Muhammadan Jurisprudence According to the Sunni Schools

Shi'i Islamic Perspective on Finance (Foundations of the Islamic Economical System)

A Legal Framework for Sovereign Sukuk

Reaching Consensus in the Shari'ah Compliance Debate

Blockchain Technology – What Is It and How Are Islamic Financial Institutions Beginning to Use It?
Education, learning and development
Over 20 years of service to the Islamic finance industry

“Our Industry is a moral disaster”
Jonathan Bulfer, 2011 Banker and Philanthropist

“At a time when world leaders are calling for financial reforms, it is appropriate to have our financial system built on widely accepted ethical and moral basis to serve the common good of humanity”
Dr Ahmad Mohamed Ali, President, Islamic Development Bank

“The ethical principles on which Islamic finance is based may bring banks closer to their clients and to the true spirit which should mark every financial service”
Osservatore Romano, Vatican official newspaper March 2009

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Based on a series of lectures given at the University of Calcutta by Sir Abdur Rahim, this article offers a historical perspective on the very earliest origins of Islamic jurisprudence. The lectures covered a very broad range of issues, but in this piece we concentrate on those that relate to Islamic finance today.

25 Shi’i Islamic Perspective on Finance (Foundations of the Islamic Economical System)
This lecture delivered at the University of Vienna in 2011 by Hujjatul Islam Taher Amini Golestani, brings the story of applying Islamic principles to finance and the economy up to date. It ultimately draws the distinction between equal distribution of wealth and resources and fair and equitable distribution. In other words, unlike communist ideologies, it does not forbid the accumulation of wealth and resources, but it does insist that this cannot be done in a way that results in poverty and destitution for any member of society.

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Cover: Kul-Sharif Mosque. It was opened in 2005 to celebrate the 1000th anniversary of Kazan, the capital of Tatarstan, Russia. The original mosque was destroyed in 1552 and construction of the new mosque started in 1996 was completed with a decisively modern look. At the time it was reputed to be one of the largest mosques in Russia, and in Europe outside of Turkey.
Executive Editor’s Note

This issue of NewHorizon has two articles which look back to the past and in the case of an article entitled Muhammadan Jurisprudence to the distant past. Shari’ah is based not only on the Qur’an and the Hadiths, but was also influenced to an extent by the customs of the pre-Islamic tribes. It is often difficult for the modern Islamic finance industry and the scholars who advise it to reconcile laws laid down more than 1,500 years ago with a world that could not have been dreamed of at that time. It is critical, however, that they do so and do so in a way that lays down clear standards for the Islamic finance industry today without contravening the two principle sources mentioned.

Competing with the conventional industry must not mean developing products and services that are thinly disguised versions of that industry’s products and services, but it does mean Islamic financial institutions need to be able to compete on a global basis, across borders with no fear that its products and services will be challenged on the basis that they are not Shari’ah compliant. Even worse is the situation where a product is declared not Shari’ah compliant in the same jurisdiction that apparently approved it just a few years before, as was the case with Dana Gas. Without complete confidence in the integrity of Islamic financial products and services some investors will shy away from investing in them.

The importance of clear guidelines is being recognised not just by Islamic standards setting bodies but also by organisations such as the World Bank, who, in 2017, issued a discussion paper on a legal framework for sovereign sukuk. In addition to some very practical suggestions such as clear debt management objectives and assurance of debt services, they include the rider that it is important to respect underlying Islamic principles.

The road towards standardisation on a global basis will not be an easy one. It will take time and a willingness to put aside vested interests, but it is a goal of which the industry should not lose sight. The rewards in terms of industry growth and the development of an alternative approach to that of the conventional finance institutions, satisfying the aspirations not only of Muslims but also all people who want to see a fairer, more humane financial system, will be significant.
Are Conventional Bank Practices Diluting the Principles of Islamic Banks?

New research co-authored by the London-based Cass Business School suggests that traditional Islamic banks are more likely to adopt controversial practices introduced to the sector by conventional banks, than those that are introduced by a similar Islamic bank. The research is based on a data set consisting of 143 Islamic banks in 23 countries; 101 of these banks are considered ‘insiders’ as they are full-fledged or traditional Islamic banks, while 42 are Islamic bank operations owned by a conventional bank, often internationally known, and are considered ‘outsiders’.

The asset worth of the Islamic banking sector tripled between 1996 and 2017, growing from 509 billion US dollars to more than 1.5 trillion US dollars. This rapid growth has seen conventional banks venture into the sector to establish their own Islamic bank operations, bringing with them practices that are often in opposition to Islamic banking principles that are embedded in religion. Among the most controversial of these practices is the adoption of financial derivatives – a practice considered incompatible with Shari’ah and in violation of the principles of Islamic banking.

The research found that despite the controversy surrounding financial derivatives, traditional Islamic banks are willing to adopt the practice when it is introduced by conventional banks seen as outsiders to the industry. These practices are most frequently adopted by traditional Islamic banks as a means of competing with the outsider and under the rationale that the outsider bank is so different to the traditional insider bank that adopting their practices is akin to levelling the playing field.

Co-author of the paper, Cass Business School’s Dr Maima Aulia Syakhroza said that as competition from conventional banks increases in the Islamic banking sector opposition to violations of its traditional principles is diluted. ‘The more intense the competition, usually what happens is that the theological undertones become more subtle,’ Dr Syakhroza said. In contrast, derivatives introduced to the sector by full-fledged Islamic banks, are rejected by their peer banks as there is a perception it could damage the purity of the Islamic banking sector as a whole.

‘When a fellow Islamic bank violated the principles, other banks were afraid that their whole image would be tainted; they were afraid that they would be seen as no different to the conventional banks,’ Dr Syakhroza said.

The paper ‘Holier than Thou? Identity Buffers and Adoption of Controversial Practices in the Islamic Banking Category’ is published online and will be printed in the Academy of Management Journal later in 2019.
Unleashing the Potential of Islamic Finance

The Islamic Research and Training Institute (IRTI) of the Islamic Development Bank (IsDB) Group has published the second edition of the Global Report on Islamic Finance, which highlights steps for unleashing the potential of Islamic finance to help harness the much-needed funds for long-term investment in development programmes.

Subtitled ‘The Role of Islamic Finance in Financing Long-Term Investments’, the report was launched by the Acting Director General of IRTI, Dr. Sami Al-Suwailem, during the 25th World Islamic Banking Conference in Bahrain. The report presents global perspectives on the challenges of financing the 2030 global agenda for sustainable development and highlights the potential of Islamic finance to address the funding gap.

Development partners have identified that the scale of funding required to achieve sustainable development goes beyond the scope of traditional financing sources, underscoring the need to tap alternative sources. While private sector funds are available for investment, the report finds that these resources are mostly deployed in short-term instruments, largely because of the potential risk of investing for the long term. The annual long-term funding gap for the Sustainable Development Goals (SDGs) is estimated to be $2.4 trillion, even though $42 trillion is available in short-term funds with low or negative returns.

Islamic finance, which is based on the principles of risk sharing, addresses the risk element and therefore offers an alternative channel to mobilise long-term financing. The report notes that by unleashing the potential of Islamic finance, funding could be harnessed for programmes aimed to eradicate extreme poverty, develop infrastructure, provide education, ensure access to clean water and fight climate change. It therefore proposes incentivising risk sharing and asset-backed finance as the potential mechanism to attract financing for long-term investments. The report finds, however, that in order to optimally tap the potential of Islamic finance in this regard, developing the enabling legal, regulatory and financial ecosystem is essential.

The report made two major recommendations, namely to strengthen the financial system through developing the regulatory environment and to enhance the institutional framework and diversity of instruments for long-term financing.

The full text of the report is downloadable from the IRTI website.

State Bank of Pakistan Approves Three Refinancing Schemes for Islamic Banks

Islamic banks in Pakistan are to be allowed to offer cheaper refinancing facilities to agriculture, renewable energy and SMEs (small and medium-sized enterprises). Conventional banks have been allowed to do this for the last three to four years and Islamic banks have been lobbying for the State Bank of Pakistan (SBP) to create a level playing field for some time. Apart from opening up new opportunities for the Islamic banks, it will allow them to find a home for some of their excess liquidity. (The main avenue for using excess liquidity in the past has been investment in sukuk, but there have been no sovereign sukuk issued in Pakistan for two years.)

Islamic Banks Doing Well in the UAE

Emirates Islamic's latest Islamic Banking Index study suggests that the popularity of Islamic banking products continues to grow in the UAE among both Muslim and non-Muslim customers. Findings demonstrate that Islamic banks are outperforming their conventional peers in customer acquisition - 55% of the UAE consumers now have at least one Islamic banking product, compared to 47% when the Index was launched in 2015. In contrast, the penetration score for conventional banking products has shrunk from 69% in 2017 to 63% in 2018.

In addition the study found that Islamic banks are considered to be more trustworthy, supportive of the community in meaningful ways and more financially sound than conventional banks. Non-Muslims, however, feel that Islamic banks are falling behind conventional banks on faster service and easy procedures.
Increasing Financial Inclusion in Ethiopia

International consultancy IFAAS (Islamic Finance Advisory and Assurance Services) and Mercy Corps (MC), a global non-governmental, humanitarian aid organisation, are working together to unlock the potential of Islamic finance to address the issue of financial inclusion in Ethiopia. (Mercy Corp specialises in facilitating financial inclusion for chronically under-served individuals and businesses through market-driven approaches in countries affected by conflict, natural disasters, and economic and political crises. Their work in this area is partly-funded by the United Kingdom’s Department for International Development).

The primary objective of the project was to undertake a comprehensive assessment of the Ethiopian financial industry, including banking, insurance and microfinance to identify the obstacles in the development and growth of Shari’ah-compliant financial services that are critical to financial inclusion initiatives in Ethiopia.

Muslims make up around 34% of Ethiopia’s population of nearly 100 million, the second largest Muslim population on the African continent. According to World Bank statistics in 2017, only 35% of the population have an account with a regulated financial institution, a rate that is significantly below the global average (it is estimated to be much lower among the Ethiopian Muslims). The availability of interest-free finance is therefore a crucial element to any financial inclusion programme in Ethiopia.

The key findings of the study have highlighted a wide range of challenges and gaps in the areas of policy framework and regulatory infrastructure, awareness and capacity building, market intelligence and product development.

Najib al Aswad, Director at IFAAS, commenting on the study said, ‘Our overarching aim was to develop a roadmap for MC with a set of sustainable and scalable interventions for the development of interest-free finance in Ethiopia. These interventions were structured to ensure that the interest-free finance sector plays an active role in the economic development of the country and achieves the national targets for financial inclusion. We are pleased that MC is facilitating the implementation of our recommendations. We also look forward to seeing our work delivering positive and real impact to the livelihood of the country’s population. Limited financial inclusion is a real issue in the country, and across Africa as a whole, and MC’s work in this area is critical in tackling poverty in the region’.

Following the success of this project, MC has appointed IFAAS to assist a leading Ethiopian microfinance company in setting up its Islamic window and accordingly offering interest-free microfinance products to deprived local communities.

World Islamic Banking Conference Reports Positive Outlook for Islamic Finance

Several speakers at the World Islamic Banking Conference, held in Bahrain in November 2018, were bullish about the prospects for Islamic finance. Shaima Hasan, research and product development manager, Refinitiv, a provider of financial products and services and formerly part of the Thomson Reuters Group, said the Islamic finance industry will continue to grow in the short to mid-term. She forecast that total assets are likely to reach $3.8 trillion by 2023 (assets stood at $2.4 trillion in 2017). The main drivers of growth are Malaysia, Bahrain and the UAE, but new players are likely to boost the sector, particularly Morocco, Nigeria, the UK, Hong Kong, Russia, Luxembourg and Kazakhstan.

Issam Abousleiman, regional director, GCC countries, World Bank, noted that Islamic finance industry growth is set to continue, but he commented that regulations in the industry are lagging behind and that the industry needs to focus on this to bring them up to global standards.
Dubai Islamic Bank to Acquire Noor Bank

Dubai Islamic Bank (DIB) is set to acquire Noor Bank, creating the region’s most powerful Shari’ah banking group. Noor Bank’s operations will be integrated and consolidated within DIB. The acquisition is dependent on the approval of the regulatory authorities and DIB’s shareholders.

DIB believe the acquisition will enhance its influence, deliver increased market share and improve operational efficiencies. With the planned acquisition, DIB is set to consolidate its position as one of the largest Islamic banks in the world with combined assets of nearly AED 275 billion.

Dr Adnan Chilwan, GCEO, Dubai Islamic Bank, commented, ‘The acquisition of Noor Bank is in line with our disciplined yet flexible growth strategy which strikes the perfect balance between market dynamics and shareholder interest. We have always been open to both organic and inorganic growth as long as profitability and returns are protected and this transaction is no different. The economics of the deal will allow us the opportunity to capitalise on synergies, notably cost efficiencies, digitisation, product and business development and most importantly the customer experience.

‘We are confident that this acquisition will build upon the already strong foundations we have established and accelerate our growth in the sector. Islamic finance is increasingly acknowledged as a viable alternative to conventional banking and through this acquisition, we believe that we can geometrically accelerate the growth and popularity of Shari’ah-compliant finance across the region and beyond.

‘Our focus will remain on providing the highest standards of service and we are committed to integrating the two operations as quickly and effectively as possible in order to provide a seamless experience for our increased customer base.

‘This scale will provide greater efficiencies and reduce our operational costs. However, we recognise the importance of maintaining strong governance and will be working tirelessly to embed robust compliance across the group to ensure that our customers, business partners and regulators enjoy the utmost confidence in the new combined operation.’

Cost efficiencies, as a result, of the acquisition are expected to contribute to profitability and allow the bank to capitalise on more competitively-priced products and services across an increasingly diversified portfolio. Similarly opportunities to drive innovation and accelerate the Group’s digitisation programme are also expected.

Al Hilal to be Acquired by New UAE Banking Group

Abu Dhabi Commercial Bank (ADCB) and Union National Bank (UNB) have agreed a merger and the decision to acquire Islamic bank, Al Hilal for Dh 1 billion. One of the main drivers of the merger/acquisition is to produce savings in operating costs, which are expected to be in the region of 13%.

The new entity will be the third largest banking group in the UAE and the fifth largest in the GCC. The group will operate under the ADCB identity, although the Al Hilal will retain its separate name and identity and operate as a separate Islamic banking entity within the group. The new group will be 60.2% owned by the Abu Dhabi Investment Council, 28% by other ADCB shareholders and 11.8% by UNB shareholders. The merger/acquisition is subject to regulatory and shareholder approval, which is expected in the first half of 2019.

