Assets:
$14.2 billion

- Finance Companies Control Law
- Sharīʿah Governance Directive for Finance Companies
- Real Estate Finance Law
- Finance Lease Law
- Rules Regulating Consumer Microfinance Companies
- Rules for Engaging in Debt-based Crowdfunding

Sukūk
Total Sukūk Outstanding:
$157.5 billion

- Capital Market Law
- Rules on the Offer of Securities and Continuing Obligation

Islamic Investment Funds
Total Assets under Management
$53.16 billion

- Investment Funds Regulations Real Estate
- Investment Funds Regulations

Waqf
Total Assets
$62.5 billion

- Law of the General Authority for Awqaf
- Instructions for approval on establishing Waqf investment funds

Saudi Central Bank (SAMA)

Capital Market Authority (CMA)

General Authority for Awqaf (GAA)

EDUCATION AND AWARENESS

Education
- 6 degrees
- 35 courses
- 17 qualifications

Provided by 58 academic and training institutions

Awareness
- 10 conferences
- 46 seminars

Most active organizers
- Islamic Development Bank (IsDB)
- Islamic Research & Training Institute (IRTI)
- Islamic Economics Institute (King Abdulaziz University)

Source: Saudi Central Bank, Capital Market Authority, General Authority for Awqaf, Refinitiv
Note: Total Waqf assets include $4 billion, which are overseen by GAA

REGULATORY OVERVIEW

Regulatory and Supervisory Framework

Regulation and supervision of the Islamic finance banking, non-bank finance, insurance, Islamic capital markets and Waqf sectors are divided between three regulators: SAMA oversees the Islamic banking, cooperative insurance, and non-banking finance sectors, while Islamic capital markets fall under the remit of CMA. Islamic FinTechs are regulated by both authorities depending on the type of product and services offered. Additionally, Waqf is overseen by the GAA.

Saudi Central Bank (SAMA)

The Saudi Central Bank was established in 1952 as the Saudi Arabian Monetary Agency. In November 2020, it was re-named as the Saudi Central Bank (SAMA) under the new Saudi Central Bank Law. It is an independent and autonomous government authority. SAMA's main functions include:

- Dealing with the banking affairs of the Government;
- Minting and printing the national currency (the Saudi Riyal), strengthening the Saudi currency and stabilizing its external and internal value, in addition to strengthening the currency's cover;
- Managing the Kingdom's foreign exchange reserves;
- Managing the monetary policy for maintaining the stability of prices and exchange rate;
- Promoting the growth of the financial system and ensuring its soundness;
- Supervising commercial banks and exchange dealers;
- Supervising insurance and reinsurance companies, as well as insurance and reinsurance-related service providers;
- Supervising finance companies; and
- Supervising credit information companies.

The Saudi Banking Control Law, which covers both the conventional and Sharīʽah-compliant segments of the banking system, is supplemented by a Sharīʽah governance framework. This framework is the first in a series of new regulations that have been planned by the central bank to enhance the regulation and supervision of Islamic banking in the Kingdom. The cooperative insurance, finance and real estate finance (non-bank finance) sectors are exclusively Sharīʽah-compliant as mandated by their respective laws.

Sharīʽah governance of Saudi Arabia's Islamic finance industry is decentralized, where the function is carried out at institution-level by their in-house Sharīʽah boards. The onus of approving new Islamic financial products also falls on these boards.

Islamic Banking Regulation Islamic banks in Saudi Arabia are primarily governed by the Banking Control Law of 1966. SAMA has also issued the Sharīʽah Governance Framework for local banks operating in Saudi Arabia, ensuring appropriate Sharīʽah governance is maintained in the sector. The framework is based on international best practices for Islamic banks, set by multilateral bodies such as the Islamic Financial Services Board (IFSB). It sets the minimum governance standards for Islamic banking operations and defines the formation, appointment, membership and responsibilities of the board of directors, executive management, Sharīʽah committee, as well as the internal control functions, Islamic windows' operations, and the development process of Sharīʽah-compliant products.

Cooperative Insurance Regulation Saudi-based insurers are regulated under the Cooperative Insurance Companies Control Law, issued in 2004 and supplemented with regulations for its implementation. All insurance companies operating in Saudi Arabia are required by this law to maintain a Sharīʿah-compliant structure under the cooperative insurance model. The cooperative insurance regulatory framework also includes other mechanisms, such as the Insurance Market Code of Conduct regulation, the Rules of Insurance Products Approval and the Investment Regulations.

Non-bank Finance Regulation Finance companies in Saudi Arabia are governed by a number of regulations depending on the type of financing they offer. Generally, finance companies are regulated under the Finance Companies Control Law which also requires them to be Sharīʿah compliant. In June 2021, SAMA issued new directives on the Sharīʿah governance of financing companies in the Kingdom aiming to improve their compatibility with Islamic rules and principles.

Specialized finance companies are also subject to more specific regulations which also require Sharīʿah-compliance:
- Real Estate Finance Law;
- Finance Lease Law;
- Rules for Engaging in Debt-based Crowdfunding; and
- Rules Regulating Consumer Microfinance Companies.

BOX 1 - DEVELOPING A ROBUST SHARĪ'AH GOVERNANCE FRAMEWORK

One of the key priorities of the FSDP's Islamic finance strategy is to enhance the Islamic finance Sharīʿah governance framework in the Kingdom. As previously mentioned, the Sharīʿah governance of Islamic financial institutions in Saudi Arabia is decentralized, but the introduction of a comprehensive Sharīʿah governance framework will contribute to enhancing confidence and greater independence of Sharīʿah decisions in line with international best practices.

The strategy has set out two commitments to be achieved by 2025, to ensure full independence of Sharīʿah scholars that are experts in the field of Islamic finance:

KPI	2018	2020	2021	2022	2023	2024	2025
Number of distinct Sharīʿah scholars to total Islamic Finance institutions	0.5	0.71	0.85	1.0	1.2	1.4	1.6
Percentage of Saudi scholars to seats on international bodies and financial institutions	16.07%	17.83%	18.78%	19.79%	20.84%	21.96%	23.13%

Moreover, the Islamic finance strategy outlines some strategic initiatives to be implemented by SAMA and CMA by 2030, with the goal of enhancing Sharīʿah governance through regulating and overseeing essential Sharīʿah governance functions within financial institutions. These initiatives include:

1. Regulating the work of Sharīʿah Committees at financial institutions
This initiative will focus on the issuance of regulations governing Sharīʿah committees across various financial institutions in the Kingdom. These regulations will set guidelines and requirements for the membership, responsibilities and authorizations of these committees among other governance aspects.

2. Define the functions of Sharīʿah compliance at financial institutions
This initiative aims to define the functions of Sharīʿah compliance units at financial institutions, including contributing to the development of Sharīʿah-compliant products and reviewing these before they are introduced to clients. These units will also be responsible for conveying the Sharīʿah Committee's resolutions to the management.

3. Define the functions of oversight and internal Sharīʿah audit at financial institutions
This initiative aims to define the functions of Sharīʿah oversight and internal auditing at financial institutions, which include overseeing the application of Sharīʿah Committee resolutions and regular Sharīʿah-compliance reporting to the Sharīʿah Committee.

When they are executed, these initiatives are expected to enhance financial stability and financial inclusion in Saudi Arabia, boosting the value of the Islamic finance industry locally and garnering more trust, confidence and transparency. Customers and investors will rest assured that their interests are protected against the risk of Sharīʿah non-compliance with the presence of oversight functions such as Sharīʿah compliance and Sharīʿah internal audit.

Capital Market Authority (CMA)

CMA was established in 2003 as the regulator of Saudi Arabia's capital markets, which include equities, debt instruments and investment funds. CMA is mandated with drafting and enacting the rules and regulations that govern these markets in line with the Capital Market Law and Companies Law. It is also responsible for developing capital markets, as well as enforcing governance requirements and promoting measures that limit their risks.

CMA exercises its regulatory and development roles in a balanced way that guarantees no overlap by establishing a department under the Strategy and International Affairs Deputy tasked with developing regulatory policies. CMA issued its latest Capital Market Strategic Plan in 2021, setting an ambitious roadmap to become the leading market in the Middle East and among the top ten capital markets in the world. The plan also aims for Saudi Arabia to become an advanced market that is attractive to both domestic and foreign investors, enabling it to play a pivotal role in economic development and diversification.

The program consists of four main pillars:

- **Facilitating funding:** deepening the capital market and promoting its role in raising capital;
- **Encouraging investment:** supporting the growth of asset management and promoting institutional investment;
- **Promoting confidence:** reinforcing the capital market's Regulatory Structure; and
- **Building capacities:** supporting the development of market participants.

Islamic capital markets are governed by overarching rules covering the establishment, offering and listing of Sukūk and investment funds. They also include guidance pertaining to Sharīʽah-compliant offerings, which today account for a significant proportion of the Saudi debt market and almost the entire public funds market.

Sukūk Regulation

The Capital Market Law is the primary legislation governing capital market issuances, including Sukūk. It allows CMA to adapt and impose regulatory standards introduced by international standard-setting bodies such as the IFSB. Sukūk issuance and listing on the Saudi Stock Exchange (Tadawul) are also regulated by the Rules on the Offer of Securities and Continuing Obligations.

Investment Funds Regulation Investment funds are governed by the Investment Funds Regulations, which regulate the establishment, registration, offerings and management of investment funds, as well as supervise all their associated activities. The law is applicable for Sharīʽah-compliant funds. Similarly, REITs are governed by the Real Estate Investment Funds Regulations.

General Authority for Awqaf (GAA)

The GAA was established by the government in 2010, replacing the Deputy Ministry of Islamic Affairs, Endowments, Dawah, and Guidance in the oversight of the Waqf sector. GAA is mandated to enhance the status of Waqf assets in the society, develop and maintain them, and diversify their disbursement, in order to increase the economic and social contribution of the Waqf sector in line with Vision 2030.

Awqaf Company

The investment arm of GAA, which works on developing investment mechanisms for Waqf managed by the Authority, diversifying the investment portfolio, and developing an investment strategy to ensure an investment return. Awqaf Company is also concerned with ensuring that investments, funds and assets are managed more effectively and efficiently to achieve financial growth and sustainability and diversify the sources of income.

Ryada Endowment Center

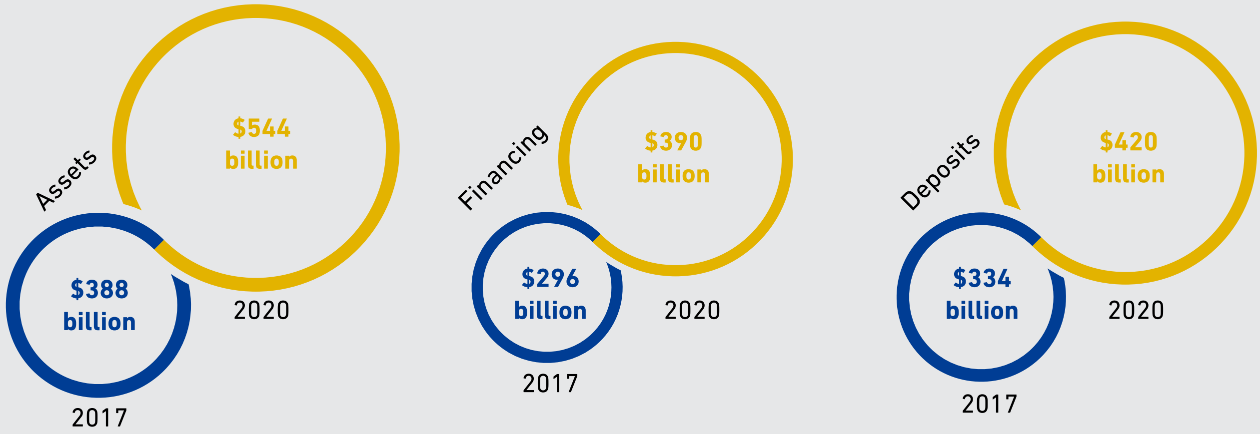
A specialized center established by GAA to be one of its executive arms in the fields of empowering the Waqf sector and building its capacities to bring it to the highest degree of professional excellence and enhance its development impact.

