Shari'ah
(Islamic Jurisprudence)

Shari'ah is the a body of laws, rules, code of conduct and teachings which are intended to benefit the individual and society. Muamalat is that section of Shari'ah that means interactions or transactions. Shari'ah is all about justice, mercy, wisdom, and good. These are essential in all dealings in order to achieve the welfare of the people.
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Deal not unjustly, and ye shall not be dealt with unjustly.
Surat Al Baqara, Holy Quran

Executive Editor’s Note

Islamic finance has two main driving forces – the desire to expand the industry and move forward and the need to remain true to its Islamic roots. This issue of NewHorizon rather neatly demonstrates these twin aims. On the one hand there are the articles which talk about the opportunities for Islamic finance in the green/ethical space, in credit unions and the development of products that allow Islamic banks to compete on a more equal footing with their convention counterparts. On the other hand there are articles, which remind us about the importance of the ban on riba and the need for rigorous Shari'ah screening.

At first sight these two forces may seem to be antithetical, but are they? Those who remind us that the industry needs to remain true to the teachings of the Prophet Muhammad (pbuh) are not saying that the industry should not be innovative and forward thinking; they are simply reminding us that the drive for progress should not be at any cost. Islamic finance’s unique selling point lies in its difference, its claim to offer a moral and socially-responsible form of finance. Lose that and it is just another bank or building society on the high street and quite likely to lose out to very well-established financial institutions with very deep pockets.

Beyond the internal tensions within Islamic finance, several articles draw attention to external factors that have the potential to cause the growth of Islamic finance to falter. These include regulatory environments that are designed for the conventional finance industry and national constitutions and legal systems that are sometimes invoked to try to deny Islamic financial institutions and products equal treatment, for example, the US’s First Amendment enshrining the principle of the separation of church and state (see the article on takaful in this issue).

There is also an important report on the 7th LSE Islamic Finance workshop 2013 focusing on the benefits and misuses of limited liability in Islamic finance, examining the Shari’ah issues, the economic issues and the most desirable Shari’ah-compliant organisational forms.

Islamic finance practices will only be taken more seriously when there is broad agreement on exacting Shari’ah standards on core transactions and outcomes capable of attracting wider acceptance and greater success for the industry. As long as there is the Malaysian voice, the Saudi Arabian voice, the UAE voice, etc., it is difficult for the public, regulators and legislators to know clearly the aim and vision of the Islamic finance industry.
IIFM Launched Collateralised Murabahah Standard

Mr. Khalid Hamad Abdul-Rahman Hamad, Chairman of the IIFM said, “This standard is based on rahn or collateral and will provide an alternative avenue for institutions for low-risk financing arrangements locally as well as cross-border. With the publication of this global standard document, institutions of all sizes will be equally comfortable to transact and better utilise their Islamic securities portfolio particularly sukuk. Another feature of this master agreement is the potential to make use of a tri-party agent for safe keeping as well as marking to market and other such services.”

‘This global master agreement has been developed as an additional tool to be used for liquidity management by institutions active in Islamic finance. It is the best possible alternative to conventional repo arrangements and will enable the institutions to utilise their idle sukuk or Shari’ah-compliant portfolio for generating liquidity. The master agreement also provides for credit enhancement resulting in better risk management in an environment where the global finance market is generally moving away from clean lending,’ said Mr. Ijlal Ahmed Alvi, Chief Executive Officer, IIFM.

Mr. Alvi explained, ‘This standard document has been developed in accordance with the IIFM comprehensive procedure in developing global standards, i.e. consultation with the IIFM Shari’ah Board from the early stages, market consultative meetings, forming a global working group and the appointment of external legal counsel.’

The key features of this agreement is that the fund placing institution will have the comfort of knowing collateral is safely segregated and has a margin maintenance mechanism to support risk management. The collateral is taken through a pledge mechanism and envisages that the collateral will be held by a third party custodian to facilitate getting hold of the collateral in case of default or severe impairment of the collateral giving an institution’s credit worthiness.

‘The industry will find the Operational Guidance Memorandum very useful in explaining how the standard is to be used and in addition to that it provides very comprehensive recommendations,’ Mr. Alvi added.

Mr. Naveed Khan, Deputy Chairman of IIFM and Managing Director, ABC Islamic Bank said, ‘This standard fills the acute gap and removes a disadvantage for the Islamic finance industry compared to its conventional counterpart. In as much as re-use is not a feature, it retains its full Shari’ah-compliant flavour. I am hopeful that both existing and new users will find the standard useful in bridging their liquidity needs’.