Bangladesh Islamic Banks See a Sharp Fall in Liquidity

According to a report in Bangladesh’s Daily Star, based on central bank information, Islamic banks in the country saw a sharp fall in liquidity in the three months July to September 2018. The loan/deposit ratio rocketed to 97%, which is significantly above the 90% ceiling set by the central bank. Five of the eight fully-fledged Islamic banks breached the ceiling. The central bank has required the affected banks to reduce the ratio to 89% by March 2019.
A Disappointing Year for Islamic Finance

Zubair Mughal, Chief Executive Officer of AlHuda Centre of Islamic Banking and Economics has said that 2018 has not proved as beneficial for the global Islamic banking and finance industry as expected. He ascribed the muted results to a variety of factors including the Middle East political situation, depressed oil prices, and international trade wars. He was, however more hopeful about the prospects for 2019. He predicted that the Islamic finance industry would reach $2.5 trillion in 2019 with banking taking the lion’s share of the pot at 81%, sukuk 11%, takaful 2% and Islamic microfinance 1%.

He went on to say that, while he expected average growth levels in the Middle East to remain static, he expected emerging Islamic finance markets to do rather better. He highlighted the fact that Tanzania and Kenya are expected to introduce and enhance regulatory frameworks for the Islamic financial industry and these moves are expected to have a positive effect on growth. He also expected Uganda, Ethiopia, Nigeria, Morocco and Senegal to show growth.

In 2019 prospects for the takaful industry are not seen as strong for all the same reasons that have held it back in the past. Prospects for the Sukuk industry are thought to be good, as are those for Islamic microfinance, which is expected to grow from a 1% to a 2% share of the growing total.

Zubair Mughal further expressed his views that the Islamic banking and finance demand in Malaysia, Indonesia, Pakistan and Bangladesh in Asia will increase, as will Russia, Kazakhstan and Uzbekistan.

He also rather boldly suggested that the Reserve Bank of India (RBI), after the Indian elections on April/May 2019, will allow Islamic banking. (There have been several false dawns for Islamic banking in India and it will be interesting to see if anything happens this time. We have to confess to a certain degree of scepticism.)

Jam Tomorrow for the Islamic Finance Market

S&P recently reported a slowdown in the growth of the Islamic finance industry, falling from 10% in 2017 to 2% in 2018. S&P suggest that the 2017 growth was largely attributable to some very large sukuk issuances in the GCC. The Islamic banking market has also been fairly flat mainly due to declines in Iran and Turkey. Malaysia, Indonesia and the GCC countries bucked the trend.

S&P expect market growth to be slow in the next two years, although in the mid to longer term they are expecting to see some bounce back. They list the factors that will drive growth as greater standardisation of documentation, the acceptance of and implementation of fintech and the impact of environmental, sustainable and green initiatives.

Untapped Market for Islamic Finance in the UK

In April 2019 UK Islamic bank, Gatehouse surveyed 1,000 Muslims living in the UK. The results showed that nearly half (46%) of Muslim consumers have never used Shari’ah-compliant products. That figure rises to 53% among Muslim women. Gatehouse believe this should be a wake-up call for Shari’ah-compliant financial services providers in the UK.
Despite the fact that so many Muslims have not chosen to use Shari’ah-compliant financial services, they nevertheless have a positive view of these services. Of the 1,000 Muslim consumers interviewed 71% said that they believed Islamic finance is dedicated to the interests of the community and 61% believe that it works harder to serve its customers better. Of those respondents who had used Islamic financial services, 85% said that their experience had exceeded expectations.

Despite these seemingly positive attitudes, 61% of respondents expressed scepticism about just how Shari’ah compliant the products on offer were. It would seem that the industry in the UK is failing to get its message across. This is backed up by the fact that 53% of non users admitted to knowing nothing about Islamic finance and only 35% of non users viewed it favourably. Among those who were non users and who further said they were not interested, awareness of Islamic finance fell to just 35% and positive perception to a meagre 3%. In addition 60% of respondents said they found products difficult to buy and 62% found it difficult to compare with other options.

Just over one-third of the non users had heard about Islamic finance through friends, family or work colleagues. The internet was a source of information for 28%; 18% had heard about it through social media and 14% through Muslim-specific media. The over 45 age group were more inclined to rely on advice from Muslim financial leaders, whereas the 25 - 44 age group valued media sources.

Charles Haresnape, CEO of Gatehouse Bank commented, ‘Our report highlights that providers of Shari’ah-compliant finance are missing out because of a largely untapped market for their products. If nearly half of all Muslim consumers have never used Islamic finance that means hundreds of thousands of potential customers are waiting to be reached. A key lesson is that we and the whole industry need to do a better job of reaching out to the Muslim community and explaining the benefits of Shari’ah-compliant products. Most importantly, the research shows we need happy customers and faith leaders to become community advocates for Islamic finance because word-of-mouth is highly valued among Muslim consumers.’

**IFSFB Examine Risk-Sharing Practices in the Islamic Banking Sector**

The Islamic Financial Services Board (IFSB) has issued its 10th research paper (WP-10) in the IFSB Working Paper series that explores the risk-sharing practices in the Islamic banking sector. This working paper is basically both exploratory and cross-sectional in nature. It describes the views of both Islamic banks and regulatory and supervisory authorities (RSAs) on the practices of Islamic banks in IFSB member jurisdictions. This is in relation to the governance rights of unrestricted profit-sharing investment account (UPSIA) holders, as well as likely reasons that may account for the limited usage of equity-based contracts (such as mudarabah and musharakah) especially on the asset side of the balance sheet of Islamic banks.

The findings in WP-10 reveal that the capital treatment of the UPSIA in general varies across different jurisdictions and Islamic banking type. In most of the jurisdictions UPSIAs are considered to be ‘investments’ exposed to losses rather than ‘deposits’ with capital certainty. In addition, the UPSIA holders’ lack of governance rights is well-noted by both the RSAs and the Islamic banks. However, neither consider indirect monitoring by the shareholders sufficient to make up for the lack of governance rights of the UPSIA holders.

Furthermore, WP-10 indicates that Islamic banks comply mostly with the disclosure requirements relating to the utilisation of the profit equalisation reserve (PER) and/or investment risk reserve (IRR) and consider the basis of allocation of profits between the Islamic banks’ shareholders and UPSIA holders, including the maximum mudarib percentage share as being very important. Both the PER and IRR are also often used as smoothing techniques.

WP-10 also reveals that high regulatory risk weights required on mudarabah and musharakah assets (excluding diminishing musharakah for home purchase finance) discourage Islamic banks from placing funds in such assets. Other reasons include the agency and transactions costs attaching to such assets. Specifically in this regard, the operational risks reflected in the lack of human resources with the requisite knowledge and understanding of the specificities of risk-sharing contracts is noted.
FTSE Russell has launched a new Shari’ah-compliant index tracking companies listed on the Singapore Exchange (SGX). The FTSE ST Singapore Shari’ah Index has been designed to track Shari’ah-compliant companies listed on SGX and can used as the basis of investment products. Independent screening is carried out by Yasaar Ltd, an organisation with a global network of expert Shari’ah scholars. The indexes have been certified as Shari’ah-compliant through the issue of a Fatwa by Yasaar’s principles. Using the FTSE ST All-Share Index as a base universe, constituents are screened against a clear set of Shari’ah principles to create a robust Shari’ah-compliant index for the Singapore market. At launch, there are 48 constituents in the FTSE ST Singapore Shari’ah Index.

The National Bank of Bahrain has entered discussions with the Islamic Development Bank to acquire the latter’s 14.4% share holding in Bahrain Islamic Bank. The deal is subject to all the usual approvals and due diligence. The acquisition would create a bank with $11.5 billion in assets.

In mid November a bill to establish a framework for Islamic banking in the Philippines was given its second reading in the House of Representatives. The bill allows for the central bank of the Philippines to licence, supervise and regulate Islamic banks and Islamic banking window operations, provided the latter are completely segregated from conventional banking operations.

The UAE’s Al Hilal Bank has become the first Islamic bank to use blockchain technology to settle a portion of a sukuk issued in the late summer of 2018. The $0.5 billion sukuk is due to mature in September 2023. The Bank partnered with UAE fintech company, Jibrel Network, to facilitate the transaction.

The Tunisian Government has sold its stakes in Zitouna Bank and Zitouna Takaful. The Qatari Majda Group, an investment company acquired the stakes through an international tender.

In Brief

In the UAE, Arabian Business, has reported that Abu Dhabi Islamic Bank is looking for some kind of merger, either with a larger entity or by buying a smaller institution. The UAE has seen two major mergers in the last 18 months, leaving Abu Dhabi Islamic Bank out in the cold with limited options to consolidate its position. One of the driving factors is thought to be the rising cost of regulatory compliance, which is a heavier burden for smaller institutions.

The Turkey’s BDDK, the country’s banking authority, has approved Turkey’s sixth Islamic bank. Emlak Katilim Bankasi, a state-owned bank specialising in the real estate and constructions sectors has converted from a conventional bank to become a participation bank as Islamic banks in Turkey are known. The bank aims to have 15 branches in seven regions by the end of 2019. (Emlak was
founded in 1946, but its licence was revoked in 2001 and its assets and liabilities transferred to another state-owned bank – Ziraat.)

Islamic banking is about to arrive in the Seychelles. Al Salam Bank, 70% owned by Al Salam Bank of Bahrain, has already opened for business, although in mid February it was still awaiting the legal framework for Islamic banking to be approved by the National Assembly of the Seychelles. Currently they are able to offer retail and corporate banking and must await legislative approval before it can offer personal banking.

Bahrain Islamic Bank (BisB) has launched its first fully fledged digital branch in Galleria Mall, Zinj. The branch will allow customers to perform a variety of transactions without the need for human intervention such as cardless cash withdrawals or deposits, cheque book printing as well instant card issuance through the use of a dedicated self-service kiosk. Customers can also open accounts, apply for financing, maintain or update their records and even speak to a bank representative through a video screen.

Turkey’s Participation Banks Association has reported that the net profits for participation banks in the country rose 34.1% in 2018. Assets were up 29.1% to account for 5.3% of total banking assets in Turkey, up from 4.9% in 2017.

RAM Ratings’ annual publication, Islamic Banking Insight, suggests that Islamic finance remains the driving force behind the growth of the Malaysian banking industry. In 2018 loans from Islamic banks grew at 11% compared to just 3.3% for the conventional sector. At the end of January 2019, Islamic financing accounted for some 32% of the overall system’s loans. RAM Ratings expects the financing growth of the Islamic banking sector to stand at around 10-11% in 2019.

Plans to launch an energy-focussed bank in Qatar were disclosed at a recent Islamic finance event in Doha. The bank is expected to launch towards the end of 2019. With a capital of $10 billion, the bank will target energy projects both inside and outside Qatar.

The Islamic Corporation for the Development of the Private Sector (ICD) signed an agreement to assist Kapitalbank, a private commercial bank in Uzbekistan, with technical advisory services for the establishment of a new Islamic banking window.

Uganda is currently evaluating applications from three banks, two foreign and one local, to offer Islamic banking services in the country. Uganda amended its Financial Institutions Act in 2016 to allow Islamic banking.

Barwa Bank has announced the official completion of its legal merger with International Bank of Qatar. The combined entity’s total assets are valued at more than QAR 80 billion. The merger announcement follows the initial agreement signing between both banks in mid 2018. The operational completion of the merger is expected by the end of 2019.

The Malaysian Building Society (FNB) has launched a trade finance module as part of its Islamic banking product suite. It is modelled on a murabaha arrangement, where the bank enters into an agreement to purchase and assume legal possession of items being imported and selling them to the customer upon delivery.

South Africa’s First National Bank (FNB) has launched a trade finance module as part of its Islamic banking product suite. It is modelled on a murabaha arrangement, where the bank enters into an agreement to purchase and assume legal possession of items being imported and selling them to the customer upon delivery.

Qatar Central Bank (QCB) is understood to be investigating the possibility of establishing a centralised Shari’ah board with overarching responsibility for setting the standards for Shari’ah-compliant banking products in the Emirate. Currently Islamic banks have their own Shari’ah boards responsible for ensuring these institutions conform to Islamic principles in the products and services they offer. (In 2018 Islamic banks in Qatar saw an 8.5% increase in profits when compared to 2017.)

The Malaysian Building Society, which became a fully-fledged Islamic bank in 2018, following their acquisition of Asian Finance Bank Bhd, posted a fall in profits for the first quarter of 2019 compared to the same period in 2018. The loss is put down to higher than expected credit losses recognised by the bank. The decline in profits is believed to be, at least in part, responsible for a significant weakening in the bank’s share price.
Sukuk Update

Oman Raises $1.5 Billion Sukuk
In late October Oman raised a seven-year $1.5 billion sukuk, but at a price. The final spread was 280 basis points, which was 15-20 basis points above what some considered to be a fair value and 50 basis points above Oman’s last sukuk issued in late 2017. Commentators believe the deterioration in Saudi Arabia’s international relations due to the killing of journalist, Jamal Khashoggi, is responsible for the higher costs of funding.

The sukuk issuance received orders worth $3.5 billion and closed with a final spread of 280 basis point above mid-swaps. (The initial price guide was 300 basis points above mid-swaps.)

Malaysia Sukuk Market Ahead of Target
According to RAM Ratings by the end of September 2018 Malaysia’s sukuk issuance had exceeded its target for the 2018 calendar year. The total sukuk issued amounted to RM 123.9 billion against a full year target of RM 100-120 billion. The growth was attributable to government issuance, up 17% on the previous year. Corporate issuance declined by 41.8%. Overall Malaysia remained dominant in the global market, commanding a 35% share.

Malaysia is the bright spot in the global sukuk market, which, for the year ending September 2018, showed a decline of 12.2% over the 12 months to September 2017. RAM ratings expect the sukuk market to remain muted during the rest of 2018, possibly falling below their forecast level of $75-85 billion.

Al Baraka South Africa Claim a Sukuk First
Durban-based Al Baraka Bank has become the first South African financial institution to issue a Tier 2 capital sukuk raising R200 million from the retail market. A total of 94 people and institutions have invested in the sukuk, primarily individuals in the professional and business sectors, with a number of institutions also joining the investor base. Al Baraka Bank has created a special purpose vehicle, Al Baraka Sukuk Trust, to manage the flow of investments from sukuk holders to the bank.

