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ISLAMIC BANKING IN RUSSIA: INSTITUTIONALIZATION,
PROBLEMS, PROSPECTS

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Abstract

Features of the Islamic banking development in contemporary Russia are considered in the paper. The relevance of the research is determined by the growing significance of Islamic financial institutions (IFI) in the global economy. The interaction of Islamic banking with the traditional Western model of financial and credit activities is a popular topic for international scientific discussions. The formation problem of financial banking in Russia has found only partial reflection in the scientific literature to date and requires further study. The authors have set the task of identifying the system key parameters of Islamic financial institutions in Russia, and the most essential factors and prospects for their growth. The research hypothesis is that Islamic banking has great development prospects in Russia. The research was carried out on the basis of the data revealed by the authors on the creation and operation of Islamic financial institutions in Russia using invent-analysis and expert assessments of the development of international Islamic banking. The novelty of the paper is determined by the comprehensively introduced information about Islamic banking in Russia including the regions of its greatest prevalence such as the Republic of Tatarstan, the Chechen Republic, and the Republic of Bashkortostan. The paper focuses on the state policy and regulatory activities of the Central Bank of Russia in relation to Islamic financial structures. The research outcomes confirm the hypothesis about favorable prospects for the development of Islamic banking in Russia and its integration into the system of the Eurasian financial market.

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1. Introduction

Islamic banking occupies a significant position in the current global financial system. The main Islamic banking markets are in Egypt, Saudi Arabia, Malaysia, UAE, Qatar, Kuwait, Indonesia, Turkey, Pakistan, and Bahrain. Islamic banking is dynamically developing in the European Union system, and particularly in Great Britain where, along with Islamic banks, there are specialized Islamic windows in ordinary banks (Citibank, Barclays and etc.), through which halal operational activities can be carried out (Alharbi, 2016; Sobol, 2015). According to data of 2019, Islamic financial institutions including 428 commercial banks have been established in 105 countries. The total volume of Islamic financial assets has reached about 2 trillion dollars showing a steady upward trend (Puri-Mirza, 2021).

Islamic banking is an ancient financial phenomenon built on ethical and organizational principles which are sourced from the Quran (Abdul-Rahman, 2010). The main principle of Islamic banking is such an approach when the remuneration of the bank or a depositor is not initially guaranteed but occurs as derivatives of the invested business profit. Accordingly, the Islamic ethics of investment contributes to the development of the economy real sector and the enhancement of business culture. Thus, Geoffrey Grosh emphasizes that the emergence of Islamic banking in Central Asian countries contributed to their economic liberalization and access to global markets (Grosh, 2008). Despite certain difficulties in integrating European and Islamic banking models, it is obvious that this process is one of the most significant global trends in the 21st century (Di et al., 2013). It is shown below that contemporary Russia is one of the emerging centers of attraction for the Islamic financial world.

2. Problem Statement

The integration process of the Russian banking system into the global financial and economic space of the 21st century is currently taking place. Investment cooperation with the countries of the Arab world – Saudi Arabia, the United Arab Emirates, Oman, Kuwait, as well as Iran belonging to the Islamic civilization, is a considerable area of interbank interaction. An insufficiently explored issue of the formation of Islamic banking institutions in Russia is of significant scientific interest in the context of world and regional financial processes, and an aspect of global civilizational development.

3. Research Questions

The research subject is Islamic financial institutions in Russia, their typology, legal, and social activity conditions.

4. Purpose of the Study

The purpose of the study is to identify the features and prospects for the Islamic banking development in contemporary Russia.

5. Research Methods

The research is carried out on the basis of a systematic approach using invent-analysis, content analysis, and the method of expert assessments.

6. Findings

The active development of Islamic banking began in 1975, when the Islamic Development Bank and Dubai Islamic Bank were opened. World Islamic banking has various institutional forms: classical Islamic financial institutions (Islami Bank Bangladesh Limited, Meezan Bank in Pakistan, and etc.); Islamic windows in banks in Europe and the United States, as well as Islamic branches of traditional banks, for example, Citi Islamic Investment Bank in Bahrain, etc. (Zhuravlev, 2020). There are also differences in the doctrines and organization of banking in Islamic countries (Warde, 2000) which affects the process of establishing business relations between them in Russia and the countries of Eurasia.

The choice of sources and areas of capital investment, a ban on loan interest, and the distribution (rather than transfer) of risks and other regulations based on Sharia norms (Hussain et al., 2015; Warde, 2000), create potential competitive advantages of Islamic banking in the regions of Russia and post-Soviet states with predominant Muslim population (Bekkin, 2006; Grosh, 2008).

