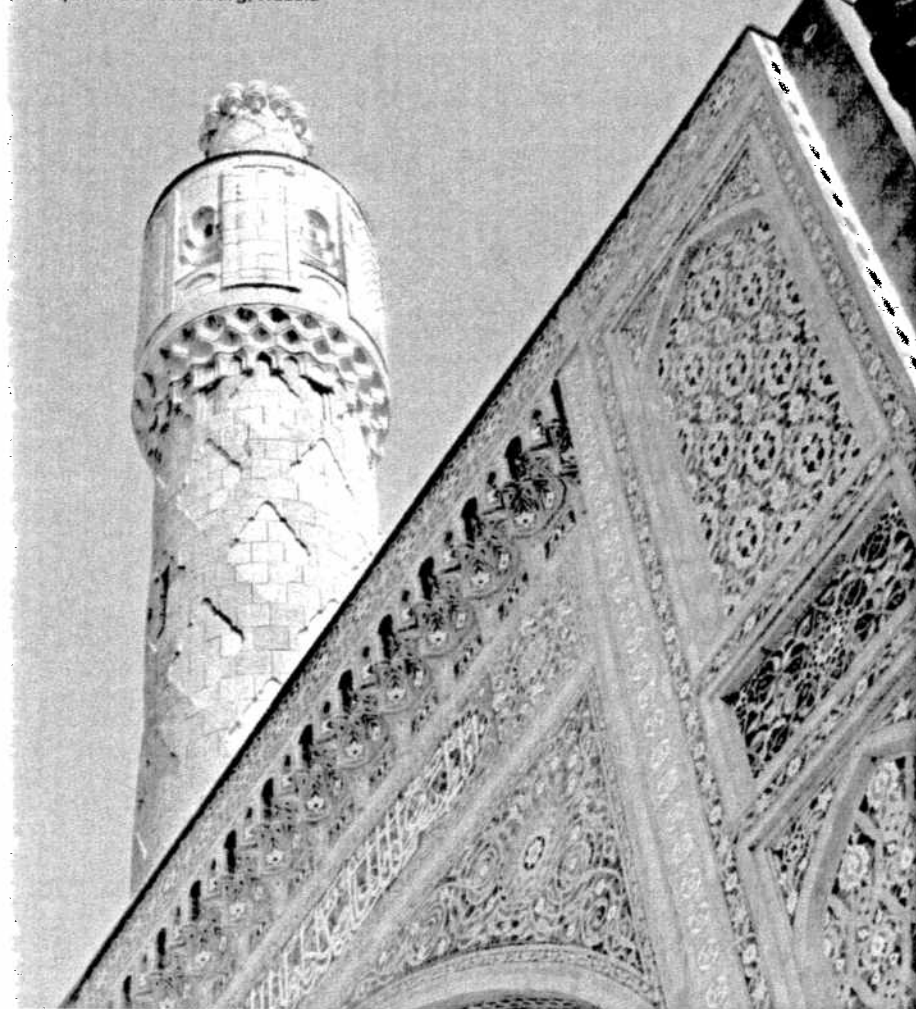


## Islamic banking and takaful in Russia: What the future holds

With over 15 million Muslims living in Russia today, the domestic introduction of Islamic financial services has been discussed and attempted by both businessmen and scholars. But is the country ready for it? Renat Bekkin, Moscow State Institute of International Relations lecturer, talks to Tanya Andreasyan about the challenges facing Islamic banking and insurance in Russia.

Mosque in St Petersburg, Russia



In recent years, the Russian banking market has been developing at a rapid pace. As the country's economy is stabilising and taking a definitive shape, so is its financial services industry.

In typically dramatic Russian style, recent events within the Russian banking sector have attracted attention on a worldwide scale, not always in a positive way. The murder of the Central Bank's vice chairman, Andrei Kozlov; the revoking of banking licences; the control of many domestic banks by foreign investors; and the upcoming changes connected with the Russian Federation joining the World Trade Organisation (WTO) are contributing to the shape of the Russian banking sector today.

