

[参考資料]

ISLAMIC FINANCE IN the FORMER SOVIET UNION

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Table of contents:

Part I. Islamic finance in Russia

Part II. Islamic finance in Kazakhstan

Part III. Islamic finance in Kyrgyzstan

Part IV. Islamic finance in Azerbaijan

Part I.
ISLAMIC FINANCE IN RUSSIA

Russian Muslims

Somebody might find the situation with Islamic finance in Russia far from being optimistic in terms of interest of regulatory authorities. However, one should keep in mind that despite the attitude of authorities the future of Islamic finance is much dependent on the demand for such services from local Muslim population.

Since the crash of the Soviet Union there has been only one population census in Russia in 2002, whereby no religious affiliation was taken into account.

In this connection we can find different data on the quantity of Muslims in Russia: from 10 to 25 million. In our opinion, the truth is somewhere between these figures. The key question is whether we should take into account so-called ethnic Muslims, that is those who have Muslim name or surname, but do not live in accordance with rules of Shari'ah or include only so-called "observant" Muslims. In the latter case the figure would be 10 million.

Since 1989 one may observe the renaissance of Islam in Russia. However, even among those Muslims who regularly go to mosque, the share of Muslims who obey the Shari'ah rules in the economic sphere is insignificant.

In 2004 Takafol.ru, the only Russian language web-site dedicated to Islamic finance, conducted a public opinion poll among the parish of St. Petersburg's only mosque to reveal their attitude to Islamic finance and the idea of Islamic economy as a whole. The results turned out to be as follows: 50 per cent have never heard about the Islamic prohibition of interest (*riba*), 40 per cent could not explain the essence of the prohibition and as little as 10 per cent, mostly young men, were aware of the ban on interest and economic relationships in Islam.

Islamic banking in Russia: short review

1992: an attempt to set up "United Islamic Joint-Stock Commercial Bank" in Kemerovo (Western Siberia). The project remained on paper. On 14 August 1992, it was announced that "United Islamic Commercial Bank Inc." was being set up in Kemerovo. The initiative of the leaders of the Union of Industrialists and Entrepreneurs of Russia was supported by the administration of the Kemerovo Region.

This entity was set up for practical rather than religious reasons: its declared aim was to develop the scientific and technical potential of the CIS countries and encourage business activities of enterprises by attracting foreign capital primarily from the Muslim states. In practice, the latter aim prevailed. Business communities of Saudi Arabia, the United Arab Emirates, Turkey, and the Central Asian states initially showed a certain interest in the project. Nevertheless, the project was not realized - the bank never went into operation.

In the early 1990s “Sberbank”, the largest Russian state-owned bank, – was looking into opportunities to provide Islamic banking services in Russia. However, the bank’s initiative was not supported by the state.

In 1997, “Forte-Bank” started utilizing Islamic financing tools in its operations. “Badr-Bank”, an Islamic unit established by “Forte-Bank” shortly International Commercial Bank “Badr-Forte” used to be the only bank in Russia guided by Islamic business rules. The history of the bank began in 1997, when “Forte Bank”, a Russian bank that had operated in Russia since 1991, established a new bank – “Badr-Bank”. It was proposed that the new bank would provide Islamic banking services.

In 1998, “Badr-Bank” obtained the banking license from the Central Bank of Russia. Significantly, the bank was not called Islamic, from Russian law perspective, “Badr-Forte” was a commercial bank and its legal name read as “International Commercial Bank”. Yet its charter said 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». This was an approach approved by the Central Bank of Russia.

In 2000, “Badr-Bank” and “Forte-Bank” united into a single legal entity – “Badr-Forte Bank”, which, in particular, increased the new bank’s assets and expanded its client base.

From the very inception “Badr-Forte Bank” focused on foreign trade operations, including conversion operations, cross-border transfers, letters of credit, bank guarantees, rather than working with individuals. Its operations of this type were limited to cross-border transfers and paying cash from current accounts. It should be noted that the bank’s popularity among Muslims was limited by the fact that it had no branches in Russian regions, which it was trying to make up for by widely using Internet banking and GSM-banking.

In December 2005, the management of the bank decided to launch a new product - Islamic mortgage using diminishing musharakah scheme. “Badr-Forte Bank” assisted in establishment of the cooperative housing society “Manzil”. The aim of “Manzil” was to provide Islamic mortgage programs for Muslims living in Moscow and the Moscow region and in the long term spread into other regions of Russia.

One of the main disadvantages of the program was a short term of the mortgage loan, which originally did not exceed 5 years. Later, the term was extended to 7 years.

When “Badr-Forte Bank” faced problems with the Central Bank of Russia the halal mortgage program had already attracted about 10 clients. Despite the fact that the program was mainly addressed to Muslims, “Manzil” appreciated that non-Muslims also showed their interest in it.

We should note here that although a laudable initiative, the program was far beyond pockets of many Russian Muslims, simply because «the housing can’t be cheap», even an Islamic one. Furthermore, experts note that Islamic mortgage is rather a luxury than the cruel necessity. Those who follow Islamic prohibition of usury and choose Islamic mortgage programs sometimes face harder conditions than they would face had they choose the conventional one.

In the end of 2006, the story of Islamic banking in Russia came to an end. The Central Bank of Russia was not so tolerant towards “Badr-Forte” any more as it used to be nine years ago. In the first decade of the year 2006, in the course of inspection conducted by the Central Bank certain minor mismatches in respect of the bank were found and shortly afterwards the license of “Badr-Forte” was withdrawn.

The official grounds were the violation by the bank of the Federal Law «On Counter-acting Legalisation of Proceeds from Crime (Money Laundering), and Terrorist Financing». “Badr-Forte Bank” appeared to be one of the numbers of small banks that were winded up during CBR’s unceasing campaign against money-laundering in Russian banking sector. Among unofficial versions are politics and new property redistribution within the Russian banking sector.

Despite being the only Islamic bank in Russia, the bank was devoid of support of Muslim *ummah* who did not care much about the bank’s future.

As a closing remark to the story of “Badr-Forte Bank” it’s worth saying that “Badr-Forte Bank” used to be a member of a number of Islamic institutions, including the Accounting and Auditing Organisation for Islamic Financial Institutions and the General Council of Islamic Banks under the IDB, which means that its operations were

recognized at the international level as Shari'ah-compliant.

When studying Islamic banking in Russia, one may unwittingly draw a parallel with Islamic Bank of Britain. There are, however, much more differences between these two banks than things in common.

To begin with, British authorities have been quite enthusiastic about development of Islamic banking; they believe Islamic financial products will help diversify domestic financial market. The Russian authorities keep putting obstacles in Islamic banking development rather than show interest in it. Moreover, recent years in Russia are characterized by fast growing Islamophobia, which is also true among officials who suspect every Islamic institution of posing a terroristic threat.

Another important and in a way crucial difference between the two banks is demand for Islamic banking services. London, one of the world's biggest financial centres, is also becoming one of the centres of Islamic finance. Not only Muslims living in the UK show interest in Islamic financial services but also businessmen from different countries, in particular from the Middle-East, who comes to London for business.

In Russia, the demand for Islamic financial services is still very weak. "Badr-Forte" was thus unique not because it was the only Islamic financial institution in Russia but rather because it was established when there was practically no demand for Islamic financial services domestically. The majority of Muslims in Russia are either not aware of Shari'ah prohibitions applying to trade and business, or explain non-compliance with such prohibitions by lack of possibilities. For the majority of so-called practicing Muslims of Russia their Islamic affiliation is limited to a fivefold *salah*, attending mosques on Fridays, fasting during Ramadan and if there is money performing a *hajj*. The fifth pillar of Islam, *zakah*, is often ignored. Absence of a centralised body, which would collect this purificatory tax, is a weak excuse for ignoring this pillar of Islam. Moreover, most faithful do not consider themselves to be bound by Islamic prohibition of dealing with interest at all.

Does this mean that every future attempt to set up an Islamic bank in Russia is a losing battle?