There are many models and approaches for including IFI in European banking systems in the world. Thus, the principle of “no obstacles, but no special favors” is typical for Great Britain in relation to Islamic financial institutions, and “wait and see” for Italy (Belouafi & Belabes, 2010). In both cases, leeway is given to market forces that determine the role and place of Islamic banking in specific markets under the current legislation. Further implementation of Islamic banking in Russia is associated with the development of additional legal instruments taking into account Russian specifics and world experience. There are no fundamental obstacles to the widespread introduction of financial institutions of Islamic banking into activities in modern Russian legislation. Representatives of the Bank of Russia have several times declared their readiness to develop this area of financial business. Russian regulator is restructuring a number of business models so that Muslim customers could receive banking services in accordance with Sharia law. In 2017, the first Islamic finance roadmap was developed by an expert working group of the Central Bank of the Russian Federation. The register of insurance products for Muslims was offered by the branch of the “Allianz” insurance company. At the same time, the International Association of Islamic Finance (IAIF) opened a number of its branches in the Muslim regions of Russia.

In the summer of 2017, the first sukuk object was released for the deployment in Russia. The Central Bank of the Russian Federation registered a package of Islamic bond certificates “Sukuk Invest” in the amount of 1 million rubles, and allowed the use of a floating coupon rate in accordance with the profitability of investment projects in the halal industry (Riabchenko, 2018).

In 2017, PJSC Sberbank completed its first transaction using Ijara Mudarabah (investment in a leasing company in the Republic of Tatarstan). PJSC Sberbank, together with the government of Tatarstan, established the Russian Center for Islamic Economy, whose task was to activate fintech complying with Sharia law. In 2018, PJSC Sberbank launched a pilot project to accept deposits from the

population in accordance with Sharia principles. Citizens' deposits are accepted for deposit accounts, and the issue of payment cards is planned in Tatarstan, Chechnya and Bashkiria.

Russian VEB expands partnerships with foreign financial institutions operating in accordance with the principles of Islamic banking. The crucial partner of VEB in this direction is the Islamic Development Bank with which a Memorandum on the joint development of industrial and logistics infrastructure projects, non-resource exports, and urban economies was signed in 2016.

Many investment projects based on the principles of compliance with halal technologies are of experimental nature. For instance, the Russian "Sovcombank" created a product taking into consideration the needs of Muslims, namely, the Halva Halal installment card (companies operating in accordance with Sharia norms are on the list of Halva Halal partner organizations). MKB, being not a Muslim bank, has developed a line of Islamic cards which includes three banking products at once tested by the Muftis Council Chairman of Russia, and approved for use by Muslims: 1. Simple Islamic card for everyday use; 2. Pilgrim premium card; 3. Pilgrim Cumulative Card.

The topic of the approval and development of Islamic banking in Russia receives scientific discussion at all-Russian and international economic forums, scientific and practical conferences, within the framework of specialized seminars, and etc. Since 2009 the "Russia is Islamic World" summit has been annually held in Kazan, the Republic of Tatarstan (Kalimullina, 2009). On November 29, 2019, a discussion of relevant issues on the development of Islamic banking in Russia and its prospects in economy and business was held in Ufa within the framework of the 2nd Russian Islamic Economic Forum "Russia – Expanding Opportunities." Promising opportunities for the Islamic banking development in Russia and IFI technologies integration into the banking sector of Chechnya get an expert support at the Academy of Sciences and universities of the Chechen Republic. The scientific seminar of the Center for European Studies of Islamic Financial Models in modern world operates at the Research Institute of World Economy and International Relations named after E.M. Primakov (Moscow) (Kuznetsov et al., 2017).

The first Islamic bank Badr-Forte-Bank was created in Moscow in 1991 by the efforts of the Dagestan diaspora (in 2006 its license was revoked by the Bank of Russia). Currently, PJSC "Ak Bars Bank" and the financial house Amal (Tatarstan), LP (limited partnership) "LaRiba-Finance", LP "Masraf", the Islamic window of MVS Bank – LP Saada (Dagestan) and others provide halal banking services in Russia.

The implementation of Islamic financial products including halal investments, transport, and installments for movable and immovable property is successfully evolving in Tatarstan. These services are provided by the Financial House "Amal", "Ijara Leasing", and HC "Housing Traditions." The first halal unit investment fund "Lale" registered by the Central Bank of the Russian Federation began to operate under the leadership of the management company of "AK BARS CAPITAL" (AK BARS CAPITAL, 2020). Center for Partner Banking (CPB), Eurasian Leasing Company, and Non-Profit Fund "Barakat" also function in the Republic of Tatarstan.

Kazan Islamic Ak Bars Bank, within the framework of project financing operations, carried out a deal to raise funds on Sharia principles in the amount of 60 million dollars under the murabaha contract (for a period of 1 year). Such a widescale deal with halal funds was carried out for the first time in Russia and recognized as the "Best deal in Europe in 2011" (Petrova, 2012). The received investment funds were

used to develop the transport and logistics infrastructure of the Republic of Tatarstan on the eve of the 2013 Universiade in Kazan.

The banking sector modernization program using variable adapted banking models is being implemented in the modern Chechen Republic taking into account the task of attracting foreign investment funds to the economy. The idea of applying financial instruments of Islamic banking for investing in the modernization of Chechen economy was supported by the participants of the 4th International Peace Forum “Islam is the Religion of Peace and Harmony” held in Grozny in August 2011. In January 2016, an agreement on the project development to open an Islamic bank in Grozny was achieved with Mazcorp (UAE).