Financial Director, Mr Abdullah Ameed commenting on the issuance said, ‘Because of the little-known nature of sukuk and its risks and rewards in South Africa, we adopted a one-on-one, soft marketing approach to presenting and securing acceptance of the concept, which proved most successful. Although fully-subscribed at this time, we now have numerous prospective investors showing great interest in the sukuk investment concept which, based on the risk involved, yields an encouragingly higher rate of return to holders. ‘This makes it a most attractive investment vehicle and, because of the popularity it has gained, we intend giving serious consideration to further capital issuances in the future,"
Oil Price Key to 2019 Sukuk Performance
A report from S&P suggests that the sukuk market performance in 2019 is likely to remain muted, if Brent oil prices stabilise at $55 a barrel. They are forecasting issuance of between $105 billion and $115 billion for the year. This follows a drop in issuance in 2018 to $114 billion, a fall of 5% on 2017. If Brent oil prices fall below the $55 a barrel level for a sustained period, this could see sovereign issuances from GCC countries increase. S&P also cite tightening liquidity conditions worldwide, geopolitical risks in the Middle East and the general level of risk associated with sukuk issuance as reasons for the predicted lacklustre performance of the sukuk market. In 2018 the market was particularly affected by drops in issuances from Saudi Arabia and Qatar, which were only partially offset by issuances from the Central Bank of Kuwait and private issuances in the United Arab Emirates. Malaysia and Indonesia were mainstays of the sukuk market in 2018 accounting for 52% of total issuances. Turkey also ramped up activity in the second half of the year in an attempt to offset their reliance on external debt and reduced access to global capital markets.

AAOIFI Revises Sukuk Standards
AAOIFI has issued two new financial accounting standards for sukuk. The first, FAS33, supersedes FAS25 and sets out improved principles for classification, recognition, measurement, presentation and disclosure of investment in sukuk, shares and other similar investment instruments made by Islamic financial institutions in line with Shari’ah principles. It defines the key types of instruments of Shari’ah-compliant investments and defines the primary accounting treatments commensurate with the characteristics and business model of the institution under which the investments are made.

The second, FAS34, establishes the principles of accounting and financial reporting for assets and businesses underlying the sukuk to ensure transparent and fair reporting to all relevant stakeholders, including the sukuk holders. It is proposed that this will be achieved through an external audit of the sukuk at least annually. The aim is to fill a void where there are currently no financial reporting requirements for the stakeholders, a situation that jeopardises confidence in sukuk. The new standards will come into effect from 1 January 2020.

Dubai Islamic Bank Lists $750 million Sukuk
On January 22 2019 Dubai Islamic Bank (DIB) listed a $750 million sukuk on Nasdaq Dubai. The sukuk was 4.9 times oversubscribed with a profit rate of 6.25% per annum. Allocation was 62% to Middle East investors, 19% to Europe, 18% to Asia and 1% to US offshore. As a perpetual non-call six-year sukuk, it was the first hybrid capital issuance from the GCC in 2019.

Just over a month after this successful sukuk issue, DB shareholders approved the setting up of a $5 billion non-convertible sukuk programme, plus a $2 billion ($1 billion tier one and $1 billion tier two) issue of capital-
boosting Islamic bonds. The timing and currency of the sukuk will be determined by the DIB board.

**Islamic Development Bank Issue EUR-Denominated Sukuk**

At the end of January the Islamic Development Bank (IsDB) successfully priced its debut EUR-denominated issuance amounting to EUR 650 million, 5-year Trust Certificates (Sukuk) under its US$25 billion Trust Certificate Issuance Programme. Following the success of the issuance, the IsDB plans to become a frequent issuer in the EUR space in future.

Overall orders reached almost EUR 700 million from 30 investors. The majority of orders came from central banks and official institutions. There was also significant demand from bank treasuries, asset managers and pension funds Europe. The issuance witnessed first time investors from Austria, Finland, France, Germany and Netherlands.

In terms of the final allocation, the distribution was well diversified with 43% allocated to MENA, 20% to Asia, 29% to Europe and 8% others. The Trust Certificates will be listed on the London Stock Exchange, NASDAQ Dubai and Bursa Malaysia (under the Exempt Regime).

**First Qatari Listing on the London Stock Exchange**

In early March Qatar International Islamic Bank’s (QIIB) $500 million sukuk became the first Qatar sukuk to be listed on the London Stock Exchange (LSE). The issue was seven times oversubscribed. The overwhelming majority of bids came from outside the Middle East. The issue was priced at 175 basis points over the five-year mid swaps and it carried a fixed coupon of 4.264% per annum.

**Indonesia Lists Two Green Sukuk**

The government of Indonesia has listed two green sukuk on NASDAQ Dubai. The sukuk are valued at $1.25 billion and $750 million. The monies raised are intended to support sustainable development initiatives. (Indonesia is the largest sukuk issuer on NASDAQ Dubai with a total of 12 issuances worth some $16.5 billion.)

**Is Pakistan’s Energy Sukuk a Solution or a Sticking Plaster**

The Pakistan Government has raised Rs200 billion through a privately placed Pakistan Energy Sukuk. A consortium led by Meezan Bank assisted the Government in the structuring the 10-year ijarah instrument. It is backed by the assets of the power companies in Pakistan and is eligible to be used as a liquidity instrument. It is understood that a further sukuk is in the pipeline.

The Government’s objective is to bring down Pakistan’s surging circular debt, which is largely related to power generation and distribution in the country. While the proceeds of the sukuk issuance will be used to retire some of the debt, in the longer term the solution to the problem lies in radical reform of the power generation and distribution sector. This will be no easy task given the vested interests involved.

**Top Sukuk Issuers**

According to RAM Ratings Malaysia was the top issuer of sukuk in the first quarter of 2019. They issued 35.1% of the total issuance of $39.5 billion. Indonesia came second with 17% and Saudi Arabia third with 15.3%. They suggest that the nations to watch are Indonesia with plans for sovereign issues to support its sustainability agenda and Saudi Arabia who may be tempted into further issuance to solve its budget deficit problems.

**Emirates Strategic Investment Company Issues $600 million Sukuk**

Emirates Strategic Investment Company (ESIC), owned by Sheikh Mansour Bin Zayed Al Nahyan, has launched a five-year $600 million sukuk as part of its $1 billion sukuk programme. Listed on the London Stock Exchange, the sukuk carries a profit rate of 3.939%.

The sukuk was 6.2 times oversubscribed. It attracted 135 investors from 20 countries. The largest tranche went to GCC investors (39%), with 33% to Asia, 24% to Europe and 4% to the USA. Fund managers accounted for 62% of the take-up with banks taking 25%, private banks taking 9% and central banks and pension funds taking 4%.

**In Brief**

Philip Hammond, the UK’s Chancellor of the Exchequer, has announced that the UK will issue a second sovereign sukuk. The UK issued its first sukuk in 2014. No timeline was given for the second issuance.

Turkey issued a further $2 billion sukuk in early 2019. The sukuk was three times oversubscribed. Middle Eastern investors accounted for 47% of the subscribers, with the UK taking up 30%, other European countries 9% and the USA 8%.
IIAL Acts to Increase Takaful Capacity

A key problem for the takaful market currently is the shortage of retakaful capacity. In many cases, and particularly in the case of big commercial risks, Islamic insurers have no alternative to using conventional reinsurers, which is permitted under the ‘necessity’ rule. (Scholars are increasingly critical of the ‘necessity’ rule and want the market to offer alternatives that make recourse to the conventional insurance market unnecessary.)

Now the Islamic Insurance Association of London (IIAL) has launched a set of guiding principles designed to address capacity constraints in the sector. The guiding principles will help underwriters to create Islamic window operations, which will offer Shari’ah-compliant insurance and reinsurance cover. The move is not entirely philanthropic. The IIAL see this as a significant opportunity to enable London to access new risks and reach new markets.

Digital Technology – Is it the Key to Boosting Takaful Growth?

In a speech at the Takaful Rendezvous Conference in October 2018 Malaysian Takaful Association chairman Muhammad Fikri Mohamad Rawi advocated a radical approach to reinventing the takaful industry to allow it to remain sustainable. In particular he called for the industry to embrace digital technology in order to change the way takaful products are delivered; to make delivery more cost efficient and cost effective.

He highlighted the fact the industry in Malaysia had grown dramatically in the first decade of the 21st century – an average growth rate of 17.7% for family takaful and 20.7% for general takaful. Between 2011 and 2017 that growth has fallen away – just 8.1% for family takaful and 10% for general takaful.

Without wishing to disparage Muhammad Fikri Mohamad Rawi’s argument, it is not unusual for market growth to slow once the ‘low-hanging fruit’ has been picked off. There may indeed be a proportion of customers who opt for conventional insurance, because digital delivery of their products is more convenient and who could be wooed to takaful by an equivalent customer experience, but the heady growth of the early days of takaful may be difficult to replicate in a tough, competitive market.

Good News and Bad News for Takaful in the GCC

S&P Global in a report entitled ‘Islamic Insurers’ Net Income Continues to Fall but the Sector Will Stay Profitable in 2018’ suggest there is good news and bad news about the Islamic insurance sector in the GCC. The net income of listed GCC companies in the Islamic insurance sector decreased by nearly 50% in 2017 to $375 million from $744 million in 2016. The decline in 2017 net income was mainly driven by weaker results in the Saudi Arabian insurance sector and follows an increase in earnings by about 151% in 2016, indicating some considerable earnings volatility in the sector.

In S&P’s view, the Islamic insurance sector continues to face secular challenges around relatively concentrated and undifferentiated business models and high expense ratios that leave them susceptible to adverse event risk related to solvency, governance and accountancy. That said, they believe that medium-term growth prospects in the sector remain satisfactory given relatively low penetration levels and they expect Islamic insurance to remain profitable overall in 2018. They also note strengthening capital levels.

The Saudi Arabian market, which contributes about 85% of total GPW (Gross Written Premiums), has been the main source of earnings volatility in recent years. While net income in 2016 grew significantly due to rate increases as a result of stricter application of actuarial pricing, 2017 results dropped materially.

This was because of additional reserving needs at the largest insurer and high bad debt provisions at the fourth-largest insurer. First-quarter 2018 also shows a year-on-year drop in net income of 63%, suggesting that this might be another challenging year.

In contrast, the Islamic insurance industry in GCC countries outside Saudi Arabia recorded an increase in net income by about 832% to $82 million in 2017 from $9 million in 2016 and an increase of more than 60% in first-quarter 2018 compared with the same period last year. This improvement was mainly driven by better results in the UAE (the second-largest Islamic insurance market in the GCC contributing about 8% of total GPW), with Salama generating a net profit of $10 million in 2017 against a net loss of $48 million in 2016. Year-on-year earnings of Islamic insurers in other GCC countries remained broadly flat in 2017.

While S&P expect the Islamic insurance sector in the GCC to remain profitable overall in 2018, there are a number of factors that may affect insurers’ profitability in Saudi Arabia and the UAE and therefore the overall results. First, underwriting profits are lower in Saudi Arabia and the UAE because insurers apply no claims and other discounts to motor policies to gain or maintain market share. Second, insurers in Saudi Arabia have been providing additional coverage under medical policies, which may lead to weaker earnings if this business is not priced adequately. Third, the challenge of collecting value-added tax (VAT) from retail clients for policies written in 2017 and into 2018, as well as new accounting standards leading to higher doubtful debt provisions, could see net earnings decline further this year.

In addition to weaker profitability, GPW growth in the Islamic insurance sector has slowed considerably over the past two years. It stood at slightly below $11 billion in 2017, having remained flat...
year-on-year. This was despite moderate growth in some markets outside of Saudi Arabia. For example, Islamic insurers in the UAE recorded premium growth of about 15% in 2017 on the back of higher motor rates and an expansion of basic medical insurance coverage in Dubai. Industry-wide, first-quarter 2018 saw an overall decline in GPW by about 3% compared with first-quarter 2017, driven by a 3.7% drop in GPW in Saudi Arabia during that period mainly because of pressure on rates as well as slower consumer spending following the introduction of VAT in January 2018. The departure of a large number of expats from Saudi Arabia over the past year has also resulted in lower premium income. S&P anticipate that the local authorities’ efforts to tackle the large number of uninsured drivers, combined with the arrival of women drivers in mid-2018 and higher rates for medical business, following the introduction of additional benefits, will support a slight pick-up in premium growth in Saudi Arabia in the medium term. However, this may be offset in the short term by the large number of foreign workers that have already left, or will be leaving in 2018, as Saudization policies are increasingly enforced.

Total shareholders’ equity in the Islamic insurance sector in the GCC improved by about 3% to $4.8 billion in 2017, from $4.6 billion in 2016, as a number of insurers retained parts of their profits or raised additional funds through rights issues. The rate of increase in shareholders’ equity exceeds premium growth, which indicates a slight improvement in overall capital adequacy, in S&P’s view. However, despite this overall improvement in capital adequacy S&P still believe there are too many insurance companies in the GCC and that many of these players lack the scale to operate successfully in overcrowded and highly competitive markets.

S&P believe that credit conditions in the sector may weaken over time, if total premium growth remains slow and insurers try to capture market share by further lowering their rates. They also believe that the local regulators, particularly in Saudi Arabia and the UAE, will remain committed to maintaining market discipline by introducing more sophisticated risk-based regulations. This may mean that there will be fewer but more profitable insurers in these markets over time, particularly if smaller and weaker capitalised insurers are not able to cope with all the additional regulatory demands.

**IFSB Issue Working Paper on Consumer Protection in the Takaful Sector**

The Islamic Financial Services Board (IFSB) has issued a working paper, which examines regulatory and market practice issues relating to consumer protection in the takaful sector (WP-09). Supported by the results of an industry-wide survey with responses from takaful operators and their regulatory and supervisory authorities, this working paper explores how an effective and comprehensive consumer protection regime can be designed and implemented throughout different phases of customer engagement with takaful operators and their intermediaries.

The Secretary-General of the IFSB, Dr. Bello Lawal Danbatta stated, ‘This paper is the second in the IFSB’s Working Paper series that addresses issues specifically for the takaful industry.’ He further added, ‘This new working paper identifies challenges to consumer protection arising from the asymmetry of information and difficulties for consumers in evaluating product quality and price, as well as challenges arising from distribution and promotion practices, and from specific features of takaful. Moreover, the paper also identifies regulatory issues faced in designing and implementing effective and efficient consumer protection regulations and suggests ways to strengthen regulatory oversight of market players. Given the high expectations of consumers seeking Shari’ah-compliant solutions to their risk coverage through takaful, a well developed consumer protection regime can guide the market operators to provide better products and services to cope with the needs of the public and the economy.’

The analysis and survey results suggest that market practices can deviate significantly from supervisory expectations, particularly with regards to the scope for takaful operators and intermediaries seeking to maximise their own benefit rather than to pursue the consumer’s best interest. The potential conflict of interest is often present in selling practices and the ability of market players to exploit it presents a potential for reputational damage in a sector where consumer confidence is an essential attribute.

The paper emphasises the fair treatment of consumers, covering the whole products lifecycle from development, through distribution, to claims settlement, in order to reduce the potential risks for mis-selling and other forms of consumer detriments. Further, it recognises that different jurisdictions take different approaches to addressing these issues.

WP-09 also identifies evolving business models and the use of emerging technologies to re-engineer consumers’ experience from the purchase of takaful products to filing of the claim, with benefits and threats that these changes may bring.

