

Development of technologies of application of Islamic financial products in the Russian federation

Simone La Bella, Professor, Università degli Studi "Guglielmo Marconi", Rome, Italy

Vladimir Malyaev, Associate Professor, National Research University Higher school of Economics in Nizhny Novgorod, Russia

Received: 10 March 2014
Revised: 15 May 2014

ABSTRACT. Now problems of adaptation of national financial systems to processes of globalization and issues in globalization are one of important areas of modern economic and financial sciences.

Islamic financial products become more and more popular in the world, and now will be applied more than in 40 countries of the world, among them there are also those, only small which part of the population professes the Islam. The success and scales of distribution are explained, on the one hand, by demand from Muslims and the Islamic companies which don't have opportunities to use traditional financial products. On the other hand, these tools are attractive from the point of view of diversification of investments and opportunities of attraction of financial resources from the Arab companies and the Muslim population of this country.

Prospects for the use of Islamic financial products may not fail to attract Russian companies, and traditional and oriented to the observance of the Quran. However, Russian legislation does not provide opportunities for the application of these tools, in this connection, the issues of adaptation of Islamic financial products and possibility of realization of these projects in Russia are becoming very relevant.

The aim of this paper is to present the results of research devoted to the analysis of possibilities of application of Islamic financial products in Russia.

KEYWORDS: *Diversification of investments, Islamic banking, Islamic financial products, "Islamic window"*

Introduction and summary

The presence of the large Muslim community in Russia, the expansion of international relations of the Russian business with the Middle East countries require analyzing the principles and characteristics of the business, which are typical for the Islamic countries, and using their positive experience.

The emergence of Islamic financial institutions in Russia and an increase in the number of joint ventures points to growing interest in conducting a joint business, economic principles and standards, which are largely, focused on the religious morals tenets of Islam. In this framework the focus on the study of the ethical aspects of management, defined religious differences and cultural diversity of the Islamic community, is laying the foundation for success in this business segment.

The relevance of studying of the international experience is determined also a pressing need of a society in transition modern business relations, focusing on their ethical aspects. Economic principles and norms of countries, which are potential partners, are largely focused on the points of religious morals¹.

It is critical to take them into consideration. For example, some similarities of economic tenets of world religions make it possible to search for new approaches to developing of mechanism of joint ventures management, taking into account the country specifics.

Such control will help to build new relationships, collaborate and achieve the high efficiency of a business and understanding at both the macro and micro levels.

The lack of consideration of the cross-cultural factors in business partnerships, such as: peculiarities of national behavior; religious morals; ethical norms and rules; organizational culture - is negatively reflected on the conduct of joint business. It often leads to conflict situations and, ultimately, to higher costs for both the representatives of the Russian business community and external partners. Consequently, it results in a decrease in the competitiveness of the joint business. The higher the predictability of the partnership is, and the more reliable the expectations of cooperation are, the greater the opportunities are for mutually beneficial cooperation.

Russian business is interested today in the significant expansion of trade and economic cooperation within the framework of

1. Since Max Weber the dominant religion is considered as an important factor influencing economic development. This tradition is reflected in the work of Stulz and Williamson (2001), in which the main reason for the differences is associated with cultural differences caused by the prevailing religion. In the given aspect interest are the results of The World Values Surveys that were designed to provide a comprehensive measurement of all major areas of human concern, from religion to politics to economic and social life and two dimensions dominate the picture: (1) Traditional/Secular-rational and (2) Survival/Self-expression values. These two dimensions explain more than 70 percent of the cross-national variance in a factor analysis of ten indicators-and

each of these dimensions is strongly correlated with scores of other important orientations.

Inglehart and Baker find evidence that orientations have shifted from traditional toward secular-rational values, in almost all industrial societies. But modernization, is not linear-when a society has completed industrialization and starts becoming a knowledge society, it moves in a new direction, from Survival values toward increasing emphasis on Self-expression values. These points are explored in Weber (2009); Stulz, Williamson (2001); The World Value Survey; Inglehart, Baker (2000).

2. Most economists and financial experts point to the same causes and consequences of the global financial crisis - a crisis of liquidity, lowering of lending standards by traditional financial institutions, the rapid growth of financial engineering that has created complex and tangled financial risk transfer instruments, lack of adequate regulatory control the state (see Chapra Umer, 2009).

Most experts and practitioners in the field of Islamic finance are of the opinion that in fact the global financial crisis is a crisis of morality, which is expressed in greed, exploitation and corruption. As remark D. Loundy, moral inconsistency complements communication gap between the institution offering the investment, and the borrower (see Siddiqi, 2008 and Kabir Hassan, Rasem Kayed, 2013).

As noted the Executive director of the Association

multilateral investment projects and requires advanced training for managers, who can work effectively and implement business contacts in the cross-cultural business environment.