Waqf Regulations

The Law of the General Authority for Awqaf was issued in 2015, mandating the Authority to regulate, maintain, and develop the sector, and to enhance its role in economic and social development and social solidarity, in accordance with Islamic law. GAA issued a licensing framework for Waqf investment funds in 2018 under Instructions for Approval on Establishing Waqf Investment Funds.

ISLAMIC BANKING

DIAGRAM 2 – KEY ISLAMIC BANKING INDICATORS IN SAUDI ARABIA 2017 – 2020



Source: Saudi Central Bank

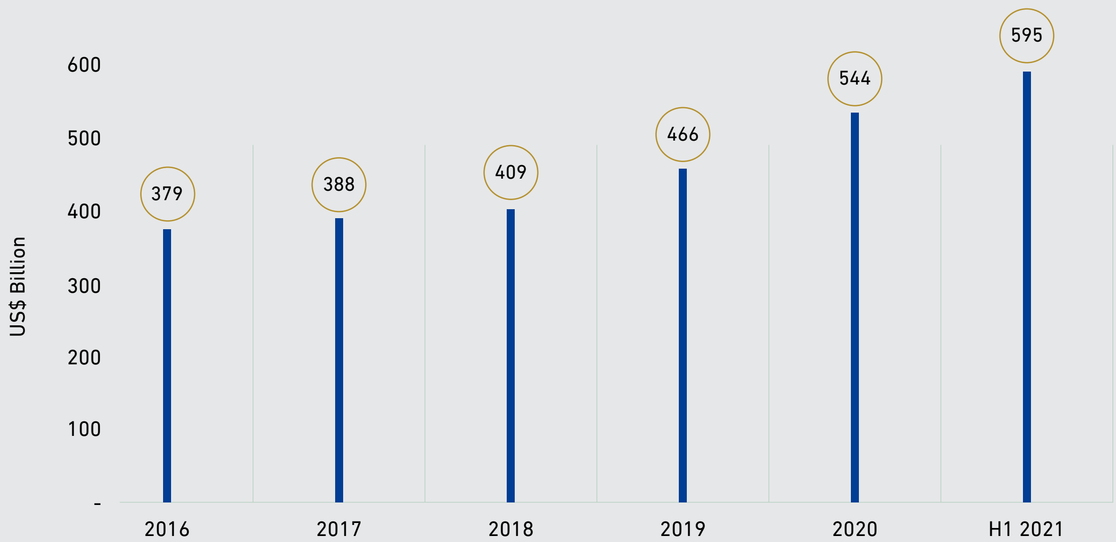
Double-digit growth for Islamic banks despite pandemic

Saudi Arabia has the largest proportion of Islamic banking assets among jurisdictions that follow a dual banking system, where Sharīʿah-compliant banks operate alongside Islamic windows. Islamic banking assets in the Kingdom account for around 28% of global Islamic banking assets, according to IFSB's 2021 Islamic Financial Services Industry (IFSI) Stability Report.

Islamic banking assets in the Kingdom were valued at $544 billion (SAR 2 trillion) by the end of 2020, growing at a five-year CAGR of 8.9% from $388 billion in 2017. These assets made up 73% of Saudi Arabia's total banking assets for 12 local banks in 2020 (excluding foreign banks), compared to an average of around 25% in other GCC jurisdictions.

During 2019 and 2020, the Saudi Islamic banking sector witnessed double-digit asset growth of 14% and 17%, respectively. This was driven by a similar growth pattern in Sharīʿah-compliant bank financing, driven by retail financing, which is the largest segment for Islamic banks in the Kingdom.

CHART 4 – ISLAMIC BANKING ASSETS IN SAUDI ARABIA 2016 – H1 2021

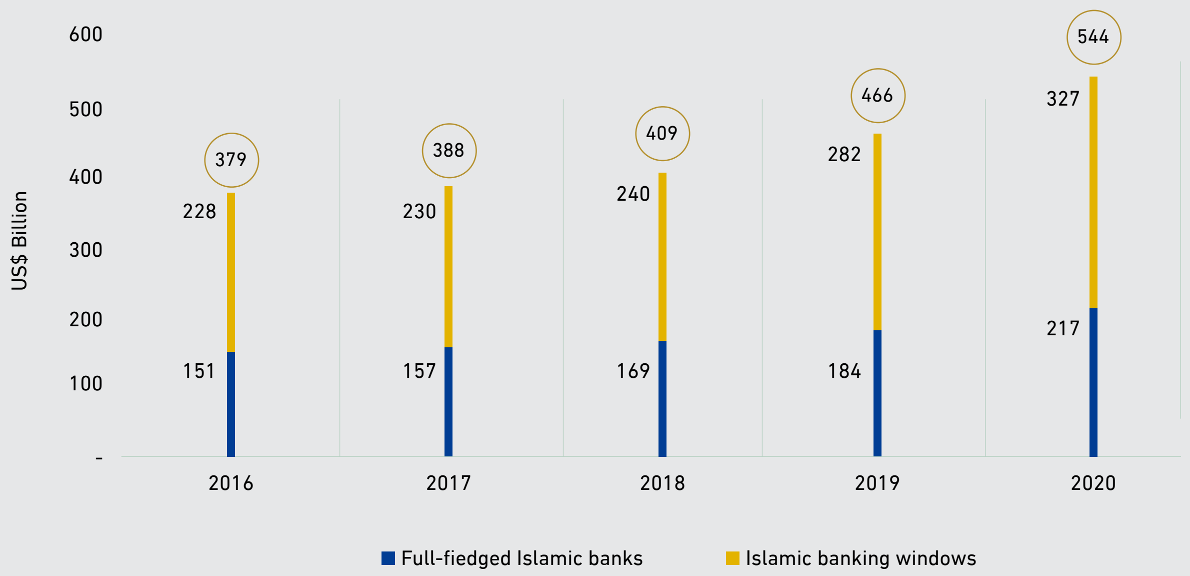


Source: Islamic Financial Services Board (IFSB)

Structure of Islamic banking sector

There are currently four full-fledged Islamic banks operating in Saudi Arabia, in addition to eight Islamic windows.

CHART 5 – STRUCTURE OF ISLAMIC BANKING ASSETS IN SAUDI ARABIA 2016 – 2020



Source: Islamic Financial Services Board (IFSB)

Full-fledged or standalone Islamic banks made up 40% of Islamic banking assets in the Kingdom in 2020, while Islamic banking windows accounted for the remaining 60%. Full-fledged Islamic banks are banking institutions that are entirely Sharīʼah compliant in terms of their operations. Islamic windows, on the other hand, represent the Sharīʼah-compliant division or business line that operates with a conventional bank or banking group.

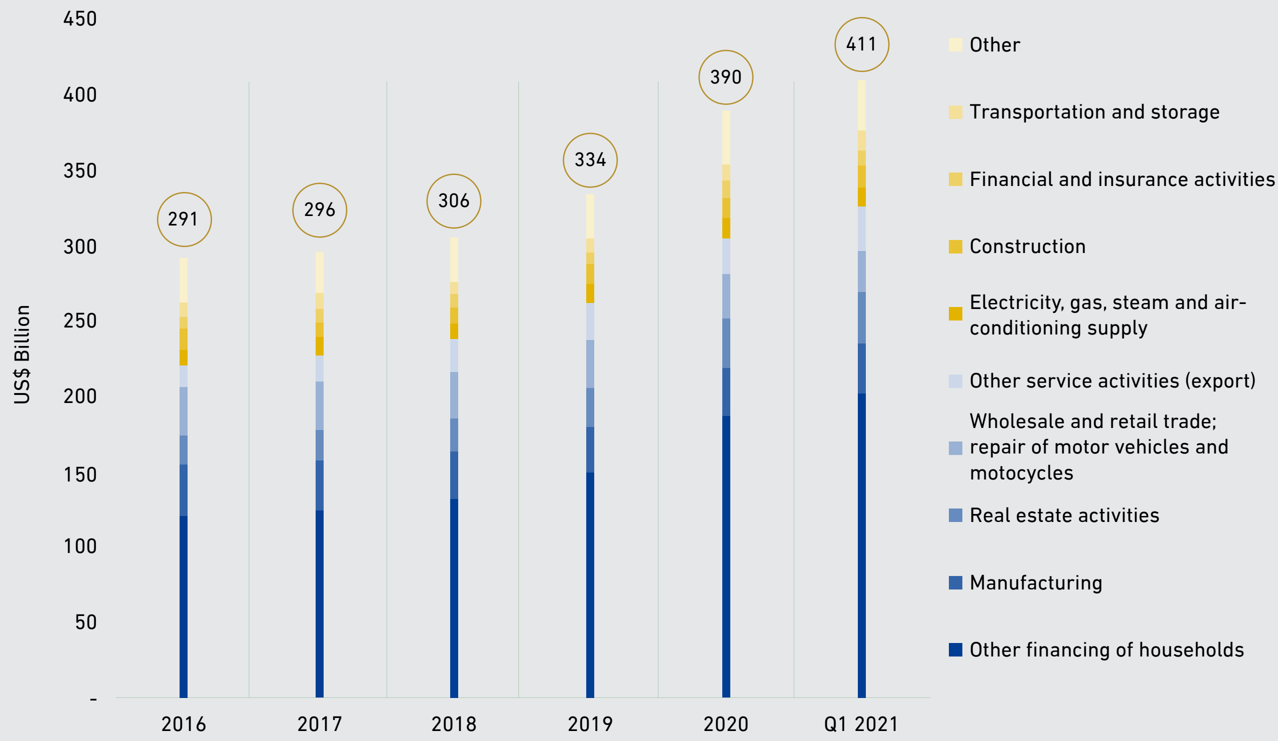
Full-fledged Islamic banks' aggregate financing portfolio is concentrated mainly in retail financing, which made up 61% of total financing from Islamic banks in 2020. The aggregate financing portfolio for Islamic banking windows is relatively less concentrated compared to Islamic banks, with 40% of total financing extended to retail customers in 2020, and greater exposure to some sectors such as the export, construction, transportation and storage sectors.

Sharīʼah-compliant financing boosted by a surge in mortgage financing

Sharīʼah-compliant bank financing reached $390 billion by the end of 2020, increasing by a CAGR of 6% from $291 billion in 2016. Financing grew by 17% during 2020, the highest growth rate since 2016, despite the fallout from the Covid-19 pandemic. This was mainly supported by government stimulus packages extended to the overall banking sector as well as a surge in residential new mortgages taken out by retail customers.

Retail financing (to households) made up 48% of total Islamic bank financing in 2020, being the main driver of growth for the sector.

CHART 6 – SHARĪ'AH-COMPLIANT BANK FINANCING IN SAUDI ARABIA BY SECTOR 2016 - Q1 2021

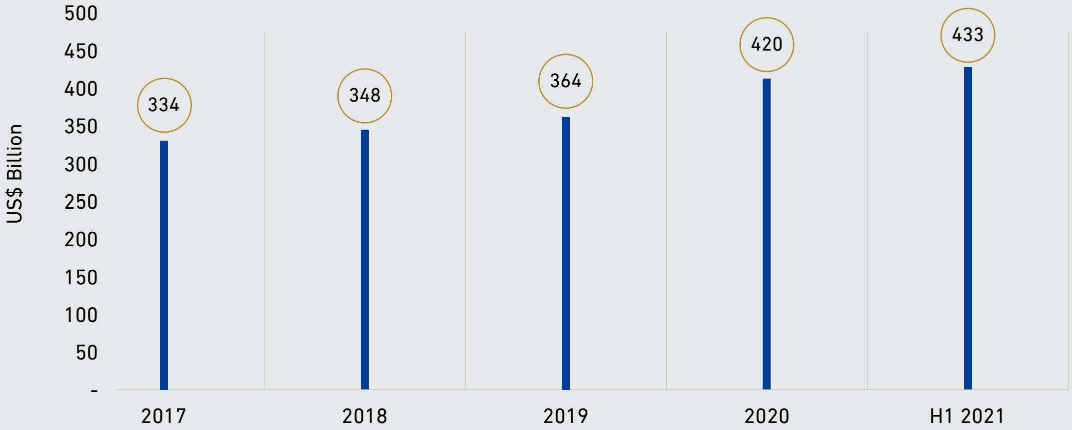


Source: Islamic Financial Services Board (IFSB)

Islamic deposits parallel financing growth, supported by SAMA liquidity injection

Sharī'ah-compliant bank deposits in the Kingdom were valued at $420 billion by the end of 2020, up from $334 billion in 2017. Deposits grew at a CAGR of 6%; slightly lower compared to growth in Sharī'ah-compliant bank financing during the same period. Deposit growth was sustained during 2020 by SAMA's injection of SAR 50 billion ($13.3 billion) in the banking sector to enhance its liquidity. This helped the wider banking sector to continue providing credit to borrowers during this challenging period.