The current global financial crisis and liquidity problems that Russian banks are facing seem to make Russian authorities more tolerant towards Islamic banking. Now a number of Russian wholesale and retail banks are seeking for capital from Middle Eastern banks, including Islamic ones, to launch Islamic banking operations in Russia. Some Russian banks seriously plan to extend their product lines with Islamic

banking services by opening an Islamic banking “window” or setting up a subsidiary. The solid financial position of some of these banks and their strong relationship with the Central bank’s officials grants to the supporters of Islamic banking movement in Russia a hope to see Islamic banking operations launched there in 2009-2010.

Islamic Insurance (*Takaful*) in Russia

In 2004 on the basis of “Itil” insurance company (Tatarstan Republic located in the very heart of Russia) Islamic insurance directorate was established. The main area of responsibilities of the directorate was working out the concept of *takaful* in Russia and composing a business plan

As the company did not have enough money to realize the project at its own expense, the agreement was reached between “Dubai Islamic Insurance and Reinsurance Company (Aman)” (the United Arab Emirates) and “Itil” insurance company to joint efforts in order to establish the first *takaful* operator in Russia. It was proposed that 49 % of shares would belong to AMAN and 51 % to “Itil” respectively.

The management of “Itil” planned to convert the company into an Islamic insurance company. A deep analytical work was carried out. However, in 2005 the first ever Islamic insurance project in Russia based on “Itil” insurance company ended off. The two main reasons for it were as follows the shareholders of “Itil” insurance company had lack of money and AMAN lost interest in the project.

At the moment, two major Russian insurance companies are studying the possibilities to set up *takaful* business in Russia in 2009-2010.

Waqfs

At the dawn of Islamic finance, when there were no Islamic banks, some of the scholars were writing that it would be enough to create an effective mechanism of collecting and distributing *zakah* and to restore *waqfs* in order to set up a fair economic system in the Muslim world.

However, even today only a handful of countries have set up working systems of collecting and distributing *zakah* and effective *waqfs*. Even in the countries with developed Islamic banking, investment and insurance systems *zakah* and *waqf* do not play a key role in economic development.

Naturally, it is harder to use *waqf* and *zakah* in countries and regions where

the experience of using these institutions never existed or was lost over time. For example, in the protostates on the territory of Somali many banking functions are performed by money brokers – *hawaladars*. Besides opening deposit accounts they often provide loans to their regular customers. At the same time the tribe, the clan continues to remain the main source of financing. Developing the system of conventional microfinance institutions with the help of the EU has not been able to seriously compete with traditional financing so far.

Nevertheless, it is fair to note that by mid-twentieth century *waqf* and *zakah* did not play key role in economic development in most of the Muslim countries.

Russia can be viewed as one of the countries with historically developed *waqf* usage, which was seemingly lost in the Soviet times. Let us try to see whether this is true and if it is, whether there are objective preconditions for setting up *waqf* and *zakah* systems anew in Russia.

In the middle of June 2004, Kazan hosted the 7th All-Russia Seminar of the Heads of Muslim Religious Boards called «*Waqf* and Its Prospects in Russia Today».

Let me remind You that *waqf* is property alienated for charity. When certain property is made *waqf* (or, according to some Muslim theologians, when the intention is announced), it no longer belongs to the *waqf* institutor (*waqif*), but nor is it transferred as property to those who receive the *waqf* and manage it in the interests of the receivers (designated by the *waqif*) of *waqf*-created profits. Using *waqf* property for purposes other than those designated by the *waqif* is prohibited.

According to the imams who spoke at the seminar, today, *waqf* is the only chance for Russia's Muslim religious organizations to preserve their financial independence. Judging by what was said at the seminar and by the information presented at previous similar seminars, the Muslim spiritual leaders do not always clearly understand the purpose of *waqf*. They tend to forget that *waqf* property is not transferred to the religious organizations for ownership: they are entitled to the revenue this property produces.

Sometimes *waqf* is confused with other Islamic institutions: *gyshar* ('*ushr* is the more correct name, that is, tithe, or a tenth part of the yield), *zakah*, as well as the revenues produced by some religious rituals: *khatemlar* (gatherings that pray for the dead), *janaza* (burial rites), etc.

Quite often *waqf* is treated as fund for financing of the operational expenditure of mosques and Muslim clergymen. It is hard to start a constructive dialogue if those who want to develop the *waqf* system have vague ideas about it.

Significantly, similar problems also existed in Russia before the revolution: one of the first officially registered *waqfs* bequeathed in 1830 to the First Main Mosque of Kazan by merchant Gabdulla Yunusov did not specify the rules of its management and control over the revenue it produced. This was by far not the only example of misunderstanding the *waqf* institution in the Volga area: the heirs of a rich industrialist Utiamyshev refused to fulfill his will under which part of his money was intended for *waqf*, arguing that there was no specific procedure for executing the will¹.

An outstanding Tatar enlightener Shigabuddin (Shikhabaddin) Mardjani (1818-1889) resolutely rejected this interpretation of *waqf* exploited by rich merchants to control the economic life of the community (*mahallya*). It was mainly thanks to his efforts that the question regarding the direct purpose of *waqf*, which corresponded to the Shari'ah, was raised and a system of collective self-administration in individual Muslim parishes established. The number of embezzlements in the charity sphere decreased along with, first, the power of the patrons in the Yunusov brothers' *mahallya* and then of other Tatar merchants who had been dominating their communities. Thus, approximately since the mid-nineteenth century in the Volga region *waqf* started being used for its main social purpose, that of an institute for protecting economic interests of Muslim communities and their individual representatives.

Late in the 19th century, the mechanism for transforming property into *waqf* was legally registered. Under the newly established legal procedure, *waqf* institutor applied in writing to the assembly of parishioners representing the community. He was duty bound to describe in detail the property to be turned into *waqf*, state its value, and enumerate the owners and the conditions for managing and disposing of this property. The community empowered the mosque leaders to apply to the governor with a request to seek permission from the Ministry of the Interior Affairs. The latter's permission was sent to the Orenburg Mahomeddan Spiritual Assembly which, in turn, approved the permission and informed the parishioners of the ministry's decision. After a dedicatory inscription was made on the property transferred to *waqf*, a notary procedure completed the process. The community was responsible for annual reporting about *waqf* management and bookkeeping.

It should be said that in pre-revolutionary Russia, so-called cash *waqf* was very popular: the institutor allotted a certain sum, the interest on which was used by the mosques, Muslim clergy, students (*shakirds*) of religious schools, etc., for which the *waqf* was intended. In this way, while one of the provisions of Islamic law was strictly observed practically everywhere, another, much more important provision², the ban on

usury repeatedly formulated in the Quran, was violated: «*Those who devour usury will not stand except as stands one whom Satan by his touch has driven to madness. That is because they say: 'Trade is like usury', but Allah hath permitted trade and forbidden usury*» (interest-receiving in excess on money lent to others) (2:275).

This interpretation of *waqf*, which does not fit the classical pattern, was not restricted to Russia alone. At one time, outstanding Muslim theologian Mehmed Birgevi sharply criticized the practice of donating cash for religious purposes which served as one of the cornerstones of financial transactions in the Ottoman Empire. This money was normally loaned under interest, which contradicted the Islamic ban on *riba* (usury). At the same time, religious and secular institutions used only profits created by this money³.

In the Volga region a large part of Muslim parishes was financed by the interest rates from bank deposits.

After the October revolution 1917 *waqfs* were abolished in various regions of Russia, however, it happened over time. *Waqf* institutions existed the longest in the North-Eastern Caucasus. Only ten years after the revolution, on January 23, 1927, Central Executive Committee and Council of People's Commissars of the Dagestan ASSR have issued a decree "On nationalization of *waqf* property".

The *waqf* issue was repeatedly discussed in present-day Tatarstan Republic in Russian Federation at the highest level. In 1993, at one of the first meetings, members of the Muslim clergy discussed with President Shaymiev the possibility of setting up a *waqf* system badly needed for the construction and maintenance of mosques and *madrasahs*, and for publishing activities. The president set up a special commission to study the issue in depth. Specialists were sent to Turkey to exchange experience. Later, in 1998, a uniting congress of the republic's Muslims created the post of chairman of the *waqfs*, in the rank of first deputy mufti, and a *waqf* department under the M. The very concept of *waqf* was first introduced into Russian Federation laws by the Law of Tatarstan on the Freedom of Conscience and Religious Associations.