Mr. Habib Motani, Partner, Clifford Chance LLP, said ‘This new standard document provides the Islamic financial market with a significant new tool for addressing the increased regulatory focus on liquidity and collateral and Clifford Chance is delighted to have been able to contribute to its development.’

The IIFM Master Collateralised Murabahah Agreement and Operational Guidance Memorandum are available on the IIFM website: www.iifm.net for its members. All IIFM standard documentation is available in both Arabic and English.

IIFM are also planning to develop contract and trade finance templates. Trade finance in particular has been somewhat overlooked by Islamic finance, possibly because Islamic banks have been put off by the entrenched position of conventional Western banks.

Maybank and Bosera Target ASEAN and Greater China Markets

Maybank Asset Management Group Berhad and Hong Kong-based Bosera Asset Management (International) Co., Limited have signed an agreement to explore the opportunities for jointly developing Shari’ah-compliant investment products aimed at the South East Asian and Greater China markets. With a population of around 230 million Muslims, these are attractive markets.

Chief Executive Officer of Maybank Asset Management Group Berhad, Nor’ Azamin Salleh commented, ‘The prospects of this partnership with Bosera, the leading asset management company in China, is enormous. Having built and strengthened our on-the-ground expertise in key ASEAN markets, i.e. Malaysia, Thailand, Singapore and Indonesia over the past three years, the time has come for us to tap into the full potential of our Asian-focused investment team and leverage heavily on the ASEAN Framework platform. Given our capabilities in managing Islamic assets, we are confident we can deliver world-class Islamic products conforming to international Shari’ah guidelines and standards. We are working towards a Greater China and ASEAN Islamic equity fund due to be launched in the first quarter of 2015.’

In Mid November 2015 the Bahrain based International Islamic Financial Market (IIFM) launched the IIFM Master Collateralised Murabahah Agreement, which is supplemented by an Operational Guidance Memorandum.
Takaful Still Has Problems to Solve

EY’s report, Global Takaful Insights 2014 forecasts a continued double-digit growth for the global takaful market of approximately 14% from 2013 to 2016 and expects the industry to reach US$20 billion by 2017.

The report says that within the Gulf region, Saudi Arabia accounts for the majority of the total gross takaful contribution at 77%, followed by UAE, which accounts for 15%. The rest of the Gulf countries accounts for just 8% of gross takaful contributions. Saudi Arabia will probably remain the core market of Islamic insurance business, commanding approximately half (48%) of the global contributions.

Among the GCC countries, competition, operational issues, the shortage of experienced personnel and the lack of uniform regulations across geographies continue to be impediments. In particular, the profitability of takaful companies has been threatened by undifferentiated strategies, meaning that competition is fierce, which will probably result in some of the weaker providers being forced out of the market.

Abid Shakeel commented, ‘To continue to grow and improve profitability, the industry needs to re-set its strategic direction according to emerging customer trends. In the face of a competitive landscape, large takaful operators are developing segmentation strategies to allow them to refine their product offerings and match them to customers with a propensity to buy. Success for smaller operators will be to accelerate their digital capabilities for sales and service with the aim of reducing their operational costs. These principles apply to both personal lines as well as commercial lines and have proven to be critical strategic decisions by the more advanced insurance industry. The industry should also gear up for new solvency, accounting and regulatory reforms. These, coupled with the support of regulators in nurturing growth through a stronger focus on the standardisation of regulatory and Shari’ah frameworks, will provide a strong roadmap for the industry as a whole to build a sustainable and thriving ecosystem.’

The survey findings were based on responses from 30 senior executives in leading takaful markets across six countries including Saudi Arabia, UAE and Malaysia as well as desktop research collation.

Islamic Banking – Good Results But Must Do Better

According to EY’s World Islamic Banking Competitiveness Report 2014-15: Participation Banking 2.0, Islamic banking assets with commercial banks in international markets are set to exceed US$778 billion in 2014. Global Islamic banking assets witnessed a compound annual growth rate (CAGR) of around 17% from 2009 to 2013.

Approximately 95% of international Islamic banking assets of commercial banks are based out of nine core markets, five of which are in the GCC (Saudi Arabia, UAE, Qatar, Kuwait and Bahrain). The market share of Islamic banking assets in Saudi Arabia, UAE, Qatar, Kuwait, Bahrain and Malaysia is now between 20% and 49%. The analysis excludes Iran.