CHART 7 – SHARĪ'AH-COMPLIANT BANK DEPOSITS IN SAUDI ARABIA 2017 - H1 2021



Source: Saudi Central Bank

Stable performance, resilience during Covid-19

Overall, Islamic banks and Islamic windows in Saudi Arabia exhibited resilience despite the fallout from Covid-19. The sector's performance was relatively stable in terms of profitability, asset quality, capital adequacy and liquidity over the past five years.

1. Profitability and Efficiency The Islamic banking sector's profitability remained relatively stable since 2016, albeit marginally impacted by Covid-19 shocks in 2020. Most notably, net profit margin (NPM) improved overall from 44% in 2016 to 50% in 2019, and 53% in Q1 2021. This was owing to strong Sharī'ah-compliant financing growth, which was supported by the liquidity injection from SAMA in 2020.

Similarly, return on assets (ROA) for Islamic blanks and Islamic windows also remained stable during this period at an average of 2.1%. ROA dipped slightly in 2020 as net income fell by 4% in the wake of the Covid-19 pandemic. During Q1 2021, net income from the Islamic banking sector exceeded the full-year profit of the previous five years.

TABLE 2 – PROFITABILITY RATIOS FOR SAUDI ISLAMIC BANKING SECTOR 2016 - Q1 2021

	2016	2017	2018	2019	2020	Q1 2021
Return on assets (ROA) (%)	1.9	2.2	2.4	2.2	1.8	2.0
Net profit margin (NPM) (%)	44.4	49.2	51.2	49.5	45.1	53.3

Source: Islamic Financial Services Board (IFSB)

2. Asset Quality
The non-performing financing (gross NPF) ratio for the Saudi Islamic banking sector continued to increase between 2016 and 2020, mainly stemming from increasing impairments in the manufacturing, construction and auto sectors (wholesale and retail trade; repair of motor vehicles and motorcycles), which were exacerbated by business closures during Covid-19 lockdowns. Although the provision coverage of non-performing financing has increased during this period, it remains at a very healthy level, well in excess of realized financing impairments.

TABLE 3 - ASSET QUALITY RATIOS FOR SAUDI ISLAMIC BANKING SECTOR 2016 - Q1 2021

	2016	2017	2018	2019	2020	Q1 2021
Gross nonperforming financing (gross NPF) ratio (%)	0.9	1.0	1.5	1.6	1.9	1.9
Provisions for gross nonperforming financing (gross NPF) (%)	152.0	167.2	157.5	143.4	132.1	130.7

Source: Islamic Financial Services Board (IFSB)

3. Capital Adequacy
Islamic banks remain well capitalized, with an average Tier 1 capital to risk-weighted assets (RWA) ratio of 19% and a total capital adequacy ratio of 20% between 2016 and Q1 2021, both well above recommended Basel III requirements. This is largely due to high proportions of retail banking assets and lower off-balance-sheet activities, which result in lower risk weightings.

TABLE 4 – CAPITAL ADEQUACY RATIOS FOR SAUDI ISLAMIC BANKS 2016 - Q1 2021

	2016	2017	2018	2019	2020	Q1 2021
CAR (%)	21.1	21.9	20.8	20.2	19.5	18.6
Tier 1 Capital to RWA (%)	19.2	20.1	18.9	18.4	17.7	16.9

Source: Islamic Financial Services Board (IFSB)

4. Liquidity
Islamic banks maintained healthy liquidity levels with an overall increase in liquid assets on the balance sheets. Despite the marked decrease in the sector's liquidity coverage ratio (LCR), it remains well above the minimum Basel III requirement.

TABLE 5 – LIQUIDITY RATIOS FOR SAUDI ISLAMIC BANKS 2016 - Q1 2021

	2016	2017	2018	2019	2020	Q1 2021
Liquid assets ratio (%)	26.0	28.5	24.6	33.5	31.6	30.5
Liquidity coverage ratio (LCR) (%)	203.4	167.1	161.8	158.4	159.0	150.3

Source: Islamic Financial Services Board (IFSB)

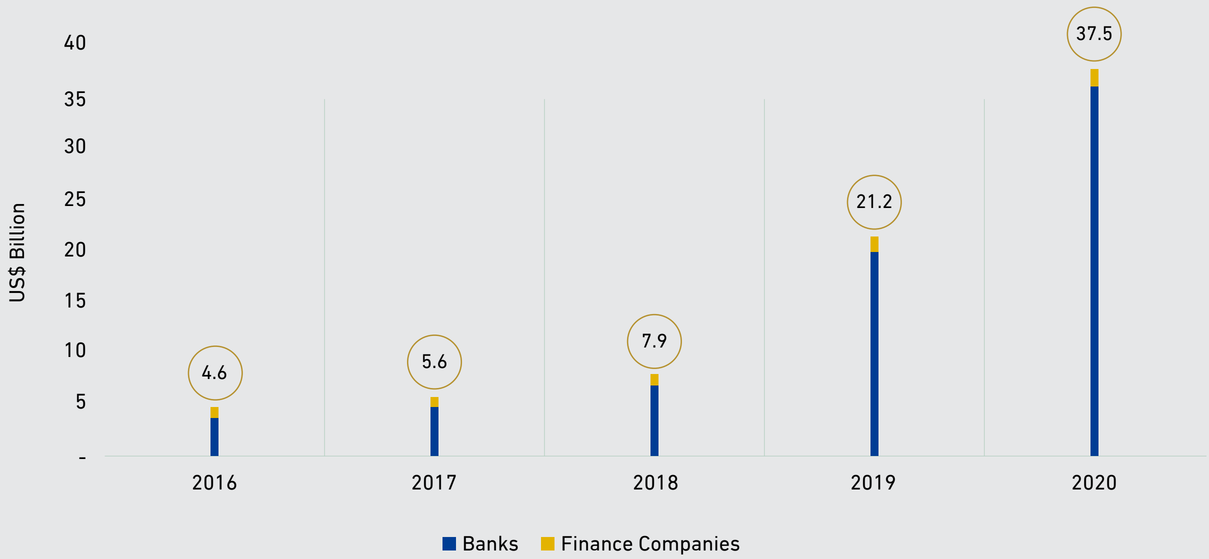
Retail mortgages driving future growth

In accordance with the Real Estate Finance Law, all residential mortgages in Saudi Arabia must be Sharīʾah-compliant.

The value of new residential mortgage financing extended by banks and finance companies to individuals in Saudi Arabia reached a record of $37.5 billion in 2020, more than eight times the value in 2016. This represents a 52% CAGR during the five-year period. Overall, banks accounted for 97% of mortgage financing in 2020, gradually increasing from an 87% share in 2016.

New residential mortgages extended by banks were valued at $36.3 billion in 2020. Despite the pandemic, total mortgage financing increased by 77% while mortgages from banks increased by 83% compared to 2019. This was driven by the increase in government-backed housing programs, fewer avenues for consumer spending in the wake of the pandemic and the stabilizing of real estate prices in 2020 following a sharp decline between 2015-2019.

CHART 8 - RESIDENTIAL NEW MORTGAGES FINANCE FOR INDIVIDUALS PROVIDED BY BANKS AND FINANCE COMPANIES 2016 – 2020



Source: Saudi Central Bank

Various factors support the high growth in mortgage financing, including the Saudi government placing home ownership at the center of its Vision 2030 strategic plans. Under Saudi Vision 2030, the Housing Vision Realization Program had set a target of a 70% home ownership rate for citizens by 2030. Home ownership has already exceeded 60%, beating its 2020 target by 8% and remaining on track to achieve the target ahead of schedule.

In May 2017, SAMA issued a circular stating that all security against real estate needs to be registered as a mortgage and that all active Ifragh[5] agreements must be registered as a mortgage by May 2020. In October 2020, Saudi Arabia made real estate transactions exempt from the 15% VAT rate, but instead introduced a 5% real estate transaction tax.

In addition, SAMA announced the development of a subsidized mortgage product in 2016, to finance housing for eligible citizens in coordination with the Ministry of Housing and the Ministry of Finance. The product made borrowers – that are first-time homebuyers – responsible for a down payment of 15% of the property value, with commercial banks financing 70% and the remaining 15% being guaranteed by the Ministry of Finance. The down payment was later reduced to 10% in 2018, in an effort to further stimulate mortgage lending and contribute towards achieving the Kingdom's national housing strategy. Subsequently, new residential mortgages from banks nearly tripled in 2019.

The Saudi Real Estate Development Fund (REDF) also offers a variety of mortgage subsidies through banks, including a guarantee worth 5% of the property value as a down payment, up to a maximum limit of SAR 500,000.

The total value of mortgage financing from Saudi banks is forecasted to grow by 30% annually in 2021 and 2022, according to an estimate by S&P Global Market Intelligence[6]. Meanwhile, mortgages are expected to make up 68% of net new financing in 2021, and by 65% and 57% in 2022 and 2023, respectively.

5. The transfer of title structure involves the obligor transferring legal title to a special purpose company, set up by the bank providing the financing, for the duration of the financing. The title to the property would revert to the obligor once the financing is repaid
6. S&P Global Market Intelligence, Saudi Arabia's 'Fannie Mae' to boost portfolio, issue mortgage-backed securities" (May 2021)

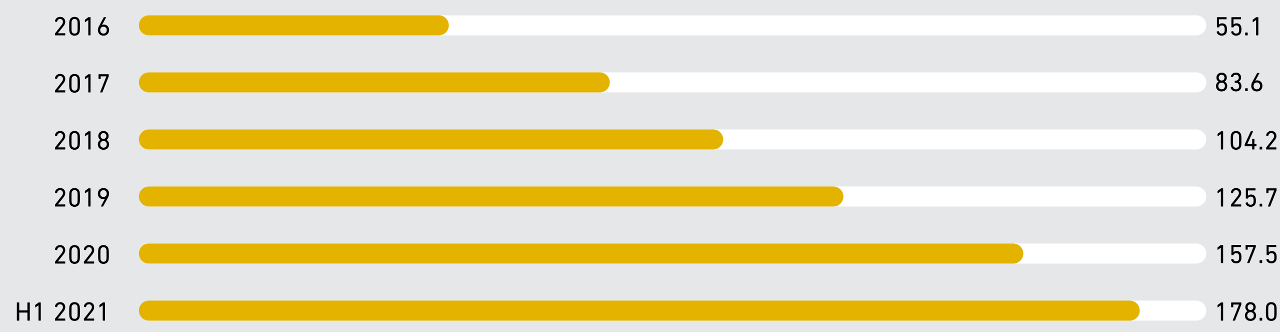
ISLAMIC CAPITAL MARKETS

Sukūk

Government Sukūk program driving market development
Saudi Arabia has been a leading country in terms of Sukūk issuance since 2017, driven by a government Sukūk program that also spurred greater corporate issuances. The Kingdom is the second-largest market globally in terms of new issuances and outstanding Sukūk in 2020. It was also the largest sovereign Sukūk issuer and home to the third-largest market for corporate Sukūk.