Finally, the WP-09 identifies regulatory and supervisory best practises from various jurisdictions on the conduct of business in takaful that could form a basis for a common framework in addition to the existing IFSB Standards and Guiding Principles. WP-09 also acknowledges the role of consumer education in creating awareness and uptake of takaful products.

WP-09 is available for download from the IFSB website: www.ifsb.org.
UAE Takaful Companies Gain on the Conventional Market

AM Best’s recent report on the UAE takaful market shows that it is catching up with the conventional insurance market. Profitability has improved significantly in recent years, although it should be noted this is net profits, gross profits declined slightly. AM Best suggest that this is due to regulatory changes in 2017 that improved underwriting and pricing discipline and also to management changes at a number of companies that have focused on bottom line profitability. There has also been reasonable growth in the level of gross contributions – 5.8% compared to a marginal decline of 0.5% for conventional insurers.

Takaful is still, however, a modest player in the total insurance market, commanding a 17% market share. AM Best believe that takaful companies are under-delivering and continue to lag behind the performance of Islamic banks in the region.

The largest takaful operator in the UAE is Islamic Arab Insurance with a 29% share of the market, followed by Takaful Emarat with 16%, Abu Dhabi National Takaful Company and Dubai Islamic Insurance & Reinsurance Company with 10% each, Methaq Takaful Insurance Company with 9%, National Takaful Company and Dar Al Takaful with 8% each and Orient UNB Takaful and Arabian Scandinavian Insurance Company with 5% each.

FWD Group Expand into Malaysia

Hong Kong-based FWD Group has announced that it has successfully completed the acquisition of HSBC Insurance (Asia Pacific) Holdings Ltd's stake in HSBC Amanah Takaful (Malaysia) Berhad. FWD is now the largest shareholder in the joint venture and intends to rename the business FWD Takaful Berhad. All existing takaful certificates issued under HSBC Amanah Takaful will continue to be honoured by FWD Takaful.

‘Malaysia represents another landmark market entry and strategic milestone in our journey,’ said Huynh Thanh Phong, FWD Group Chief Executive Officer. ‘We see huge potential for growth in Malaysia and I’m excited to work together with our new team in Malaysia to grow our business and footprint through long-term investment and implementation of our customer-led strategy.’

The new company will be headed by Salim Majid Zain. He had previously served as CEO of Zurich Takaful Malaysia for 12 years.

Malaysia Introduces Mandatory Testing and Disclosure for Investment-Linked Products

Bank Negara Malaysia is to introduce mandatory testing and disclosure of sustainability of coverage for investment-linked products (sustainability test) by insurers and takaful operators.

The objectives of the mandatory testing and disclosure of the sustainability of coverage at point of sale and after purchase are to improve transparency on the active management of the sustainability of cover by insurers/takaful operators and to ensure that consumers are provided with sufficient and timely information to actively monitor and manage investment-linked policies/certificates.

To achieve this, Bank Negara Malaysia requires insurers and takaful operators to:

- Maintain strong governance in the management of investment-linked business.
- Ensure professional conduct in the sales and marketing of investment-linked policies/takaful certificates.
- Enhance product transparency and disclosure to enable policy owners/takaful participants to make informed decisions when purchasing.

In Brief

Egypt’s state-owned Misr Insurance group is to launch a family takaful operation. (Misr launched a general takaful operation in 2017.)

The latest Fitch dashboard report on the Indonesian takaful market predicts stronger growth for the industry based on new operators and capital entering the market, plus a government move making insurance for Umrah and Hajj trips compulsory. In the first nine months of 2018 growth in the sector was a modest 1% with family takaful outperforming the general takaful sector.

Morocco has moved a step closer to takaful with the draft amendments to the Insurance Code ready to be submitted to parliament, following approval by the Governing Council. As soon as the Code and its implementing texts have been published, the supervising insurance authority says it will process applications for takaful licenses. It is understood that there will be just two takaful companies licensed, as, in the opinion of the authorities, that is all the market will sustain at first.

Egypt’s Financial Regulatory Authority has imposed a cap on wakala fees charged by takaful companies. For property takaful fees must not exceed 30% and for family takaful the cap is set at 25%. The FRA said that the cap was designed to correct imbalances in the industry.

The Tunisian government’s 70% stake in Zitouna Takaful has been sold to a member of the Qatari royal family.

Oman is expected to finalise regulations for the takaful market in 2019. Currently there are just two takaful operators in Oman.
Muhammadan Jurisprudence According to the Sunni Schools

Published in 1911 Muhammadan Jurisprudence – According to the Sunni Schools by Sir Abdur Rahim charts the roots and development of Islamic law and is based on a series of lectures given by the author at the then University of Calcutta in 1907. The author begins by reminding us that Islamic law is based on the customs and usages of Arab peoples at the time that Islam emerged in the 7th century. This article focuses on laws concerning money, trade, property, etc. – those aspects of Islamic law that affect Islamic finance to this day.

Arab Society in the 7th Century

Arab societies in the 7th century were just beginning to emerge from their nomadic, tribal past and to form larger groupings for the purposes of offence and defence. It was the formation of these larger groups and the reduction in tribal hostilities plus the development of cities such as Mecca and Medina and trading entrepôts that set the scene for the development of government and a legal system.

Initially the legal system was simply a formalisation of what had been common practice. For example, there were customs or laws relating to different types of sale and some of the terms used are familiar down to the present day, e.g. salam, where a buyer pays in advance for goods to be delivered at a defined date in the future. One notable difference between these pre Islamic and Islamic societies was that riba or the lending of money at interest was widespread.

Islamic Law – The Four Phases of Development

The first period of development was during the final ten years of the Prophet’s (PBUH) life, when laws were enacted by the divine legislator and promulgated in the words of the Qur’an or by the precepts of Muhammad.’ These texts form the basis of the pronouncements of the four Sunni schools.

The second phase runs from the death of the Prophet (PBUH), when the Companions and their successors effectively organised, interpreted and extended the laws through a process of deliberation, often in response to changing circumstances. In the next 100-200 years, the four Sunni schools were established and the law was further developed through theoretical and scientific study of the law and religion. It was in this period that the law was first codified.

What came after this, the fourth phase, is where we are today. Essentially, scholars have continued to interpret laws drawn up more than 1,000 years ago to apply them to changing circumstances, to situations that were not imagined when they were codified, while still trying to stay true to the intentions of the texts contained in the Qur’an and the Hadiths.

The Sources of the Law – The Qur’an and Hadiths

The Qur’an is of divine origin, the word of God, as revealed to the Prophet (PBUH). The texts of the Qur’an were collected by the State in the years immediately following the Prophet’s (PBUH) death.
The Hadiths or traditions are grouped into three categories. The first are those delivered by the Companions, those people that lived during the lifetime of the Prophet (PBUH) and who met or came into contact with him. This category is regarded as the ‘gold standard’ – ‘righteous and reliable’. The second group were delivered by people that lived during the lifetime of the Companions and who met or came into contact with them. These people are known as the successors of the Companions. The third group are those people who lived during the lifetime of the successors and who met or came into contact with them. The third class of traditions is known as isolated traditions and some jurists do not regard them as having any authority in law.

Any traditions arising after the third group are not accepted at all and, of course, traditions narrated by people who were well known and were perceived to be well qualified were more likely to be accepted.

Muhammadan Jurisprudence covers a comprehensive range of topics, many of which such as marriage, divorce, etc are not directly relevant to this publication. The rest of the article concentrates on those topics, which are relevant to Islamic finance.

Contracts
The concept of a contract in Islamic law is that it establishes a legal tie between two people. For example, one person contracts to sell or gift something to another person. In Islamic law the completion of the transaction i.e. the transfer of a physical object, is treated as a separate issue and the legal obligation will not be deemed to have been completed until that transfer takes place. In certain situations the law relaxes this principle. Sir Abdul Rahim describes it thus, ‘taking the declaration of consent by both the parties as a complete creation of legal relations and compels each party to carry out what he declared he would do.’ This relaxation of the law can only be allowed where both parties will gain; where there is no chance of injury to anyone and where the necessities of daily business require it, e.g. a farmer agreeing to sell a crop, which he cannot deliver until harvest time.

Pre-Islamic Sales Customs
Sir Abdur Rahim catalogues the types of sale practised in the pre-Islamic era and from which Islamic law developed. These types of sale are as follow:

1. Sale of goods for goods or barter - muqayada.
2. Sale of goods for money – bai’
3. Sale of money for money or money changing - sarf.
4. Sale in which the price is paid in advance; the goods to be delivered at a later date – salam.
5. Sale with an option to revoke.
6. An absolute or irrevocable sale.
7. Sale of goods, the price to be paid in the future.
8. A transaction in which the vendor sells the article for cost price and certain stated profits – murabaha.
10. Sale at less than cost price - wadi.
12. Sale by throwing a stone, e.g. several pieces of cloth are on sale; the buyer throws a stone and whichever piece of cloth it lands on becomes the property of the buyer, neither party having the option to revoke the sale.
13. A form of sale in which the buyer touches the goods, thereby concluding the sale whether the vendor agreed to the price or not - mulamasa.
14. A sale in which the vendor throws the goods at the buyer, thus completing the sale – munabadha.
15. The sale of dates on a tree in consideration for plucked dates - muzabana.
The question of goods being in existence is an important one, because it is designed to prevent any element of gambling or speculation, which was prevalent in pre-Islamic days.

Islam believes that prior to the birth of the Prophet (PBUH) God’s laws had been considerably corrupted. The Prophet (PBUH) was charged with the mission of reviving the eternal principles of all laws.
which may not be in existence at the time of sale; however the law will be satisfied if the goods are delivered on the agreed date. Articles bought under such a contract cannot be sold by the purchaser before they have been delivered.

Istisna – this is another type of forward contract, but in this case payment in advance of delivery is not required. For example, a buyer orders a pair of bespoke shoes from a shoemaker and pays on delivery. Such contracts lapse on the death of either party or if the purchaser finds the goods to be of unacceptable quality on delivery.

A valid contract assumes that the goods being sold are in existence except in the case of salam, for example advance payment for an agricultural crop that has not yet matured or istisna, for example an agreement to build a house at an agreed price with payment being made on completion of the building. The question of goods being in existence is an important one, because it is designed to prevent any element of gambling or speculation, which was prevalent in pre-Islamic days. Bearing in mind that these lectures were given very early in the 20th century some of the examples that Sir Abdur Rahim gives seem rather archaic, but they make the point. For example, a man cannot sell milk, which is still in the cow’s udder.

**Riba**

Riba literally means increase, but in the context of Islamic law it is taken to mean usury or interest. It is important, because it lies at the root of many restrictions relating to contracts – sales and loans.

The authority for the prohibition of riba is to be found in the words of the Prophet (PBUH), which are ‘(Sell) gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates and salt for salt of the same kind, for the same kind and the same quantity for the same quantity, from hand to hand and if they differ from each other in quality sell them as you like but from hand to hand.’

Commenting on riba, Sir Abdur Rahim says, ‘The tradition seems to conflict with what ‘Umar the second Caliph is reported to have said, namely, that the Prophet (PBUH) died without having made any clear pronouncement on the question of riba, which is left vague and ambiguous in the Qur’an where all that is laid down is that God has forbidden riba. The Sunnis, however, have generally accepted the tradition.

‘But the question of the scope of this doctrine is one on which the greatest difference of opinion exists among the jurists and the practice of the Muhammadan world also considerably varies in this respect. It is, therefore pre-eminently a doctrine in the application of which the circumstances of the time and the practice of the people of different countries should be given the greatest weight.

‘Let us now see how the doctrine is expounded by the ancient jurists. The Hanafi doctors have interpreted the tradition to mean that whenever an article belonging to the description of similar of capacity or of weight is sold or exchanged for an article of the same species, neither party is allowed to receive anything in excess of the quantity sold by himself, in other words absolute equality in quantity is insisted on. The Shafi’ia hold that the law of riba only applies to articles of food and such things as constitute price, namely, gold and silver.

‘The principal rules that have been deduced are that when one similar is sold for another similar there must always be immediate delivery of both the things, though equality is not insisted on if they differ in species. If the articles opposed to each other in a sale are not of the same genus or are not measured by quantity then excess or profit is lawful and so also delay in the delivery of one of the articles, such as the sale of wheat for money. If the articles are not similars of measurement by capacity or weight but they agree in being of the same kind then delay in delivery is not allowed but any excess or profit is not prohibited.’

The law of riba can be relaxed in certain circumstances, e.g. when it causes hardship or inconvenience.

**Sir Abdur Rahim** was a politician and judge in British India at the turn of the 19th and 20th centuries. He received his legal training at the English Inns of Court. Born in Bengal and a leading member of the Muslim League, he moved to Karachi, Pakistan after the partition of India.
There is an increasing number of financial institutions offering Islamic financial services as part of their spectrum of services and as a result there is increasing demand for staff with relevant knowledge and skills.

DISCOVER NEW PERSPECTIVES
The need for Islamic Finance Education

The Pioneering Role of IIIB

There would have been no career in Islamic Finance for me and for many of my friends without the Institute of Islamic Banking and Insurance. The organisation provided the only source for education and response to the need across Europe. So it feels that none of the new or developmental programmes of education would have occurred and would have never been able to meet the need without the Institute in place.

Richard Thomas, OBE, Chief Executive
Gatehouse Bank, London, United Kingdom, 2011

Our Aim

To motivate, educate and develop people to achieve their personal and professional goals through distance education, practical training, membership, research and publications.

The goal of the IIIB is to empower individuals with knowledge and understanding of the processes that enable them to conduct their dealings based on the universal principles of Adl (justice), Niyah (intention that translate into good actions), Iklaas (purity, morality), Ihsan (perfection, excellence), and avoiding Haram (actions and activities that are morally reprehensible).

IIBI courses delivered through an online platform (virtual learning environment) by email (distance learning) makes it possible to acquire knowledge and skills for a career in the Islamic finance industry or simply to pursue higher studies.