Currently, there are around 1200 banks operating in Russia, with Sberbank (Savings Bank of the Russian Federation) having the largest share and the widest spread over all eleven time zones of the country. The rest are a pretty mixed bunch, but there are some strong and growing players. Regional expansion is high on the banks' agenda and retail banking services are of the utmost importance in capturing the largest market share.

However, having suffered a number of situations in which people's savings were lost in the recent past, the Russian population is being cautious and somewhat sceptical of the current developments. There is still an estimated \$1.5 billion in so-called 'mattress' money held by the public. Nevertheless, the

banks hope to introduce the financial services to as many of the 145 million Russian citizens as possible.

An estimated 15–20 million of them are Muslims. And while the country's population is largely diminishing, Russia's Muslim population is on the increase. It has grown by around 40 per cent since 1989, due to high birth rates in the Muslim community and continued immigration from the Caucasus and Central Asia. Some analysts project Muslims to become one-fifth of the country's overall population by 2020.

Today, Russia has about 8,000 mosques compared to 300 mosques 15 years ago. Statistics predict that by the end of 2015, the number of mosques in the country will exceed 25,000.

One would expect that, with such a growth in the Islamic population in the region, there would be increasing demand for Islamic financial services. However, this is not quite the case. As mentioned earlier, the confidence of Russia's population in the country's banking system is still low. And it's not only the confidence problem; it is the general knowledge about banking. Russia's President, Vladimir Putin, once mentioned that 'the majority of Russian citizens are still avoiding banks, just don't understand how they work and consider them to be too complicated and requiring professional knowledge'. According to Putin, only one quarter of Russian citizens have bank accounts and less than ten per cent of the population uses plastic cards.

And if conventional banking, which has existed for a long time, is still a mystery for a large number of people in Russia, what can one say about the Islamic financial institutions, which have emerged only recently? The situation is much the same in other countries comprising the Commonwealth of Independent States (CIS), the successor to the USSR. Depending on the geographical location and ethnic population, some of these countries are more advanced in their knowledge of Islam and Islamic banking than others. The countries situated in Central Asia – for example Kyrgyzstan and Tajikistan – are predominantly Muslim,

as so are some countries in the Caucasus such as Azerbaijan.

One of Russia's specialists in Islamic finance, who has contributed to its promotion across the territory of the former USSR, is Renat Bekkin, international law lecturer at one of the most prestigious universities in Russia, the Moscow State Institute of International Relations (MGIMO-University). The university functions under the auspices of the Ministry of Foreign Affairs of the Russian Federation.

Bekkin studied at MGIMO and graduated from it with a Master of Law degree in

transactions; and the philosophy of Islamic law.

So what is his opinion on the situation with Islamic financial institutions in Russia?

'There is still a lot of scepticism over the idea of Islamic banks among Russia's Muslims,' says Bekkin. 'Actually, a number of Muslims around the world do not support Islamic banking and consider it to be unacceptable, the same as Islamic whisky. Some people in Russia also support this theory, even if they don't know much about Islamic finance to begin with.'

**Although the Arab world considers Russia a potentially emerging market with regard to Islamic finance, there is still a lot of apprehension when it comes to investing capital in it. 'There are many hitches and complications.'**

2000. A few years later, he received a PhD in Law, having written a dissertation 'Insurance in Islamic Law: Theory and Practice'. Today, he is a professor at the UNESCO (United Nations Educational, Scientific and Cultural Organization) department in MGIMO.

Bekkin is originally from St Petersburg but moved to Moscow to attend the university and continues to live there today. He speaks three foreign languages – English, Arabic and Chinese. Literature is one of Bekkin's passions, so much so that he writes himself and has also established an open literary prize called 'Islamic Breakthrough'.