The market for Sukūk issued by Saudi-based entities, in terms of Sukūk outstanding, nearly tripled between 2016 and 2020, reaching a value of $157.5 billion in 2020, according to Refinitiv. Sukūk outstanding has been valued at $178 billion in H1 2021.

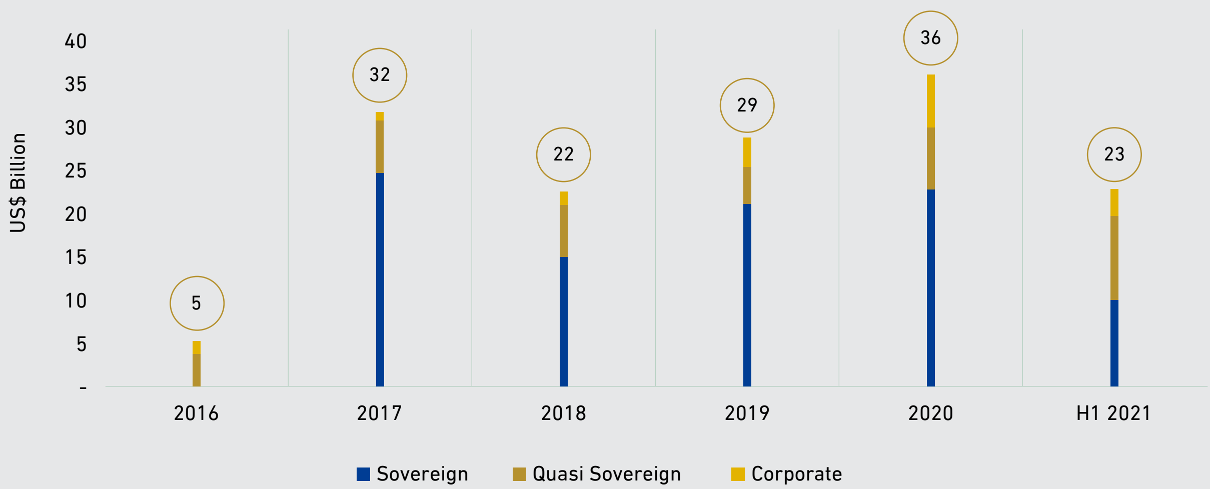
CHART 9 – OUTSTANDING SUKŪK IN SAUDI ARABIA ($ BILLION) 2016 – H1 2021



Source: Refinitiv

Overall Sukūk issuance in from Saudi-based issuers increased more than sevenfold since 2016, reaching $36.3 billion by the end of 2020. The Saudi Sukūk market saw a boost in new issuances since 2017, when the Saudi government launched its "Sukūk Issuance Program" to diversify the state budget funding base. Since its inception and until the end of H1 2021, the program has raised a total of $79.8 billion, according to Refinitiv.

CHART 10 – SUKŪK ISSUANCE FROM SAUDI-BASED ISSUERS 2016 – H1 2021



Source: Refinitiv

The program's primary focus has been developing the domestic Sukūk market. In 2018, Saudi Arabia launched a new 'primary dealer' scheme for local-currency government Sukūk.

With various tenors of up to 30 years, the Sukūk program is helping to establish a domestic benchmark Sukūk yield curve.

This has already led to growing numbers of corporates such as, Arabian Centres issuing Sukūk in 2019 and ACWA in 2021.

TABLE 6 - DEBUT CORPORATE SUKŪK ISSUANCES IN SAUDI ARABIA 2018 – H1 2021

Issuer	2018	2019	H1 2021
Maaden Phosphate Co	$933 million		
Maalem Financing Co	$26.7 million		
Saudi Real Estate Refinance Co	$66.7 million		
Arabian Centres		$500 million	
Iffim		$50 million	
ACWA			$750 million

Source: Refinitiv

In 2018, Saudi Real Estate Refinance Co. also entered the Sukūk market with a $66.7 million issuance, and later launched a $2.9 billion (SAR 11 billion) domestic Sukūk program that would likely make it a major issuer in the Saudi Sukūk market.

In addition, CMA introduced several incentives in 2019 for corporate Sukūk issuers and investors to encourage further issuances and increase trading activity in the secondary market. Corporates now benefit from lower regulator fees for new and repeat issuances as well as smaller face values for Sukūk from SAR 1 million to SAR 1,000 to offer easier access for retail investors. Lower trading commissions in addition to zero tax/ Zakāh on investments on domestic sovereign Sukūk also promises a more active and liquid secondary market.

CMA has strived to ensure the development and growth of the Sukūk market and to enhance its role as one of the Kingdom's main funding channels for the public and private sectors.

This interest in the Sukūk market aims to achieve alignment with global best practices and is considered a crucial contributor to financing and economic growth, and a key pillar in the aspirations of the FSDP.

The global boom in green investments promises new Sukūk growth prospects

Green bond issuances are expected to reach around $400 billion in 2021, according to several market estimates reported by S&P Global Market Intelligence. The rising demand for green and sustainable financial assets from institutional investors is expected to also fuel demand for green and sustainability Sukūk.

Renewable energy has become central to many national economic strategies and the numerous mega projects that are underway or planned will likely lead to further green Sukūk issuances, particularly within the GCC. This will capitalize on interest from a broad range of institutional investors, particularly from non-OIC countries, as demand grows for sustainable and responsible investments. Government support has been integral in encouraging green Sukūk issuance.

Saudi Arabia has recently caught onto the ESG (Environmental, Social and Governance) debt movement in efforts to further diversify its economy away from the oil sector. In 2021, the Saudi government announced it was considering issuing ESG Sukūk as part of its public debt strategy. Meanwhile, the Kingdom's sovereign wealth fund – the Public Investment Fund (PIF) – was developing a framework for ESG debt issuances.

In 2020, the majority government-owned Saudi Electricity Company issued a $1.3 billion green Sukūk that attracted over $4.8 billion in bids from international markets. The company has earmarked the proceeds for funding its 'smart meter' rollout scheme, a national program that is part of the digital transformation and sustainability strategy. The proceeds from this scheme will go towards facilitating the Kingdom's shift to a low-carbon nation, in line with Vision 2030.

The Islamic Development Bank (IsDB) issued the world's largest sustainability and ESG Sukūk issuance to date, ranking the bank as the largest issuer of ESG Sukūk with total issuance standing at $5.2 billion. The oversubscribed issuance – with an order book of over $2.65 billion – will be partly financing or refinancing eligible projects under IsDB's sustainable finance framework. Under this framework, sustainability Sukūk are used to finance the development bank's green or social projects. IsDB previously issued € 1 billion of green Sukūk in 2019 under the sustainable finance framework.

Islamic Investment Funds

Islamic funds boosted by double-digit growth

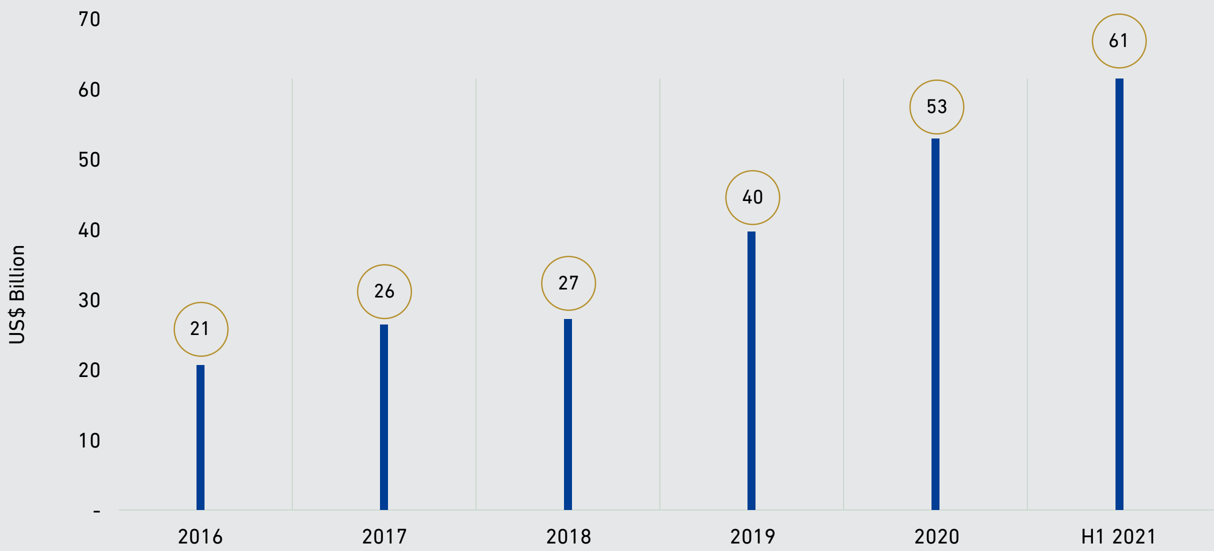
Saudi Arabia's public investment funds are almost entirely Sharīʿah-compliant. Islamic funds accounted for 95% of assets under management (AuM) managed by public investment funds in the Kingdom in 2020. The Islamic funds in the Kingdom account for around 36% of global Islamic funds' AuM, according to IFSB's 2021 IFSI Stability Report.

The AuM of Islamic funds grew at a CAGR of 21% since 2016, reaching a value of $53 billion in 2020.

Although the Covid-19 pandemic brought on heightened volatility to global financial markets, assets managed by Sharīʿah-compliant funds grew by 33% during 2020 alone, from $40 billion in 2019, pointing to the resilience of Islamic investments. Islamic funds also saw significant growth of 48% in 2019.

Around 67% of Sharīʿah-compliant AuM were invested in money market funds in 2020, followed by 9% invested in Sukūk funds and 7% in equity funds. The remaining 17% of AuM were invested in other types of funds, including Real Estate Investment Fund (REITs) and Exchange Traded Fund (ETFs).

CHART 11 – PUBLIC ISLAMIC INVESTMENT FUNDS' AUM IN SAUDI ARABIA 2016 – H1 2021



Source: Capital Market Authority

> **SAUDI ARABIA'S PUBLIC INVESTMENT FUNDS ARE ALMOST ENTIRELY SHARĪʿAH-COMPLIANT. ISLAMIC FUNDS ACCOUNTED FOR 95% OF ASSETS UNDER MANAGEMENT (AUM) MANAGED BY PUBLIC INVESTMENT FUNDS IN THE KINGDOM IN 2020**

Innovation diversifying Islamic fund offering

REITs – CMA had set the stage for new growth opportunities in the Islamic fund space when it issued the instructions for offering and listing REITs in 2016. In 2017, the first Islamic REIT – Al Jazira Mawten REIT – was launched by Al Jazira Capital, soon followed by another 14 Islamic REITs in the following two years.

This fund type is still considered a nascent segment of Islamic capital markets, but it typically offers average annual returns of 6%-8%, making it an attractive diversification tool for long-term investors. It also offers exposure to real assets and protection against inflation.

The further development of the REIT market can potentially attract untapped demand from large Islamic institutional investors, particularly Takāful firms that typically face a lack of Sharīʿah-compliant investment options. In 2019, selected Saudi-based REITs were included in the FTSE EPRA/ Nareit Emerging Market Index, a benchmark index for emerging market REITs, which will enhance the visibility of the Saudi REIT market to foreign investors, broaden its investor base, and increase the level of disclosure.

The main challenge facing the Saudi REIT market is the limited pipeline of suitable institutional-grade real estate assets to be placed in REITs' structures.

However, with the Saudi Vision 2030 economic diversification plans underway, a wide range of mega real estate projects in the hospitality, entertainment, commercial and housing industries will be available for the structure of new REITs.

Sukūk ETFs – In 2019, a new Islamic fund structure emerged in the Saudi market – the Sukūk ETF. Two Sukūk ETFs based on the Saudi government's domestic Sukūk issuances currently exist: the Albilad Saudi Sovereign Sukūk ETF, launched in 2019, and the Alinma Saudi Government Sukūk ETF, launched in 2020.