The actuality of this research is determined by the great demand for Islamic banking nowadays which is connected with consequences of global financial crisis.²

According to the judgment of most outside observers, over the last years Islamic banking system performs high rates of growth, caused by stable increase of demand for Islamic financial instruments.³

In recent times, specifics of Islamic finance became considered by European banks. Services, offered by them, are called "Islamic window", but everyone, who wants to, can make use of it. In some countries (for example in the United Kingdom) the government changed the legislation in order to introduce the conception of Islamic finance into practices of financial organizations. In Russia, despite the fact that the considerable part of population is Muslim, such services are not rendered by banks. That is why the bankers are interested in studying international practices of Islamic finance and possibilities of adaptation it to Russian conditions within the current legislation as it is done in the majority of developed European countries. Opening "Islamic windows" promotes the inflow of considerable volumes of resources to a banking system of the country, and also the growth of its capitalization as a result of gain of the additional income from use of new financial instruments by banks. Introduction of Islamic banking in Russia is an innovation in the domestic market of financial services.

A number of problems peculiar to Islamic banking

The analysis of Islamic banking allowed finding out a number of problems peculiar to this sector of economy:

1. Legislative problems. Islamic banking is a young institute and even in the countries of the Middle East where it is most developed, legislative problems are not solved yet, and especially acute is a problem of compliance of the products used to the principles of Sharia. In the countries with traditional economy there is a permanent contradiction between existing legislative norms and the principles on

which Islamic financial products are based. Nowadays, except the Muslim states with a hybrid financial system, this problem is solved only in Great Britain. All sector of Sharia finance is not sufficiently regulated. The work performed by AAOIFI (The Accounting and Auditing Organization for Islamic Financial Institutions) concerning creation of standards of accountancy, audit, ethics, management of Islamic financial institutions, is insufficient for full-fledged management of the growing sphere of Islamic finance.

2. High costs of services. The line of financial products used by Islamic banks is not so range, as the product line of banks which do not have to be consistent with the principles of Sharia, so, Islamic credit institutions have not so many opportunities for making profit, as classical banks. Nevertheless, Sharia banks are obliged to meet economic standards, maintain liquidity and acceptable level of profitability. At the same time the incentives to increase the prices and tariffs made by the consumers of Islamic financial products must also be mentioned. Muslims demand *halāl* ("permissible") that means Sharia-compliant financial services, and are ready to pay more for them. All these factors force Islamic banks to establish high costs of their services.
3. The distrust of the population to Islamic finance and banking. Despite a significant amount of organizations, seeking to work according to Sharia, the attitude of the public towards Islamic finance remains very cautious. It is believed that such organizations participate in terrorist financing by some means. These fears are based on the negative statistics connected with informal money remitter *havalā*⁴ The lack of confidence is based also on a weak awareness of financiers and clients about basics and principles of functioning of the Islamic financial system.
4. Not transparent reporting, absence of statistical information. Not transparent reporting is typical for many Islamic banks and that lowers their investment potential for foreign investors, and for some of them, serves as a factor generating mistrust to Sharia banks.

for the development of alternative and financial innovations (ASSAIF) Alberto Brugnoli, none of these factors is not peculiar policy of the true Islamic banks, whose activity is based on transactions involving real values and sharing the risks (Brugnoli, 2013).

3. The evidence accumulated on these points is overwhelming and comes from official and academic sources. Reference is made to Sudin Haron, Wan Nursofiza Wan Azmi (2009).

4. *Havala* is an ancient method of transferring money between people in Asia. Today, it is a method of transferring money overseas that does not involve complex payment infrastructures and processes, but more of a trust with traditional ways of doing business. Only in USA about \$200 billion are every year transferred through this system and finally appear on the accounts of Islamic banks of the United Arab Emirates, Pakistan, Iran and other Asian countries (see Skinner, 2007).

Questions of formation of the Islamic financial system in Russia

In Russia as in the majority of the developed countries with traditional economy, there is no the legislation regulating Islamic part of a financial system. However, the 2002 population census found 14.5 million Muslims in Russia (around 10% of the population). In 2005, the Ministry of Foreign Affairs advanced the number of 20 million people. Though, other sources have to estimate that Russia could have as much as 26 to 30 million Muslims, including Azeri and Central Asian migrants. It is perhaps safe to say that approximately 15% of Russia's total population is Muslim and demographic trends predict Muslims could represent as much as the third of the total population of the Russian Federation by 2050. The potential size of the Russian Islamic finance domestic market has received various estimates, from a modest 10 percent of the practicing Muslims to the whole ethnic Muslim population, or even more; so, Islamic financial products are much demanded.

Considering the level of development of the local credit market in the Muslim areas of Russia and institutional credit and banking sector as a whole, as well as the financial condition of many regional commercial banks and other credit institutions, it seems that Islamic banks may become one of the major factors of development (stimulants and permanent investors) of the real economy and the local commodity market, in particular the formation of small business and small local private entrepreneurship in the first place among Muslim population.

Thereby the operating activities of Islamic banks in the Muslim areas of Russia will contribute to the solution of complex problems of sufficiency of local financial resources, including the ongoing support and funding for local projects of investment.

The replenishment of local budget revenues is possible by the influx of taxes raised from both local Muslim-entrepreneurs and Islamic banks by financial and investment, including bill transactions which operations will mediate a significant part of the investment activities of the local entrepreneurship.

Another important reason - the deepening of economic cooperation with Muslim countries in various forms and areas. Islam is practiced not only by the population of the Middle East, it is the state religion of some CIS countries, as well as many countries in Asia and North

Africa, with which Russia seeks to maintain a stable economic ties. Meanwhile, trade between Russia and the Islamic countries in the last decade have fallen markedly.