Bekkin's interest in Islamic finance has developed gradually. Originally, international law was his subject of specialisation but then, in the course of research, he came across the legal issues of Islamic insurance (takaful) which later became the topic of his thesis. Eventually, Bekkin's area of interest broadened to other aspects of Islamic law and finance including: retakaful; Islamic law in non-Muslim countries; Islamic economics; Islamic law of banking, securities and business

Bekkin explains: 'Generally, the attitude of Muslims in Russia towards Islamic finance can be divided into four main categories. The first one is that it is not vital to use Islamic banking services. These people consider that observing other rites, for example, praying and fasting, is sufficient. The second category consists of those who do not practise any rites at all or are not even aware of them. This category often includes ethnic Muslims. And there is a third small category of people who think that practising all principles of Islam, including in the financial sphere, is essential.' He goes on: 'So, these Muslims have to somehow find a way of minimising the risks of using non-Islamic banking products. The solution of banking abroad is, unfortunately, not affordable for the majority of them.'

'There is also a fourth category of intellectuals who are very enthusiastic about Islamic finance. These Muslims, generally ethnic, may not be as strict in following other Islamic rites but are very interested in Islamic finance and the concept of ethical banking.' The latter category includes Muslims who have tried to establish Islamic financial institutions in Russia since the early

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1990s. Regrettably, none of these undertakings seems to have resulted in anything long-lasting.

Back in 1992, an Islamic Cultural Centre in Moscow and the All-Russia Tatar Cultural and Educational Centre, together with a number of Russia's large machinery and metallurgical plants, announced the establishment of the United Islamic Commercial Bank Inc. It was going to be located in the Kemerovo Region, an industrial district in the north-east of Russia. The reasons behind this collaboration were more practical than religious; the bank was set up to develop the industry in the region and to attract foreign investors primarily from Muslim states. 'The regional government knew next to nothing about Islamic finance at the time, they just wanted to create a financial structure to attract capital from the Arab world,' says Bekkin. However, this project was never completed.

Another unrealised project, which directly involved Bekkin, was the launch in 2005 of an Islamic insurance company in the republic of Tatarstan (a federal subject of Russia) called 'Itil'. It was supposed to be a joint venture between local entrepreneurs and foreign investors from the Arab world. 'There were no obstacles from the legislative or political point of view,' says Bekkin. He was appointed director of the company. 'We drew up a business plan and presented it to the foreign investors. The problem turned out to be quite worldly – apathy from both sides to actually press on with the project. So, it didn't end with anything.'

Indeed, although the Arab world considers Russia a potentially emerging market with regard to Islamic finance, there is still a lot of apprehension when it comes to investing capital in it. 'There are many hitches and complications,' admits Bekkin. 'One of the potential investors [from UAE] in the takaful company, Itil, once said that Sudan interested him more than Russia from the point of view of the Islamic financial services market.'

And it's not just the Middle East countries that are contemplating introducing Islamic banking in Russia. Not long ago, Bekkin

Renat Bekkin, MGIMO-University



Kul Sharif Mosque, Kazan, Republic of Tatarstan, Russia



held some talks 'on a consulting level' with the Swiss bank Fortis, which was pondering a move into the Russian banking market with its Islamic offering. The idea was to develop tailored financial products and services using the Islamic model, yet without calling them Islamic. However, the bank's initial analysis was not satisfactory and so far Fortis has not taken any further steps.

Bekkin thinks that chances of success in this field would be higher if large international conglomerates like HSBC or Citibank opened their Islamic subsidiaries in Russia, as opposed to purely Arab banks doing the same thing. 'It is more likely to have a positive reaction,' he says. However, to date, neither western nor Middle Eastern investors have carried out such a project from start to finish.

The only undertaking that actually moved further than 'half a step' (although today it is also history) was Badr-Forte Bank. This bank was set up in Moscow back in 1991, and operated according to Shari'ah law from 1997. Officially it was not called Islamic, but its charter stated that the bank had the right 'to act according to Russian and international laws by applying Islamic economic technologies which do not contradict the banking laws of Russia'. Badr-Forte was also a member of the General Council of Islamic Banks under the IDB (Islamic Development Bank).