The provision on the *waqf* property and its inalienability, contained in the Law, was just a declaration of intentions rather than a legal norm that was spelling out existing practices. However, even this provision over time has raised questions on its compliance with federal legislation. The Tatarstan law «On the freedom of conscience and religious associations» was amended, however, the provision on *waqf* property, although non-existent in practice, was retained.

The deputies of the State Council of Tatarstan have insisted that all efforts to

provide legal framework for non-existent *waqfs* are useless unless necessary changes are made in federal laws. In June 2008 they came up with an initiative to include into Russian legislation the notion of «*waqf* property». Earlier, in March of the same year chairman of the Muslim Religious Board of the Republic of Tatarstan Gusman Iskhakov proposed the same measures. There has been no reaction from the side of the federal authorities so far.

The issue of spelling out the notion of *waqf* in federal legislation is also important in terms of restoring Muslim ownership of the *waqf* property, nationalized after the October revolution. For example, in Republic of Crimea (Ukraine) when local Tatars argue for restoring their ownership of the lands, confiscated in Soviet times, they refer among other things to the existence of *waqf* property in the tsarist times in Russia. As was mentioned before, work is done by Tatarstan historians and law scholars on finding previously existing *waqfs* in the Volga region. However, even if the notion of *waqf* is introduced in federal legislation, it will not guarantee the Muslims that their *waqf* property, confiscated after revolution, would be returned, since the major part of documentation on setting up *waqfs* has not been preserved.

And if we speak about setting up new *waqfs*, then, even without the notion of «*waqf* property» spelled out in the Russian federal legislation, those willing to do so can use many other legal mechanisms at their disposal. For example, in order to set up the already mentioned cash *waqf* there is no need to create any institutional structure.

Cash *waqfs* were known in the early years of Islam. Cash *waqf* is first mentioned in connection with a question posed to one of the most prominent representatives of the *Hanafī* school of law Zufar ibn Hudhayl. The scholar was asked about the legitimacy of cash *waqf* in compliance with Shari'ah. Zufar replies that cash *waqf* is allowed if the money used for creating *waqf* is invested in accordance with the *mudarabah* mechanism.

Cash *waqfs* exist in two forms. In the first case, cash turned into *waqf* is given to the beneficiary as a loan with no interest rate. This form raises no objections on the side of Islamic law scholars. In the other form money is invested not based on the *mudarabah* mechanism, but instead is provided as a loan with interest rate, where the interest is transferred to the beneficiary.

Turkish scholar Murat Çizakça is a supporter of the wide use of cash *waqf* in modern economic relations. He proposes using cash *waqf* in Islamic banking. Çizakça believes that cash *waqf* and Islamic banks perform the same functions. When cash *waqfs* and Islamic banks were created they were supposed to work in accordance with

the *mudarabah* principle⁴. This scholar thinks that the best decision would be to set up special *mudarabah* companies which will manage *waqfs*⁵.

Modern world provides plenty of other ways to use cash *waqf* in compliance with Shari'ah rules. For example, transferring Shari'ah-compliant shares into *waqf* that have been approved by Muslim law scholars. The shareholder might decide that all of the dividends on shares or part of it will be used for charity purposes. Institute of *waqf* may also play an important role in dealing with Islamic bonds (*sukuk*).

In terms of Russian legislation it is inadvisable to include cash *waqf* in the trust law structure. In accordance with the Civil Code of Russia, money cannot be an independent object for a trust, except for the cases specified by law (art. 1013, point 2, Civil Code of Russian Federation). We see an alternative solution in acquiring shares and other equities allowed by Shari'ah law in the name of the beneficiary.

As to the real estate as the base for *waqf* property, on 24 September, 2004, the State Duma (parliament) passed amendments to the Land Code which transferred, free of charge, land under the buildings and other facilities used for religious and charity purposes to the religious organizations that owned them. Those religious organizations that do not own the buildings in which they function will receive the land under them gratis for the entire period they continue using the buildings. These amendments were intended to favor the Russian Orthodox Church, however other confessions benefited from them as well.

Therefore, from a legal point of view, there are no problems with instituting *waqfs* in Russia or, to be correct, institutions close to *waqfs*. Neither were there such problems in the previous legislation, which was more vague about *waqf* property. However, we talk about institutions close to *waqf* or the so-called *quasiwaqfs*. *Waqfs* in their classical interpretation in the Muslim law cannot be set up in modern Russia – except for the cash *waqf* mentioned by Zufar ibn Hudhayl. When the status of all parties to a *waqf* is not clear, it is hard to guarantee that *waqf* will be used for the purposes it was initially set up for and that the rights and obligations of the parties will be within Shari'ah law.

Those who propose using trust agreement (chapter 53 of the Civil Code) in order to set up a *waqf* forget that trust agreement in contrast to *waqf* is limited in time and cannot be concluded for a period over 5 years (art. 1016, point 2 of the Civil Code). Moreover, current legislation does not envisage any mechanism of managing the trust if it is managed by a citizen, who is not a businessman, or by a non-commercial organization (art. 1015, point 1 of the Civil Code).

Naturally this situation requires appropriate amendments to the legislation. Certainly it would be naive to talk about introducing provisions of Islamic law on *waqf* property into Russian legislation. And the problem is not even in the political complications. A more serious obstacle lies in the loss of Islamic legal culture in Russia.

After analyzing the recent experience of reviving *waqf* property in Russian republic Dagestan where a few *waqfs* appeared here and there in the mountains early in the 1990s, V. Bobrovnikov concluded that even this republic, which is the most Islamic among Russia's republics, lacks the prerequisites for further development of the *waqf* system as it was known before the revolution. The most important reason is that the institution of *waqf* lost its former social and cultural meaning. Today, Muslim schools and higher educational establishments in Dagestan are mainly functioning on personal donations (*sadaqah*) and incomes derived from leasing out property and trade rather than on *waqf*-created incomes.

The same is true of Volga region where the *waqf* culture was lost even earlier than in Dagestan.

In view of the above, we tend to declare that *waqf* today and tomorrow is a different phenomenon which has little in common with the classical *waqf* of the Islamic law. It seems that in the context of the lost Islamic legal culture in Russia as a whole (and in Dagestan in particular), most *waqf*-related issues will be regulated by Russian legislation and *adats*, while Islamic law will no longer affect this institution in the old way.

Does all the above-mentioned mean that *waqf* in contemporary Russia has no prospects? Not at all. We believe that the fact that Russia lost its *waqf* culture, which existed before the revolution, is rather positive than negative. Contemporary Tatar historians often recall the experience of using *waqfs* in the Volga region in mid-nineteenth century⁶. However, the fact that a substantial part of these *waqfs* functioned in violation of a fundamental Islamic law on prohibition of usury is omitted. A large part of *waqfs* in the Volga region were the results of usurious operations! That means that Russian Muslims, instead of restoring *waqfs*, questionable from the point of view of Shari'ah law, have a chance to set up new *waqfs*, capable of coping with the challenges of the twenty-first century, one of which still is the demand of small and medium Muslim enterprises for financing.

A lot has been written recently on the increased necessity of using *waqf* in various Islamic financial institutions. However, so far there has been little progress.

Council of the Islamic law academy in Jeddah during its sessions has discussed different possibilities of turning to *waqfs* under modern conditions, in particular:

— establishing a joint venture with statutory fund comprising real estate of the existing *waqf* and private capital with which its owners want to set up a new *waqf*;

— transferring real estate of the existing *waqf* as the main equity to the individual who wants to set up new *waqf* by investing his own financial resources and receiving part of the revenue;

— restoring *waqf* through Islamic banks by signing a contract on building a real estate property (*istisna'*) and redistributing revenue from this contract;

— leasing the *waqf* based on real estate in return for goods or a minimal pay; etc⁷.

The process of creating new characteristics for the *waqf* institute in our days is inevitable. In contrast to *zakah*, *waqf* is open to a wider interpretation within specific provisions of the Quran and *Sunnah* on charity.

Since the problem of *waqfs* is mostly raised by Muslim clerics and people associated with them, *waqf* in modern Russia is usually associated with religious *waqfs*, not the philanthropic ones.

