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Prospects and opportunities for the development of Islamic finance in Kazakhstan: opening Islamic windows

Abstract. *The article considers the prospects for the development of Islamic finance in Kazakhstan by opening «Islamic windows». The world practice of introducing Islamic windows in traditional institutions (banks) in such countries as Indonesia, Malaysia, Qatar, Germany, the United Kingdom, Algeria was also considered. This study aims to compare Islamic institutions and Islamic windows of traditional institutions(banks) in terms of their advantages and disadvantages. The purpose of this article is to investigate the prospects of the implementation of Islamic windows in the Republic of Kazakhstan.*

The article used empirical research methods (comparison). And strengths, weaknesses, opportunities, and threats (SWOT-analysis) of the application of Islamic windows in traditional institutions (banks) in the Republic of Kazakhstan were analyzed.

The analysis carried out in this study shows that in the world practice the opening of Islamic banking departments in traditional banks, which is called «Islamic windows» was the beginning of the development of Islamic finance in the same countries. It was also found that the effectiveness of Islamic windows of conventional banks was much higher compared with the Islamic bank.

Thus, opening Islamic windows in the second-tier banks and traditional financial institutions of the Republic of Kazakhstan can be an effective mechanism for the development of the Islamic finance market and accelerate the process of implementation of Islamic financial instruments.

Keywords: *Islamic finance, Islamic windows, Islamic banks, traditional banks, second-tier banks, Islamic finance market, Islamic financial instruments.*

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Introduction

Islamic finance is becoming an effective tool and the concept of opening Islamic windows in traditional institutions is further flourishing in the world today. Most of the research conducted in articles on these thesis compares conventional and Islamic banks and their products. However, there is an active debate in the Islamic finance industry today about the opening of the Islamic

windows in traditional banks or turning them into full-fledged Islamic banks.

This study examines the prospects for the development of Islamic finance (the opening of Islamic windows) in the Republic of Kazakhstan. In Kazakhstan, Islamic finance began to develop in 2009, and during this time, the market infrastructure, legislative and regulatory frameworks have been formed and continue to develop. Kazakhstan is developing the sphere

of Islamic finance in order to create alternative sources of financing for state or municipal projects.

The development of Islamic finance in Kazakhstan will create additional resources to maintain the financial stability of the country's economy, as well as provide investors with alternative investment instruments [1].

However, the fastest growing sector in Kazakhstan's financial sector is Islamic banking (70% of the total assets of the Islamic financial sector), along with this, insurance (takaful) and the Islamic capital market are also developing. Therefore, we decided to consider such an urgent issue as the perspectives for the introduction of Islamic banking windows into the banking system of the Republic of Kazakhstan.

Literature review. Recent years have seen an increase in research in the field of Islamic finance in the literature, but this growth is largely evident in Malaysia as there is a favorable atmosphere for this kind of research [2].

Authors Alshater M., Hassan M.K., Khan A. & Saba I. identified the following six research topics in Islamic finance: foundations, growth, and legitimacy; attitude and perception of the client; accounting and social reporting; performance and risk management; Islamic financial markets; efficiency of Islamic financial institutions [3].

According to Biancone, P.P., Saiti B., Petricean D. & Chmet F., research by various authors on Islamic finance has focused on Islamic banking, comparing banks (traditional and Islamic), portfolios, and analysis of governance and control structures [4].

But also some authors have conducted research related to the Islamic windows.

According to Elgammal M., Bakri A. A., Alshami A. the ongoing controversial debate about Islamic windows can be summarized in three opinions by supporters, opponents, and conservators: «the Islamic windows supporters believe that the interest of conventional banks in running Islamic windows reflects a practical recognition of the success of the Islamic banking system and the Islamic banks in practice. The opponents of Islamic windows claim that the Islamic branches are a just way from the

conventional banks to take a share from the growing Islamic financing market without fully applying the Islamic methods in Finance. The third group of scholars suggests that dealing with Islamic branches should be for necessity only» [5].

As we know, the Islamic window is a department or branch that operates within a traditional bank and provides products and services in accordance with Islamic financial principles [6].

Bertayeva K. Zh., defines Islamic windows as, «a branch of an ordinary conventional bank, carrying out activities in accordance with the requirements of Sharia. At the same time, the assets of Islamic and conventional divisions of the bank are not mixed, they are managed and regulated separately» [7].

The Islamic Windows are not independent financial institutions, but specialized departments within traditional financial institutions offering their clients products that comply with Islamic Sharia law. With the growing demand for products (Sharia-compliant) and fear of losing customers, non-Western traditional banks have also started offering Islamic windows [8].