"The IIIB comes to mind as the original thought leadership platform from which many of the products, services and ideas have come to the Islamic Finance Industry."
Iqbal Khan, Ex-CEO, UAB, UK, Former CEO & Founder, HSBC Ammann, 2009

"The IIIB is an organisation with which the CISK has been working for several years. I can confirm that the IIIB plays an important role in the promotion of UK Islamic finance education and IIIB is an active member of the Education and Training working group of the UK Islamic Finance Secretariat (UKIFS) which is part of CityUK."
Ruth Martin, Managing Director, Chartered Institute for Securities & Investment (CISI) UK, 2013

"Many of the practitioners in Islamic finance and related support disciplines have benefited from an association with the IIIB. With its dedicated work over the decades, the IIIB has become the first port of call for anybody exploring Islamic finance in the UK and worldwide."
Mohammed Iqbal Anwar, CBE, Visiting Faculty, CASS Business School, Teaching Fellow Aston Business School, Visiting Faculty, Bangor Business School, UK, 2013

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INSTITUTE OF ISLAMIC BANKING AND INSURANCE
7 Hampstead Gate | 1A Frognal | London NW3 6AL | United Kingdom
T. +44 20 7622 0841 | F. +44 20 7251 9769
www.islamic-banking.com
Shi’i Islamic Perspective on Finance (Foundations of the Islamic Economical System)

Presented in: University of Vienna, 2011 by Sheikh Dr Taher Amini Golestani
Director, The International Institute for Peace and Religions (IIPR)

Introduction
Islam directly talks about rules and laws regarding business, merchandise, contracts, agreements, ownership, taxation, Waqf (perpetual endowment for the sake of God), punishments, penalties, etc; and in the indirect approach, Islam prescribes some ethical and moral values for the people involved in economics to have safe and respectful mutual understandings, which will be mentioned as well (Martyr Motahari 1985). Islam differs from both, Capitalism (which believes that the cause of economic problems is the scarcity of natural resources) and Socialism (which claims that the economic problems arise from that which the Capitalists make out of the workers’ efforts) by considering the reason of the economic problems to be man himself. This attitude is given by the Qur’anic verse; ‘And He has made subject to you the sun and the moon, both diligently pursuing their courses, and the Night and the Day has He (also) made subject to you. And He gives you of all that you ask for; and if you count the favours of God, you will not be able to number them; Verily man is very unjust, very ungrateful”. (The holy Qur’an, 14:32-34)

Hence we can conclude the following:
1. There exists, sometimes, unjust people who do not comply with the principles of social justice which creates differences between classes.
2. Man is liable to be (kafir-infidel) for it seems that man always tends to try the easy path. It is man who does not work to utilise the natural resources. Islam considers that the root of the problem is in man, if man is cured, then there are no more problems.

In Islam, the following rule is applied: ‘Work is the excuse for possession, but it does not alone create the value of goods.’

Man has needs that require satisfaction, so there must exist the means to satisfy them. These needs are purely materialistic, such as the need for food, clothing, medicine, education and security. As for the moral needs such as pride and honour, or spiritual needs such as the sanctification of God’s will, they are not recognised economically and are therefore disregarded and have no place in economic studies.

Muslim economists reject the theory of scarcity of resources, as it implies imperfection of nature and Allah’s plan. The Qur’an states that Allah has provided an abundance of everything that humankind needs in order to subsist. Therefore, scholars of Islamic economics contend that scarcity does not exist in nature. Instead, the limitations of mankind’s productive capacity are what cause scarcity and, subsequently, value.

‘It is Allah, who created the heavens and the earth, and He sends down water from the sky and with it He brings forth crops for your sustenance. And He disposed the ships for you [benefit] so that they may sail at sea by His command, and He disposed the rivers for you--He disposed the sun and the moon for you, constant [in their courses], and He disposed the night and the day--and He gave you all that you had asked Him. If you enumerate Allah’s blessings, you will not be able to count them. Indeed man is most unfair and ungrateful (The holy Qur’an, 14:32-34)

Islam does not share this idea of relative scarcity. Islam does not allow this to happen. The basic needs are guaranteed to every Muslim and non-Muslim living under the rule of Islam. These needs include the tangible, such as adequate food, clothing, and shelter, as well as the intangible, such as medicine, education and security. The primary goal is to have everyone producing and everyone consuming. (Malkawi, 2002)

Islam ordered the Muslims:

‘Seek the abode of the Hereafter in that, which Allah has given you, and neglect not your portion of the world, and be kind as Allah has been kind to you and seek not corruption in the earth.’ (The holy Qur’an-28:77).

The Islamic economic system is derived from the only source that is capable of satisfying the needs and desires of everyone, without resulting in chaos. Freedom is living by the best system possible, not creating a system that destroys the lives of human beings.

Important Tenets of Islam:
Three major tenets of Islam form the basis of Islamic economics:

Tawhid (Monotheism) The single most important tenet of Islam is Tawhid, the oneness of Allah. Not only does Tawhid espouse that there is no other
god than Allah, but it also holds that Allah’s plan for the universe is perfect. In economic discussion, the importance of Tawhid is extremely relevant in the discussion of scarcity of resources, as will be explained later.

Idalah (Justice) The second most important tenet of Islam, as applicable to economic discussion, is Idalah, or the justice born from Umma. Idalah commands fairness among the brotherhood of Muslims and can be seen as the reasoning behind many aspects of Islamic economics.

Shari’ah The Shari’ah is composed of three major sources, the Qur’an, the Sunnah and the hadith, all with varying degrees of interpretation.

With the knowledge of Islamic jurisprudence and the underlying tenets of Islam, as set forth above, explanation and comparison of Islamic economics and capitalism can begin: Islamic economics’ ties to the religion are obvious; the practice of Islamic economics is heralded as the will of Allah and therefore offers little alternative to the devout Islamic state. Capitalism was born from the minds of Western mortals.

Important Tenets of Islamic Economics
Discussion of Islamic economics must begin with discussion of Islam itself. This might cause astonishment among academics who received Western style education. They are taught that religion is a mere relation between God and man. They are told that religion has nothing to do with society, its welfare and organisation. This world is Caesar’s Kingdom, while God’s Kingdom is the next world. Islam firmly rejects these foreign ideas and dictates that both worlds are belonging to God alone and it is the Heavenly light which truly guides towards prosperity.

Muslim thinkers pursued the traditional manner of Islamic legislation which depends on the following sources:
- Qur’an - which is God’s revelation to the Prophet
- Tradition - which is the sayings of the Prophet and His Ahlul Bayt
- Iljma’ (Consensus) - this comes when there is no specific mention in the Qur’an or Tradition about a particular case. It specially refers to concepts that have been accepted throughout Islamic history as Islamic concepts.
- Human reasoning or logic - this again comes in when there is no specific mention in the Qur’an, and Tradition.

Hence it is relevant for Muslim thinkers to seek solutions for the various problems of life, in the Qur’an. If there was no clear-cut solution, then the true sayings of the Prophet are reviewed to get more satisfaction. If that was not enough, then, Iljma’ and Logic are used as a final resort. This particular topic is the field of specialists who possess sound knowledge of Islam. It is pointless to say that the following analysis is only the quotation of modern Muslim thinkers, and ideological leaders and cannot be regarded as my own analysis or reasoning.

Prohibition of Riba (Usury – Interest)
Usury, based on numerous verses of the Qur’an and sayings of the Prophet and Ahlul Bayt, is strongly prohibited in Islam in verses such as:

‘O you who have faith! Do not exact usury, twofold and several fold, and be wary of Allah so that you may be felicitous.’ (The holy Qur’an 3:130)

Riba is strictly prohibited under Shari’ah and therefore also prohibited in an Islamic economic system. The Arabic root of the word Riba is ‘to increase.’ In the economic sense, Riba is the increase of value of an item against an item of the same species. (Sayed, 1989)

Islam categorically prohibited the use of money to grow money, i.e., usury. Loans in Islam are given to others and considered a means of worship. Allah declares that whoever gives a loan (no interest) to another person is indeed giving a loan to Allah. In return, Allah multiplies the reward for the loan giver.

Allah stated:

‘Whoever gives a good loan to Allah; and Allah will multiply it to him many folds’ (The holy Qur’an 2.245)

According to Islamic economics, the only correct way to trade similar products is to do so in equal quantities unless, it is Riba. Riba can be committed in two forms: Riba-ul-fazl and Riba-un-nasiyah. Riba-ul-fazl is the act of exchanging something for like specie and receiving a larger quantity. Gold must be sold for gold in equal quantities and wheat must be sold for an equal quantity of wheat. The quality of the items is irrelevant, so inferior quality wheat cannot be exchanged for a smaller amount of superior quality wheat.

Riba-un-nasiyah is the exchange of a product for a time period that, when elapsed, the lender receives a larger quantity of the product. This is, in effect, like the interest charged by capitalist financial institutions. By lending money, a bank expects that the borrower will pay back the lent amount, at a later date, plus interest. This system of interest and credit, that is so intrinsic to capitalist economics and is the basis for lending money to individuals or firms, is forbidden in an Islamic economic system. (Sayed, 1989) ‘The forbidden nature of interest in Islamic economics and the
necessity of interest in capitalism is the greatest difference between the two economic systems.

**Distribution of wealth**

No doubt Islam accepts unequal distribution of wealth as natural and part of the Divine Scheme of world order, yet it does not allow the existence of wide discrimination or disparities in the distribution of wealth. If the distribution of wealth in a community is unfair and inequitable, social peace in that community is always at stake and conflict between the poor and the rich is bound to result in war and class struggle. Islam being a religion of peace is against such class conflict. It establishes fraternity and brotherhood in the ranks of the members of the Islamic community. Islam believes in the well-being of its followers and, therefore, ensures fair and equitable distribution of income and wealth among them. For bridging the gulf between the rich and the poor and for ensuring just and equitable distribution of economic resources and wealth, Islam has taken very effective measures. Positive measures taken by it are Zakat and Sadaqat, laws of inheritance and bequest, monetary atonements, voluntary charities and compulsory contributions in the form of taxes and various levies. To prevent concentration of wealth in a few hands, Islam has taken some prohibitive measures also. These include the abolition of interest, the prohibition of wealth through illegal and unfair means, the prohibition of hoarding of wealth, etc.

**Guarantee of basic human needs**

Islam enjoins upon the well-to-do to fulfil the needs of the poor and the destitute. According to the Qur’an, the poor and the needy have a share in the wealth of the rich. The Qur’an says: ‘And in whose wealth there is a right acknowledged for the poor beggar and the destitute’ (The holy Qur’an, 70: 2425).

To the question as to how much wealth should be spent by the rich for the cause of the poor, the Qur’an replies: ‘And they ask thee how much they are to spend; say: ‘What is beyond your needs” (The holy Qur’an 2:219).

According to some Muslim jurists, the Islamic state should provide social security cover to all its citizens and undertake especially to provide the basic necessities of life to all those poor, destitute, deprived of, disabled and unemployed citizens, who themselves are not able to provide for them and their families. If the Islamic state fails to do so it has no right to demand allegiance from its citizens.

**Elimination of economic exploitation**

Elimination of the economic exploitation of the weak by the strong is another element of Islamic social justice. Many steps have been taken by Islam in this direction. Riba or usury is one of the worst instruments of human exploitation and this has been abolished root and branch. Other means of human exploitation such as bribery, gambling, speculative transactions, fraudulent practices, prostitution, embezzlement, etc. have also been prohibited in Islamic society.

The interests of the weaker classes of society such as women, orphans, labourers, consumers, etc., have been protected through detailed legislation by Islam. For example, the Qur’an warns the devourers of orphan’s property in these words: ‘Lo! Those who devour the wealth of orphans wrongfully, they do but swallow fire into their bellies, and they will be exposed to burning fire’ (The holy Qur’an 4:10).

**Right to ownership**

The existence of the right of private ownership of property is the hallmark of capitalism. It gives unrestricted and unencumbered full rights of ownership to the individual. The individual may acquire, own or alienate his property in whatever manner he likes. This necessarily disturbs the balance of distribution of wealth and income in society. The economic disparities and the ever-increasing gulf between the rich and the poor sow the seeds of discord and destruction in capitalist society. But, Islam believes that ownership, in reality, belongs to God while some rights only vest in man so that he may fulfil the purpose of God; that is the purpose of community by acting as a trustee for those in need.

‘To Allah belong the east and the west: so whichever way you turn, there is the face of Allah!’ (The holy Qur’an 2:115)

In other words, what Allah has created for the benefit of and service to man belongs collectively to the whole of humanity. ‘It is He who made the earth tractable for you; so walk on its flanks and eat of His provision.’ (The holy Qur’an 67:15)

‘Do you not see that Allah has disposed for you whatever there is in the heavens and whatever there is in the earth and He has showered upon you His blessings.’ (The holy Qur’an 31:20)

Legal ownership by the individual is recognised in Islam – ‘O you who have faith! Do not eat up your wealth among yourselves unrightfully, but it should be trade by mutual consent.’ (The holy Qur’an 4:29)

But it is subject to the moral obligation that in all wealth, all sections of society have the right to share. Thus private or individual ownership in Islam is not unlimited or unrestricted. All the means of production are not
placed under private ownership as public ownership of certain things of common utility exists side by side with it in an Islamic state. The Islamic state also has the right to nationalise certain things which are under private ownership for the benefit of the community.

**Economic freedom**

Islam also allows economic freedom to an individual who is at liberty to earn wealth, own it and spend his wealth at his discretion. But the freedom given by Islam in the economic sphere is not unlimited. Islam makes distinction between Halal (permitted, being lawful) and Haram (forbidden, being unlawful) in every economic activity. Certain means of earning wealth such as interest, bribery, embezzlement, gambling, games of chance, speculation, monopoly and other weaker persons, prostitution, sale of narcotics, short weighing and short measuring, trade in Haram things, immoral and exploitative methods, etc. are prohibited to a Muslim. Similarly consumption of wealth on luxurious living, haram things and extravagant spending is also forbidden. A Muslim is required to pay Khums and Zakat and spend whatever he can for the cause of the poor and the destitute. All these regulations promote moral values in Islamic society and eliminate the mad race for wealth and material gains. Islam also disallows establishment of monopolies. Imam Ali wrote in his letter to Malik al-Ashtar (governor of Egypt at the time): ‘Prohibit monopoly, for the Messenger of God had forbidden it. Therefore, if anyone who indulges in monopoly after being warned, should be punished and penalised with no excess.’ (Razi, 1010)

Commodities and services which are in the common interest of the community are never allowed to be monopolised. Those essential things which are required by everyone are generally maintained under the joint ownership of the community. Thus the interests of consumers and labour are protected and balance between production and consumption is never allowed to be disturbed. Islam considers interest as the most exploitive institution for humanity and has abolished it root and branch in its every form and manifestation. According to the Qur’an the taking of interest is tantamount to war against God and His Apostle. While according to the Prophet Muhammad interest is worse than adultery. Islam builds its economy on an interest-free basis and promotes profit and partnership as an incentive for saving and investment.