One of the leading contemporary *waqf* specialists Monzer Kahf divides *waqfs* into the following categories: philanthropic, religious (mosques, graves of the religious leaders, grave-stones, etc.⁸) and private. At the same time, *waqf* of any of the three groups can be direct or secondary. In the first case *waqfs* directly perform their charitable, religious or social role: e.g. a well transferred into *waqf* is a free source of water for everybody. In case of the secondary *waqf* material objects or revenue from them are initially invested in various spheres and only afterwards the revenues from these investments are donated for charity purposes. An example of secondary *waqf* is cash *waqf*.

We think that in modern Russia direct *waqfs* are practically ignored, while they are in fact an example of non-targeted help to the impoverished. Even when we talk about a *waqf* in the form of a public library, given the high prices for books, this library may practically be the only source for the poor to increase their social status by increasing their knowledge.

As is known, revenues from *waqfs* as well as from *zakah* and *sadaqah* can be transferred gratis to those, who are not capable of providing themselves (children, disabled, etc.) as well as to those, who are in temporary need of resources, including resources for implementing specific projects.

An example of successful combination of targeted help to individuals who are not able to provide for themselves and to those in need of resources for implementing their projects is the Mardjani Foundation⁹. The activities of the Foundation can be nominally divided into two general directions: providing help to the needy, first and foremost children, and supporting scientific and educational programs.

Mardjani Foundation, founded in December 2006 in Moscow, provides gratis aid for children who need medical treatment, funds children art exhibitions and concert programs. Educational and scientific programs of the Foundation include grants for scientific research. Foundation sponsors publishing of academic literature on various aspects of Islamic studies. Foundation also sponsors an Islamic studies public library open for everybody.

Therefore, Mardjani Foundation manages to combine pure charity with sponsorship of art and scientific and literary projects.

Mardjani Foundation can hardly be classified as a *waqf* by classical Islamic law. However, if the modern interpretation of *waqf* is used, where Iranian *bonyads* and some other charity funds are considered a modern kind of *waqfs*, then Mardjani Foundation de facto in some respects functions as a charity *waqf*.

And as for the *waqfs* that put their primary goal in receiving revenues, we do not believe there is need to invent the already existing practices anew, the experience of Western states, where *waqf* and *quasiwaqf* enterprises effectively function, can be borrowed. The managing organization, specializing on managing *waqf* property plays the role of a collective *mutawillis*. One of the most renowned examples that can be successfully implemented in Russia is Islamic Relief¹⁰. Any volunteer may participate in the *waqf* – it costs 890 pounds as a lump sum or in installments. Upon receiving the whole sum of money the organization sends a thank-you letter and a receipt to the donor. No later than six weeks after that the received money is invested and the donor receives a document stating that his money has been placed in management of Islamic Relief.

The donor has the right to choose any of the 8 projects, managed by Islamic relief: common *waqf*, educational *waqf*, *waqf* for orphans, etc. Upon the subtraction of the commission of 10%, the rest of the sum is invested. At the end of the year the revenue received from the invested money of the donor is divided in the following way: 80% go into the project of donor's choice; 10% are administrative fees, that is revenue for Islamic Relief as the manager of *waqf*; the remaining 10% will be reinvested in order to increase capitalization and alleviate the results of inflation. All

donors annually receive an account statement on managing of their parts in the *waqf*.

However, although the main goal of the Russian *ummah* lies in developing charity *waqfs*, the philanthropic enterprises that want to provide various services and not generate revenue should not be left unnoticed. It is hard to deny the importance for Muslim people of a *waqf* in the form of a public library, where besides access to books the visitors can enjoy free access to the Internet, including access to scientific and other articles on various aspects of Muslim faith.

For example, there was a tradition to transfer handwritten books into *waqf* in the Bukhara khanate and in Fergana. Thus the donors of the manuscripts pursued several goals: to preserve the manuscript from being lost or destroyed and to make it accessible to a wide audience. The founder of such *waqf* could set a condition that the book has to be read every day¹¹.

Waqf institute can prove to be effective in the sphere of helping Muslim migrants to Russia to adapt. It is common knowledge that there is a large amount of migrants from the Central Asia working in Russia. For example, according to some sources from 500 000 to 1 million Tajik citizens temporarily live and work in Russia. The majority of them does not speak proper Russian, does not know the basic information on the country, the basic Russian laws, etc. It is the migrants from former Soviet republics, who are most actively involved in developing small and medium enterprises. Increasing their knowledge will undoubtedly facilitate the increase of effectiveness of their businesses.

In order to help Muslims from other countries adapt to Russian environment it is necessary to set up a non-governmental center, where migrants could study the Russian language, Russian legislation, even master a new profession. It is even possible to pay stipends to the needy Muslim students from the funds of this quasi*waqf*. The center can be set up either by one legal entity or by a number of individuals.

The real support to small and medium enterprises belonging to Muslims in Moscow and in other regions of Russia is provided by their fellow believers. In this way, given the high rent prices for commercial real estate, some owners or renters of the buildings provide them to the small and medium enterprises gratis. Specifically, there were known cases when publishers, specializing in publishing Islamic literature, were given offices to sell books and other printed matters for free. Moreover, these premises can be used for an extended period of time. Statistics on these kinds of activities is hard to find since businessmen try not to make it public.

In other words, help for small and medium enterprises does not have to take

the form of cash money, but can also be contained in substantial decrease of the expenses for them. In this respect information and consultancy services financed through a *waqf* or *quasiwaqf* can also be priceless.

As far as financing of Muslim Religious Boards and mosques is concerned, up to now the most effective sources of financing Muslim religious organizations in Russia are *sadaqah* and partly *zakah*, not *waqf*.

Zakah

It is not accidental that the Muslim Religious Boards in Russia promote federal legislative amendments regarding *waqf* and almost ignore the issue of *zakah* while the latter could be a part of a federal religious tax like the one in Germany.

The lack of interest in *zakah* of the Muslim clergymen is logical. As distinct from *waqf*, *zakah* is not a universal instrument designed to cover the expenses of religious organizations. Most theologians, for example, are convinced that the money received as a purifying tax should not be used to build mosques in places where there are enough of them. They believe that the state (obviously, the Muslim state) should shoulder these expenses. In a non-Muslim state, likewise, it is undesirable to spend the larger part of *zakah* on the same things. *Zakah* can be used, however, to fund education, publishing, and other activities designed to promote religious knowledge among the Muslims.

For example a considerable part of expenses of the business owned by Rustam Suleymanov – the president and one of the founders of the Mardjani Foundation – goes to the financing of the Mardjani Publishing House which specializes in Muslim academic publications written by Russian scholars.

As for the culture of *zakah* in Russia, it was also lost during the Soviet rule as the culture of *waqf*. However, during the first years of Soviet power in Russia *zakah* was collected in places with predominantly Muslim populations (the Volga area, Northern Caucasus, Central Asia) and was used to buy implements for collective farms. Yet, during the following years *zakah* was not collected in the areas of compact settlement of Muslims. It was replaced by irregular *sadaqah* paid by devout Muslims on the days of religious holidays.

Sooner or later the Russian Muslims would inevitably come across the issue of *zakah* since – unlike *waqf* – it is one of the five pillars of Islam. Since February 2005, two banks, Ak-Bars and Tatfondbank, have been receiving, *zakah* payments from

the Muslims of Tatarstan; it seems that they work as intermediaries. It should be said that the money received is unlikely to be used as effectively as in some of the Muslim states. For example, the Nasser Social Bank of Egypt not only distributes *zakah* money among the needy, but also helps buy labor implements (mainly in the countryside) and buys agricultural products from peasants at market prices, thus helping them evolve from receivers to donors. In such conditions the purifying tax indeed functions as an effective means to fight poverty.

In some regions of the Russian Federation, the Islamic clergymen are trying to use other religious taxes, although it is not always sure of their original meaning in the Shari'ah. In some districts of Tatarstan (Baltasinskiy, Arskiy; etc.), imams ask collective farm chairmen to donate potatoes for the students of Muslim religious establishments¹². This should be described as the collection of *sadaqah*, a charitable donation paid once in a while, not *'ushr* called *gyshar* (*gyshyr*) in Tatarstan, which is a tithe.