In general, the concept of a full-fledged Islamic bank is being implemented in countries where the existence of such banks is legally provided for, and where the majority of the population is Muslim. For example, the United Kingdom, Malaysia, the United Arab Emirates, Oman, Kazakhstan, and Kyrgyzstan have changed their legislation to allow the existence of Islamic banks. In some countries, the law allows the existence of only full-fledged Islamic banks (along with conventional banks), and Islamic windows are limited, for example, in such countries as, Qatar and Kazakhstan [7].

The Malaysian experience shows that the opening of the Islamic windows in traditional banks has led to a sharp increase in Islamic banks in the consumer sector and an increase in interest in Islamic products and services. That is, the opening of the first Islamic bank took place back in 1983. But concrete spread began only in the nineties, after the introduction of the Islamic «windows» in conventional banks. The performance indicators of the Islamic window of

a commercial bank are relatively better compared to subsequent performance estimates obtained for the same Islamic banks. Thus, in Malaysia, the Islamic windows are more efficient than full-fledged Islamic banks [9].

In 2011, the Central Bank of Qatar issued a decree obliging all traditional banks to close their Islamic windows in order to clear Islamic services from unauthorized use of interest, or the main purpose of the decree was to create a fair competitive environment for the banking system in Qatar. However, there was no expected inflow of money to Islamic banks over the next three years and the market share did not change much. The explanation for this was that during the closure of Islamic windows, depositors kept most of their money in conventional banks. This example also shows that Islamic banks compete with traditional banks for customers who value highly efficient products [5].

In Algeria, several Islamic windows in traditional banks have been created in recent years. An example is the Islamic Window of a Housing Bank (branch). Nowadays, Housing bank's Islamic window offers 4 products: Murabaha, Salam, Istisna and El Ijara.

Currently, the Islamic window of the Housing Bank offers four Islamic products: Murabaha, Salam, Istisna, and El Ijara.

The Housing Bank started offering Islamic products and services five years ago, and during this time bank has an advantage in terms of Sharia experience and compliance. The Islamic window of the Housing Bank considers three fundamental fields:

- separation of accounting;
- separation of the computer system;
- Sharia control.

These three areas are now being observed by the management and in the future, they want to make divisions, such as counters or agencies dealing with Islamic finance.

«According to the director of the Islamic products department, the profitability of the window is higher than that of conventional banking, for several reasons:

- The window provides for an increase in the rates for financing from the start due to the absence of late penalties.

- Often, there are anticipations of payment by the customers, so the window collects all the margin even the unexpired before the due date» [10].

However, the practice of using Islamic banking windows in order to attract new clients is extremely normal in the West.

For example, in Germany, there are Islamic windows in some financial institutions such as Deutsche Bank, Hypo Real Estate Bank, Commerzbank, and insurance companies such as Allianz and FWU AG, which offer Islamic financial products: real estate transactions, private equity investments, as well as operations with Islamic securities [11].

The UK experience failed when they started by opening full-fledged Islamic banks. However, the UK has become the center of Islamic finance in the West since the opening of Islamic windows to introduce customers and players, and only then to open full-fledged Islamic banks. Today in the UK there are 5 Islamic and 17 British banks and subdivisions of foreign banks, the so-called bank windows [12].

In conclusion, countries of the Middle East prefer the creation of full-fledged Islamic banking institutions, rather than the introduction of Islamic «windows» in second-tier banks, which is gaining a large turnover in the states of Southeast Asia and in Western countries.

Methodology

The subject of the research is Islamic windows in second-tier banks. The article used empirical research methods, identified the advantages and disadvantages of Islamic windows, and applied a comparative analysis in the study of world practices of the concept of the Islamic window. In addition, we used the SWOT analysis method to comprehend the need of opening Islamic banking windows in Kazakhstan.