TABLE 7 – SAUDI GOVERNMENT SUKŪK ETFS OVERVIEW

	Alinma Saudi Government Sukūk ETF Fund - Short Maturity	Albilad Saudi Sovereign Sukūk ETF
Launch Date	January 2020	August 2019
Index	iBoxx Tadawul SAR Government Sukūk 0-5 index	Albilad IdealRatings Saudi sovereign Sukūk Index.
Underlying Assets	SAR-denominated sovereign Sukūk with maturities of 0-5 years	SAR-denominated sovereign Sukūk with remaining 3 months or more in maturity
Total NAV at Inception	SAR 1,250 million	SAR 30 million
Total units at Inception	12,500,000 units	3,000,000 units
Initial Unit Value	SAR 100	SAR 10

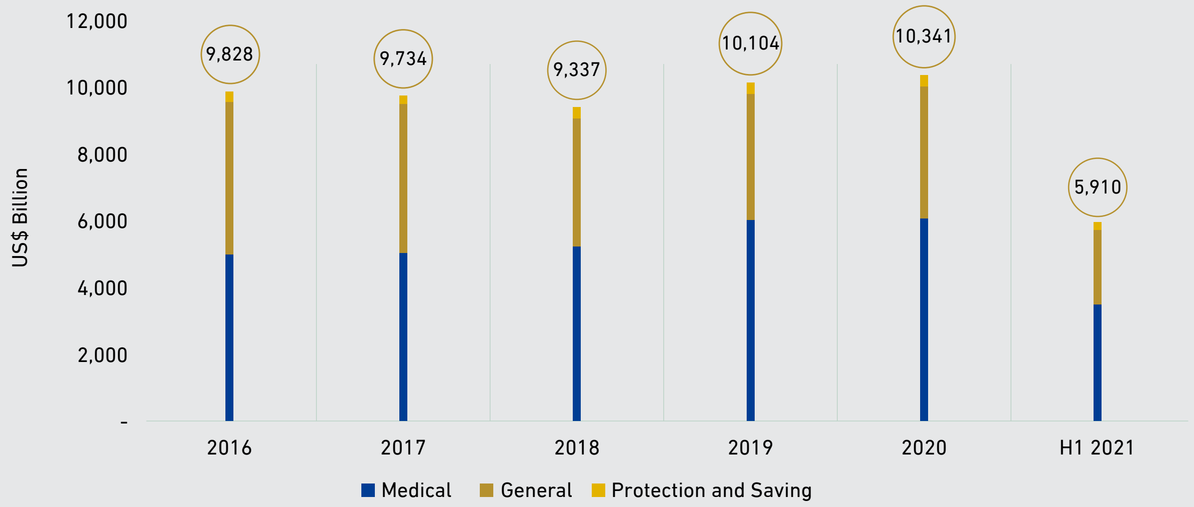
Source: Saudi Stock Exchange (Tadawul)

COOPERATIVE INSURANCE

Insurance sector continues recovery despite pandemic

Saudi Arabia is home to the world's largest Sharī'ah-compliant insurance market, accounting for more than 40% of global Takāful contributions in 2019, according to data from IFSB. Gross written premiums reached a total of $10.3 billion by the end of 2020, up 5% compared to $9.8 billion in 2016. In 2020, 32 insurers were operating in the Kingdom, with the largest eight insurers attracting 75% of total gross written premiums.

CHART 12 – COOPERATIVE INSURANCE GROSS WRITTEN PREMIUMS 2016 – H1 2021



Source: Saudi Central Bank

Total premiums fell in 2017 and 2018, brought down by lower premiums in general insurance lines (mainly motor insurance). Premiums from motor insurance have steadily declined since 2016 when SAMA issued instructions to insurers to offer no-claims discounts of up to 40% on individual mandatory motor insurance. The sector recovered in 2019, after a three-year decline, registering an 8% growth in premiums, driven by enhanced pricing in the health, property/fire, accident and liability, and engineering segments. Premium growth carried on throughout 2020, despite the economic fallout of the Covid-19 pandemic.

The medical line predominates the insurance business in Saudi Arabia, making up 59% of total contributions in 2020, compared to 51% in 2016, gaining market share from motor insurance which had shrunk from 33% in 2016 to 22% in 2020. This business segment has also been the best performing – registering positive growth over the last five years – after the compulsory health insurance scheme was extended to include Saudi employees working in the private sector and their dependents.

Consolidation remains on the books

A consolidation drive in the Saudi insurance sector started in 2020 and will be spurred on by the amendment of the regulatory minimum capital requirements. As a result, further M&A deals between insurers are expected during the implementation window for this new requirement, should it go forward.

The most notable M&A deals in the sector include:

- The merger between Walaa Cooperative Insurance and MetLife AIG ANB Cooperative Insurance in 2020. The first-ever merger within the Saudi insurance sector;
- The merger between Al-Ahlia Cooperative Insurance and Gulf Union Cooperative Insurance in 2020; and
- The merger between Solidarity Saudi Takāful and Aljazira Takāful Taawuni in 2021.

SAMA has been supportive of consolidation, aiming for a healthier, stronger and well-capitalized insurance sector.

WAQF

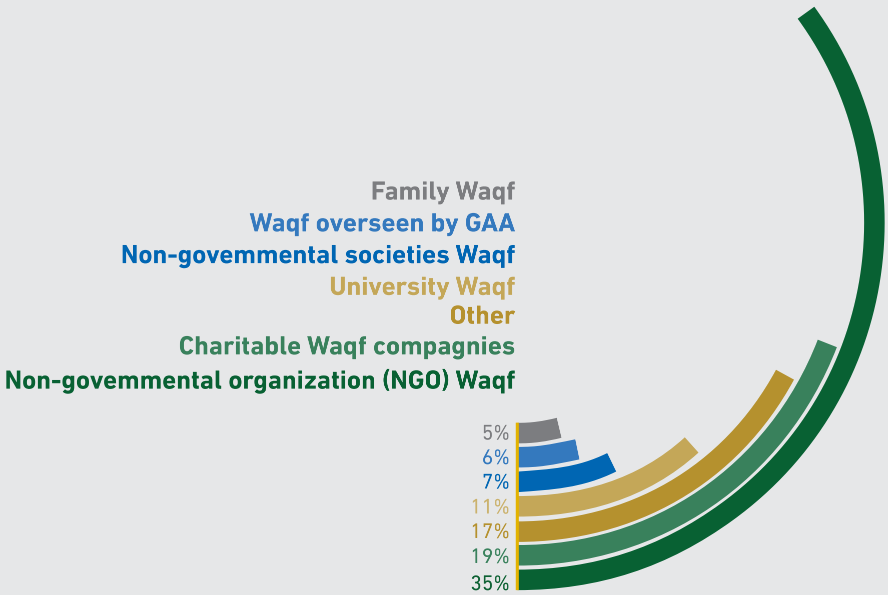
Vision 2030 guiding Waqf development

Saudi Arabia is one of the first economies to utilize Waqf in funding socioeconomic development, and it has recently turned to modernizing and institutionalizing the sector in order to boost its role as a funding source for sustainable development in the Kingdom.

Waqf assets in the Kingdom are funded and managed by various governmental and non-governmental institutions, such as semi- and fully-independent public sector entities including universities and hospitals, charities, non-governmental organizations (NGOs) and family offices. These institutions typically undertake the management of the Waqf assets directly, overseen by a board of trustees (Nazirs), or through investment managers.

Overall Waqf assets in the Kingdom stood at $63 billion by the end of 2020, which are managed by 113,489 Waqf institutions. Out of these assets, around $4 billion are overseen by GAA, which have grown by 323% since 2018. However, the majority of Waqf assets are managed by NGOs ($22 billion) and charitable Waqf companies ($12 billion).

CHART 13 – WAQF ASSETS BY TYPE 2020



Source: General Authority for Awqaf (GAA)
Note: The "other" category includes Waqf managed by various government agencies

Waqf's contribution towards achieving Vision 2030 goals

One of the Vision 2030 objectives is to utilize Islamic financial resources to create a more impactful non-profit sector and support sustainable development in the Kingdom. In line with the economic plan, GAA has set a target to grow the size of the Waqf sector to $93 billion (SAR 350 billion) by 2030 and increase the contribution of the non-profit sector to 5% of GDP.

In 2020, Waqf assets aligned with the goals of Vision 2030 are estimated at $60 billion (SAR 227 billion), while Waqf assets aligned with Sustainable Development Goals (SDGs) are worth $49 billion (SAR 185 billion), according to a report by the United Nations (UN) and Islamic Corporation for the Development of the Private Sector (ICD).

Diversification is one of the biggest challenges

GAA also works on addressing the challenges facing Saudi's Waqf sector, based on international best practices and standards, in cooperation with relevant authorities and using specialized consulting offices.

One of the biggest challenges facing the Waqf sector is the high concentration of real estate investments, which are estimated to have accounted for 80% of Waqf investments, according to a study by the Awqaf Committee at Asharqia Chamber. Hence, a key area for developing the sector is the diversification of its investment pool and seeking new and innovative investments that add value to the economy and the community. In addition to reducing portfolio risk, diversifying Waqf investments will also contribute to sustainable socio-economic development in the Kingdom.

Waqf Investment Funds

As part of its mandate to develop current and new Waqf structures and schemes, GAA issued a licensing framework for Waqf investment funds in 2018, making Saudi Arabia the first GCC state to introduce such funds. These funds take the form of publicly listed Sharī'ah-compliant mutual funds, offered to individual and institutional subscribers. This milestone has been a step towards the institutionalization of the Waqf sector and developing greater transparency and governance around these investments.

The Kingdom's first Waqf investment fund – Alinma Wareef Endowment Fund – was launched in 2018 as a partnership between Alinma Investment Company (fund manager) and Wareef Charity Foundation (beneficiary).

By H1 2021, eight Waqf investment funds were approved by GAA and CMA with AuM of $104 million. Five of these funds are managed by Alinma Investment Company. These are mostly open-ended funds that invest the fund assets to build up the Waqf capital and disburse a percentage of their returns to the Waqf beneficiaries.

TABLE 8 - LICENSED PUBLIC WAQF FUNDS IN SAUDI ARABIA H1 2021

Fund Name	AuM ($ million)	Fund Manager	Focus	Fund Type
Alinma Wareef Endowment Fund (2018)	16.49	Alinma Investment Company	Healthcare	Open
Alinma Enayah Endowment Fund (2019)	4.66	Alinma Investment Company	Healthcare	Semi-Closed
Alinma Orphan Care Endowment Fund (2019)	3.91	Alinma Investment Company	Orphan Care	Open
Ensan Endowment Fund (2019)	53.81	AlBilad Investment Co	Orphan Care	Open
Bir Ariyadh Waqf Fund (2020)	14.12	Alinma Investment Company	Welfare Support	Open
Alinma Roads Mosques Endowment Fund (2020)	7.53	Alinma Investment Company	Mosques	Semi-Closed
Nafaqah Waqf Fund (2020)	3.16	Jadwa Investment	Welfare Support	Open
Alkhabeer Waqf Fund 1 (2020)	0.55	Al-Khabeer Capital	Social Development	Open

Source: Saudi Stock Exchange (Tadawul)