It's another matter if *zakah* paid by Muslim businessmen will be paid in the form of an interest-free loan given to those collective farms or individual farmers under the condition that they should provide the needy with food instead of paying back the principal of the loan – in other words, to provide those who belong to at least one of eight categories of *zakah* recipients.

The *zakah* culture is very slow to strike root in Russia because the local Muslims know next to nothing about it. The above example shows that most of the faithful do not distinguish between *zakah* and other Islamic charities. So far, the clergy has failed to deal with this ignorance. Several years ago the imam of a mosque in Maykop (Adigey Republic) set up two boxes - one for *zakah*, the other for *sadaqah* - only to remove them after a while because the believers could not distinguish between them¹³.

However confusion of *zakah* and *sadaqah* is half the trouble. In Moscow regular payments of Muslims that cover administrative expenses of local communities are often called *zakah*. It is obvious that the leaders of those communities deliberately seek to sacralize the membership dues collected for the community's needs and attach a "special" status to them. From our point of view such tricks are rather improper. The believers see that the money paid as *zakah* does not go to those categories that were indicated in the Quran, and consequently they lose trust to *zakah* as an institution that contributes to effective redistribution of wealth in society for the benefit of its needy members.

Abuses are inevitable while redistributing the part of the purifying tax that is supposed to go to the collectors of *zakah*. Often their share goes up to 30% of the redistributed *zakah*.

In recent years in Russia paying such Muslim tax as *zakah al-fitr* has been observed. Some Muslim peoples of Russia (e.g. Adygs and Kabardin) distribute *zakah al-fitr* even before the end of fasting. At the same time paying *zakah al-fitr* is regulated not only by Muslim law, but by local customs as well. There was a case, when one of the women in *aul* Hatukai (Adygei Republic) while calculating *zakah al-fitr* included not just her children among those for whom she should pay the tax, but her cows as well, saying that they are also living creatures and she should pay alms for them as well. In another Adygei *aul* Koshehabl *zakah al-fitr* was distributed mostly among relatives and close friends of the payer¹⁴.

Unfortunately, it is the local superstitions and prejudices rather than conscious necessity to follow one of the five pillars of Islam that form the basis of paying irregular alms by many Muslims in Russia. For example, in the Northern Caucasus they pay *sadaqah* for deceased relatives if the payer saw them in night dreams¹⁵.

Given that there is no centralized *zakah* system in Russia, some regional Muslim religious administration assumed the function of collection and distribution of the purifying tax. At the same time in most mosques the clergy and believers continue to confuse *sadaqah* and *zakah*.

Karelia probably has the most positive record of collection and distribution of *zakah* in today's Russia with direct participation of the local Muslim Religious Board. In the Republic the collection and distribution of *zakah* is the responsibility of the Muslim Religious Board of the Republic of Karelia which have communities in Petrozavodsk, Kostomuksha and Kondopoga.

The success of the Karelian community in collecting and distributing *zakah* is to a large extent explained by its small population. The community members know each other as well as those who can pay *zakah* and those who are in need. Consequently, the Muslim Religious Board of the Republic of Karelia fulfills rather technical task of collecting and distributing the purifying tax. It is also important that the mufti of the Republic of Karelia places emphasis to the necessity to pay *zakah* in his sermons, publications and public speeches.

Today it is too early to talk about establishment of a centralized all-Russia *zakah* collection and distribution system under the aegis of the Council of Muftis or other Muslim coordination structures given the absence of a Muslim Religious Board

that would be common for all the Muslims. The first step on this path should be improvement of the database of those who receive the purifying tax. Moreover, it is necessary to spread the use of modern technologies. For example, in 2005 the Russian web-site takafol.ru – the first Russian Internet resource about Islamic economy and finance – launched the Russian-language *zakah*-calculator that is the only one in the country.

Given the imperfect system of *zakah* collection and distribution under the aegis of the Muslim Religious Boards in Russia, *zakah* for support of small and medium-sized enterprises (SME) is often replaced by non-interest loans given by wealthy businessmen – usually to those who come from their own ethnic environment. Today it is more convenient for payers of *zakah* and *sadaqah* to give money directly to those SME businessmen in need whom they know well and whom they trust, avoiding the *zakah* collection and distribution system under Muslim Religious Boards that are not always transparent.

To collect and distribute *zakah* in Russia it is not necessary to amend the legislation. Yet it is necessary to provide tax remissions for regular payers of *zakah*. Otherwise *zakah* is bound to be irregular charity payments – in other words, it will merge with *sadaqah*.

‘Halal’ UIF

In January 2008 the «BCS» management company launched “Halal” unit investment fund (UIF). The fund includes shares of the companies, whose activity does not contradict Shari’ah.

As of January, 15th, 2008 cost of net assets of the UIF has exceeded 10 million rubles and has reached 10,9 million rubles.

It is worth noting that the UIF was launched not at the most appropriate time. The beginning of 2008 was marked by the fall of stock exchange indexes. Private investors rushed to the asset managing companies to buy investment fund units hoping to receive high profits when they would grow in value. However, in spring of 2008 it became already clear that the stock market has entered into a period of volatility during which a private investor can hardly hope to profit from investment. The fall of the stock markets in the end of summer that year made investments into unit investment funds highly loss making.

However, even during the first half of 2008 when the quotations of “Halal”

UIF were supposed to be growing along with the stock market, there was not much interest into it, even in Tatarstan despite a heavy advertising campaign there.

Part II.

ISLAMIC FINANCE IN KAZAKHSTAN

Kazakhstan banks demonstrated a strong interest in Islamic financial services since early 2000's.

The first experience of applying Islamic finance in Kazakhstan took place in 2003, when «Bank TuranAlem» (BTA) in Kazakhstan got the first loan on a *murabahah* basis, which was fully compliant with Shari'ah.

In total, the bank managed to obtain 250 million US dollars. In 2006, two other Kazakh banks «CenterCredit» and «Alliance Bank» also used the opportunity to receive Shari'ah-compliant loans from Islamic banks.

All projects based on Islamic modes of financing are realized by BTA in cooperation with Islamic Development Bank (IDB) and Islamic banks from the Gulf region. In August 2007, BTA and IDB signed a Framework Agreement. According to this Agreement, BTA undertook to finance certain projects of small and medium-size enterprises using *istisna'* mode of financing. Furthermore, BTA and «Emirates Bank Group» signed a Memorandum of Cooperation. According to this Memorandum, BTA will assist «Emirates Bank Group» in providing Islamic financial products not only in Kazakhstan, but in the whole Commonwealth of Independent States (CIS).

Obviously, Russia can be the first country in the CIS, where BTA can try to implement its initiatives in the field of Islamic finance.

BTA holds majority stakes in two Russian banks: «Volzhsko-Kamsky» joint-stock bank and «Slavinvestbank».

The main reason for strong interest of Russian and Kazakhstan banks to Islamic banking is the problem of liquidity in both countries. Facing the lack of money Kazakhstan's banks were forced to seek sources of financing in Kazakhstan and in countries, which were not touched by the crisis of liquidity. To find financing from foreign countries turned out to be more preferable, because the money accumulated in the internal market was not enough.

In any case, banks from Kazakhstan are not going to give up the opportunity to expand into foreign markets, first of all to the neighboring Russia¹⁶.

The experts from BTA are now researching Russian market to find out whether there are possibilities for development of Islamic banking products in the Republic of Tatarstan and other regions of Russia. It is noteworthy, however, that BTA is not providing Islamic banking services in Kazakhstan yet.

At present time, in Kazakhstan a new bill «On amendments and additions to certain legislative acts of the Republic of Kazakhstan concerning organization and operations of Islamic banks and Islamic financing» was passed by the country's parliament. According to the bill, a considerable amount of amendments to the Civil Code, the Banking Activity Act, the Tax Code and some other acts should be made.

Under the bill an Islamic bank is “a bank of the second level¹⁷ that carries out banking activity in compliance with Islamic principles of financing ... on the basis of a license issued by an authorized body” (Article 1.2.2 of the bill).