Financial infrastructure of support to external economic exchange is almost absent. The situation in this area is improving very slowly. Russian entrepreneurs and investors are at most interested in expanding trade and economic cooperation between Russia and the member countries of the Organization of the Islamic Conference on both bilateral and three-way basis and in the framework of collective multilateral investment projects.

Islamic countries also follow the path of establishing long-term business relations with Russian entrepreneurs. For example, Iran, whose trade potential is significant, becomes one of the most promising trade partners of Russia. This is primarily military-technical cooperation, as well as cooperation in other industries - oil, machinery, electricity and energy in general.⁵

As noted by the international experts (Brugnoni, 2011), key aspects of development of the Islamic financial system in Russia at present are the following moments:

- In the last few years, Russia has intensified its diplomatic engagements in the Islamic world and has clearly identified Muslim countries as an ideal ground to reposition herself favorably in the emerging 21st century world order;
- Islamic finance is a major element of this repositioning. Russia, as the hub for the Commonwealth of Independent States, has recognized that to be a serious international financial center it cannot leave out Islamic finance as a tool to raise finance, diversify her sources of funding, mobilize domestic savings and to a certain extent manage monetary policy;
- Russia has the potential to be the largest Islamic finance market in the EU due to its wealth of raw materials, the size of its Muslim population and its geographical proximity to many Muslim majority countries in Central Asia and the Middle East. As a BRIC country she will be able to compete with India and China and with the MIFC with other European IF centers;
- The domestic general environment is changing fast and is becoming rapidly conducive to the implementation of Islamic

5. An organized system of mutual bank accounts is required for maintenance of mutual trade and long-term investment. In late 2000, the central banks of the two countries signed an agreement on mutual cooperation in payment and settlement. Russian bank VTB and the largest Iranian bank "Bank Melli" (fully owned by the Government of Iran) develop various payment agreements on the organization of a system of mutual settlements and payments on export-import transactions and targeted investment. On the basis of its Moscow representative office "Bank Melli" opened the subsidiary bank in Russia.

finance tenants;

- The business case for Islamic finance is proven and major Russian banks and businesses are moving into this market sensing the business opportunity. By doing so, they are pushing the Russian authorities, the Central Bank of Russia and other regulators to review their policies and consider facilitating Islamic finance through the relevant legal and fiscal improvements;
- The civil society, professional practices and universities are joining forces with Islamic multilateral organization in shaping up this new environment. They are basing their endeavors on Russia's wealth of historical ties with the Muslim world and on a natural resources-rich economy that naturally lends itself to asset-backed (i.e.: Islamic) transactions.

The Russian Federation is now in the enviable position of being able to build up on the experience of several Western countries that have been confronted during the past decade with issues of different nature regarding the implementation of Shariah-compliant products in their respective societies. A thorough market research will allow Russian regulators, legislators and policy makers to choose the most suitable solutions and quickly adapt them to Russian conditions.

Despite the attractiveness of the market of Islamic finance and benefits from the use of Islamic products, not all the companies are ready to associate their activity with Sharia finance that proves that there is a number of obstacles in the way of development of Islamic financial products in Russia.

As the survey findings show, there are the following obstacles to the development of Islamic Finance in Russia:

- skepticism of the perception of most of the population;
- lack of appropriate national legislation and regulatory frameworks;
- low awareness of citizens about the products;
- absence of experts and developed risk management tools;
- the political participation of the highest public officials is essential for such project⁶;
- there is no professional demand for services of Islamic financial institutions⁷

6. Taking into account anti-Muslim attitude of the majority of population of the country, it can be stated

- moreover, Russia proves as the country with high level of corruption⁸ and inefficient state machinery⁹.

One of the most serious and formidable obstacles are absence of legislation, regulating the relations, arising while working with Islamic financial instruments.

They are no such concepts as *murâbahah*, *mudarabah*, *musharakah*, *istisna*, *ijarah*¹⁰, etc in the Russian law; therefore, Islamic financial products can be realized only through analogical schemes. However, the current legal framework allows applying only a small number of Islamic instruments, which is a serious obstacle in the way of development of this financial sector.

Legislation change could become a solution; however, this work assumes essential expenses. By estimates of a number of experts, changes or amendments directed on legalization of Islamic financial products in Russia, can affect about fourteen federal laws, among which Civil and Tax codes, Federal Laws “About Banks and Bank Activity”, “About the Securities Market”, a number of the acts regulating insurance activities, and others.

Along with legal problems one of the serious obstacles for the development of Islamic Finance in Russia is the lack of information about Sharia financial products and principles of their work. This is the reason why only about 1 million Muslims in Russia are now ready to use these tools. However, the consumer market of Islamic financial services can be considerably expanded by carrying out the advertising companies and the events aimed on the increase in the awareness of the population in the field of Islamic banking.

In Russia there are a considerable number of publications connected somehow with Islamic finance, explaining the essentials and principles of their work, differences from traditional economy. A growing number of authors emphasize not only for religious or social and ethic component, as well as economic, representing Islamic products as effective instruments of financing various projects. That is why; the market of potential clients of Islamic “windows” can be extended considerably by not Muslim population. One more problem is a small number of experts in Islamic finance. Now in the Russian Federation there is only limited number of short-term programs giving information concerning the functioning of banks, observing the principles of Sharia, the major part of domestic experts is being trained abroad. In case of active

that the authorities are not going to carry out politically sensitive project throughout.