ISLAMIC FINTECH

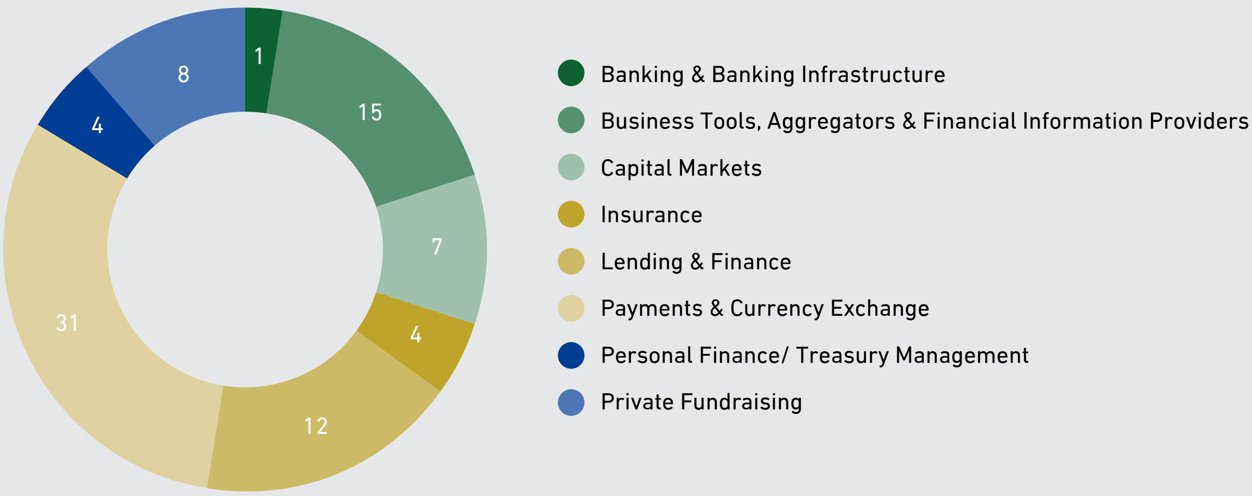
The overall FinTech sector in Saudi Arabia is thriving, as the number of FinTechs operating in the Kingdom increased from 60 in 2020 to 82 in 2021[7]. Saudi Arabia is the largest Islamic FinTech market globally with a market size of $17.9 billion in 2020[8], based on estimated transaction volume. This represents 37% of the global Islamic FinTech sector and projected to reach $48 billion by 2025. The Kingdom was ranked second among 64 Islamic FinTech jurisdictions for conduciveness by the Global Islamic Fintech Report 2021.

Payments segment dominates Saudi FinTech landscape

The most heavily represented FinTech segments in Saudi Arabia are payments and currency exchange, financing, business tools, aggregators and financial information providers. Key players include STC Pay and Geidea.

Overall, most Saudi-based FinTechs that reported funding figures have raised funding at the pre-seed/ seed or Series A funding stage, indicating an emerging FinTech landscape. The largest reported funding rounds raised to date were by players in the payments and currency exchange segment, such as STC Pay which raised $200 million, while Geidea raised $268 million.

CHART 14 – SAUDI ARABIA FINTECH LANDSCAPE



Source: Saudi Central Bank, Capital Market Authority, Fintech Saudi

There are various enabling factors that Saudi Arabia can continue to expand on to make its ecosystem more conducive to the growth of Islamic FinTech. Three key FinTech enablers present in the Kingdom are:

- **Access to capital** has been cited in industry surveys as the biggest challenge for Islamic FinTechs. Most Saudi Islamic FinTechs are at the pre-seed/ seed stage of funding and scaling up is important to produce regional and eventually global champions that have gone through multiple funding rounds and built solid customer traction.
- **Fostering suitable and qualified talent** is crucial to the operational success of emerging Islamic FinTechs – evidence suggests that high caliber graduates and mid-career professionals who understand finance, software development and Islamic law and values (Sharīʿah) are still in short supply.
- **Clear regulatory support** can help guide Islamic FinTechs on their journey, such as providing a safe environment to test their business models via a Regulatory Sandbox, such as the one SAMA has in place.

7. Fintech Saudi Annual Report 20/21
8. Global Islamic FinTech Report (2021)

Growth opportunities in MSME financing and digital banking

Several trends have emerged in the Saudi Islamic FinTech space. One of the most trending areas is MSME finance. Islamic FinTech is gaining traction as a tool for Sharī'ah-compliant fundraising. Ta3meed became the first Islamic FinTech in Saudi Arabia to provide purchase order (PO) financing for MSMEs through a crowdfunding platform that connects businesses with institutional and individual investors. Other Sharī'ah-compliant players such as Lendo are developing scale and raising funding to help improve access to finance for MSMEs.

Although some FinTech segments have gained traction in Saudi Arabia, like payments and financing, other segments such as digital banking remain relatively less utilized. A survey by FinTech Saudi found that 93% of respondents prefer banking online, indicating strong potential demand for digital banking services. Meem, the region's first digital bank, was launched in the Kingdom in 2014 and offers retail Islamic banking services online. In June 2021, SAMA approved the licensing of two standalone digital banks: one granted to STC Pay, which will be converted from a payments platform to a local digital bank – STC Bank. The other will be established as Saudi Digital Bank. Several digital banking licenses are currently pending approval, potentially expanding the Sharī'ah-compliant offering in this segment.

BOX 2 – FINANCIAL SECTOR POLICY RESPONSE TO COVID-19 IN SAUDI ARABIA

At the outset, the outbreak of the Covid-19 pandemic was expected to have a significant impact on the Saudi economy. The economic outlook at the time was further dampened by falling oil prices, as global demand fell worldwide due to the suspension of travel and most economic activities.

This situation led the Saudi government and financial regulators to institute robust economic and financial measures to limit the impact of these shocks and to provide social and economic support. These measures have included support for businesses and households through government fiscal and medical support measures, financing and lending measures supporting the private sector especially MSMEs, deferrals on loan payments and fee waivers on some government services.

Banks and Finance Companies
SAMA announced a SAR 50 billion Private Sector Financing Support Program, at the time of launch, aimed at mitigating the impact on the private sector, especially MSMEs. Some of the programs include:

Deferred Payments Program
the program aimed to reduce the potential impact of the decrease in the cash flows that MSMEs may have faced, by delaying the payment of the obligations of the beneficiaries for a period of nine months, and the amount allocated to the financing entities would be used to cover their cost of financing. The program covered outstanding installments on financing received from banks and finance companies.

Guaranteed Financing Program
SAMA, in cooperation with the Small and Medium Enterprises Financing Guarantee Program (Kafālah), launched the Guaranteed Financing Program by guaranteeing 95% of the granted financing value according to the approved mechanisms within the Kafālah Program.

The guarantee program aimed to provide additional support and enhance the creditworthiness of micro-enterprises. This would help these enterprises to overcome financing challenges, reducing the impact of lower cash flows and making it easier for them to serve their customers and pay the salaries and dues of their employees.

Loan Guarantee Program – this program deposited with banks and finance companies to help reduce the cost of lending to MSMEs, allowing them to exempt MSMEs from fees associated with the MSME Finance Guarantee Program during 2020.

Cooperative Insurance
Free extension of motor policies
Saudi insurers voluntarily announced two-month extensions of all motor policies, free of charge, following a decline in motor claims during the COVID-19- lockdown. SAMA has required all insurers make adequate provisions towards this extension, ensuring that these provisions remain on the books until all extended policies have expired.

Provisions for health claims deferrals
SAMA instructed all insurers to allocate provisions for deferred medical claims resulting from non-Covid-19 medical services postponed due to lockdown measures. This prevented insurers from declaring pre-mature profits.

Government coverage of Covid-19 treatments - the Saudi government announced that it would bear the cost of Covid-19 treatments, which alleviated what would have been a substantial strain on insurers resulting from a significantly large number of medical claims.

Capital Markets
CMA had taken measures in the light of the significant impact of the pandemic to support capital market activities, financial institutions, and entities subject to CMA supervision. These included:

- Reducing the trading hours for all listed securities temporarily;
- Exempting listed companies from CMA's fees and extending the period for submitting statutory and regulatory requirements;
- Extending the deadline to meet the conditions and requirements for companies that obtained a Financial Technology Experimental Permit;
- Suspending the freezing of investment accounts;
- Urging financial market institutions to take precautionary measures towards COVID-19 by implementing remote work for all market institutions;
- Holding listed Companies' Assemblies Remotely and Suspension of physical attendance; and
- Extending the deadline for disclosing the annual reports for investment funds.

Waqf
Community Fund – GAA, in partnership with the Ministry of Human Resources and Social Development, established the Community Fund with a capital of SAR 500 million. GAA contributed SAR 100 million, while the Ministry contributed SAR 50 million and the remaining capital was contributed by Health Endowment Fund, Civil Institutions Council, Civil Associations Council and several endowments, donors and companies.

The fund was established to utilize Waqf to mitigate the impact of the pandemic in the Kingdom, supporting segments of society that were affected the most, such as the poor, people with disabilities, widows, divorced women, prisoners' families, the elderly, workers of small professions and needy students. The assistance extended by the fund covers various fields, including relief, social, educational, health awareness, technical, service, housing and mosques.

3.

KEY ISLAMIC FINANCE INITIATIVES AND TRENDS

ISLAMIC FINANCE IN THE POST COVID-19 ECONOMY IN SAUDI ARABIA

The COVID-19 pandemic has been more severe on the world's economy than the Global Financial Crisis of 2007. Economic activity came to a near halt in most countries as the pandemic triggered strict lockdown measures throughout most of 2020. Global GDP contracted by 3.2% in 2020, compared to a 1.7% contraction in 2009 following the financial crisis.

The economic impact for oil-dependent core Islamic finance jurisdictions was even more severe as oil prices crashed in April 2020, with Brent Crude reaching a low of $9 per barrel. Malaysia registered a 5.6% contraction, while GCC economies collectively contracted by 4.9% in 2020. Meanwhile, non-oil dependent jurisdictions such as Indonesia (-2.1%), Pakistan (-0.4%) and Turkey (1.8%) proved more resilient in terms of economic growth.

Slower growth, if any, was expected for the Islamic finance industry since its two largest regional markets were heavily impacted by the oil price crash. Islamic banks, in particular, were expected to take a hit to their profitability and capital reserves as the pressure of lower interest rates mounted, in addition to increasing impaired financing stemming from worsening credit conditions during the pandemic.

Despite the many challenges that the pandemic posed to the Islamic finance industry, substantial and timely government support measures helped maintain liquidity and financial stability in their respective financial systems. While Saudi Arabia's economy contracted by 4.1% in 2020, its domestic Islamic finance industry continued to grow.

All Islamic finance sectors experienced growth during this period. Islamic finance asset growth was mainly driven by Islamic banks, boosted by significant financing growth. In particular, measures taken by SAMA to support the domestic banking sector during the pandemic, including provisions for deferred payments and financing guarantee programs, played a vital role in preserving the resilience of Islamic banks. The Sukūk market also proved resilient, setting a new record for issuances in 2020 driven by higher sovereign debt.

> **“DESPITE THE MANY CHALLENGES THAT THE PANDEMIC POSED TO THE ISLAMIC FINANCE INDUSTRY, SUBSTANTIAL AND TIMELY GOVERNMENT SUPPORT MEASURES HELPED MAINTAIN LIQUIDITY AND FINANCIAL STABILITY IN THEIR RESPECTIVE FINANCIAL SYSTEMS”**

Funding sustainable development through Islamic social finance

Although the direct impact of the Covid-19 pandemic on the Kingdom's Islamic finance industry was muted, the effects prevailing in the real economy will persist over the coming years. Islamic finance can help the government and the domestic market mobilize resources to fund economic recovery and protect vulnerable segments of society that have become more disadvantaged by the economic fallout from the pandemic.

Islamic financial instruments have the potential to contribute to the Covid-19 recovery response through mechanisms including Zakāh, Sadaqat, Qard Hasan, Sukūk, and Sharīʿah-compliant microfinance and crowdfunding. These instruments must be coordinated and integrated with national economic recovery and sustainable development policies.

Zakāh and Sadaqat (short-term)

Zakāh and Sadaqat have been vital tools for offering emergency financial support during the pandemic, utilized by both government and charitable organizations. These donations are intended to offer immediate benefit, making them suitable for crisis response. Beneficiaries would include the economically disadvantaged who are at higher risk of further economic impact due to the pandemic.