Presently, the positive dynamics of financial and economic cooperation has been established between Chechnya and the United Arab Emirates (UAE) whose business takes part in investing in the pharmaceutical cluster, in the construction of large business and scientific and educational centers. Moreover, the UAE supports entrepreneurial initiatives including innovative businesses through the Fund of Sheikh Zayed (Ershov et al., 2019).

Investors from the UAE provided, in particular, financing for the construction of the multifunctional high-altitude “Akhmat Tower” complex, and also invested heavily in the construction of Grozny International University, the groundbreaking ceremony of which took place in October 2015. The project investor is the “Emaar Properties” company. In 2017, the Khalifa Investment Fund was established to finance projects in the field of small and medium-sized businesses in the Chechen Republic.

The integration of the Russian banking system into the global financial and economic space of the 21st century is taking place with the direct significant participation of the leadership of Chechnya, the complex of state power, and financial institutions of the republic. The head of the Chechen Republic Ramzan Kadyrov took part in the solemn signing of the “Declaration on Strategic Partnership between the Russian Federation and the United Arab Emirates” by the President Russia Putin and the Crown Prince of the United Arab Emirates (UAE) Sheikh Mohammed Al Nahyan on June 1, 2018 in the Kremlin. Issues of promising investment cooperation were discussed between Ramzan Kadyrov and the King of Jordan Abdullah II. Business negotiations with the financiers of the Arab world which assumed the expansion of investment cooperation with the Chechen Republic, particularly, on the basis of the Islamic banking principles, were actively carried out in 2018 declared the “Year of Investment” in the Chechen Republic. The possibilities of combining Islamic banking technologies with contemporary methods of the Russian banking system open up prospects for attracting significant halal funds from the Arab world, the Middle East and Iran to Russia and the Chechen Republic economies.

In 2011, the first Islamic Ellips Bank was opened in the Republic of Bashkortostan, the work principles and financial products of which fully comply with Sharia norms. Ellips Bank is a branch of the Moscow bank "Vostok-Capital." Modern Bashkiria is an attractive region for the Organization of Islamic Cooperation (OIC), which gives an economic activity support to banks and investment companies of countries that have built their financial systems on the basis of Sharia law. The Republic of Bashkortostan is currently creating socio-economic and technological conditions for the introduction and development of Islamic banking, the coupling of halal fintech technologies with banking models traditional for Russia. The development of the legal work of Islamic banking organizations is discussed by the expert

community (Bulatova, 2015). A number of pilot projects of Islamic banking have been developed in Bashkiria. Rustam Muratov, the Minister of Economic Development and Investment Policy of Bashkortostan, says: “In the context of global cooperation, Bashkiria is interested in cooperation with the countries of the Islamic world. Therefore, today, in the context of the need for breakthrough economic growth, certain conditions appear for the entry of Islamic investments into the economies of Bashkiria and Ufa” (Gareev, 2019).

7. Conclusion

Therefore, Islamic banking as a technological and economic phenomenon has a number of significant advantages that make IFI’s work promising in Russian financial market: Islamic financial institutions provide investment in the real economy sector, the Islamic banking model has a lower degree of riskiness in carrying out operational actions compared to the traditional one while ensuring the social orientation of financing, IFI demonstrate high resilience in a situation of global financial crises, and etc.

The institutional structure formation of Islamic banking and the formation of the halal finance market open up great opportunities for attracting investment resources to the Russian economy from countries of the Middle East and the Arab world which are ready to invest in constructive halal projects.

The development of Islamic banking in Russia in the long term makes it possible to attract money to financial and economic activities of people who, for religious reasons, cannot use traditional banking products. Almost 25 million Russian Muslims are potential customers of Islamic banking in Russia.

There are a number of circumstances that hinder IFI’s activities in the Russian financial and economic market. These restrictions include the lack of recognized uniform standards of operating activity and regulatory framework, the distribution heterogeneity of the Islamic financial product, the lack of public awareness about the possibilities of Islamic fintech, and etc. Many Russian banks operating in traditional fintech discern competitors in the structures of IFI that are capable of switching over a part of financial resources to themselves.

A number of organizational and technological measures are promising in order to intensify the development of Islamic banking in Russia:

- prepare a legislative basis for the systematic use of Islamic fintech;
- ensure the possibility of the conjugate functioning of IFI with classical credit institutions, taking into account the existing specifics of Islamic and traditional banking activities;
- carry out a more active information policy in terms of IFI activities, publish scientific and popular science literature on the foundations and principles of Islamic banking;
- develop institutional ties with international Islamic financial institutions (Arab countries, the Middle East, Iran, South Asia, and etc.);
- expand the training of qualified personnel for the development of Islamic banking in Russia.

Islamic banking provides supplementary opportunities for the further extension of the Russian economy, permits the formation of alternative types of business, and expands the possibilities of internal and external investment.

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