Discussion and Results

At a time when the business of traditional banks in the world was unstable due to the pandemic, Islamic banks showed an example

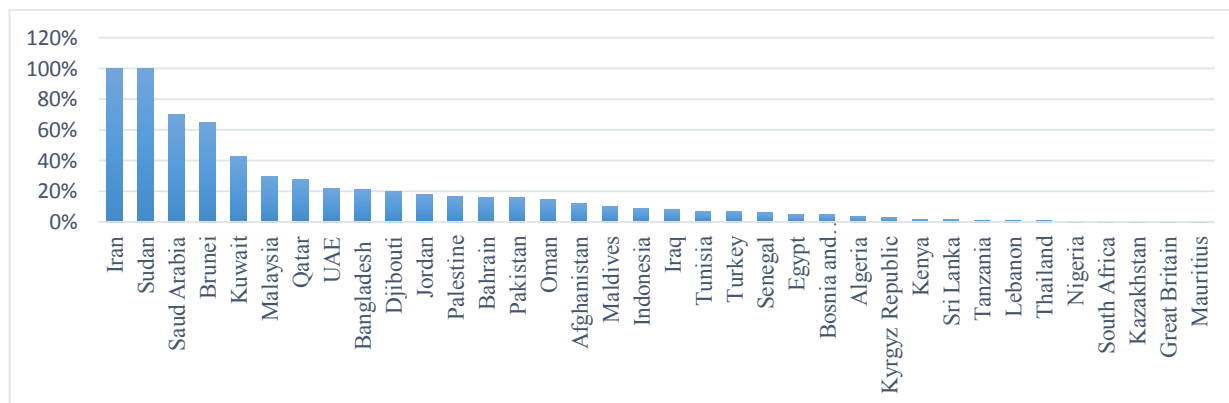


Figure 1 – Islamic Banking Share in Total Banking Assets by countries, 2019-2020.

Note: compiled by the authors [13]

of stability and reliability. They allowed clients not only to save money but also to increase their capital.

Islamic banks became more widespread as an alternative to traditional Western banks, achieving tangible results as they are able to effectively withstand these global crises.

In general, in recent years, the demand for these banking products has been growing rapidly. This is due to the fact that Islamic banks are actually the only financial institutions in the world that have not been hit by the global economic crisis. Currently, none of them need significant financial support to survive. Therefore, to a certain extent, keeping your savings is safer than in traditional banks.

Today, the Islamic finance market consists of about 700 organizations operating in more than 90 countries. The segmented volume is about 2.4 trillion. It is projected to grow by \$ 3.8 trillion by 2023. The main share of Islamic finance assets belongs to Islamic banking institutions (about 68.3%), followed by sukuk (25.6%), Islamic funds (5.3%), and takaful (0.9%)[13].

As can be seen from the figure above, the share of Islamic banking in total banking assets around the world was studied. In countries such as Sudan, Saudi Arabia, Brunei, and Kuwait, the share of Islamic banking is about 43% -100%.

In the second group of countries - Afghanistan, Oman, Pakistan, UAE, Qatar, and Malaysia - the figure is 10-30%.

Indicators of the third group of countries are 0.2% -9%. Among them are Kazakhstan, South Africa, Nigeria, Thailand, the Kyrgyz Republic, Egypt, Turkey, Indonesia, and others [13].

In 2020, the rating agency Moody's published its report. It says that in the next five years Islamic banking in the CIS will grow rapidly. This is due to the measures taken by governments in some countries to develop this area. Among the CIS countries, the leaders in the development of Islamic banking will probably be Kazakhstan, Kyrgyz Republic, Tajikistan, and Uzbekistan.

In the table was given information about the situation of Islamic windows in the CIS countries such as Kazakhstan, Kyrgyz Republic, Tajikistan, and Uzbekistan. It can be noted that in all of these countries except Kazakhstan Islamic windows are allowed. In recent years, Kazakhstan has taken the following steps to create a framework for the development of Islamic finance:

- amendments to the laws;
- defined the procedure for the reorganization of traditional banks in the form of conversion into an Islamic bank (to date, there is only one precedent of reorganization of a bank into an Islamic bank);
- The first intergovernmental agreement with the United Arab Emirates on the establishment of the country's first Islamic bank was signed;
- Kazakhstan's Constitutional Law On the Astana International Financial Centre ("AIFC") was adopted, with one of its goals being the development of Islamic finance.