The bank managed to adapt successfully to the Russian legislation and economy whilst following the Islamic principles of banking although, according to Bekkin, 'due to the specifics of Russian laws Badr-Forte had to compromise more in some respects than its foreign counterparts'. The piece of legislation that became a stumbling-block for Badr-Forte and Russia's Central Bank was the deposit insurance scheme, which the Central Bank made mandatory. Badr-Forte tried to explain that the essence of an obligatory deposit insurance scheme contravened the very principles of Islamic banking, but the Central Bank stood firm. In the end, Badr-Forte's licence was revoked on the grounds of money-laundering activity plus the gross violation of order and period when reporting suspicious transactions.



Kremlin of Kazan, Republic of Tatarstan, Russia

The bank had focused on foreign trade operations, such as cross-border transfers, guarantees and letters of credit. Unfortunately, its retail Islamic offering was limited to deposits, money transfers and mortgages, with the latter being launched shortly before the bank's closure. Furthermore, the bank had no branches and was not widely known to the general Muslim public even in Moscow (the city which hosted the bank's headquarters), let alone regionally. Badr-Forte, however, tried to compensate for its absence of outlets by actively promoting both internet and mobile phone banking.

Bekkin is very familiar with the bank and its founder and chairman, Adalet Dzhabiev, as Bekkin worked on probation in the bank for a while during his university years. 'Actually, everyone who was studying Islamic finance at the time or was writing about it bore some relation to Badr-Forte,' he says. 'Everything concerning Islamic banking in Russia and everybody involved in it were revolving around this bank.'

However, in December 2006, the Central Bank of Russia revoked Badr-Forte's banking licence. There have been a few unsuccessful attempts to recover the licence,

but it doesn't seem likely that Russia's only Islamic financial institution is going to be revived any time soon. Dzhabiev is not in a rush to open another Islamic bank in the country. As the proverb goes, 'Once bitten twice shy'.

Of course, Bekkin regrets that the idea of an Islamic bank in Russia still remains only theoretical, but he thinks that Badr-Forte had more than Russia's legislation and the current state of the Russian banking market to blame. The lack of the bank's activity in the social and educational spheres resulted in the absence of a wide-spread support for the bank among Russia's Muslims.

'One of the primary functions of any Islamic financial institution is a social one,' states Bekkin. 'Unfortunately, Badr-Forte did not really fulfill that.' He goes on to give an example: 'Dzhabiev and his right hand, Samira Karahanova, were the only Muslims working in the bank, and Dzhabiev was keen on recruiting qualified Muslim staff to work in Badr-Forte. Since such personnel were hard to come by, there was a suggestion to train the potential staff, provide them with the necessary literature and let them get a feel for Islamic banking in practice. Dzhabiev's position on this issue was far from supportive, as he suggested that those willing should research and learn Islamic banking themselves, without the bank's help. And this kind of attitude spread to other things too.'

However, in spite of Badr-Forte's fate, the idea of establishing an Islamic financial institution in Russia continues to hover in the air. So, if another Islamic bank were to open in the country, what would be the best geographical location for it? Bekkin thinks that 'Moscow is the city with the most potential of developing an Islamic finance service industry, as it has a large Muslim community, and quite a lot of well-off Muslims, both ethnic and newly converted'. Russia's capital is among the most expensive cities in the world, and the standard of living there (regardless of people's faith) is traditionally high compared to other parts of the country. Plus, Moscow has embraced the financial services industry with considerably more enthusiasm than the regions.

Another part of Russia that is also a potential Islamic banking and insurance hub is the republic of Tatarstan, situated in the central part of Russia. Tatarstan lies between the Volga River and the Kama River (a tributary of the Volga) and extends to the Ural Mountains. It is a predominantly Muslim republic, with a population of nearly four million people. 'It has a claim on being the leading Muslim community centre of Russia,' says Bekkin, 'so there is a potential interest in the Islamic financial structures there; however, it is more political than economic'.

