



# Completion Report

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Project Number: 46061-001  
Technical Assistance Number: 8214  
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## Implementing Prudential Standards in Islamic Finance

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TA Number, Country, and Name: TA 8214-REG : Implementing Prudential Standards in Islamic Finance			Amount Approved: \$750,000.00	
			Revised Amount: Not applicable	
Executing Agency: Asian Development Bank		Sources of Funding: -Financial Sector Development Partnership Fund -Republic of Korea e-Asia and Knowledge Partnership Fund	Amount Undisbursed: \$165,177.07	Amount Utilized: \$584,822.93
TA Approval Date: 13 Nov 2012	TA Signing Date: 13 Nov 2012	Fielding of First Consultant: 8 Mar 2013	TA Completion Date Original: 30 Nov 2014 Account Closing Date Original: 30 Nov 2014	Actual: 30 Nov 2015  Actual: 18 Feb 2016
<b>Description</b> Through their respective central banks, the governments of Afghanistan, Bangladesh, Indonesia, and Pakistan have asked ADB for assistance in implementing prudential standards developed by the Islamic Financial Services Board (IFSB). <sup>1</sup> The Government of Malaysia, through Bank Negara Malaysia, has indicated interest in working with ADB in implementing such standards to develop Islamic finance in the region. The context of the request has been the significant development of Islamic finance with annual growth averaging around 20% between 2000 and 2012 and growth continued even through the global financial crisis. With this development, prudential standards to safeguard financial stability become a priority area for governments and central banks where Islamic finance had gradually become of systemic importance. Islamic finance also provides access to the unbanked and promotes financial stability through development of an alternative asset class. This helps to diversify the finance sector in ADB's developing member countries (DMCs).				
<b>Expected Impact, Outcome, and Outputs</b> The expected impact of the TA was increased financial inclusion through sustainable growth of Islamic finance. This is based on the understanding that sustainable growth of Islamic finance will diversify the financial sector and provide financing intermediation for the unbanked especially those who abstain from conventional finance. The indicator for the impact was increase in the total Islamic banking assets, including assets under management in ADB's participating developing member countries (DMCs). The outcome of the TA was prudential standards developed by the IFSB and implemented by DMCs. The four outputs were: (i) developing the e-module platform for disseminating standards and guidelines; (ii) capacity building to implement prudential standards, including financial implementation standards (FIS) workshops; (iii) developing an action plan to develop an Islamic capital market in participating ADB DMCs; and (iv) reviewing and completing phase 2 of the prudential and structural Islamic finance indicators (PSIFI).				
<b>Delivery of Inputs and Conduct of Activities</b> This TA was designed as a continuation of TA 7246-REG which was successfully implemented. <sup>2</sup> This is based on the understanding that work in prudential and supervisory framework of Islamic finance is highly specialized and support should be over a medium-term framework supported by several TAs instead of a stand-alone TA. There was extensive discussion with IFSB on the scope of the TA and areas of collaboration. Surveys were also sent to the representatives of central banks in ADB's DMCs with an Islamic finance subsector to gauge their interest and secure ownership of TA outputs and activities. The terms of reference for the consultants were adequate and required specific knowledge, skills and experience. The procurement of consultant services was implemented based on the specific requirement of the outputs and activities. An individual consultant was engaged to support activities related to PSIFI, an individual through a firm was engaged for the capacity building activities and a firm was engaged using single source selection (SSS) to develop the e-modules. The decision to use SSS was based on the need to engage the same firm who developed e-modules for the Basle Committee on Banking Supervision which is the counterpart for IFSB in standard setting for conventional finance. This is so that the staff of central banks would use the same interface to understand standards in conventional and Islamic finance. Overall, all consultants performed satisfactorily although they were not rated in the system. This was due to change in the focal point within ADB. The TA's original completion date was 30 November 2014 but was extended to 30 November 2015 to provide more time for the development of e-modules and PSIFI database. Out of the \$750,000 approved, approximately \$165,000 was undisbursed. This was mainly due to the reprioritizing of output 3 into an international conference and publication of				

<sup>1</sup> The IFSB is an international standard-setting body of regulatory and supervisory agencies that have a vested interest in ensuring the soundness and stability of the Islamic financial services industry. It is based in Kuala Lumpur, Malaysia.