Zakāh collection in Saudi Arabia is regulated and primarily undertaken by the Zakāh, Tax and Customs Authority. Zakāh regulations stipulate that the payment of Zakāh is compulsory for all resident companies in the Kingdom, making this the main source of Zakāh revenue. The Authority also encourages individuals to make formal Zakāh payments through its online 'Zakaty' portal. Revenues from Zakāh are transferred to the Ministry of Human Resources and Social Development's Social Security Agency, which allocates these funds to various social security programs through the Social Development Bank (SDB).

Qard Hasan, Islamic Microfinance and Crowdfunding (medium-term)

Given that low-income households and small businesses have been the most affected financially by the pandemic, small-ticket financing will be essential to help them recover their livelihoods. These segments suffer from ongoing funding gaps given the risk considerations for traditional banks. Islamic microfinance and Qard Hasan are ideal for this size of financing. They can also support the sustainable development of local economies, ensuring financing goes towards locally-focused sustainable business practices.

Sharīʿah-compliant equity and debt-based crowdfunding can become a channel for impact investing, targeting businesses with positive social impact and supporting their recovery. This model can also help in funding low-income individuals looking to set up new and innovative small businesses.

Ta3meed is the region's first PO financing platform, based on a Sharīʿah-compliant peer-to-peer financing model. The platform offers SMEs access to affordable financing by connecting them to crowdfunding investors, aiming to promote their financial inclusion and the accessibility of working capital finance. This is an important contributor to Saudi Arabia's economic development and currently accounts for only 8.3% of banks' and finance companies' total financing facilities.

Sukūk and Waqf (long-term)

Sukūk has already proven to be an integral instrument for funding infrastructure development. Green and sustainable Sukūk have become more prominent in 2020 as the government endeavors to achieve economic recovery through sustainable development, aligned to the UN's Sustainable Development Goals (SDGs).

Waqf assets, mainly real estate, can be further utilized to support government infrastructure development plans, ultimately supporting sustainable development and economic recovery. The Community Fund was established by GAA and the Ministry of Human Resources and Social Development in April 2020 as a response to the pandemic. The fund also receives contributions from individuals and institutions. Addressing the needs of the population segments most impacted by the pandemic, the fund implements its initiatives through accredited NGOs to reach beneficiaries and verify their needs.

ACCELERATING DIGITAL TRANSFORMATION AND RETHINKING BUSINESS MODELS

Digital transformation is one of the key pillars of Saudi Arabia's National Transformation Program, launched in 2016 under Vision 2030. This pillar aims to enable sustainable digital transformation by developing the Kingdom's regulatory frameworks and legislative enablers, e-government, digital economy and improving digital infrastructure.

So far, the Kingdom has made strides in this area across various sectors.

DIAGRAM 3 - SAUDI ARABIA'S KEY ACHIEVEMENTS IN DIGITAL TRANSFORMATION IN THE FIRST PHASE OF THE NATIONAL TRANSFORMATION PLAN 2016-2020[9]

KSA ranked the **Top Digital Riser** among G20 Countries

(European Center for Digital Competitiveness: Digital Rise Report 2020)

KSA ranked **1st** in 5G Download Speed

(Opensignal: Benchmarking the global 5G user experience Oct.2020)

KSA ranked **12th** among G20 Countries in E-Government Development Index

(UN E-government survey 2020)

KSA ranked **8th** among G20 Countries in telecommunication infrastructure index

(UN E-government survey 2020)

Provided **+576,000** houses in remote areas with wireless broadband by the end of 2020

KSA ranked **10th** among G20 Countries in Human Capital Index

(UN E-government survey 2020)

Increased average internet speed from 9 Mbps in 2017 to **109 Mbps** by the end of 2020

KSA ranked **9th** among G20 Countries in Corruption Perceptions Index 2020

(Issued by: Transparency International)

Source: National Transformation Program Delivery Plan 2021 - 2025

9.Saudi Arabia was ranked second among the G20 digital risers by the European Center for Digital Competitiveness in its 2021 Digital Riser Report

The digital transformation pillar also supports the development of fourth industrial revolution technologies, including artificial intelligence (AI), Big Data and blockchain. As a result, several government authorities, including SAMA, have established regulatory sandboxes to foster the development and innovation of these technologies and enable incumbents and startups in their respective sectors to experiment in a controlled environment under regulatory supervision.

Boosting the potential reach and impact of Islamic financial services

Islamic financial institutions (IFIs) no longer compete only with each other, rather they now face fiercer competition from conventional banks, many of which also have Islamic banking windows. This has made the digital transformation of their business models crucial for retaining their customer bases.

The IFIs will need to shift to leaner and more tech-centric business models that align with the evolving preferences of a millennial- and Gen Z-dominated customer base. According to a 2021 survey by Backbase and YouGov, the growing consumer appetite for digital banking services in Saudi Arabia has been accelerated by the Covid-19 pandemic. A majority of respondents (88%) said they have become more inclined to choose digital banking services compared to making physical trips to a bank branch.

Many IFIs across various sectors had generally been slow in implementing their digital transformation plans, which came to light as lockdown measures were enforced following the global outbreak of the Covid-19 pandemic in 2020. This led them to accelerate the implementation of their digitalization strategies, completing two or three year transformation plans within months.

This accelerated pace of digital transformation will continue through the next couple of years as IFIs look to deliver efficient, effective and sustainable financial services. The demand for digital financial services from IFIs has also increased, with investments earmarked for various technologies including process automation, predictive analytics and AI that will drive customer-centric digital services such as call center bots, account opening procedures and financing automation. Digital identity technologies will also receive greater attention from IFIs as they increasingly shift Know Your Client (KYC) processes online.

In June 2021, SAMA granted two digital banking licenses to STC Bank and Saudi Digital Bank with more expected as Saudi Arabia progresses towards becoming a digital economy. Digital banks will help strengthen the digital offering that is already available in the Kingdom and reinforce and further promote the supportive regulatory framework, which continues to evolve based on the latest developments in the industry.

Most Islamic banks now offer instant and contactless account opening while many digital and traditional banks now offer their customers an array of digital services, ranging from remote account opening to using online conferencing platforms for meetings with clients.

Yet, many of these new digital functions sit within fragmented systems that require a further digital transformation in terms of customer experience. In the Backbase survey, 32% of respondents said that their banks were lacking in terms of offering seamless access to online banking services – a key area for banks to improve their performance. They also expressed a preference for digital banking delivered through self-service digital solutions, offering the same convenience as E-commerce, entertainment, and transport solutions.

By adopting the single platform approach to technology that other industries have already mastered, IFIs can be leaner and more flexible, with the ability to instantly execute new digital services while also providing enhanced customer support.

Considering the evolving requirements of IFIs, it is likely more collaborations between traditional IFIs and Islamic FinTechs will take place as the former come to terms with the necessity of digital transformation and offering digital financial services in a post-COVID era. Many banks will pivot towards value-adding partnerships with FinTechs to reduce operational costs, which will lead to competitive product offerings reaching a wider target market.

As the Kingdom transitions to a new normal, Islamic banks will have the opportunity to enhance online customer engagement. However, customer engagement should be at the forefront of digital operations, allowing banks to adapt and capitalize on changing customer behavior patterns.

Customer experience is a main differentiator for digital financial services, with 39% of respondents citing poor customer relations as a key influencing factor in deciding to switch to a different bank. Collaboration with a FinTech partner can accelerate the shift towards customer engagement-focused financial services and manage change on the technology side.

FINANCIAL INCLUSION DRIVE AND INTEGRATION OF ISLAMIC SOCIAL FINANCE

Financial exclusion can be voluntary where individuals opt out of the financial system by choice, or involuntary, where individuals do not have access to the financial system due to insufficient income, they present an extremely high lending risk, discrimination, or because it is too costly for financial institutions to provide financial services to this segment.

DIAGRAM 4 – UNBANKED GLOBAL POPULATION SEGMENTS

Women
constitute 56% of unbanked persons

Low-income groups
the poorest 40% of families constitutes approximately half of the unbanked persons worldwide

Less-educated individuals
constitute 62% of unbanked persons

Persons outside the labor force
represent 47% of unbanked persons

Those living in remote and rural areas

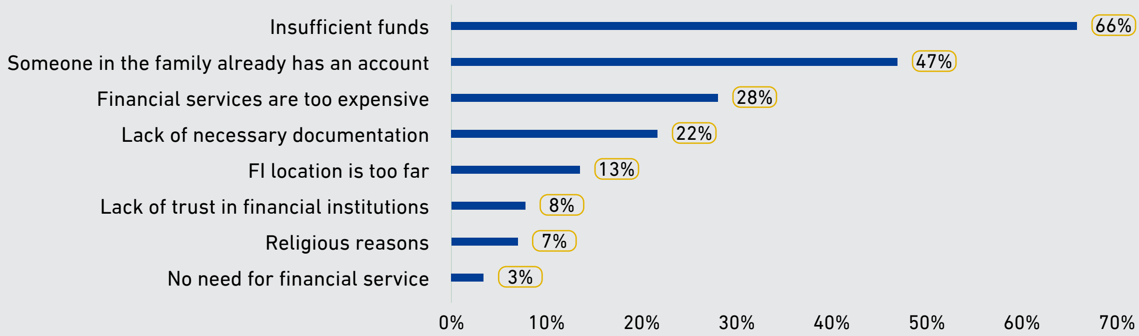
Source: King Khalid Foundation

Globally around 1.7 billion adults remained unbanked in 2017, out of whom 6.9 million were in Saudi Arabia, according to the most recent data from the World Bank's Global Findex Database. Around 72% of the Kingdom's adult population at the time held accounts with financial institutions, compared to 69% globally.

Only 58% of adult females held bank accounts, while 50% of adults outside the labor force were accountholders, making them the main targets for financial inclusion efforts.

Taking a closer look at the 28% of adults who remained unbanked, they attributed their status to two main reasons: 1) insufficient funds, which can be linked to individuals out of the workforce, and 2) someone in the family already had an account which is assumed to be linked the low proportion of accountholders among women.

CHART 15 – REASONS FOR FINANCIAL EXCLUSION IN SAUDI ARABIA



Source: World Bank Global Findex Database 2017

One of the strategic objectives that SAMA aims to accomplish is to increase the level of financial inclusion in the Kingdom, in line with Vision 2030. To achieve such a goal, SAMA, in cooperation with other stakeholders such as the Ministry of Finance and CMA, has been working to enhance financial inclusion through improving individual and SME access to financial services.

The following targets set by the FSDP for 2030 will support the drive to promote financial inclusion in Saudi Arabia:

- Increasing the number of adults with a bank account to 90%;
- Increase SMEs' contribution from 20% to 35% of GDP; and
- Increase SMEs' share from 5.7% to 20% of total bank financing.

DIAGRAM 5 – SAMA INITIATIVES TO ENHANCE FINANCIAL INCLUSION

Set an upper limit of charges and commissions that banks are entitled to apply when providing products and services

Prevents requesting financial charges or depositing funds to open bank accounts in order to encourage individuals to open their accounts and benefit from them.

Issued governing rules for banking agency activities

Allows banks to use qualified agents to provide services on their behalf in areas where there is no bank cover or with limited availability of banking services, with the aim of diversifying channels of access to financial services by different members of society.

Introduced a wide range of banking services and digital solutions

Allows individuals to access services through multiple channels, in an efficient way and round the clock, through the use of ATMs, POS, apps and the internet.

Launched regulatory sandbox to understand and assess the impact of new technologies in the Kingdoms' financial industry

Allows financial institutions and FinTechs to test innovative digital solutions that can potentially facilitate more efficient financial transactions at lower costs, and enable customers to carry out financial transactions remotely, which would enhance financial inclusion.

The Islamic finance approach to financial inclusion can further supplement SAMA and the government's efforts, based on two main approaches:

1. Adoption of financial products, mainly microfinancing, based on risk-sharing structures such as Mudārabah and Mushārakah, which provide equity-based participation as an alternative to conventional debt-based financing.

2. Wealth redistribution through Islamic social finance instruments, such as Zakāh, Sadaqat and Waqf, which take the form of grants and are typically used to fund social welfare.