Then, there is also the republic of Dagestan, situated on the Caspian Sea coast in the southern part of Russia, the North Caucasus. Over 90 per cent of this republic's population (2.3 million) is Muslim, with Islamic faith dating back centuries there. 'This region is exactly the case where people follow Shari'ah principles in various aspects of life except the financial one. There is a lack of understanding and support of this matter both from the local government and the local population,' says Bekkin. Even so, there has been sporadic talk of establishing an Islamic financial institution there, but this has turned out to be unsubstantiated.

Such empty promises are not an unusual thing for Russia. Once in a while, announcements of establishing an Islamic

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bank or a takaful company appear in the mass media. Bekkin thinks that most of the time 'it is merely a trick to attract attention and to occupy a niche in this market in advance'.

Nevertheless, the development of Islamic banking in Russia is by no means a lost cause. More widespread education about Islamic economics and finance is needed, as 'the lack of knowledge in this area is one of the main causes of low demand for Islamic

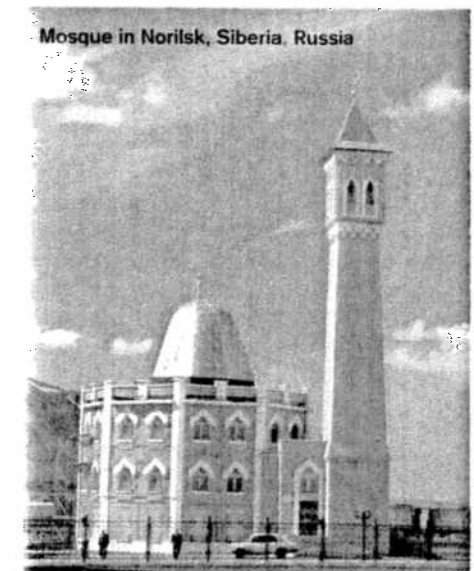
financial products'. Even a basic thing, such as zakat (Islamic concept of tithing and alms), is a very unclear subject for a lot of Muslims in the country. 'Knowledge of zakat is a touchstone by which you can judge the people's attitude to Islamic finance,' says Bekkin. 'Here it is very often thought to be unnecessary, or many people think that giving alms to the paupers by the mosque is zakat.'

Also, creating favourable conditions for the development of Islamic financial services is essential. 'The secret of success is to introduce the economic aspects of Islam before any penalising sanctions. It is necessary to begin with economics rather than with scaring. This is a much more effective way to familiarise and attract people to Shari'ah law,' states Bekkin.

At the moment, Bekkin is involved in the project of creating an Islamic mutual fund, Gold Dinar, which is expected to commence operations later this year. 'The management company has already been registered, and now we are in the process of developing the products,' says Bekkin. Gold Dinar will be situated in Moscow, with the ambition of moving into Russia's regions in due course. At present, Bekkin's role in the project is purely consultative; however he is considering further involvement in this mutual fund. 'I am always interested in

learning something new,' he says. 'Maybe I'll work in the company.' It all depends whether the company's investors stick to the project and go all the way. So far 'everything seems to be serious', but having encountered so many canards before, Bekkin is cautious in his prognosis.

The 'initiative group' organising Gold Dinar consists of seven people. Most of the participants are originally from Dagestan, but they have been living and working in



Mosque in Norilsk, Siberia, Russia

Moscow for a long time. Although the primary goal of establishing this company is to offer the public Shari'ah-compliant services, it is also seen as a 'promising business'. 'The investors are very experienced in this field – some of them have been dealing in securities for over a decade,' says Bekkin. 'So they clearly see the potential in the Islamic mutual fund and know that there is a demand for its products and services in Russia.'

The concept of mutual funds is relatively new to the Russian market and this niche has recently been developing rapidly, with plenty of coverage in the mass media and a mushroom growth of conventional mutual funds as an alternative way of depositing money. Muslims in Russia turn to mutual funds for financial services, as these organisations are regarded as more ethical and less contradictory of Shari'ah law than banks. Therefore, setting up a proper Shari'ah-compliant mutual fund in the country is indeed 'a hopeful activity'. And the successful completion of this project will surely be a step in the right direction towards further development of Russia's Islamic financial services market. ☪