Table 1

Islamic windows in CIS countries

	Countries	Islamic financial institutions (Islamic windows)
1	Kazakhstan	Currently, in Kazakhstan, there are only two Islamic banks, one Islamic financial institution, and one leasing company. It should be noted here that by law it is forbidden to create Islamic «windows» within the existing bank. That is, only a bank created from scratch, according to the Sharia can work with Islamic financial instruments.
2	Kyrgyz Republic	In the Kyrgyz Republic, Islamic banking began its development in 2006, when, with the joint efforts of the Government of the Islamic Development Bank and the National Bank of the Kyrgyz Republic, Eco-Islamic Bank was launched in pilot mode - the first bank operating on the principle of Islamic window. For 12 years, it was the only financial institution in the country, which operates according to the principles of Shariah. However, since 2017, other commercial banks in the Kyrgyz Republic have also begun to introduce new financial instruments through Islamic windows. In June 2018, the Islamic Financial Center at Bakai Bank opened in the Kyrgyz Republic. BTA Bank received a license to conduct operations on Islamic principles. Several other commercial banks are in the queue, waiting for the NBKR's approval.
3	Tajikistan	With the support of the National Bank of Tajikistan, a number of activities on the formation of the mechanism of Islamic banking and financing have been carried out, at this time the process of systematic and balanced way to introduce Islamic financial services, taking into account the experience of other countries as a modern financial product, is continuing. Also in Tajikistan in 2020 the first two Islamic «windows» for Islamic banking operations (Khumo MDO and Imon International MDO) were opened and are operating.
4	Uzbekistan	In Uzbekistan, the first attempts are being made to introduce the instruments of Islamic finance: a regulatory framework is being formed, and a number of banks are preparing to open «Islamic windows».
Note: compiled by the authors [14]		

From this, it follows that Kazakhstan has considerable potential for the development of Islamic finance with the help of the AIFC. Today, one of the projects to promote Islamic finance at the AIFC is the Master Plan, or Roadmap for the development of Islamic finance in Kazakhstan until 2025. The roadmap reviewed the recommendations and plans for the implementation of sectors such as Islamic banking, capital market, insurance (takaful) and reinsurance (retakaful), non-banking institutions, Islamic social finance, fintech, halal sector, education, and training in Islamic finance.

However, achieving the goal of 3% of the assets of Islamic banks from the total volume of banking assets of Kazakhstan by 2025 can be realized with the assistance of all interested bodies and organizations.

A fairly extensive structure of Islamic banking has been created at the AIFC. But there is still uncertainty regarding this structure and its interaction with the local jurisdiction of Kazakhstan. Another topical issue is the formation of an Islamic window in the Astana International Financial Centre. In conformity with the legal framework of AIFC, an ordinary bank can open

Table 2

Islamic windows: advantages and disadvantages

№	Advantages	Disadvantages
1	Scale and effectiveness	Drain of Islamic funds into the traditional system and mixing of reserves
2	Less effort and more efficiency	Financial reporting problem
3	Quick and easy way to attract customers	Weak sharia governance
4	Low operating costs and capital costs	Ignorance and misunderstanding by employees of the principles of Sharia
5	Experience and operating systems of traditional finance	
6	Positive relationship between Islamic banking products and bank performance (ROA)	

Note: compiled by the authors

the Islamic window, but for some participants, it remains a question of opening windows in the AIFC if their local jurisdiction does not allow the formation of the Islamic windows.

Also, our local banks cannot open windows in the AIFC, since the AIFC allows opening windows only to those institutions that are allowed to do so in their jurisdictions. It can be said that these restrictions prevent interested banks from offering Islamic banking products and services [15].

Below is given the benefits and drawbacks of Islamic windows.

Firstly, the Islamic windows have key advantages in scale and efficiency over Islamic banks. For example, windows have access to data and resources of parent banks (legal, technological, marketing, risk management, etc.). Also, the Islamic windows have a wide global reach, because, compared to Islamic banks, they are more integrated into the global financial system.

Thus, Islamic Windows can use these advantages to offer their customers a cheaper and wider range of banking services and products [16].

Also, the results of analyzes and research show that the Islamic windows of second-tier banks have higher efficiency and lower risk than

full-fledged Islamic banks. And perhaps because of the small size of full-fledged Islamic banks, they cannot enter large markets [17].

Secondly, opening Islamic windows requires less effort and more efficiency than setting up a branch of an Islamic bank. Therefore, it is an efficient way to increase the number of organizations, which offer Islamic banking products and services. They are also a faster and easier way to attract customers [18].

Third, new Islamic banks may face stiff competition from traditional banks with a good reputation and customer base. This could serve as a barrier for new Islamic banks to enter the market. In addition, Islamic windows have lower operating and capital costs compared to full-fledged Islamic banks [19].

Fourth, there is a positive relationship between Islamic banking products such as Murabaha, Ijara, Mudaraba, and the return on assets (ROA) of commercial banks. Many researchers regard to return on equity (ROE) as a measure of a bank's performance, but ROA considers the risk associated with loans as an important indicator of a bank's return on maturity [20].

These Islamic products affect the performance of commercial banks (ROA). That is, second-tier banks can grow and diversify their revenues using Islamic products [21].