It is noted that Islamic banks do not participate in the compulsory deposit insurance system and that deposits in an Islamic bank are not guaranteed (Article 1.2.2).

Unlike in Russia, Turkey and some other countries where Islamic banks have to refrain from making a show of their Islamic nature, the bill adopted by the Kazakhstan parliament explicitly provides that an Islamic bank must have the words “Islamic bank” in its legal name (Article 1.2.6).

The bill prescribes that Islamic banks must «explain to their clients peculiarities of banking activities in compliance with Islamic principles of financing» (Article 1.2.10). The bank that fails to comply with this requirement may lose its license.

In the bill the terms of different Islamic modes of financing such as *murabahah*, *musharakah*, *ijara* etc. are provided for by reference to analogous civil law contract (e.g., *murabaha* - commercial credit; *ijara* – leasing; *musharaka* –partnership agreement) which terms apply to a particular Islamic mode of financing if not otherwise provided in the bill.

Passing this law will provide more favorable conditions not only for those banks that want to turn into Islamic, but also for conventional banks which want to attract money from foreign Islamic banks. On 18 May 2008, the President of Kazakhstan N. Nazarbaev announced the plan to establish joint Qatar-Kazakhstan bank – “Bank of Islamic Financing”.

At the same time, even after establishing Islamic banks in Kazakhstan conventional banks in the country will continue lending money from IDB and foreign

Islamic banks. External lending, including from Islamic banks which often provide financing on more favorable terms than conventional banks do, is likely to continue because of liquidity problems that banks in Kazakhstan and Russia are now facing.

Moreover, the cooperation with the IDB in investment projects and in trade financing will help to realize the plans of Kazakhstan to become one of the 50 most competitive countries in the world.

At present time, the possibility of issuing Islamic securities nominated in tenge is also being studied. Kazakhstan has all chances to become the second country in the world after Malaysia to issue Islamic securities nominated in national currency. The main problem on the way of this project is the undeveloped capital market in Kazakhstan.

As to Islamic insurance, BTA Life, a subsidiary of BTA bank, is now studying the perspectives of offering Islamic insurance products along with their conventional insurance products.

In our opinion, the success of most projects concerning implementation of Islamic modes of financing into conventional banking systems of different CIS countries is, in fact, very dependant on cooperation of Kazakh banks (first of all BTA and its subsidiaries) with Islamic Development Bank and other Islamic financial institutions.

Part III.

ISLAMIC FINANCE IN KYRGYZSTAN

In April 2006, in conversation with the author, the Advisor to the President of Kyrgyzstan, the Managing Director representing Kyrgyzstan in the Islamic Development Bank (IDB), S.M. Murtazaliev spoke in earnest about the plans to Islamize Kirghiz financial sector. At that time, such a statement sounded like a sensation. Despite the fact that Muslims constitute 84 per cent. of Kyrgyzstan's population, the majority of them are not as strong in following Islamic rites as Muslims in neighboring Uzbekistan and Tajikistan are. The lack of demand for banking services among Kyrgyzstan's population is a result of a low level of financial culture rather than a sign of their ethical economic behavior.

Nevertheless, the words of S.M. Murtazaliev about implementation of Islamic banking principles in Kirghiz banking sector were not merely good expectancies. On

16 May 2006, a memorandum of understanding (MOU) between Kyrgyz Republic, an open joint-stock company “Ekobank” and the IDB was signed¹⁸. The MOU sets forth mechanism of cooperation between Kyrgyz Republic and the IDB in implementing Islamic banking principles in the country.

According to Article II of the MOU it is planned that the implementation of Islamic modes of financing will be involve four stages.

The first stage includes establishment of a managing committee that will put the articles of the MOU into practice, study of the current banking legislation with a view to make necessary amendments, establishment by “Ekobank” of a special Islamic banking subsidiary and some other steps.

At the second stage recapitalization of “Ekobank” is contemplated whereby every party involved in the project, including the Government of Kyrgyz Republic, the IDB and other financial institutions from countries that are members of the IDB, can subscribe for the bank’s shares.

The third stage is dedicated to adoption of necessary amendments to the legislation of Kyrgyz Republic to facilitate development of Islamic banking industry in the country. The authors of the MOU stress their intention to provide in Kyrgyz Republic equal possibilities for both conventional financial sector and an Islamic one.

The fourth stage envisages conversion of Bishkek (the capital of Kyrgyz Republic) into the center of Islamic financial services in the Central Asian region.

On 12 July 2006, two months later after the MOU had been signed, the President of Kyrgyzstan K. Bakiev signed Order No. 373 «On the Pilot Project Dedicated to Implementation of Islamic Principles of Financing in Kyrgyz Republic». According to the Order Islamic financing should be developed along with conventional financing. This means that Kyrgyzstan has chosen in favor of the dual model of Islamic economy. All the banks incorporated in the country may choose between continuing conventional business or converting their operations into Islamic.

The pilot project for implementing Islamic banking principles in Kyrgyzstan is limited to one subsidiary of “Ekobank” in Bishkek. This subsidiary is de-facto like an Islamic “window” within a conventional bank. The state is not a shareholder of “Ekobank”. However, the management of “Ekobank” is in good quarters with the country’s President and Government. It is well-known that it is the key factor for success in a region like the Central Asia.

In July 2007, the President of Kyrgyz Republic K.Bakiev and the President of the IDB Ahmad Muhammad ‘Ali attended the official ceremony of opening the Islamic

“window” in “Ekobank”.

Since May 2008, both legal entities and individuals can open a savings account in “Ekobank” which is based on qard hasan mode of financing. No interest accrues on the account balance. “Ekobank” plans to start accumulating deposits from individuals based on amana and dhaman modes.

Despite certain expected difficulties we can be quite optimistic about the future of Islamic banking in Kyrgyzstan, because this project is supported by the President of the country.

Nevertheless one can hardly expect that Islamic banking activity will become a common practice among Kyrgyzstan’s banks. The more likely scenario is that Islamic banking services will be provided by conventional commercial banks through Islamic “windows”. Now a group of experts is working on amendments to the banking legislation. It is expected that once the amendments have been passed by the Parliament. Islamic banks and Islamic banking “windows” will be able to provide a wide range of Shari’ah-compliant banking services.

It is also hard to believe that the management of “Ekobank” can realize its intention to provide Islamic banking services in other states, including Kazakhstan and Russia. The bank has no resources to do it¹⁹.

As to other Islamic financial institutions nowadays, it is too early to discuss its perspectives in Kyrgyzstan.

Part IV.

ISLAMIC FINANCE IN AZERBAIJAN

Like many other former republics of the USSR, for a few years after the October Revolution of 1917 Azerbaijan was an independent state. Azerbaijanis are proud that the Azerbaijani Democratic Republic (ADR), declared in 1918, became the first secular state in the region, a few years prior to abolition of caliphate in Turkey. At that time, the ADR was a classic parliamentary republic.

The modern Republic of Azerbaijan, which gained independence in 1991 after the demise of the USSR, adopted ADR’s flag, the national emblem and the anthem, as well as the policy of secularism, which meant minimization of Islamic influence in the public and political life of the country. ADR’s ideology was based on the views of founders of the Musavat Party (‘musavat’ is translated as equality), who believed that

religion should be separate from the state. Interestingly, today's Musavat Party, which considers itself the successor of original Musavat movement of early 1900s, is in the opposition to the current Azerbaijani government, despite the mutual support of secularism.

Analysing the role of Islam in Azerbaijan today, it is important to remember that at the time of ADR's emergence, Musavat's opposition, an Islamist party called Ittihad (Arabic word for 'alliance, union') was against the creation of ADR. The ideologists of Ittihad were true pan-Islamists and therefore were calling for the unification of all Muslim nations of the Russian Empire and against the concept of the national state of Azerbaijanis, or 'Transcaucasian Tatars', as they were often referred to in those days. So, the leaders of Ittihad felt there was no other option but to support the Soviet regime as the only power, in their opinion, capable of uniting the Muslims of the fallen apart Russian Empire.

