

# Closing Islamic branches of Qatari Commercial Banks

April 2011

The Qatari Central Bank (the “QCB”), has recently announced its decision in relation to closing the “Islamic banking windows” of commercial banks.

The Qatari Central Bank (the “QCB”), has recently announced its decision in relation to closing the “Islamic banking windows” of commercial banks. It is too early to foresee the impact of this decision on the Qatari banking sector and existing costumers of commercial banks which provide Islamic banking products. According to a memo issued by the QCB following its decision (the “Memo”), all commercial banks which have Islamic branches have been requested to stop opening new Islamic branches, accepting Islamic deposits and dispensing new Islamic finance operations. As for any current liabilities or ongoing finance operations, commercial banks may continue to manage them until the end of 2011. After that, any related asset of the bank must be managed in a special portfolio. The details of how these special portfolios will be subsequently managed in practice remain unclear.

Only few banks in Qatar are exclusively licensed to practice Islamic banking activities; the main three being Qatar Islamic Bank (QIB), Rayyan Bank and the International Bank of Qatar (IBQ Islamic). According to the Memo, the QCB’s rationale behind the decision relates to supervisory issues. These include the difficulty of effectively managing banking risks in a “combined” banking practice; the consistency of financial reporting considering the overlapping nature of Islamic and non Islamic activities; the complexity of applying unified capital adequacy standards; and the prejudice arising from the nature of competition between the banks and their transparency levels. From an internal QCB perspective, these issues have caused the QCB to face a number challenges relating to its ability to create liquidity, increase money supply and adopt certain monetary policies.

According to local newspapers, the volume of Islamic banking activities of the commercial banks is estimated at around 20 percent of their overall banking activities in Qatar. Banks licensed under the Qatar Financial Centre (the “QFC”) are not covered by the decision. Also, we understand that the Governor of the QCB has decided to “reconsider” the decision following the reactions received from the commercial banks.

If the QCB persists in its decision, the banks will ultimately need to “liquidate” their Islamic banking activities, presumably through selling their portfolios to the remaining market competitors (Islamic banks). Whether or not QCB’s decision is fully implemented, it is a strong indicator of the intention to dissociate Islamic banking in Qatar from the standard international rules of conventional banking. The decision will reinforce the position of the existing Islamic banks but is likely to render Qatar less attractive for a number of commercial banks that endeavour to establish in Qatar.

The grip of conventional banking thus far, has caused Islamic banking to adapt to the conventional regulatory systems by modelling finance structures that fit in both banking worlds notwithstanding the particularities of Islamic banking. Clearly, the local regulator has decided to review its policies and adapt them to Islamic banking in Qatar. The decision is the first of its kind in the region and is probably driven by the desire to further control both banking sectors in an effective way given the increasing demand on Islamic banking. However, it can also be seen as an innovative opportunity for the QCB to implement a vision which will enhance the Islamic banking expansion provided that

the right legal instruments are used to minimise negative impacts on the commercial banks and their customers.