7. Professional demand requires a good understanding of why need the service and how it differs from traditional services. The reason for the absence of professional demand is financial illiteracy of the population as a whole.

8. The total lack of legal certainty is a fundamental problem for business development and investments in many countries of Eastern Europe and Central Asia. Working in these countries, private firms see corruption as one of the most problematic factors for doing business in the region. For an analysis of these issues, see: Anti-corruption Reforms in Eastern Europe and Central Asia. Progress and Challenges, 2009-2013. This will interfere with the effective work of the Sharia committees of banks, which includes the influential persons of the Muslim world, who for decades have created their reputation and zealously, they protect it.

9. Between 2007 and 2012 trust in governments has declined considerably, as citizens' growing expectations have been hard to address with limited government resources. A new approach to public governance is needed if governments are to meet citizens' expectations with the limited means at hand. This approach should be built around creating strategic capacity, strong institutions, effective instruments and processes and clear measurable outcomes. On these points, see:

Government at a Glance
(2013).

10. *Murābahah* (Arabic: “resale”) a sale contract with deferred payment. Under the terms of this contract, one party (the seller) purchases the goods and sells it to another party (the buyer) at an agreed price, including costs incurred by the seller. Money is paid for the goods in whole or in part in the future. See AAOIFI Shariah Standards (N. 8).

Mudarabah - a contract under which the owner of surplus funds (*rabb al-mal*) trust his surplus to an individual (*mudarib*), who has the ability and entrepreneurial experience to use them effectively. See AAOIFI Shariah Standards (N. 13).

Musharakah (Arabic: “partnership”, “complicity”) is equity joint venture in which investors (one of which is an Islamic bank) invest its savings and divide between gains and losses in the pre-agreed proportions, often in accordance with the size of the unit each participant. Financing of the project can also be carried out by more than two parties, then the control is performed either by all parties to the treaty, either one of them. See AAOIFI Shariah Standards (N. 12). *Istisna* (Arabic: “production on order”) is a kind of a sale contract, the subject of which does not exist in the time of the agreement. Manufacturer produces the goods especially on order (for example, building a house on the customer’s request). See AAOIFI Shariah Standards (N.11).

Ijara is an agreement between

development of the branch of Islamic finance, the lack of qualified personnel will most likely occur, however, this problem can be solved by the creation the special field “Islamic Finance and Banking” in the institutes of higher education of the Republic of Tatarstan and Bashkortostan - centers of Islamic finance in Russia.

Thus, the main factors, stimulating the development of a branch of Islamic finance in the economy of the Russian Federation are, on the one hand, the initiative of the Muslim community having an urgent need for Islamic financial products, and, on the other hand - the potential size and profitability of a new market of financial services. Legal problems, lack of information on Islamic finance are counteracting forces for consumers, as well as for potential service providers.

It is a fair assumption to say that necessary information space in Russia is forming gradually, a work is carried out on creation a legal framework for Islamic financial products, however, it is difficult to judge whether this or that financial organization is ready to use these tools. After all, in order the bank could render services which are based on observance of the principles of Sharia, its internal policy on attraction and placement of funds and even structure have to be changed seriously.

One of such internal changes is creation of Sharia council (or its analogue) in the organizational structure of a bank - the special advisory body made up of experts, exercising control over compliance of financial products to Sharia laws. Results of research made by the council can serve as an additional mean to attract the customers since they serve as guarantees of observance of norms of Islam when using these instruments.

Besides internal control of products on compliance to Sharia, banks seek to carry out and external Sharia audit that is an instrument of increase of their reputation and rating on the international scene. Now, members of Russia muftis Council, KPMG auditors, and other experts in the field of Islamic finance are attracted as such external auditors. The creation of own Sharia council is planned in the Republic of Tatarstan in order that anyone who wishes could check these or those financial services on compliance to norms of Islam.

Because of the fact that Islamic finance is a young branch of economy and is still developing, new tools and methods appear, it is necessary to have advisers in the field of Muslim right and finance in the bank.

Sharia council can serve a source of such information and promote it. The scheme of attraction and placement of funds of the bank also has to undergo considerable changes. Because of the fact that the Quran forbids the use of loan interest, uncertainty and excessive risk, traditional credit organization has to renounce use of those tools that bear such prohibitions. The result of this refusal is not only a new product line of the bank, but also a division of funds of the bank into Halal and traditional (see Chapra, M. Umar, 1994; Sudin Haron, Wan Nursofiza Wan Azmi, 2009; Zarqa, Anas, 1989; Ariff, Mohamed, 1989 and other).

As world practice shows, the problem of division of funds is most effectively resolved by opening "Islamic windows". However, it is not always possible to collect the necessary volume of "pure" (*Halal*) capital from the point of view of Sharia for opening the affiliated organization; it is much easier to open a branch (office). It does not require such considerable expenses as opening the new credit organization, but in this case cash flows will be properly divided.

However, a turn to the Islamic principles of functioning means that not only the Islamic bank itself doesn't pay or gain interest¹¹ but also doesn't provide financial resources to those credit organizations and companies that will use them, breaking thus Sharia laws. This condition reduces considerably the set of objects and instruments of investments of such a bank.