However, a third option that combines both approaches can also be an effective tool in promoting financial inclusion. Both Zakāh and Waqf funds can be used to support microfinancing. Zakāh funds can be disbursed immediately and on a one-to-one basis, while Waqf fund returns can be disbursed through microfinance providers.

Economic empowerment programs conducted through Zakāh funds, either as grants or loans, must assign top priority to meet the immediate basic needs of the most disadvantaged. Next in line would be financing education and training of the economically less privileged or funding their businesses through startup capital or micro-equity. This would enable the poor to generate a sustainable means of livelihood and convert them from Zakāh recipients to Zakāh payers. Such programs can be undertaken by the government and non-profit organizations.

In Saudi Arabia, Zakāh is formally collected from companies, and sometimes from individuals, by the Zakāh, Tax and Customs Authority. This Zakāh revenue is then used to support the Kingdom's Social Security Agency under the Ministry of Human Resources and Social Development to fund social protection programs, which include small-ticket financing extended to segments such as the unemployed through the SDB. In 2020, SDB extended $2.7 billion in financing (SAR 10 billion) and has set a budget of $2.9 billion (SAR 11 billion) for financing in 2021.

Waqf, on the other hand, is more suitable for addressing greater social needs like education and healthcare. Cash Waqf funds operate similarly to mutual funds, having a separate legal entity from its manager. Existing examples of integrating Waqf with the market have produced positive results in terms of providing microfinance, education, and healthcare at affordable prices to the financially excluded.

The cash Waqf funds listed on Tadawul that were mentioned earlier in the report already use their returns to provide free healthcare and social welfare assistance. However, the use of these returns could be expanded to support small businesses and education. Also, encouraging a wider variety of integration with Waqf can make microfinance more affordable. Banks offering Sharī'ah-compliant microfinancing and MSME financing that also manage cash Waqf funds can allocate part of the returns to cover the cost of operations fully or partially and ensure that financing is offered to the financially excluded at zero or low cost.

4. LOOKING AHEAD: POSITIONING ISLAMIC FINANCE IN VISION 2030

Islamic finance will have a significant role to play in achieving Vision 2030's objectives, for at least two reasons. First, Islamic finance is a significant supporting component of Saudi Arabia's economic and financial system and is driving growth across areas in Islamic finance such as Islamic banking, capital markets (via Sukūk and Sharī'ah-compliant equities), asset management (via Waqf and Islamic funds), and cooperative insurance. Second, the FSDP's cross-sectoral nature, namely its potential to unlock growth and development across other aspects of the economy mentioned in Vision 2030, means that Islamic finance will also have a similar cascading effect on the achievement of these plans.

Over the medium term, Vision 2030 and the FSDP will transform both the supply and demand sides in Islamic finance. Increased government expenditure on infrastructure will increase demand for the use of Islamic financial instruments, particularly Islamic bank financing and Sukūk. Meanwhile, on the supply side, Vision 2030 will broaden the Sharī'ah-compliant investment pool by boosting the volume and value of Sukūk, Islamic funds and Islamic equities, which will in turn draw more foreign investors to Saudi capital markets.

Moreover, the development of the broader private sector, through increasing access to finance for SMEs and the proliferation of domestic FinTechs, will help channel funds throughout the economy more efficiently, while also developing the digital infrastructure of Saudi Arabia. Finally, as the Kingdom diversifies away from hydrocarbons and moves towards the growth of its non-oil sectors, sustainability will be enhanced across these and other sectors.

STRATEGIC INITIATIVES FOR FINANCIAL SECTOR DEVELOPMENT

Stakeholders' initiatives are crucial to the success of Vision Realization Programs such as the FSDP, where SAMA is taking the lead in establishing collaborative efforts with other key stakeholders across regulatory, industry and academic spheres, such as CMA, to implement the program in a timely and effective manner.

For example, some of the joint initiatives taken on by SAMA and CMA under the FSDDP include:

- Supporting the move towards a cashless society via linkages with major payment operating systems such as Apple Pay;
- Creating a regulatory sandbox for financial institutions and FinTech companies;
- Completing the strategy for the Financial Literacy Entity under FSDP;
- Implementing regulation for crowdfunding activities;
- Developing an online factoring finance program; and
- Shepherding the recent start of three mergers in the insurance sector.

Other stakeholder initiatives that are crucial to the achievement of Vision 2030 include those from the CMA's Strategic Plan 2021-23. CMA's Strategic Plan contains four key themes:

- To facilitate funding;
- To encourage investment;
- To promote confidence in Saudi Arabia's capital markets; and
- To build the capacities of market participants.

These thematic goals, by design, display several inter-sectoral linkages with Vision 2030 and SAMA's strategic objectives. Moreover, CMA's Strategic Plan lists a significant number of objectives, such as supporting asset management and institutional investment growth. There are 13 initiatives in all, including enabling the establishment and growth of endowment funds and displaying linkages with other sectors in the Saudi economy, such as the Waqf sector.

ISLAMIC FINANCE STRATEGY AIMING FOR GLOBAL INDUSTRY LEADERSHIP

The FSDP Program Charter for 2021 includes a strategy for Islamic finance, which aims to further develop the industry in the Kingdom and position it as a global leader and benchmark by 2030.

The Islamic finance strategy identifies three strategic goals: governance, international positioning and education, R&D and innovation. It then identifies seven supporting sub-goals. The strategy further identifies 11 specific initiatives.

DIAGRAM 6 – FSDP ISLAMIC FINANCE STRATEGY

Strategic Goals	Sub-goals	Examples of Initiatives
Governance Enhance and develop the Islamic finance industry governance	Enhancing Sharīʿah governance structure and increasing transparency Reducing legal risks and cost of doing business Increasing efficiency and transparency	Regulating the work of Sharīʿah Committees at financial institutions Define the functions of Sharīʿah compliance at financial institutions Define the functions of oversight and internal Sharīʿah audit at financial institutions
International Positioning Enhance Saudi Arabia's international position as the leader in Islamic finance	Driving recognition as a sector leader Enhancing sector capacity and superiority	Holding the Saudi international annual Islamic finance conference Launch of the King Salman International Award in Islamic Finance Activate Islamic financing sources in large Vision programs Study Launching an International Islamic Finance Saudi Center Launch Global Sharīʿah Compliant Indices
Education, R&D, and Innovation Develop and enhance the educational and research institutions to support the growth of the sector	Enhancing workforce capabilities Increasing diversity of products/services through innovation	Develop higher education courses and programs in the Islamic finance field Support workers capabilities in the sector through training programs Activation of an Islamic Finance research and development center

Source: Financial Sector Development Program Charter 2021

FSDP sets Islamic finance development commitments for 2025

The FSDP has also sets shorter-term targets for Islamic finance development in Saudi Arabia, focusing on asset growth, Sharīʿah governance and research and education by 2025, supporting the broader Islamic finance strategy.

DIAGRAM 7– FSDP ISLAMIC FINANCE COMMITMENTS FOR 2025

	Targets	
Islamic finance assets		
Saudi Arabia's share of global Islamic finance assets	21% 2018	22.5% 2025
Percentage of total Islamic finance assets locally to GDP	21.1% 2018	79.3% 2025
Enhancing Islamic finance Sharīʿah governance framework		
Number of distinct Sharīʿah scholars to total Islamic finance institutions	0.5 2018	1.6 2025
Percentage of Saudi scholars to seats on selected international organizations and institutions	16.1% 2018	23% 2025
Further enhancing specialized Islamic finance research, development, and educational centers		
Number of publications related to Islamic finance	19 2018	>60 p.a. 2025

Source: Financial Sector Development Program Charter 2021

Regulators' initiatives supporting Islamic finance strategic goals

The regulators of the various Islamic finance sectors are also undertaking their initiatives to support the FSDP's Islamic finance strategy. SAMA has introduced several other initiatives to help guide such efforts and collaborations across industry, academic and regulatory spheres.

TABLE 9 – SAUDI CENTRAL BANK'S INITIATIVES TO POSITION ISLAMIC FINANCE IN VISION 2030

Regulatory	Industry	Academia
• Developing and implementing a local and international Islamic Finance strategy • Establishing and supervising the Islamic Banking Committee to contribute to the development of the Islamic finance sector • Enhancing the Sharī'ah governance framework for the Islamic finance sector (banking and finance companies)	• Developing an Islamic finance database for the Saudi ecosystem • Designing and launching professional certificates in Islamic finance • Organizing awareness events about Islamic finance	• Preparing and launching training programs in Islamic finance • Launching the 'Islamic Finance Research & Translation Programs' • Launching the 'Joint Research Program' including Islamic finance research • Regular meetings with universities to discuss subjects related to Islamic finance

Source: Saudi Central Bank

More specifically, some of the tangible developments from CMA's Strategic Plan include reducing issuance costs, as well as lowering commissions and increasing Zakāh (tax) exemptions for sovereign Sukūk investors. Consequently, the domestic Sukūk market has continued to be a major component of the global Sukūk market. The reforms are likely to increase demand for Sukūk, while the release of a dedicated regulatory framework for REITs has helped encourage the rapid growth of these instruments in Saudi Arabia since 2016.

In order to effectively transform the economy by 2030, the financial sector must achieve a greater reach and broader societal impact. To this end, initiatives are needed to promote financial inclusion and boost Islamic social financing. The growth of Islamic FinTechs across the financial services value chain has the potential to encourage more, and better, use of Waqf and Zakāh, which help meeting multiple SDGs at the same time. It is recommended that these interventions should be promoted and driven by the various key stakeholders in Saudi Arabia in conjunction with market players, so that Islamic finance takes its rightful place as a key driver of Vision 2030's success.

For its part, the GAA has five strategic pillars and 12 corresponding objectives in its mandate to develop the Awqaf sector in Saudi Arabia. These five strategic pillars are:

- Developing the laws and governance of the Awqaf sector;
- Developing the Awqaf sector;
- Enhancing institutional excellence;
- Diversifying the sources of income; and
- Developing disbursements.

To achieve these pillars, the GAA has spearheaded several initiatives, such as: starting an Endowment Inventory Project, launching a crowdfunding platform for cash and in-kind donations, and developing a National Endowment Studies and Research Center. The GAA has also specifically articulated how it will contribute to achieving Vision 2030, since Awqaf are crucial to the development of the non-profit sector in Saudi Arabia and can help the country achieve economic sustainability and Islamic social finance goals.

ISLAMIC FINANCE AND SUSTAINABLE DEVELOPMENT

> **“WAQF CAN HELP ACHIEVE BOTH SOCIAL AND ENVIRONMENTAL GOALS, GIVEN ITS BROAD REMIT”**

The aims of Islamic finance and the United Nation’s SDGs mostly overlap, and Islamic finance can help contribute to achieving several of the 17 SDGs. More specifically, Zakāh, for example, aligns well with the social-focused SDGs.

Waqf can help achieve both social and environmental goals, given its broad remit. A tangible example of Waqf being used to help achieve an SDG is the Islamic Development Bank’s (IsDB) $10 billion Special Fund for Poverty, which leverages Saudi-based Waqf as a source of funding to help reduce poverty by developing real estate properties. The proceeds from these properties are then invested in education and healthcare projects to help reduce poverty over the longer term.

Another aspect of Islamic finance that can help achieve the SDGs is Sukūk. Issuances of sustainability Sukūk, while in the nascent stage, indicate their potential as a source of funds to help with sustainable development in Saudi Arabia and other member states of the Organization of Islamic Cooperation (OIC) in years to come. The proceeds from sustainability Sukūk can be generated by both sovereigns and corporates.

Some of the notable sustainable Sukūk issuances include the Saudi Electricity Green Sukūk, whose proceeds will be used to finance or refinance the installation of smart meters and development of grid infrastructure. The Islamic Development Bank also issued the largest-ever sustainability Sukūk to date, with an issuance size of $2.5 billion, where 90% of the proceeds will be used for social development projects.

EXCELLENCE AND LEADERSHIP

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