Table 3

SWOT-analysis

STRENGTHS	WEAKNESSES
Socio-economic development of the country; Well-developed market infrastructure, legislative and regulatory framework; Support from government agencies; Promotion with the help of the AIFC.	Lack of knowledge about Islamic finance among the majority of the population; Lack of interest of some local banks and institutions in opening Islamic windows Lack of experience in regulating traditional institutions by Islamic windows.
OPPORTUNITIES	THREATS
Increasing the competitiveness of Islamic financial institutions (Islamic banks); Attracting foreign investment (from Muslim countries); Increase player count and organization through Islamic windows.	Exclusion of local Islamic institutions (banks) from the market; Lack of customer trust (Sharia Compliance).
Note: compiled by the authors	

Also, results based on analysis of Data Envelopment Analysis and Stochastic Frontier Analysis show, that Islamic banks are less efficient than mixed and conventional banks in generating income from their resources, and the inefficiency of Islamic banks is related to their non-investment income.

In one of the studies, the authors evaluated the performance of traditional banks and their Islamic windows in Indonesia and found that based on the CRS production approach, the Islamic windows are less efficient than commercial banks. Whereas, based on the VRS asset and production approach, the Islamic windows are more efficient than traditional banks [22].

Furthermore, the stability of the Islamic windows and full-fledged Islamic banks in Indonesia was also investigated. It was found out, that Islamic windows were more stable than full-fledged Islamic banks [23].

A comparative study of traditional and Islamic banks in Pakistan shows that second-tier banks are more efficient than Islamic banks, due to high operating costs and poor governance [24].

The disadvantages include the following points:

One of the disadvantages of windows is associated with Islamic services. That is, usually,

the parent bank's treasury is responsible for the bank's liquidity needs, which can lead to mixed funds between Islamic services and traditional banks. Moreover, the use of Islamic and traditional banking services based on interest can lead to ambiguity in the search for profit [25].

However, such shortcomings as the mixing of reserves between traditional and Islamic banking operations and the problem of financial reporting (capital adequacy and full disclosure of information about Islamic investments) can be eliminated by a subsidiary of Islamic banking [18].

As we know, the productivity of banks (Islamic or conventional) relies generally upon the skilled staff the executives, and qualified financial tasks by representatives. Banks can lose cash assets and rich customers without qualified staff, without developing proficient potential [26].

That is why, another disadvantage is the Islamic windows goals of traditional banks, which can pursue purely commercial goals. In ordinary banks, the priority of the board directors and management is to maximize profits, and not to strive for the well-being of the society, which does not comply with Sharia principles. And here the difficulty is that Islamic windows cannot guarantee the observance of Sharia. For

example, ignorance and lack of understanding by employees of Sharia principles [18].

Based on the conducted research and the study of advantages and disadvantages of Islamic windows, we made a SWOT analysis to understand the need to open the Islamic windows in Kazakhstan.

Based on the analysis, opening Islamic windows in conventional banks in Kazakhstan and through the AIFC will have a positive effect on the country's economy. We believe that Islamic windows will help attract investment and create conditions for the further development of SMEs. Thus, the opening of «Islamic windows» can help to achieve the set goals and is an urgent issue for an early solution.

Conclusion

We agree with the opinion of Yablonovskaya M.G. about Islamic windows: «Having such an extensive banking structure, our country needs to establish relations between Islamic and traditional commercial banks. This can be done by opening Islamic windows in commercial banks. Islamic windows will enable commercial banks to provide services according to the traditional Islamic financing model. The task of opening Islamic windows should be regulated by law. If the demand for opening such windows increases in our banks, then there will be no difficulties with legislation. Experts note the need to analyze the global legislative experience in the introduction of Islamic finance, and on the basis of this, our country can already develop its own model. The best option here would be to adopt and adapt world practice to our conditions.» [27].

Furthermore, as we have seen from world practice, traditional banks often use Islamic «windows».

Therefore, we believe that the opening of Islamic windows in traditional institutions could become a lever for the growth and development of Islamic finance in Kazakhstan.

Thus, we believe that the opening of «Islamic windows» in traditional financial institutions could become a lever for the development of the Islamic finance market. It is necessary to support the «Islamic windows» that accelerate the process of introducing Islamic financial instruments. As shown in the study, the development of Islamic finance in the world proceeds precisely through the opening of Islamic banking departments in conventional banks, that is, through «Islamic windows». Therefore, we believe that the opening of «Islamic windows» would help the development of Islamic banking in Kazakhstan and that would reduce the barrier to starting work with new instruments. We would especially like to mention the experience of Algeria (Islamic Window of the Housing Bank). We assume that the opening of the Islamic window at Otbasyl Bank (HCSB) will contribute to the development of Islamic finance in Kazakhstan.