Besides the fact that such tools as credits and deposits in their traditional understanding are completely excluded from the list of services of the Islamic "window", the set of "allowed" securities will also considerably decrease. The use of derivatives is excluded completely, because they are a source of excessive ambiguity - *harar*. Also the bank has to refuse the use of bonds as their application is based on the use of a loan interest, besides the share portfolio should be checked thoroughly. Despite of the fact that possession of shares is not forbidden by Sharia (profitability on this security is not based on interest and depends on the profit of the company), the bank has to choose carefully those companies in which it wants to invest its capital. The credit organization should reject investments in shares of financial companies, including traditional banks, and also in shares of those enterprises which are engaged in the kinds of activities forbidden by Sharia. Thus, the Islamic bank can finance through purchase of shares only those enterprises, whose activity

the bank and the client, in which the bank buys and then grants on lease the equipment to the customer's request. Duration of the lease and the amount of rent specified in advance. *Ijara* serves as Islamic analogue of an operating lease: used to finance the production, construction and purchase of leasing goods, upon termination of the contract the equipment remains the property of the bank. See AAOIFI Shariah Standards (N. 9).

11. It is important to pay attention to the fact that Islamic laws prohibit the payment and receipt of interest, but it does not mean that they do not approve making profit or promote return to cash payments or barter economy. It is a question that all parties of a financial transaction should divide among each other risk and profit or losses of the enterprise. Depositors of Islamic banking system can be compared with the investors or shareholders who receive dividends when a bank makes a profit or lose the part of their savings if the bank report losses. The logic is to reconcile profit of an Islamic contract with the return and quality of the project, ensuring a more equitable distribution of wealth.

is connected directly with the real sector of economy.

Obligations of the Islamic bank also have to correspond to the principles of Sharia.

A range of problems and difficulties arising from the use of Islamic financial products stop neither Muslims nor representatives of the traditional economy to apply them. Popularity of Islamic financial instruments is growing every year, which explains the interest in the mechanism of their work.

Attention to the Islamic financial instruments is explained by successful overcoming crisis by Islamic institutions, as well as tantalizing prospects for capital investment in eastern companies and great opportunities to raise funds from this region. In addition, the system of profits division and participation in capital is seen by economists as a promising direction of the economy.

The further behavior of the financial market depends on that, how justified, from the point of view of public welfare, will be new ethical institutions of finance.

Summing up, as experts note, “none of the several challenges faced by Islamic finance institutions are insurmountable and in fact Islamic finance transactions are already happening” (Reference is made to Brugnoli, 2011).

Study of demand for Islamic banking products and services in regions of the Russian Federation

To indicate the potential level of demand for products and services of Islamic banking was developed and conducted a sociological survey among the Muslim population in the regions of location of offices of JSC CB “Ellips bank”¹² in the cities of Nizhny Novgorod, Ufa, Saratov and Kazan. In these cities there are significant numbers of Muslim population, and in the first three open offices of “Vostok Capital” branch of JSC CB “Ellips bank”.

Among the tasks of the research was to reveal:

- interest to an Islamic way of business;
- awareness on Islamic financial and economic system and ways of business;
- different factors that could influence on respondents and their answers.

1000 respondents were interrogated in the course of research. Age structure of the respondents: more than a half of respondents (53%) are 26-45 years old, a third is 18-25 years old, the others are older. So, more than 80% of respondents are young people.

As for the sphere of professional activity, the majority of respondents are employed in construction (29%), trade (20%), and industry (11%) or are students (11%).

The research of demand for Islamic banking products among the Muslim population in these regions showed the following.

Current situation on the market of banking services is characterized by the fact that more than a half of respondents are clients of various banks and upon the whole are satisfied with the quality of services. However, the important thing is that practically everyone would like to be served in "an Islamic window" of a Russian bank. So, about 20% of respondents consider such services to be more reliable from the economic point of view, more than a third (38%) specify the fact that such services will be consistent with religious traditions of Muslims as the reason of their interest, more than a quarter (27%) would like to be served in such a "window" in addition to traditional banking.

Besides, 65% of respondents agree to pay more for services on the condition of observance the principles of Islam, and 25% agree to be served in "an Islamic window" of a Russian bank on the conditions offered by traditional banks.

However, it should be noted that the level of awareness about the principles of Islamic Finance is at a low level - 42% of respondents have only some idea about these principles; not informed but interested in it - 33% of the respondents; and only 18% - are well informed.

Thus, it is extremely important to provide additional elucidations on Islamic banking by carrying out training seminars, distributing publications on this subject, etc. It is confirmed by the results of the poll according to which 85% of people need additional information and only 15% are ready to use the offered services right away. In addition to decide significantly influenced by the recommendations of religious organizations: 77% of respondents are ready to use the services of Islamic banking, of them 57% - on the recommendation of religious organizations.

The causes of failure from Islamic banking most often are the following: first of all, complete satisfaction with the quality of

services, rendered by their bank, second – misunderstanding of the principles of Islamic finance, which, in turn, emphasizes the necessity of distribution of more detailed information on this topic. Further research covered the interest of respondents in different types of banking services. On the whole, the population is interested in all types of Islamic banking, but most of all – in gaining and investing their means, which make 35% and 25% respectively in total amount of services.