So, the idea of national statehood in Azerbaijan is closely connected with secularism and anti-clericalism rather than with Islam and religious values. The religious observance of Muslims residing in the country is relatively low and Muslim identity tends to be based more on culture and ethnicity rather than religion. Even hardcore Azerbaijani nationalists admit that over 70 years of imposed atheism during the Soviet era strengthened the foundation of the country's national identity.

Nevertheless, starting from the early 1990s the number of mosques across Azerbaijan has risen dramatically. Many were built with the support of other Muslim states, such as Iran, Oman and Saudi Arabia. A Muslim seminary was also established during that period. In the last five years or so, local imams have reported increased attendance at mosques, especially among the younger generation. However, Islam does not yet play a major role in the country's social and political life. The key partner of modern Azerbaijan is Turkey, which advocates the principles of secularism, and not its other neighbor, Iran, despite the fact that the overwhelming majority of Azerbaijani and Iranian Muslims share the same denomination of Islam – Shi'a.

A handful of initiatives to amend the Azerbaijan's banking legislation to accommodate Islamic banks and facilitate their development are still by and large blocked by the regulatory bodies on the grounds of the constitutions that proclaims Azerbaijan a 'democratic, constitutional, secular and unitary republic', and asserts the separation of religion and state as well as the equality of all religions before the law.

However, with the forthcoming sweeping reforms of Azerbaijan's financial sector and the need for investment in the economy, there are expectations of the shift in

the regulators' politics (particularly of the central bank, National Bank of Azerbaijan) towards Shari'ah-compliant banking and finance.

The banking sector of Azerbaijan is characterized, above all, by a low level of transparency and a lack of capital (although the current economic upturn has spurred notable growth of the banking market, quadrupling the assets of domestic banks in the last three years). State-owned financial institutions dominate the market, but are gradually losing ground to the emerging commercial banking segment.

Since Azerbaijan is a country with a traditional banking system, Islamic banks do not have a special status or fall under a separate category. The first and the only Shari'ah-compliant bank in the country "Kauthar Bank", is considered to be a conventional bank according to the official documents. Nevertheless, it is probably safe to say that "Kauthar" is the only fully-fledged Islamic bank in the post-Soviet space, though "Ekobank" in Kyrgyzstan has an Islamic "window" and in Kazakhstan, a standalone Islamic bank is currently a work in progress.

"Kauthar" is one of the first non-state banks in Azerbaijan. It obtained a licence back in 1988 and until September 2001 was known as Universal Bank. A year later the bank obtained a new banking licence to carry out the full range of banking operations, and around the same time, it started to cleanse its loans and debt portfolios of *riba*. It also ceased participating in all transactions that involved usury. All interest-accruing loans that had been issued prior to the bank going Islamic were sold off to a specialist company.

It is worth noting that "Kauthar" is regarded as a Shari'ah-compliant by the worldwide community. At the same time, it has only four offerings – investment accounts based on *mudarabah* (profit-and-loss sharing), loans to business based on *musharakah* (joint venture), loans for retail and corporate clients by purchase and sale of bills of exchange analogous to *sukuk* (Islamic bonds), and consumer loans based on *ijara wa iqtina'* (leasing and subsequent purchase). Due to restrictions on banks' trading activity stipulated in the Azerbaijani legislation, "Kauthar" cannot base any of its operations on the *murabahah* principle (the bank buys and sells the items required by the customer).

Not being able to use some of the Islamic finance instruments, "Kauthar" fulfils its potential in financing *halal* sectors of economy, although not always with a desired outcome. A good example is a multi-million dollar project of constructing several skyscrapers in Baku. In 2004, the bank signed an agreement with ICD (Corporation for the Development of the Private Sector, a member of Islamic

Development Bank (IDB) group). According to this agreement, ICD was going to finance the bulk of the project. Kauthar's assets and one of the multi-storey buildings was the guarantee. The same year, ICD purchased a shareholding stake in the bank.

The project remained at a standstill for a long time due to the developers' main stipulation requiring financing of the entire construction project. In due course, a number of significant changes were made to the plans, such as building four 24-storey structures instead of two 45-storey ones.

Then it was decided to create a complex of two 39-storey buildings with a gross floor area of 170 thousand square metres. The last option attracted \$ 300 million from some Korean investors (conventional banks). In the end, the participation of "Kauthar" in the project was no longer a need for ICD's investment.

The entire complex is going to be rented out as offices and apartments. The project is managed by a local firm, Baku Pride, set up by the Korean investors with minimal input from the Azerbaijani partner (close to Kauthar's management).

Nevertheless, it seems that at present it is precisely the Shari'ah-compliant investment business that is the best option for unlocking the Islamic finance potential in Azerbaijan (as opposed to expanding the range of Islamic banking products and services). And the recent flurry of activity in this area seems to substantiate the point. One of the notable ventures is the launch of "Caspian International Investment Corporation" (CIIC), which operates according to Shari'ah principles. CIIC was established in June this year as a result of an arrangement signed at the International Investment Conference in Baku in 2006, a high profile event organized by the IDB.

ICD has a 75 per cent stake in the company, with the remaining 25 per cent owned by a domestic investment firm, "Azerbaijan Investment Company" (AIC). The main objective of the CIIC is to attract foreign investment to Azerbaijan and gain a strong foothold in the international market. It is expected that in the next two years the capital of the CIIC will increase many fold to reach \$ 70 million from a current \$ 4 million.

The corporation's investment activity will kick off with financing logistics projects, although other favourable spheres are also being analysed. The priority segments include agriculture, the pharmaceutical industry, the building materials industry and the service sector.

Overall, ICD and its parent, IDB, show a great deal of interest in Azerbaijan. In addition partnership with AIC and "Kauthar", the group has issued a number of credit lines for SME financing to another domestic bank, "Rabitabank". "International

Bank of Azerbaijan” and “Unibank” also received loans from ICD. Most recently, in September, a similar agreement was signed with “Azerdemiryolbank”, securing a \$ 3 million credit line for SME development in agricultural, bio-technology, multimedia, telecommunications and transport sectors. Both parties emphasize that none of the financing will be directed at spheres prohibited by Shari’ah. Two other domestic banks, “Bank Standard” and “TuranBank”, also talks with ICD about possible cooperation.

IDB group is not the only Islamic financial institution investing in Azerbaijan (although to date, it is the largest Shari’ah-compliant investor, having contributed around \$ 300 million). In May last year, “Kuwait Finance House” (KFH) and AIC signed a memorandum of understanding, according to which a company similar to CIIC is to be established. KFH will have a majority shareholding of 75 per cent in the new entity and AIC a 25 per cent stake.

Despite not being able to set up an Islamic bank in Azerbaijan so far, IDB is not abandoning this idea. Nik Zeinal Abidin, director of IDB’s regional office in Almaty, Kazakhstan has noted on numerous occasions that IDB is ready to provide support in establishing an Islamic bank in Azerbaijan, but the initiative has to come from the country’s government.

The lack of dedicated legislation and somewhat disapproving attitude towards the industry from the regulators, without doubts, hinder the development of the country’s Islamic banking sector. In October 2007, Bahrain-based “International Investment Bank” (IIB) purchased a 49 per cent stake in “Amrahbank”. IIB, which is a shareholder of “European Islamic Investment Bank” (EIIB) in the UK, is actively supporting the development of Islamic finance in both Muslim and non-Muslim countries.

“Amrahbank” was to be converted to a fully-fledged Shari’ah-compliant bank to size the benefits of Azerbaijan’s ‘untapped demand for Islamic banking products and services’, according to the IIB’s CEO, Aabed Al-Zeera. However, the initiative has never been put into practice due to regulatory and legislative uncertainty. To date, the Islamic banking section of Amrahbank’s website states that this type of products and services will be introduced in near future.

As for Kauthar’s Shari’ah-compliant activity, it is not being widely advertised and the information about it is mainly spread by word of mouth. Furthermore, the bank’s official documents contain hardly any Arabic terminology relating to Islamic finance. There is hardly any mention of Shari’ah principles the bank adheres to in the published information about “Kauthar”. For example, in the English version of

Kauthar's promotional literature its activity is described as 'Islamic banking', while in Azeri language version the phrase used is '*faizsiz qazanc*', which is translated as 'non-interest banking'.