<sup>2</sup> ADB. 2009. Technical Assistance for Development of Prudential and Supervision Standards for Islamic Financial Markets. Manila.

a knowledge product. Overall, ADB's performance as executing agency was satisfactory. IFSB also performed satisfactorily as implementing agency for the TA. The synergies between ADB's regional experience combined with IFSB's technical expertise produced quality outputs discussed below.

#### **Evaluation of Outputs and Achievement of Outcome**

The outcome of the TA based on the indicators in the Design Monitoring Framework was achieved. By November 2015, IFSB had developed 17 standards covering banking, capital market and Takaful (Islamic Insurance). The number standards adopted by ADB's DMCs increased from the baseline of 8 to 15 with Indonesia joining Malaysia and Pakistan as countries who adopt and implement IFSB standards. This can be credited to workshops organized in Indonesia and consultancy support provided including gap assessment and legal review of existing laws and regulations. Out of the 4 outputs, all were completed satisfactorily except for the action plan for capital market (output 3). The e-modules platform was developed covering 10 IFSB standards. During the implementation period, 9 workshops were organized in the 4 participating countries. The topics covered standards in implementation and development of Islamic finance. Phase 2 of the PSIFI database was launched in April 2015 compiling aggregated data from 15 countries including Afghanistan, Bangladesh, Indonesia and Pakistan. The action plan for Islamic capital did not materialize as only Indonesia and Malaysia indicated interest and both countries had different standards for evaluating stocks that are considered Syariah (Islamic law) compliant. Based on discussion with IFSB and the 4 participating countries, this output was reprioritized to organize international seminars and publication. It was agreed that there was a need to increase awareness of the potential of Islamic finance amongst ADB's DMCs as well as ADB staff. ADB and IFSB organized the first Islamic finance conference in ADB in November 2013 that was attended by more than 200 policy makers and regulators from ADB's DMCs. The proceedings of that conference were published into a book titled, "Islamic Finance for Asia: Development, Prospects and Inclusive Growth".<sup>3</sup> All the Design Monitoring Framework indicators in the other 3 outputs were achieved. This TA also was part of the policy dialogue with the Financial Services Agency (Otoritas Jasa Keuangan), Indonesia in ADB's Financial Market Development and Inclusion program.

#### **Overall Assessment and Rating**

Based on the evaluation, the TA is rated as successful. It was rated as high in the relevance section due to the demand and ownership of the participating countries. It is rated as medium for effectiveness and efficiency as the outputs all led to tangible results and were efficiently implemented. Tangible results include the e-module platform, the PSIFI database, the conference in ADB and the publication of the book as ADB's first knowledge product on Islamic finance. Sustainability was rated as partially and depends on whether TAs in this area especially with IFSB can be made operationally relevant and preferably linked to an ADB transaction.

#### **Major Lessons**

Three major lessons can be derived from this assessment. First, for regional TAs, it is important to get ownership of the participating member countries. The success of this TA was based on the commitment of the 4 central banks which were consulted during the design stage of the TA through missions and surveys. Second, implementation of prudential standards is continuous as these changes depending on the landscape of the financial sector. Third, Islamic finance in some DMCs have grown to be of systemic importance. Therefore, ADB support related to financial stability should include aspects relevant to Islamic finance.

#### **Recommendations and Follow-Up Actions**

This TA represented the third of a series of TAs supporting implementation of IFSB standards. An assessment of ADB's partnership with IFSB should be undertaken to provide recommendations on areas of future engagement with IFSB. These recommendations should be operationally relevant and can be performed by the Islamic finance working group within the Finance Sector Group.

TA = technical assistance.

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<sup>3</sup> <https://www.adb.org/publications/islamic-finance-asia>