Concerning products and services of attraction and placement of means of Islamic banking, on the whole the respondents are equally interested in all types of banking services however *mudarabah* (27%), interest-free deposits (27%), *musharakah* (16%), and *ijarah* (10%) are of the greatest demand.

The characteristics, having the most serious influence on the decision to use the services of the “Islamic window”, revealed in the course of the poll, are the following: the reputation of the bank, the quality of services and recommendations of relatives, friends, and acquaintances. At the same time, 85% of the respondents are ready to recommend the “Islamic window” to their friends and relatives.

Thus, all mentioned above allows drawing the conclusion that there is a demand for Islamic products among the Muslim population in the regions of Russia. In this framework if the bank meets the concepts of Islamic finance, based on understanding of ethical standards of Muslim life, investment in this market segment will be not only a possible, but also an effective strategy.

The results of the poll of the population concerning their attitude towards “Islamic windows” of the banks were used while developing a marketing strategy of JSC CB “Ellips bank”.

Experience of the practical implementation of the model of Islamic banking in JSC CB «Ellips Bank» (Nizhny Novgorod)

Practice is very important in the development of Islamic finance. It allows to adjust the knowledge and forecasts and to determine the ways of further movement. And the motion must be because the market is the new, the interest is great - both in Russia and foreign partners.

For a long time, the Russian market featured a substantial uncertainty with regard to Islamic finance. Finally, the years 2010 and 2011 turned the tide. It should be mentioned, that one of the most significant projects was opening of the branch “Vostok Capital” of JSC CB “Ellips bank” in March 2011 (Reference is made to Info Islam, 2011).

As a result of the project the Bank anticipates saturation of the market with the types of services, which for a long time were of high demand, rendering assistance to *Ummah*¹², promotion of Islamic finance, and, since the Bank is a commercial organization - gaining of profit.

JSC CB “Ellips bank”, was one of the first to open the offices of the bank providing Islamic banking products in Russia, considers it necessary to develop the mechanisms of implementation of the concept of Islamic finance within the existing Russian legislation.

Project aim

“Vostok Capital” branch of JSC CB “Ellips bank” aims to provide banking products and services that meet Islamic norms and principles. The branch operates in the city of Nizhny Novgorod.

Types of Islamic financial instruments

“Vostok Capital” branch of JSC CB “Ellips bank” offers the following services for corporate entities and individual entrepreneurs:

- cash management services;
- financing of asset acquisition using *Ijara* mechanism;
- financing of the acquisition of circulating assets using *Murabaha* mechanism;
- currency transactions;
- operations with precious metals (purchase and sell of coins and bars of precious metals).

“Vostok Capital” branch of JSC CB “Ellips bank” offers the following services for private individuals:

- cash management services;
- financing of private individuals using *Ijara* mechanism;
- currency transactions;

12. *Ummah* is an Arabic word meaning “nation“ or “community“. In the Quran the *umma* typically refers to a single group that shares common religious beliefs, specifically those that are the objects of a divine plan of salvation.

- current accounts;
- operations with precious metals.

The legal scheme of the project

The project is implemented in the form of the branch “Vostok Capital” of JSC CB “Ellips bank” - a separate subdivision located outside the lending institution which conducts banking operations under the license of the Bank of Russia. In this way, the advantage of a format of activity which can be called the “Islamic Window” in the form of a branch of a Bank over the others (investment company, mutual credit society and others) is that the branch operates under the banking license of the primary bank and the performance of all the obligations of the branch to its clients is guaranteed by the banking license and is secured against the equity capital of the bank. To distinguish cash flows from halal financial products and cash flows from traditional banking services, “Vostok Capital” branch has a separate correspondent account at the Central Bank of the Russian Federation (Bank of Russia). For the purpose of bank card issuance “Vostok Capital” branch opens individual correspondent accounts in the processing centers of card systems under the branch’s name.

System of Shariah control

JSC CB “Ellips Bank” has been cooperating with one of Russian consulting companies, which specializes in the field of Islamic banking and finance and has in its staff a Shariah expert whose certificate is compliant to the international standards. The company helps to ensure compliance of all products and internal procedures of the Branch to the norms of Islam and to build a system of internal and external Shariah boards. The Bank formed an Inner council for alternative financial products, which performs the functions of internal Shariah control of the bank.

Shariah expertise of “Vostok Capital” branch activities is carried out by Shariah expert through verification of the agreements, used by the bank, as well as internal documents, on which the activities of the bank are based. Besides, in the course of routine operating activities bank periodically receives consultations from the Shariah expert concerning the compliance of particular transactions with the requirements of Islam.

It is notable, that the internal Shariah control of “Vostok Capital” branch activities at the present stage of its development and

observance of operating rules, approved by the Shariah expert, is the personal responsibility of the management and employees of the bank.

The predictable result of the activities of the “Vostok Capital”

The Bank plans to bring to market competitive financial services, which are compliant with the requirements of Islam; to cover in full all the layers of population and business, which so far were not able to take advantage of the financial services due to their religious beliefs.

The range of services should be differentiated to the maximum extent in order to meet all the demands: organization of the system of integrated banking services for corporate entities and private individuals in accordance with the norms of Islam, financing of Shariah-compliant projects in the sphere of real economy and projects in halal-industry, all within the scope of a commercial bank. During the year 2012 were opened offices “Vostok-Capital” in Bashkortostan and in the city of Saratov, and also plans to open offices in the South of the Nizhny Novgorod region in the places of compact residing of the population professes Islam.