Islamic banks in Saudi Arabia, Kuwait and Bahrain represent more than 48.9%, 44.6% and 27.7% market share respectively. Positive progress has been made in Indonesia, Pakistan and Turkey, with 43.5%, 22.0% and 18.7% CAGR respectively from 2009 to 2013. Gordon Bennie, MENA Financial Services Leader at EY, says, ‘The six rapid-growth markets (RGMs) – Qatar, Indonesia, Saudi Arabia, Malaysia, UAE and Turkey (QISMUT) – commanded 80% of the international Islamic banking assets at US$625 billion in 2013. QISMUT Islamic banking assets are expected to continue to grow at a five-year CAGR of 19% to reach US$1.8 trillion by 2019.’

EY analysed the sentiment of over 2.2 million customers’ social media posts on their banking experiences with Islamic banks in Saudi Arabia, Bahrain, Kuwait, UAE, Malaysia, Indonesia, Turkey, Qatar and Oman. The results showed that customer satisfaction is mediocre for many Islamic banks. The ROEs of Islamic banks remain approximately one-fifth lower than those of traditional banks in the same markets. This performance gap could cost its shareholders, and to some extent the investment account holders, up to US$17 billion in total forgone profit over the next five years. Structural transformation and scaling up is therefore becoming extremely critical to improve shareholder returns.

Saudi Arabia and Malaysia, and increasingly Turkey and Indonesia, will drive the future of the industry. Trade finance, mobile payment solutions and managing the cost of regulatory compliance will drive the next phase of profitability. Most Islamic banks remain underweight when it comes to their role in trade finance business.

Ashar Nazim, Global Islamic Finance Leader at EY says, ‘The key driving markets for Islamic banking will continue to be Saudi Arabia and Malaysia, with Turkey and Indonesia also establishing themselves as large Islamic banking centres. With increasing market size and greater propensity for the adoption of technology-based, customer-centric solutions, the industry can be expected to further reduce its profitability gap with respect to conventional benchmarks. The challenges of going mainstream will be eliminating operational silos and leveraging customer insights to improve risk management, pricing and channel performance.’

Ashar Nazim, Global Islamic Finance Leader at EY
Indonesian Financial Services Authority Seek to Promote Growth of the Islamic Finance Sector

In mid November 2014 the Indonesian Financial Services Authority (OJK) signed a memorandum of understanding (MoU) with the National Shari’ah Board of the Indonesian Ulema Council (DSN-MUI). OJK believe that this lays the foundations for cooperation to achieve stable and sustainable development of the Shari’ah financial services sector in accordance with Shari’ah principles.

The strategic cooperation is also designed to support integrated supervision over the financial services sector as well as to improve Shari’ah financial literacy and consumer protection in the Shari’ah financial services sector. The MoU was signed by Chairman of the OJK Board of Commissioners Muliaman D. Hadad and Chairman of Executive Management of DSN-MUI KH Maruf Amin in conjunction with Committee for Shari’ah Financial Services Development (KPJKS) meeting in Jakarta.

Muliaman D. Hadad said in his speech that in order to support rapid growth of the national Shari’ah financial services industry, OJK as a regulator and supervisor of the Shari’ah financial industry needs a strategic partnership with DSN-MUI as the Shari’ah standards setter. This support is specifically required to formulate regulations relating to financial services; to foster and develop the Shari’ah Supervisory Board (DPS) and Shari’ah experts and to promote education and communication programmes in the Shari’ah financial services sector.

By November 2014, DSN-MUI had issued 95 fatwas relating to the Shari’ah financial services industry. The 95 fatwas comprise 67 fatwas for the Shari’ah banking sector, 14 for the Shari’ah capital market sector, six for Shari’ah insurance, four for Shari’ah pawnbroking (rahn), two for Shari’ah direct marketing and two for Shari’ah financial accounting.

Although the Shari’ah financial services industry continues to grow positively, OJK believe that the Shari’ah share of the industry needs to be increased. For example, by the third quarter of 2014 Shari’ah banking accounted for around 4.9% of total banking in Indonesia; the net asset value of Shari’ah mutual funds reached 4.5%; sukuk was at 3.2% of the total bond market and the Shari’ah non-banking financial industry was 3.1%.

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Gatehouse Announce Commercial Rental-Backed Security

Gatehouse Bank has launched what they describe as an innovative securitisation in the property market using a structure similar to a commercial mortgage-backed structure (CMBS), which will be known as a Commercial Rental-Backed Security (CRBS). Gatehouse will act as sole structuring agent, arranger and lead manager in the acquisition of an office property in the Paris area valued in excess of €100 million.

The two-tranche fixed rate certificates will be backed by the direct legal ownership of the property, which provides an additional credit enhancement and makes the issuance compliant with Shari’ah finance principles and differs from a conventional CMBS structure. The CRBS structure of the transaction has the added advantage for investors of avoiding potential foreclosure procedures given that the security underlying the certificates will include ownership of the property itself and not limited to a mortgage. The listed issuance will have a five-year term and will benefit from a five-year tail period between the original facility maturity and the final legal maturity date.