Islam, on the one hand, guarantees the provision of basic human needs such as food, clothing and shelter to everyone and, on the other hand, ensures fair and equitable distribution of wealth and economic resources among all. It does not tolerate the existence of wide disparities among the rich and the poor and tries to eliminate the concentration of wealth in few hands. For bridging the gulf between the rich and the poor and for ensuring equitable distribution of wealth, Islam has taken many steps such as Zakat and Sadaqat, laws of inheritance and bequest, voluntary charities and compulsory contributions in the form of taxes and duties. ‘That which you give in usury in order that it may increase people’s wealth does not increase with Allah. But what you pay as Zakat seeking Allah’s pleasure it is they who will be given a manifold increase.’ (The holy Qur’an- 30:39)

Islamic economic system, on the other hand, ensures elimination of exploitation of one man by the other. Many effective measures have been taken by Islam to do so. Riba or usury is one of the worst instruments of human exploitation and this has been abolished in all forms by Islam. ‘There has certainly come to you a manifest proof from your Lord. Observe fully the measure and the balance, and do not cheat the people of their goods, and do not cause corruption on the earth after its restoration. That is better for you, if you are faithful.’ (The holy Qur’an-7:85)

Under Islamic economics, extreme accumulation of capital is seen as a reflection of greed and shows the person’s doubt in God’s power in much the same vein as accumulation of capital, the attitudes of each system’s consumers differ. The capitalist consumer is driven by utility functions, which dictate that the more of something he or she has, the better. This behaviour is referred to as the ‘maximisation of pleasure’ and is looked down upon by Islamic economics. Instead, the Islamic consumer is expected to make purchasing decisions by the maximisation of the pleasure of Allah. Islam categorically condemns miserliness and profligacy. All Islamic consumers are compelled to purchase in moderation.

Islam also allows economic freedom to an individual who is at liberty to earn wealth, own it and spend his wealth at his discretion. But the freedom given by Islam in the economic sphere is not unlimited.
To prevent the concentration of wealth in few hands the Islamic economic code has taken measures such as the abolition of interest, the prohibition of earning of wealth through Haram means, the prohibition of hoarding of wealth, etc. Islam does not abolish private ownership of property and does not place all the means of production, distribution and exchange in the hands of the state. Although Islam upholds public ownership of some means of production, which are a common utility to the people, it concedes the rights of private ownership of the majority of the means of production and distribution.

Islam recognizes three kinds of possessions:

**Private Possession**
‘O you, who have faith, do not eat up your wealth among yourselves unrightfully, but it should be trade by mutual consent. And do not kill yourselves. Indeed Allah is most merciful to you.’ (The holy Qur’an, 4:29)

The Prophet said: ‘The possession of a Muslim is illegal to his brother except which he willingly offers to him.’

**Collective Possession**
This field covers the national wealth which belongs to all people of the Islamic State, irrespective of their financial status. The bulk of the wealth is expended and utilised in building schools, hospitals, etc. The sources or incomes of this sector of the economy are specific and noted.

**State’s Possession**
‘O you who have faith! Be wary of Allah, and abandon all claims to what remains of usury, should you be faithful and if you do not, then be informed of a war from Allah and His apostle.’ (The holy Qur’an 2:278-9)

State’s possession differs from other kinds of possession not only in the sources of income but also in their utilisation and fields of expenditure. There are specific sources of income to this economic sector, like the so-called (Dead land). The evidence of this in the Qur’an is the following verse: ‘They ask you concerning ‘Anfal’ (accessions) say ‘Anfal’ is at the disposal of God and the Apostle.’ (The holy Qur’an, 8:1)

Islam believes in a democratic form of government as the Qur’an enjoins upon Prophet Muhammad to conduct public affairs in consultation with his followers. Islam gives all the fundamental rights and civil liberties to the people living in the Islamic state such as freedom of person, freedom of religion, freedom of expression, right to own and alienate property, right to protection of honour, etc. The Islamic state does not establish dictatorship of any class; neither is it a totalitarian state.

However, despite recognising inequalities as natural and part of the Divine world order, Islam permits differences in wealth within reasonable limits, but it does not tolerate that these differences should grow so wide that some people live their life in absolute luxury while millions are left to lead a life of abject poverty and misery. In other words, we can say that Islam does not believe in equal distribution of economic resources and wealth among the people rather it believes in equitable, just and fair distribution. It bridges the gulf between the rich and the poor by taking very effective measures to modify the distribution of wealth in favour of the poor.

**Social justice**
Thus social justice (which is also referred to as economic justice or distributive justice) according to the Islamic conception includes three things, namely:

- Fair and equitable distribution of wealth
- Provision of basic necessities of life to the poor and the needy
- Protection of the weak against economic exploitation by the strong

Social justice means that man should not trespass upon the rights of others. He should consider all the people equal by the divine laws. He should not exceed justice in implementing religious laws. He must not be influenced by feelings and sentiments. He must not deviate from the right path. The Almighty Allah states:

‘Surely Allah enjoins the doing of justice.’ (The holy Qur’an 16:90).

‘And that when you judge between people you judge with justice.’ (The holy Qur’an 4:58).

The Muslim community and the labour movement share the common goals of social justice, economic fairness and fair treatment in the workplace. In fact, the history of Islam is rooted in a firm stand against economic exploitation.

- I will not waste the work of a worker among you, whether male or female, the one of you being from the other. (Qur’an 3:194)
- Mankind! We created you from a single (pair) of a male and a female, and made you into nations and tribes, that ye may know each other (not that ye may despise each other). (The holy Qur’an 49:13)

**Employer Responsibility**
‘Give full measure when you measure out and weigh with a fair balance. This is fair and better in the end.’ (The holy Qur’an 17:35)

‘Woe to those that deal in fraud. Those who when they have to receive by measure, from men exact full measure, but when they have to give by measure, or weight to men, give less than due.’ (The holy Qur’an 83:1-3)
‘Give just measure, and cause no loss
(to others by fraud).’ (The holy Qur’an
26:181-183)

In Islam equality and freedom have a solid
base, for example,

i. The entire universe is under the
care of the All Wise Allah and
there is no irregularity in it. Being
a part of this world, I cannot
do what I like and that too with
selfish motives.

ii. Our ways of doing things and
deeds and even our mode of
thinking are under surveillance of
our Lord, who knows everything
about us without our awareness.
After all we shall have to present
ourselves before Him for the
accountability of our deeds.

iii. All of us have been raised from
dust and we shall be reduced to
dust. There’s no difference among
the particles of dust; hence why
should there be any difference
between somebody else and me?

iv. Everybody is the servant of Allah
and to treat everyone with love
and affection becomes the source
of Allah’s pleasure and the best
attitude which the Muslim reflects in life
and the great care for morality. Islam
does not believe in radical changes of
the relations of production as a result
of changes in the nature of production,
as Socialism claims.

Islam starts from man and not from
production. The needs of man are
of two kinds, one is basic, while the
other is changing with time. There
must be a permanent set of standards
to ensure the satisfaction of the first
kind of needs. Also there must be a
changing set of standards which adapts
to progress in the means of production.
Islam has a very important advantage
which other principles do not have.

Islam starts from man and not from
wealth, for example, (Zakat) is viewed as a
purifying act, beside its economic value
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The Prophet of Islam said:

‘A moment of justice is better than
seventy years of worship in which you
keep fasts and pass the nights in offering
prayers and worship to Allah.’ (Jami’us
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The Qur’an says:

‘Believers, any one of you turns back on
his faith (should remember) that Allah
could verily bring (in your place) another
people whom He would love as they
would love Him, gentle with believers,
unbending with infidels, who would
strive in the way of Allah unafraid
of blame by any slanderer.’ (The holy
Qur’an 5:54)

Conclusion
The Economic System in Islam is part
of a complete set of codes for the
of whole life. With this view kept in
mind always, we should examine and
analyse. It is not possible to isolate the
economic system from other parts of
Islam because they are interconnected.
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A Legal Framework for Sovereign Sukuk

Background

While sukuk have their origins in the period 700-1300, the instrument was revived in modern times in 1990, when an international company raised a sukuk denominated in Malaysian Ringgit. It was not until 2001, however, that the first sovereign sukuk was issued by the forerunner of the Central Bank of Bahrain. Today, sovereign sukuk account for around 70% of the total sukuk market.

The market for sovereign sukuk reached an all-time high in 2012, $93 billion. In the next six years the levels of issuance declined steadily and in 2018 stood at $78 billion. One of the main reasons for the decline was higher oil prices – GCC countries were able to fund government expenditure through oil revenues. While there was steady growth in sovereign sukuk issuance in Malaysia and Indonesia, it was not enough to offset this decline. With the moderating of oil prices and the need to accommodate debt refinancing the GCC are expected to come back into the market in 2019 and 2020, according to a recent report from Moody’s, this should push the market back up in 2019, possibly surpassing the 2012 high by 2020.

Notwithstanding the recent slowing of the sovereign sukuk market, these instruments are clearly important funding mechanisms not just to majority Muslim countries in the GCC and South East Asia, but increasingly to other countries, e.g., UK, South Africa and Luxembourg. Given that fact, the World Bank are keen to ensure that there is an efficient Public Debt Management structure in place to ensure the macroeconomic stability of countries choosing to raise funds in this way.

Conventional bonds rely to a large extent on the confidence investors have in the issuing government; sukuk are more complex, because they rely on the transfer of ownership of underlying assets or the usage benefits of those assets, in addition to complying with Shari’ah. The World Bank believes that, for these reasons, sukuk need a more comprehensive legal framework, especially in non-Islamic jurisdictions. In 2017 the World Bank produced a discussion paper on the question of just what this legal framework should be. The remainder of this article provides a summary of the World Bank’s observations and recommendations.

Essential Considerations

Regardless of whether a government is issuing conventional bonds or sukuk, a strong governance structure is essential to the effective management of public debt. The World Bank, for example, recognises a legal framework as one of 14 indicators when assessing a country's performance against internationally recognised standards. The essential elements of a legal framework comprise:

- A definition of the scope of public debt
- Provision of the authority to borrow
- Assurance of debt service
- Specification of borrowing purposes
- Clear debt management objectives
- The specification of audit, reporting and accountability processes

Other elements generally included are borrowing limits, institutional arrangements such as the establishment of a debt management entity, regulations relating to borrowing by other public entities and management of contingent liabilities.

Authority to Borrow

Whether a government is raising money via conventional bonds or sukuk, it needs the authority to borrow and this authority should be clearly defined in legislation. In some cases this will be
for in a country’s constitution and in others via primary legislation. In many jurisdictions the mandate of the debt manager will need to be specifically extended to cover these instruments. In particular the types of assets eligible to underpin the sukuk need to be designated, because they differ from the types of assets that underpin conventional bonds, e.g. cash balances. (Limitations on the types of assets available to underpin sukuk may limit the size of any issuance and is, therefore, something that debt managers need to take into consideration.)

In Indonesia, for example, a clear mandate, Article 5/1, allows the Minister of Finance to issue sukuk. The law also allows the use of state-owned assets to underpin the sukuk. These assets have to be repurchased on the maturity of the sukuk.

Types of Instruments
Governments need to analyse the types of instruments, e.g. ijara, mudaraba, etc. available for medium to long-term borrowing carefully. Given that amendments to debt management legislation are likely to be time consuming, it is important that flexibility is built in at the outset.

‘In the case of sukuk, the existence of the SPV in the process would generally require a clear statement in the legislation about how debt will be serviced.’

Hong Kong, for example, has allowed maximum flexibility on the issue of instruments. It simply describes the processes for raising funds via an SPV and gives no mention to any specific structure.

Special Purpose Vehicles
Special Purpose Vehicles (SPVs) are crucial in the implementation of sukuk. They facilitate the employment of state-owned assets to generate cash flows, as well as ensuring compliance with Shari’ah. Most importantly SPVs ensure that sukuk programmes are insulated from conventional bond programmes that pay interest. (It should be noted that even Islamic states such as the GCC countries issue conventional bonds as well as sukuk.)

Turkey, for example, has established something called the Asset Leasing Company as a subsidiary of the Turkish Treasury. Its sole role is to engage in sukuk transactions by taking over government assets and using them to generate returns.

Planning for unforeseen circumstances is essential to avoid any additional burden on the debt management unit and/or the SPV, which would result in an increase in the overall borrowing costs.

Treatment of Proceeds and Debt Service
Despite the fact that SPVs are the initial recipients of any funds raised through sukuk issuance, the government’s principal debt management unit should retain oversight of the whole process to ensure that the government receives the proceeds of the sukuk. The World Bank warn that the creation of an SPV should not result in any fragmentation of the debt management structure.

The legal framework should also be designed in such a way as to reassure investors that the debt will be repaid. The World Bank discussion paper says, ‘In the case of sukuk, the existence of the SPV in the process would generally require a clear statement in the legislation about how debt will be serviced.’

Luxembourg’s sukuk law, for example, guarantees all civil liability claims against the SPV including costs and expenses of any kind, which are directly or indirectly related to the ownership, leasing, sub-leasing, assignment, redemption and management of the properties sold.

The Management of Assets and Costs
The operational issues relating to sovereign sukuk include the transfer of assets from government to the SPV and the management and, in the case of physical assets, the maintenance...
The World Bank recommends that legislation to enable the issuance of sukuk should include a clear mandate to issue sukuk and the authority to use certain public assets to underpin sukuk, as well as to establish or engage with SPVs.

Planning for unforeseen circumstances is essential to avoid any additional burden on the debt management unit and/or the SPV, which would result in an increase in the overall borrowing costs.

In the UK, for example, the maintenance and management of the underlying assets are not covered in legislation, although the sub-lease contract between the SPV and the government states that the government as the tenant or lessee is responsible for all the normal and maintenance and repair costs.

Shari’ah Compliance
Shari’ah compliance is a particular issue for countries where the legal system is independent of Shari’ah. This applies not only to Muslim-minority countries, but also to some Muslim-majority countries, which are subject to a secular legal system that cannot make explicit reference to religion. Where these secular restrictions obtain, the World Bank suggest that particular attention needs to be paid to primary and secondary legislation that either directly or indirectly describes the instruments and the standards to which they must adhere.

In the UK, for example, while the sukuk issued by the government are Shari’ah compliant, it is stipulated that any disputes will be resolved in the English courts, according to English law.

Other Considerations
Taxation
The discussion paper observes that countries tend to require equality of tax treatment for investment gains, whether those gains come from conventional bonds or sukuk. The usual approach is to reinterpret or amend tax schemes to accommodate sukuk. The UK, for example, describes investment returns for sukuk as follows: ‘The excess of the amount paid by the certificate issuer on redemption of the certificate over the amount paid in respect of the certificate by the original beneficial owner of the certificate and the amount of any other periodic payments made by the sukuk issuer to the certificate owner from profits or gains derived from the asset.’

Countries also have to ensure that sukuk are not penalised, i.e. there is a level playing field between conventional bonds and sukuk. Again, citing the UK, the 2003 Stamp Duty Land Tax removed the double payment that would have obtained when an institution buys a property and later resells it.

Market Development
The attractiveness of sukuk to investors is dependent on their receiving the same treatment as other debt securities such as stock exchange listings, custody and clearance.