Such discrepancy in terminology is not a conspiracy, but rather a sensible precaution, says Heydar Ibrahimov, chairman of "Kauthar". 'Shari'ah-compliant banking in Azerbaijan has its foes, including in the National Bank,' says Ibrahimov. 'But nevertheless, compared to Russian "Badr-Forte Bank", we are in more favourable environment.' "Badr-Forte", the only Islamic bank in Russia, had its licence revoked in late 2006 on the grounds of money laundering activity and terrorism financing. "Badr-Forte" and its chairman, Adalet Dzhabiev, are well known to "Kauthar" and Ibrahimov. Back in 2002, when nothing seemed to threaten Badr-Forte's existence, Dzhabiev consulted Kauthar's management on applying Islamic finance methods. The two banks have, indeed, a lot in common. Similar to "Kauthar", "Badr-Forte" was restricted in applying Islamic principles. The central bank not only refused to make any concessions for Badr-Forte's specifics (for example, a mandatory deposit insurance scheme introduced by the Central Bank of Russia was a huge stumbling-block for the bank), but also demonstrated excessive regulatory pressure towards every aspect of the bank's activity. All this resulted in Badr-Forte eventually losing its licence.

In their reluctance to accommodate Islamic finance, both Russian and Azerbaijani regulators consistently refer to the constitution and the secular foundation of the state, as well as absence of the necessary regulatory control over banking activity based on Shari'ah principles.

However, to be fair, Kauthar's management is in no rush to advertise its Shari'ah-compliant products, and not just for political reasons. 'The information about our bank gets about through the system of social networks', observes Ibrahimov. 'In other words, "Kauthar Bank" adheres to Know Your Customer (KYC) principles by more than 100 per cent. Our clients are religious people and understand that according to Shari'ah, we cannot guarantee them fixed profit. Our customers know and trust us and we, in our turn, know that they are prepared to accept profit as well as loss. They realise that *mudarabah* is not a guaranteed income. But if we advertise widely in the mass media, we'll gain clients that we don't know and who might not be aware of the specifics of Islamic banking. And we won't feel comfortable if we can't provide them with the same level of profit as a conventional bank'.

As a result of such caution within Kauthar's management, many Muslims in Baku have an idea that an Islamic bank has been operating in the country for over five

years now.

And what about Islamic insurance (*takaful*), is there a market for it in Azerbaijan? The potential is there. However, at present, the country's overall insurance sector is underdeveloped, constituting only one per cent of GDP (gross domestic product). There are 28 insurance companies and seven insurance brokers, as well as one reinsurance firm operating in Azerbaijan today, but so far none of them have expressed interest in *takaful*.

The issue is complicated by the new insurance legislation (compliant with the key principles of the International Association of Insurance Supervisors, IAIS) that came into effect in Azerbaijan in March 2008. This regulatory act does not cater for the specifics of *takaful*, and it seems that the same omission has been made in preparing another law on compulsory insurance, drawn up by the Ministry of Finance with the assistance from "Lawrie Savage & Associates", a Canadian law firm. Development of *takaful* is also hampered by the deficiency of effective instruments that would enable Shari'ah-compliant investment of actuarial reserves.

A lack of an insurance culture in Azerbaijan is not to the benefit of *takaful* either. There is widespread mistrust from the population towards long term investments such as insurance and as a result life insurance represents just over one per cent of insurance premiums. Nevertheless, Ibrahimov states that despite the obstacles *takaful* is a high priority task for "Kauthar".

Needless to say that the future of Islamic banking and insurance in Azerbaijan depends not only on the politicians and regulators, but on the country's Muslims as a whole. And the word of mouth spreading by the system of social networks that "Kauthar" extensively relies on is clearly not enough. The demand for Shari'ah-compliant products and services can appear and flourish only when the population of Azerbaijan has access to comprehensive information about the industry.

¹ Salikhov, R (2005), "Kak vozrodit blagotvoritel'nost'?" ("How to revive charity?"), *Tatarskiy mir*, No. 1 (54), P. 3

² It seems that in Russia today the Muslim clergy does not object to usury operations when administering *waqf*. The draft amendments to the Law on the Freedom of Conscience and Religious Associations offered by the Muslim Religious Board of Republic of Tatarstan and related to *waqf* property said, in part: «*Waqf* can include any property, be it a plot of land, building, structure, or other real estate, the right to use any securities, as well as jewelry, books, and other movable property in the Republic of Tatarstan and outside it» (*Dokumental'nye materialy o deiatel'nosti Dukhovnogo upravlenia musul'man Respubliki Tatarstan v period s 14.02.1998 po 14.02.1999* (1999), Kazan, P. 20). The fact that all types of securities are related to property that can be transferred to *waqf* violates the Quranic ban

on usury.

³ Kemper M. (2004), *Musul'manskaia etika i 'dukh kapitalizma'* (Islamic ethics and the spirit of capitalism), *Islamskie finansy v sovremennom mire: ekonomicheskie i pravovye aspekty* (Islamic finance in the modern world: economic and legal aspects), Moscow: Ummah, P. 41.

⁴ Çizakça, M. A. (1998), "Waqf in History and Its Implications for Modern Islamic Economics", *Islamic Economic Studies*, Vol. 6, No. 1, P. 60.

⁵ Pakistan's experience, where a special law on *mudarabah* companies was adopted, demonstrated that this practice did not become widespread. In any case, it is doubtful that this recommendation can be implemented in countries like Russia, where there are problems with legal definition of the status of Islamic financial institutions.

⁶ Habutdinov A. "Rossiyskie waqfy: tradicii i puti razvitiya" ("Russian waqfs: traditions and directions of development") // <http://sovetulemov.ru/ramazan.php?sid=3157>

⁷ *Decrees and recommendations of the Council of Islamic law academy – fatwas* (2003), Moscow: Ladomir, P. 78.

⁸ For example, donations for maintaining the grave of a saint can be used by his relatives, who keep up the grave.

⁹ For more information on Mardjani Foundation see the website: www.mardjani.ru

¹⁰ Islamic Relief — an international non-governmental organization, founded in 1984 in Birmingham (Great Britain). The organization has offices in 25 countries and conducts its activities in over 30 countries, both Muslim and not.

¹¹ Molchanov, A.A. (1940), "Characterizing the tax system in Heart in the times of Ali-Shir Nava'i", *Founder of the Uzbek literature. Collection of article on Ali-Shir Nava'i*, Tashkent, P. 164.

¹² Zalialetdinov M. (2004), "Razvitie sistemy waqufov v Rossii" ("Development of waqf system in Russia"), *Islamskie finansovye otnoshenia i perspektivy ikh osushchestvleniya v rossiyskom musul'manskom soobshchestve*, P. 69.

¹³ Yarlykapov, A. A. (2004), "Religioznoe povedenie" ("Religious behavior"), *Islam i pravo v Rossii* (Islam and law in Russia), Issue 3, P. 58.

¹⁴ Yarlykapov A.A. (2006), "Narodny Islam i musul'manskaya molodezh' Central'nogo i Severo-Zapadnogo Kavkaza" ("Peoples Islam" and the Muslim youth in the Central and North-Western Caucasus"), *Etnographicheskoe obozrenie* (Ethnographic review), No. 2 // <http://www.i-r-p.ru/page/stream-exchange/index-5960.html>

¹⁵ Ibid.

¹⁶ In recent years Kazakh banks used almost one quarter of the accumulated funds to finance expansion into neighboring markets. (Analiz riskov bankovskogo sektora Respubliki Kazakhstan (Analysis of risks in the banking sector of Kazakhstan Republic, a survey prepared by Standard & Poors) // <http://www.standardandpoors.ru/article.php?pubid=2501&sec=pr>)

¹⁷ The Banks and Banking Activity Act of the Republic of Kazakhstan provides that «all other banks comprise the bottom (second) level of the banking system, except for the Bank for Development of Kazakhstan which has a special legal status which is regulated by the laws of the Republic of Kazakhstan» (Article 3.3).

¹⁸ Kyrgyzstan has been a member of the IDB since 1993.

¹⁹ As of 30 November 2007 the bank's assets amounted to 1 211 380 thousand soms (USD 29 799 948).