Currently the “Vostok Capital” branch of JSC CB “Ellips bank” achieved the following results:

- A set of banking products meeting the norms of Islam as well as the requirements of the Russian banking legislation is formed;
- An internal Shariah expertise council is formed;
- The Branch started to render services for its first customers;
- Are opened offices banking standards of Shariah in the cities of Ufa (Bashkortostan) and Saratov.

As for the current date, the major achievement is the fact of opening of such an office, the fact that the supervisors (Bank of Russia) approved opening the branch which provides banking services which are unconventional for Russian banking practice.

Certain difficulties encountered in the process of functioning of the Bank.

However, analysis of the activities of the “Vostok Capital” branch of JSC CB “Ellips bank” has identified certain difficulties encountered

in the process of functioning of the Bank:

- Concerning consumer demand. Excessive expectations and requirements as regards to Islamic financing, inadequate evaluation of clients' abilities, misunderstanding and low awareness of Islamic finance. Poor financial literacy of Muslim entrepreneurs. The specifics of Islamic banking products is easier to understand for Muslims due to the Islamic foundation on existing restrictions, but a vast majority of non-Muslims is absolutely unfamiliar with the current format of functioning of Islamic financial institutions. Therefore, at the initial stage of the development of Islamic financial institutions in Russia, the number of potential customers is actually limited to the representatives of the Muslim Ummah only. And only after a while, with the increase of awareness about the functioning of Islamic financial institutions increases, the number of clients will grow.
- Concerning the legal status (government regulation). Not all Islamic contracts may be implemented in Russia within the scopes of a commercial bank due to the fact that certain conditions of these contracts contradict the Russian banking legislation. Taxation of transactions and Shariah-compliant financial activities make these services uncompetitive in terms of prices, tax administration of non-standard transactions complicates the activities. Registration of transactions with vehicles and real estate transactions makes it more complicated, the terms longer and the costs for transaction support higher. There are legal risks associated with the usage of uncommon legal structures and organizational forms. It seems that at the current stage of the development of Islamic financial institutions development in Russia, one of the main objects of financial institutions' and Islamic legal scholars' joint work should be the implementation of basic Islamic financial contracts into the national legal system.
- Other difficulties. Low activity from economically active and financially prosperous Muslims, certain religious and public figures in spreading and development of Islamic finance. Lack of specialists with a solid understanding of finance and Shariah fundamentals, as well as experts possessing profound knowledge in the Shariah aspects of financial activities.

Conclusions

Summing up, it is possible to draw some conclusions that have practical meaning:

1. Work on the analysis of Islamic banking has allowed identifying a number of problems inherent in this sector of the economy: legislative problems; high cost of services; distrust of Islamic Finance and banking; opacity of the reporting, absence of statistical information.
2. Consideration of the principles of Islamic financial institutions showed that of the majority of Islamic financial contracts are not economic, but due to the need of their conformity to Islam. Apparently, almost every Islamic financial instrument has a traditional analog, the implementation of which is simpler and less related transaction costs. In such a situation there is a serious question of whether the emergence of Islamic financial institutions in the traditional financial systems. At the same time, in countries with large Muslim populations, are not ready to trust their savings to traditional banks, as well as a significant number of Muslim entrepreneurs who do not use the services of traditional banks, the formation of the Islamic financial institutions can improve the efficiency of the financial market and accelerate its development.
3. Attention to the Islamic financial instruments is explained by successful overcoming crisis by Islamic institutions, as well as tantalizing prospects for capital investment in eastern companies and great opportunities to raise funds from this region. In addition, the system of profits division and participation in capital is seen by economists as a promising direction of the economy.
4. The agenda should be tasked with rationalization of credit and banking currency legislation operating in Russia to remove existing obstacles of artificial nature that are putting the brakes on the development of Islamic banking in Russia. It is important for Russia to consider the experience of some non-Islamic industrialized Western countries, where since the early 1990s all the necessary conditions for a stable investment activity of Arab financial and industrial capital and Islamic banks are legalized through law.

In the conditions of the Russian economy it is possible to formulate some recommendations, which help to create professional demand for Islamic financial services and prepare human base for it:

- To replace the term “Islamic finance” not to cause negative emotions in representatives of other religions. Possible alternatives – “ethical finance”, “fair finance”, “untraditional finance”;
- To develop a special rating representing financial institutions which are guided in their activity by Sharia requirements;
- To create professional instruments of mass media which will broadcast news of Islamic economy and finance;
- To include the courses “Islamic Finance”, “Islamic Banking”, “Islamic Insurance (Takaful)” in the program of higher educational institutions.