Conclusions
In the recent past ‘several countries have amended their debt management legislation to enable the issuance of sukuk.’ Some countries have favoured standalone laws, e.g. Indonesia and Luxembourg; others have amended existing legislation.

The World Bank recommends that legislation to enable the issuance of sukuk should include a clear mandate to issue sukuk and the authority to use certain public assets to underpin sukuk, as well as to establish or engage with SPVs. The legal framework also needs to clarify the treatment of debt proceeds and the government’s ability to repay the debt. Care should also be taken to ensure that the management of the underlying assets and the SPV are streamlined so as to minimise operational costs, which could increase the cost of borrowing.

It is also important to ensure that underlying Islamic principles are respected, even where they are not explicitly mentioned in the framework. Satisfying the requirements of Islamic investors in sukuk is obviously one of the keys to the success in this market, particularly where a government intends to be a regular issuer of sukuk.

The supporting frameworks for taxation and capital market management may also need to be reviewed to ensure that there is a level playing field for conventional bonds and sukuk.
Reaching Consensus in the Shari’ah Compliance Debate

The Issue of Shari’ah Compliance

The issue of what is and what is not Shari’ah compliant in the world of Islamic finance is the subject of ongoing debate. Two articles in this issue look at the roots of Shari’ah from two different perspectives. *Muhammadan jurisprudence According to the Sunni Schools* looks at the historical perspective – the pre-Islamic customs and usages of Arab societies and the development of Shari’ah through the word of the Prophet (PBUH) and his followers. *Shi’i Islamic Perspective on Finance (Foundations of Islamic Economical System)* looks at the basic Islamic principles that underpin Islamic economic theory, quoting extensively from the Qur’an. The problem is, how is it possible for these principles to be applied in the 21st century and how and why have the attitudes to what is and what is not Shari’ah compliant taken somewhat divergent paths, so that what is deemed permissible in one jurisdiction is not deemed permissible in another.

This topic is of more than academic relevance. The differences mean that it is difficult to set standards that are accepted and applied across the world. If Islamic finance is to reach its full potential, Islamic financial institutions (IFIs) need to be able to sell their products on a worldwide basis and investors need to be able to have confidence that what they are buying is fully Shari’ah compliant. (A recent survey by Gatehouse Bank among UK Muslims reported that 61% of respondents were sceptical about just how Shari’ah compliant financial products offered by Islamic banks were.)

The latter point was emphasised in 2000, when the late Mr Muzzam Ali, Founder and Chairman of the Institute of Islamic Banking and Insurance (IIBI) said, ‘One of the key requirements for the successful operations of Islamic banking is adherence to a prescribed code of moral and ethical conduct. Some of the financial institutions, while promoting the instruments of conventional banking, label these Shari’ah compliant. Their minds are so firmly set on Western financial concepts that they cannot get rid of them.’

Bilal Khan, Shari’ah scholar and executive director of the Islamic Finance Education Council (IFEC) put it rather more pithily at a 2011 conference, ‘Just calling something Islamic does not make it Islamic.’

At the same 2011 conference Nicholas Foster, Senior Lecturer in Commercial Law at the University of London’s School of Oriental and African Studies commented that in the classical period Shari’ah had a very sophisticated commercial legal system, but there was no mechanism to develop the system through changing times. Although the fundamental principles of Shari’ah do not change, the rules or laws informed by those principles need to change to reflect the realities of the modern commercial world; to deal with situations that could never have been imagined in the classical period.

If Islamic finance is to reach its full potential, Islamic financial institutions (IFIs) need to be able to sell their products on a worldwide basis and investors need to be able to have confidence that what they are buying is fully Shari’ah compliant.

It is not necessary to go back to antiquity to look for examples of the problems that beset Islamic finance when it comes to Shari’ah compliance. Richard Thomas, then Chief Executive Officer of Gatehouse Bank noted that when he first became involved in Islamic finance in the 1980s the types of deal with which he was involved...
were true murabaha contracts, physical transactions involving real ownership and transference of goods. Over time changes in the tax systems of western countries put murabaha contracts at a disadvantage in the broader market. It is at that point that commodity murabaha or tawaruq, effectively a debt financing instrument, began to push out true murabaha. Just as with any debt financing instrument, commodity murabaha allows clients to claim the repayment of the principle and interest as business expenses with all the tax advantages that stem from that classification.

The Underlying Problem
As Nicholas Foster says the fundamental principles of Shari’ah do not change, but what is needed is a mechanism to develop the system through changing times. The underlying problem is that over time a multiplicity of systems has developed. In some jurisdictions IFIs have their own Shari’ah supervisory boards that make decisions on Shari’ah compliance, in others a central Shari’ah board upholds the standards for all Shari’ah supervisory boards in that jurisdiction. Layer on top of that the fact that there are two major standards setting bodies – the GCC-based Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) and the Malaysia-based Islamic Financial Services Board) and it is easy to understand why confusion and doubt are apt to arise. (In late 2018 AAOIFI and IFSB did sign a memorandum of understanding (MoU) to increase co-operation, but it is too early to say what practical effect this will have.)

The Impact of Geopolitical Factors
It must also be taken into account that IFIs and the standard setting bodies do not make their decisions in a vacuum. These decisions are influenced by broader geopolitical and theological issues. In an interesting paper in Wiley’s Online Regulation and Governance strand, authored by Fulya Apaydin, the author examines some of the reasons why regulatory regimes have developed along very different lines and the implications in that for the Islamic finance industry. The author uses the United Arab Emirates (UAE) and Malaysia to highlight how and why the development of the former resulted in a decentralised system with IFIs relying on their own Shari’ah boards and the development of the latter ended with a centralised system relying on the Shari’ah Advisory Council (SAC), a part of the central bank, Bank Negara Malaysia, to regulate the Islamic finance industry.

The author says, ‘The combined effect of colonial legacies and regime institutions that frame political competition influence financial market building and the design of regulatory institutions in later stages. Across these two cases, the governance of faith-based markets is characterised by a contrasting pattern of religious adjudication: while a competitive authoritarian regime nurtured autonomous and centralised regulation in Malaysia, a federal autocracy like the UAE characterised by elite-competition among the ruling families gave rise to a fragmented and decentralised framework with very little emphasis on standardisation.’

Again rather counter intuitively the author demonstrates that it is the highly centralised regime in Malaysia that has led to greater product diversity than in the apparently freer decentralised system operating on the UAE. (It is worth reading the full paper to be found at https://onlinelibrary.wiley.com/doi/full/10.1111/rego.12201 to understand just exactly how and why this outcome has been reached.)

The underlying problem is that over time a multiplicity of systems has developed.
banks for the period between 2005 and 2009 (Wasiuzzaman S, Gunasegavan UN (2013) Comparative Study of the Performance of Islamic and Conventional Banks: The Case of Malaysia. Humanomics). This is suggestive of emerging competitiveness and an improving performance thanks to the centralised and well-coordinated regulatory framework in this country. On the other hand, Islamic banks in the UAE operate on higher costs and require a greater number of branches to reach similar levels of efficiency (measured in terms of return on assets and return on equity) as they compete against conventional banks (Al-Tamimi HAH2010. Factors Influencing Performance of the UAE Islamic and Conventional National Banks). In this sense, highly decentralised Shari’ah governance in the UAE appears to be closely correlated with the underperformance of Islamic banks in this country.

**In Summary**

If existing and prospective clients of Islamic financial institutions are to be reassured that products and services are indeed Shari’ah compliant and IFIs are to be enabled to trade efficiently and internationally without let or hindrance, there needs to be some consistency across all jurisdictions offering Islamic finance. There are some indications of progress towards that end such as the MoU in late 2018 between AAOIFI and the IFSB. There is also some evidence that more jurisdictions are moving towards central Shari’ah boards, which, if the Malaysian experience is to be relied on, is a positive move. (Both Bahrain and Qatar have been investigating the possibilities of establishing centralised Shari’ah boards.)

The problem is that the views of Shari’ah scholars from different parts of the world and even within jurisdictions are apt to differ and they often feel the need to accommodate local customs and practices. Putting it at its most cynical level, if a bank does not like the opinion of one scholar, they can and go and find another with more congenial views. We have even heard some commentators express the view that one of the strengths of Islamic finance is its flexibility and too much standardisation is a bad thing.

At the end of the day the Islamic finance industry has to make up its mind whether it wants to become a player on the world stage or whether it is happy to dominate markets in Muslim-majority countries, picking up the scraps wherever else it can. It would be a great pity if it settled for the latter; it has a lot to offer, particularly in view of the growing interest in ethical and sustainable finance. The problem is that there are a great many vested interests involved. These include the Shari’ah scholars themselves and the governments in Muslim-majority countries, where Islamic finance and its governance have to be seen in the broader context of the geopolitical agenda. It would be disappointing if, in 10 years time, we are still wrestling with the issue of Shari’ah compliance and international standards, but reaching consensus is going to be a difficult journey and it will require all of the players – scholars, governments and financial institutions – to be willing to make some sometimes difficult compromises. At the end of the day, if they can do this, the winners will be not just the industry, but everyone who wants to see a fairer and more equitable financial system with all the benefits that will bring to individuals, businesses, countries and the planet itself.

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Blockchain Technology – What Is It and How Are Islamic Financial Institutions Beginning to Use It?

The term ‘blockchain technology’ is now familiar to almost everyone involved in the finance industry, but exactly what is it and how is it being used?

**Background**

Most people will probably associate the term ‘blockchain technology’ with the cryptocurrency phenomenon, but its potential applications reach far beyond cryptocurrency. The most simplistic explanation of blockchain is that it is a series of information blocks stored in a public database (the chain). Each block contains a cryptographic hash of the previous block, a time stamp and transaction data.

**The Technology**

Blocks are packages of data that contain information about a transaction – the date, time and value of the transaction; the parties involved in the transaction identified by a digital signature rather than by the name of an individual or company and a unique code that allows it to be distinguished from all the other blocks of information. A block can store up to 1MB of data, so rather than each transaction being stored in an individual block, each block can potentially store details of a few thousand transactions.

Before a block can be added to the chain or public database it must be verified, however this verification is carried out by a network of computers, rather than an individual or organisation in charge of vetting new entries. (Bitcoin, for example, uses a network of approximately five million computers across the world.) Once the verification has been completed, the block is allocated a unique identifying code called ‘a hash’ and is stored with that hash, along with the hash of the block preceding it in the chain. It then joins the end of the chain and is available for anyone to view.

There are currently three types of blockchain – public, private and consortium. Public blockchains have no access restrictions and are the technology used by cryptocurrencies; private blockchains are only available to invited participants and are typically under the control of a single organisation and consortium blockchains are like private blockchains but are under the control of a group of organisations.

**Security**

If anyone tries to alter the contents of a block stored in the chain, the hash will automatically change, but the block following the edited block would still contain the original hash and so on down the chain. That means a hacker would have to go down the chain updating all the subsequent blocks. This makes it difficult to change a block and that block cannot be deleted.

Additionally, each computer in the blockchain network has a copy of the blockchain and that is one of the aspects of the technology that makes it difficult for criminals, hackers, etc. to manipulate the data. Such people would have to manipulate every copy of the blockchain on the network, because there is no single master copy.

Before anyone can reach the point where they can add or attempt to change blocks, they must pass complex tests called ‘consensus models’. These have been devised to be extremely difficult and time consuming, requiring substantial computing power. In other words attempts to hack the blockchain would be extremely costly, so attacks are not impossible, but the motivation to do so would have to be overwhelmingly strong and in most cases the benefits would not balance the effort required. In current circumstances only a state player would have the resources and motivation to mount an attack.

**Blockchain and the Financial Services Industry**

The best known application of blockchain technology is in the cryptocurrency arena, but it has potential benefits in a whole range of settings where there is a need to process transactions rapidly and securely, for example in the financial services industry. Who has not been irritated by the fact that a bank deposit can take up to three days to show in their account? Blockchain potentially solves that problem, taking as little as 10 minutes (the time it takes to add a transaction to the blockchain), any day, anytime to register that deposit. That of course is most significant for large-scale banking and securities transactions.

Effectively blockchain technology could make a whole range of intermediary organisations in the financial services
The increased complexity of Islamic finance contracts, with the need to ensure Shari’ah compliance, increases transactional costs. Smart contracts enabled by blockchain technology have the ability to streamline the process – reducing cost, eliminating duplication and preventing fraud.
organisations dip their toe into the blockchain waters. The following highlights some of the early adopters.

**Emirates Islamic**

In mid 2017 Emirates Islamic, became the first Islamic bank to announce that it would introduce blockchain technology into its cheque processing as a fraud prevention measure. Termed ‘Cheque Chain’, Emirates will issue new cheque books carrying a unique QR (Quick Response) code on every leaf, along with a string of 20 random characters. Each cheque is registered on the Bank’s block chain platform enabling it to validate the authenticity of the cheque at source.

**Al Hilal**

In late 2018 Al Hilal Bank became the first Islamic bank in the world to use blockchain technology in the resale and settlement of sukuk. It was used to transact a secondary market deal in Al Hilal Bank’s $500 million senior sukuk maturing in September 2023. In a press statement Al Hilal Bank said that it is aiming to transform the sukuk market through embracing blockchain and integrating it into their infrastructure, paving the way for digitised Islamic sukuk (dubbed ‘Smart Sukuk’).

Al Hilal Bank’s CEO, Alex Coelho, commented on the initiative, saying: ‘The advantages of using smart contracts range from safer transactions with robust Shari’ah compliance, to the unlocking of new opportunities.’

It is believed that smart sukuk will provide transactional efficiencies and significantly reduce the bloated overheads associated with issuing and settling sukuk. In addition, by leveraging smart contracts to oversee the enforcement of Shari’ah compliance, Al Hilal Bank is confident that operational efficiencies and automation benefits can be delivered.

The initiative was the result of a collaboration between the Al Hilal Bank Digital Transformation team with Jibrel Network, a UAE-based fintech company.

**Kuwait Finance House**

In early 2019 Kuwait Finance House (KFH), a member of RippleNet, has started operating an instant cross-border remittance service ‘Instant International Transfer’ using Ripple’s blockchain technology. The remittance service, launched as a zero-fee facility, is currently available in Saudi Riyal (SAR) where customers can make remittance transactions to beneficiaries at Al Rajhi Bank. This service will expand to encompass more countries and different currencies. The service allows KFH customers to make instant and secure zero fees remittances through their accounts in kfh.com.

**ICD Look to Blockchain to Solve Liquidity Problems**

The Islamic Corporation for the Development of Private Sector (ICD), the private sector arm of Islamic Development Bank Group (IsDB) has signed an investment agreement with Tunisian-based I-FinTech Solutions (IFTS) to collaborate in developing fintech solutions and implement these technologies in Islamic banks worldwide.