Also, we believe that the establishment of so-called «Islamic windows» in public development institutions such as Zhilstroisberbank KZ, Damu Entrepreneurship Development Fund, Development Bank of Kazakhstan, KazAgro National Management Holding, and others could be another effective mechanism for the development of the Islamic finance market. It is critical that Islamic financial enterprises have similar access to government programs and financing as traditional banks and financial organizations. As a result, they would be able to expand their operations and provide full access to their products to clients through government programs.

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Қазақстанда ислам қаржысын дамыту перспективалары мен мүмкіндіктері: ислам терезелерін ашу

Аннотация. Мақалада исламдық «терезелерді» ашу арқылы Қазақстандағы исламдық қаржыландырудың даму перспективалары қарастырылады. Индонезия, Малайзия, Катар, Германия, Ұлыбритания, Алжир сияқты елдердегі дәстүрлі қаржы институттарында исламдық терезелерді енгізудің әлемдік тәжірибесі де қарастырылды. Бұл зерттеуде исламдық банктер мен дәстүрлі банктердің исламдық терезелері олардың артықшылықтары мен кемшіліктері салыстырылып қарастырылып отыр. Осы мақаланың мақсаты - Қазақстан Республикасында исламдық терезелерді енгізу перспективаларын зерттеп қарастыру.

Мақалада эмпирикалық зерттеу әдістері қолданылды (салыстыру). Қазақстандағы дәстүрлі мекемелерде (дәстүрлі банктерде) исламдық терезелерді қолданудың күшті, әлсіз жақтары, мүмкіндіктері мен қатерлері (SWOT-талдау) талданды.

Осы зерттеуде жүргізілген талдау көрсеткендей, әлемдік тәжірибеде дәстүрлі банктерде «исламдық терезелер» деп аталатын исламдық банктік бөлімшелердің ашылуы сол елдерде исламдық қаржыландыру дамуының бастамасы болғанын көрсетіп отыр. Сонымен қатар, дәстүрлі банктердің исламдық терезелерінің тиімділігі ислам банкімен салыстырғанда әлдеқайда жоғары екендігі анықталды.

Осылайша, Қазақстан Республикасының қаржы институттары мен екінші деңгейлі банктерінде «исламдық терезелердің» ашылуы исламдық қаржы нарығын дамытудың тиімді тетігі бола алады және исламдық қаржы құралдарын енгізу процесін жеделдетуіне көмектеседі.

Түйін сөздер: Ислам қаржысы, Ислам терезелері, Ислам банктері, дәстүрлі банктер, екінші деңгейлі банктер, Ислам қаржы нарығы, Исламдық қаржы құралдары

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Перспективы и возможности развития исламских финансов в Казахстане: открытие исламских окон

Аннотация. В статье рассматриваются перспективы развития исламского финансирования в Казахстане путем открытия исламских «окон». Также была рассмотрена мировая практика внедрения исламских окон в традиционных банках и институтах, в таких странах, как Индонезия, Малайзия, Катар, Германия, Соединенное Королевство, Алжир. Это исследование направлено на сравнение исламских банков

и исламских окон традиционных банков с точки зрения их преимуществ и недостатков. Целью данной статьи является исследование перспективы внедрения исламских окон в Республике Казахстан.

В работе применены эмпирические методы исследования (сравнение). Проанализированы сильные, слабые стороны, возможности и угрозы (SWOT-анализ) применения исламских окон в традиционных институтах (банков) в Республике Казахстан.

Анализ, проведенный в этом исследовании, показывает, что в мировой практике открытие в традиционных банках департаментов исламского банкинга, который называется «исламские окна», стало началом развития исламских финансов в этих же странах. Также было выявлено, что эффективность «исламских окон» обычных банков оказалась намного выше по сравнению с исламским банком.

Таким образом, открытие «исламских окон» в банках второго уровня и финансовых институтах Республики Казахстан может стать действенным механизмом для развития рынка исламских финансов и ускорит процесс внедрения исламских финансовых инструментов.

Ключевые слова: исламские финансы, «исламские окна», исламские банки, традиционные банки, банки второго уровня, рынок исламских финансов, исламские финансовые инструменты.

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