All URLs checked
June 2014

References

- AAOIFI Shariah Standards (2014), *Sharia Standard n.11. Istisna*, Moscow, Islamic book
- AAOIFI Shariah Standards (2011a), *Sharia Standard n.12. Musharakah*, Moscow, Islamic book
- AAOIFI Shariah Standards (2011b) *Sharia Standard n. 13. Mudarabah*, Moscow, Islamic book
- AAOIFI Shariah Standards (2010a), *Sharia Standard n. 8. Murabahah*. Moscow, Islamic book
- AAOIFI Shariah Standards (2010b), *Sharia Standard n. 9. Ijara, Ijara repurchase*, Moscow, Islamic book
- Ahmad Machmud (1947), *Economics of Islam: A comparative Study*, Muhammad Ashraf

Anti-corruption Reforms in Eastern Europe and Central Asia. Progress and Challenges, 2009-2013. OECD Multilingual Summaries. OESD iLibrary

<http://www.keepek.com/Digital-Asset-Management/oecd/governance/anti-corruption-reforms-in-eastern-europe-and-central-asia-9789264204294-ru#page1>

Ariff Mohamed (1985), *Toward a Definition of Islamic Economics*, "Journal of Research in Islamic Economics", V. 2, n. 2, 1405/1985, p.87-103

Ariff Mohamed (1989), *Economies and Ethics in Islam*, in Aidit Ghazali, Syed Omar (Eds.), *Readings in the Concept and Methodology of Islamic Economics*, Kuala Lumpur, Malaysia, Pelanduk Publications, pp. 96-119

Brugnoli Alberto (2011), *Islamic Finance: development and prospects*, "International Accounting magazine", V. 173, n. 23, June, pp.55-58
<http://www.muslimeco.ru/eng/opubl/41>

Brugnoli Alberto (2010), *Russia cannot ignore Islamic Finance*, Interview IslamRF.Ru
<http://www.islamrf.ru/news/world/w-interview/12635/>

Chapra M. Umar (2009), *The Global Financial Crisis: Can Islamic Finance Help?* Japan, KIAS

Chapra, M. Umar (1994), *Islam and the Economic Challenge*, UK, Leicester Islamic Foundation

Haron Sudin, Wan Azmi W. (2009), *Islamic Finance and Banking System: Philosophies, Principles and Practices*, Kuala Lumpur, Malaysia, McGraw-Hill Education

Hassan M. Kabir, Rasem Kayed (2012), *The Global Financial Crisis & Islamic Finance Industry*,
<http://islamstory.com/en/node/37837>

Inglehart Ronald, Baker Wayne (2000), *Modernization, Cultural change, and the persistence of traditional values*, "American Sociological Review", V.65, February, pp. 19-51

Karim Adiwarman (2002), *Ekonomi Mikro Islam*, Jakarta, Indonesia, The International Institute of Islamic Thought

Khan Muhammad Akram (1989), *Islamic Economics: The State of the Art*, in Aidit Ghazali, Syed Omar (Eds.), *Readings in the Concept and Methodology of Islamic Economics*, pp. 49-68, Kuala Lumpur, Malaysia, Pelanduk Publications

OECD (2013), *Government at a Glance 2013*, OESD Multilingual Summaries. OESD iLibrary
http://www.keepeek.com/Digital-Asset-Management/oecd/governance/government-at-a-glance-2013_gov_glance-2013-en#page1

Siddiqi Mohammad Nejatullah (2008), *Current Financial Crisis and Islamic Economics*
<http://siddiqi.com>

Skinner Chris (2007), *The Future of Banking, In a globalised World*, John Wiley&Sons, Ltd. 2007.

Stulz Rene, Williamson Rohan (2001), *Culture, openness, and finance*, National Bureau of Economic Research Working Paper 8222, April
<http://www.nber.org>

The World Value Survey (2014), *The WVS Cultural Map of the World*
http://www.worldvaluessurvey.org/wvs/articles/folder_published/article_base_54

Weber Max (2009), *The Protestant ethic and the spirit of capitalism*, Norton critical Edition

Zarqa Anas (1989), *Islamic Economics: An Approach to Human Welfare*, in Aidit Ghazali, Syed Omar, *Readings in the Concept and Methodology of Islamic Economics*, pp. 21-39, Kuala Lumpur, Malaysia, Pelanduk Publications

Zaman Hasanuz, *Definition of Islamic Economics*, "Journal of Research in Islamic Economics", V. 1, n. 2, p. 49-50

Sintesi

La scienza economica e finanziaria moderna è ormai da tempo orientata verso l'adeguamento dei sistemi finanziari nazionali rispetto al processo di globalizzazione. In questo contesto, i prodotti finanziari e bancari islamici sono presenti in oltre quaranta paesi nel mondo, anche non a maggioranza islamica. L'analisi condotta presso l'università russa di Novgorod indaga le possibilità di diffusione di prodotti finanziari islamici in Russia. La Federazione russa, infatti, rappresenta potenzialmente il più grande mercato disponibile per la finanza islamica in Europa, grazie alla sua grande ricchezza di materie prime, alla presenza di una buona percentuale di popolazione di religione islamica, e alla vicinanza geografica con alcuni paesi islamici dell'Asia centrale e del Medio oriente. Lo studio dei meccanismi di distribuzione dei prodotti bancari islamici è il punto di partenza per favorirne il successo e la diffusione, permettendo ai compratori russi di diversificare gli investimenti. I prodotti finanziari del banking islamico, pur interessanti nel mercato russo, risentono, però, della mancanza di apparati legislativi e normativi adatti alla diffusione di questi prodotti nel mercato nazionale russo, degli alti costi nella gestione del servizio, della scarsa fiducia dei risparmiatori e investitori legata anche all'opacità della rendicontazione e alla assenza di adeguate rilevazioni statistiche sui risultati.