The partnership between ICD and IFTS involves a pipeline of fintech products that will be developed and implemented to mainly solve liquidity management issues. The first product in the pipeline is a real time transactional platform, which facilitates the transacting of real commodities (serving as a commodity market) and solves the inter-banking issues between conventional and Islamic banks in a Shari’ah compliant way. The use of blockchain in this product will reduce both the overall execution time and the cost of the financial and commercial transaction. It also addresses the issues and challenges related to the transparency and traceability of the financial transactions.

**Al Rajhi Bank**

Saudi Arabia’s Al Rajhi Bank is using blockchain technology for secure, cross-border transactions. Towards the end of 2018 blockchain-based transactions were employed for remittance payments between Saudi Arabia and India in collaboration with IndusInd Bank in India, where blockchain was used for remittance payments between Saudi Arabia and India. This followed a pilot exercise in October 2017 transferring money between Al Rajhi Bank and one of its branches in Jordan.

‘We are happy to invest in the most innovative technologies to provide our customers with the products and services they need in this digital era,’ said Abdulrahman Al- Fadda, Treasury General Manager at Al Rajhi Bank. He added: ‘We live in a time where our customers expect to receive and send their transfers instantly, be it local or international.’

The new initiative is expected to give the customers a seamless experience by shortening the amount of time the transfers take, reducing the costs while increasing the accuracy of the processes. In addition, the blockchain technology instantly makes adjustments with the beneficiary banks.
Global Islamic and Sustainable Fintech Centre Launched in Bahrain

The Global Islamic & Sustainable Fintech Centre (GISFC) has been launched by Bahrain Fintech Bay. The aim is to drive the next phase of growth in Islamic finance as well as focussing on sustainable, responsible and social innovation. The partners in this new initiative include the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), the Islamic Corporation for the Development of the Private Sector (ICD), South East Asia’s Islamic Fintech Alliance, Ethis Ventures - an Islamic crowd funding platform across Malaysia, Indonesia and Singapore, Al Baraka Banking Group, the Al Salam Bank, Arab Financial Services, Arcapita, the Bahrain Institute of Banking and Finance, Bahrain Islamic Bank, Finastra, Finocracy, GFH, IdealRatings, Ithmaar Bank and Kuwait Finance House.

Dr. Ali Adnan Ibrahim has been appointed as Chairman of GISFC. Dr. Ali is Head of Sustainability and Social Responsibility at the Al Baraka Banking Group in Bahrain. Commenting on his appointment, he said, ‘While Islamic finance is fast approaching the three trillion dollar mark, sustainability is one of history’s biggest disruptors. Islamic and sustainability fintech solutions can help solve several social and economic challenges and, while doing so, such solutions will create massive economic value including investment opportunities for individuals and businesses. Bahrain’s fintech and Islamic finance regulatory ecosystem can help Islamic and sustainability fintech start ups from the region and beyond, building on Bahrain’s position as a global centre for Islamic and sustainable fintech.’

International Turnkey Systems Win Contract in Tajikistan

International Turnkey Systems Group (ITS) will deliver a full Islamic core banking system and digital banking solution to Sohibkorbank, the first Islamic bank in Tajikistan. The new system will facilitate Sohibkorbank’s conversion into the first fully-fledged Islamic bank in the Republic of Tajikistan. The deal will see ITS implement an Islamic Banking Information System (IBIS) powered by ETHIX. The scope of work includes the implementation of a number of the ETHIX modules including ETHIX-Core, ETHIX-Branch, ETHIX-Finance, ETHIX-Net, ETHIX-Mobile, ETHIX-FATCA and ETHIX-360.

Commenting on the announcement, International Turnkey Systems (ITS) CEO, Mr. Esam Alkreshnam, said, ‘This deal represents ITS’s successful exploration into Central Asia, which is aligned with our strategic expansion plan. We are working to establish ourselves in the region as we continue to expand our brand’s geographical footprint and customer network.’

UK and Turkey Co-operate on Islamic Fintech

The UK is working with Turkey to facilitate the development of Islamic fintech. In a meeting in Istanbul the British Consulate-General in Istanbul, TheCityUK and Borsa Istanbul discussed co-operation between the two countries to find new opportunities in fintech.

‘Islamic fintech is expanding at a rapid pace in the UK, drawing strength from the country’s position as the number one Western centre for Islamic finance and a leading global centre for fintech,’ said Wayne Evans, an advisor on international strategy at TheCityUK.

‘UK-based Islamic fintechs are already supporting Turkey’s fast-growing participation banking sector – this forum can help further deepen this relationship, connecting more innovative fintechs and helping to identify next steps for UK/Turkey Islamic finance cooperation.’

The forum was supported by the UK Foreign and Commonwealth Office Prosperity Fund, which aims to remove barriers to economic growth and promote economic reform and
development in partner countries. A second meeting will take place in London in early 2019.

**Iraq’s Al Mustashar Islamic Banks Goes Live with ICS Financial Systems**

Al Mustashar Islamic Bank is a newly registered bank in Iraq that obtained approval from the Central Bank of Iraq in the second quarter of 2018 to offer Shari'ah-compliant banking services. ICS Financial Systems have successfully launched and rolled-out its universal Islamic banking and financial solution ICS BANKS ISLAMIC in a record-breaking time of only three months. Al Mustashar will be implementing ICS BANKS ISLAMIC Core Banking System, Credit Facilities and Risk Groups, Murabaha, Musharaka, Ijara, Mudaraba, Qard Hasan, Time Deposit, Profit Distribution, Remittances and Trade Finance. ICS BANKS ISLAMIC is a modular fully integrated solution designed and developed following the principles of Shari'ah in compliance with the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI).

**Boubyan Bank Completes iMAL Upgrade**

Kuwait’s Boubyan Bank has completed its core banking platform upgrade. The bank’s decision to upgrade to the new iMAL R14 version is a key part of its plan to transform the bank into an all-digital platform.

‘It takes continuous effort to maintain high customer satisfaction levels; we believe that advanced technology will help us deliver the exceptional service our customers expect from us’, stated Adel Abdul Wahab Al-Majed, Vice-Chairman & Chief Executive Officer of Boubyan Bank. The decision to upgrade the iMAL system was driven by a desire to improve service quality across the bank.

**Temenos Wins in Saudi Arabia and Palestine**

Al Rajhi Bank, Saudi Arabia’s second largest bank and the world’s largest Islamic bank with total assets of more than $97 billion, has chosen Temenos to power its digital transformation at the bank and enhance its Islamic lending and financing product capabilities. The bank has opted for a complete renovation using Temenos T24 Transact as well as additional digital solutions including Temenos Infinity and Temenos Loan Origination.

The new solution will support Al Rajhi Bank’s growth ambitions and its vision to bridge the gap between modern financial demands and intrinsic Islamic values. The Temenos Islamic Banking Suite, coupled with its Saudi Model Bank application which includes global best practices and pre-configured local functions, will enable Al Rajhi Bank to cater for the specific Saudi regulatory requirements in a timely and efficient fashion. The bank has more than 570 branches across Saudi Arabia as well as in Kuwait, Jordan and Malaysia.

In a second deal, **Palestine Islamic Bank** (PIB) has selected Temenos Infinity and Temenos T24 Transact to transform its banking systems and drive its digital transformation. Founded in Palestine in 1995, PIB now operates a network of 43 branches, making it the largest Islamic banking network in the country. In 2018, The National Islamic Investment Company purchased 31.3 million shares in the bank, representing a majority 45% holding, a move seen to strengthen the overall Palestinian banking sector and drive the national economy forward. Following the share acquisition, PIB’s new board decided to adopt a digital transformation strategy with the purpose of increasing operational efficiency as well as providing its customers with a personalised and convenient service, allowing the bank to move to a customer-centric business model.

**Finastra to Power Core Retail Banking at Al Taif Islamic Bank**

Iraq’s Al Ta’if Islamic Bank has chosen Finastra’s core banking solution, Fusion Islamic, to kick start its retail business. Al Taif Islamic Bank, which started 15 years ago as Al Ta’if Company for Money Transfer and is part of the Al Ta’if Group, has ambitious goals to establish itself as a leader in the financial market in Iraq. Finastra’s solution is delivered with pre-configured Shari’ah-compliant products, which will help the bank develop new services faster and roll them out through multiple channels at low cost, giving it a competitive edge. Fusion Islamic is also expected to alleviate pressure on IT teams whilst ensuring rapid time-to-market, minimising risks and maximising efficiency.

Reda Hamza, CEO at Al Ta’if Islamic Bank said, ‘Our vision is to challenge the status quo of the financial services sector in Iraq and there is a strong opportunity to offer new services to the unbanked population here. In addition to our branch presence, going digital is the best way for us to reach this market.’
Dubai Islamic Bank has reported profits for the full year to December 31 2018 at AED 5 billion, up 11% on the previous year with total income up 15% at AED 11.7 billion. The cost-to-income ratio fell slightly from 30.4% at the end of 2017 to 28.3%. Net financing and sukuk investments rose 11.8% to AED 175.9 million and assets were up 7.9% to AED 223.7 billion. The capital adequacy ratio stood at 17.5%. (The minimum requirement is 12.75%.)

In the first nine months of 2018 Dubai Islamic Bank Kenya recorded a loss of Sh665.8 million. The loss was largely due to spiralling costs, up from Sh569 million in the first nine months of 2017 to Sh745.8 million in the same period of 2018.

Qatar International Islamic Bank (QIB) has reported net profits of 882.1 million Qatari Riyals for the year 2018, an increase of 6% on 2017. Operating revenues were 2.1 billion Qatari Riyals, compared to 1.9 billion in 2017. Total assets increased from 46.6 billion Qatari Riyals in 2017 to 50.3 billion Qatari Riyals at the end of 2018.

The UAE’s Noor Bank has reported 2018 results showing a net profit of AED 676 million prior to adjustments for property revaluations, a 74% improvement in underlying performance. (Net profit after adjustments was AED 601 million, representing a growth of 62% over 2017.) Total assets increased by 19% to AED 50.7 billion and gross financing was up 17% at AED 34.3 billion. Total operating income was AED 2 billion. The positive results were attributed to both a strong performance in the core business and lower operating costs.

Bahrain’s Ithmaar Bank reported a net profit of BD 14.14 million for the year ended 31 December 2018, an increase of 126.7% compared to the net profit of BD 6.24 million reported in 2017. Total income remained stable in 2018 with the Bank reporting BD 151.7 million for the year ended 31 December 2018. Ithmaar Bank’s balance sheet decreased marginally by 3.5% with total assets at BD 3.13 billion as at 31 December 2018, compared to BD 3.24 billion as at 31 December 2017.

Abu Dhabi Islamic Bank (ADIB) has reported group net revenues for 2018 up by 2.4% to AED 5,769.5 million from AED 5,632.3 million in 2017. Credit provisions and impairments for 2018 decreased by 21.5% to AED 620.1 million compared to AED 790.4 million for 2017. Group net profit for 2018 increased by 8.7% to AED 2,500.8 million. This compares to AED 2,300.1 million in 2017. Total assets as of 31 December 2018 were AED 125.2 billion, representing an increase of 1.6% from AED 123.3 billion at the end of 31 December 2017.

Qatar Islamic Bank (QIB) has announced that QIB has achieved net profit attributable to shareholders of QAR 22755.3 million for the fiscal year 2018 compared to QAR 2405.4 million for the year 2017, an increase of 14.5% year on year. Total assets increased by 2% compared to 2017 and now stand at QAR 153.2 billion driven by a growth in the core banking activities. Total income for the year ended 31 December 2018 was QAR 6,899.7 million registering an 11.3% growth compared to QAR 6,199.3 million for 2017. Total expenses of QAR 1,161.2 million for the year ended 31 December 2018 are 5% above QAR 1,105.7 million for the year ended 31 December 2017. The cost-to-income ratio, however, was down to 25.7% for 2018 as compared to 26.6% for the year 2017.

Malaysia-based BIMB Holdings Berhad’s (BHB) earnings have hit a new high with group profit before zakat and taxation (PBZT) at RM1.07 billion for the financial year ended 31 December 2018. The Group’s two main operating subsidiaries are Bank Islam and Takaful Malaysia. Bank Islam Group reported a PBZT of RM810.3 million for FY2018, an increase of RM43.2 million or 5.6% over the previous financial year of RM767.1 million. Takaful Malaysia recorded a 32.9% increase in PBZT to RM337.0 million for FY2018, compared to RM253.7 million achieved in the previous year.

Bahrain Islamic Bank (BisB) has reported a net profit of BHD 11.4 million for the year ended December 31, 2018, compared to BHD 10.1 million net profit in 2017; an increase of 12.2%. The Bank achieved a net operating income of BHD 20.3 million, compared to BHD 16.3 million last year, an increase of 24.1%.

Syarikat Takaful Malaysia Keluarga Bhd recorded a net profit of MYR294.92 million in 2018, an increase of 43% over 2017. Revenue was up 23% to MYR2.63 billion. Both the family and general takaful businesses registered strong growth. Emirates Islamic have reported a 39% leap in net profits for the first half of 2019. Total income rose 10% year on year to Dh1.3 billion and assets were up 5% to Dh61.1 billion.

QIIB have announced a 5.5% increase in net profits to QR510.6 million for the first half of 2019. Total assets grew 13.9% to QR54.2 billion for the same period and total income was up 10.3% to QR1.04 billion.

Jordan Islamic Bank, part of the Al-Baraka group, reported an increase in net profits for the first half of 2019, from $49.4 million in the first half of 2018 to $55.2 million, a growth of 12%. In early 2019 the bank increased its capital to $282.1 million. (It previously stood at $253.9 million.)

Abu Dhabi Commercial Bank (ADCB) has reported an 11% fall in profits for the second quarter of 2019. This follows the merger between ADCB, Al Hilal Bank and Union National Bank in May 2019. Total net interest and Islamic income fell by 7%. The fall is attributed in part to the costs of integrating the three banks.
RECOMMENDATION FOR A

MORAL CODE OF CONDUCT IN ISLAMIC FINANCE

DECLARATION

I '(name of person making the declaration)' make this declaration on my own free will, and upon my honour. My purpose is to serve the greater good of society. I will comply with the laws, regulations and codes of ethics applicable generally and recognise that I also have moral obligations to ensure that my behaviour conduct and actions do not adversely affect the well-being of society, the natural environment and future generations. I recognise that I will face challenges and difficult choices in upholding the highest moral values and the goals of socio-economic justice underpinning all contracts and dealings in Islamic financial services.

I declare that I will be ever vigilant in aiding the general welfare of society, not engaging in such behaviour and conduct that will in any way bring harm, shame or
BUSINESS VISION SHAPED BY INSIGHT

Our clear understanding of the key issues facing Islamic finance enables us to develop strategies and recommendations that meet your business needs. Our insights are valued by clients globally. Find out how we can help you see clearer, at ey.com.