Natale Giostra, Head of Real Estate Finance at Gatehouse Bank, commented, ‘This issuance offers institutional investors access to the European securitisation market, with the added benefit of an ownership structure which gives investors greater security than would normally be available under a traditional collateralised facility. Given the increasing demand for European CMBS and the unique structure of this securitisation, we expect strong market appetite for this issuance and are confident the market for this structure will continue to grow.’
UK Takes Further Steps to Consolidate its Position as a Leader of Islamic Finance in the West

In late October 2014 the UK Treasury set out further steps to cement Britain's position as the Western hub for Islamic finance. The announcements included a statement that within months UK Export Finance (UKEF) expects to be able to provide Shari'ah-compliant support for British exporters.

UKEF expects to provide a Shari'ah-compliant guarantee for a sukuk issued by an Airbus customer. This will be the first time UKEF has provided a Shari'ah-compliant sukuk guarantee and it will be the first sukuk issued for the aviation sector that has benefited from an Export Credit Agency's support.

The Treasury also welcomed the Bank of England's announcement that it will look at establishing Shari'ah-compliant liquidity facilities to help Britain's Islamic banking sector grow. A longstanding challenge faced by Britain's Islamic banking sector is its ability to ensure its banks have sufficient liquidity due to the limited stock of assets Islamic banks can hold which are both high quality and Shari'ah compliant.

Having access to the Bank of England's liquidity facilities is a potential way to solve this problem, but unlike other banks, Islamic banks are currently unable to use these facilities because they involve interest, which is not Shari'ah compliant. The Bank of England will therefore assess the feasibility of establishing Shari'ah-compliant facilities to help Britain's Islamic banks meet their liquidity obligations and expand the services they can offer customers.

The Economic Secretary to the Treasury Andrea Leadsom said at the World Islamic Economic Forum in Dubai:

‘A key part of the government’s long term economic plan is making Britain the western hub for Islamic finance and the undisputed centre of the global financial system. The UK has already created one of the most attractive regulatory and tax systems for Islamic finance anywhere in the world and the huge success of the UK's sovereign sukuk earlier this year was a significant milestone in the development of the global Islamic finance industry.’

Takaful Windows in Pakistan Get the Green Light

Following a challenge by full takaful operators to a change in regulations to allow conventional insurers to open takaful window operations, Pakistan's Securities and Exchange Commission (SECP) reached a compromise agreement with these operators in early 2014. The compromise requires conventional insurers to back their window operations with at least $506,000 in capital. By the late summer of 2014 two licenses had been granted, with 10 more in the pipeline. The SECP believe that in 12 months there will be around 25 takaful window operations active in the market in Pakistan.

The move is not just about increasing the size of the takaful market, but increasing the penetration of insurance in general in the country. Currently insurance penetration in Pakistan stands at less than 1% of GDP, one of the lowest in Asia. The SECP believe that by harnessing the appeal of Shari'ah-compliant products to the experience and infrastructure of conventional insurers this level of penetration can be significantly improved.

AAOIFI Approve New Standards

AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions) approved two new Shari’ah standards - relating to uraboun (earnest money) and conditional termination of contracts in November 2014. It also approved revisions to existing Shari’ah standards on the conversion of a conventional bank to an Islamic bank, hawala (money transfer without any actual movement) and murabaha to the purchase orderer. Final revisions of these standards had taken into consideration the comments and feedback from the international Islamic finance community, including those received at the public hearing meeting held on 20 October 2014 in Riyadh, KSA.

AAOIFI is also carrying out, amongst others, revision of existing Shari’ah standards on ijarah and ijarah muntahiah bittamleek, salam and parallel salam, istisna’a and parallel istisna’a, sharia (musharakah) and modern corporations and mudarabah. It is seeking comments and feedback on these standards from the international Islamic finance community.

They are also looking at revising and clarifying their sukuk guidelines. The objective is to try to improve the cross-border appeal of sukuk, which to a degree is holding back the development of this area of Islamic finance and the creation of a strong secondary market.
Al Rayan Bank PLC Appoint Chairman

Al Rayan Bank PLC, formerly known as Islamic Bank of Britain (IBB), have appointment Robert Sharpe as Chairman. The appointment follows the Bank’s acquisition, in early 2014, by Masraf Al Rayan, QSC (MAR), and formal shareholder approval, in December 2014, for the Bank to change its name and brand in line with its new parent company.

Mr Sharpe brings to Al Rayan Bank more than 35 years of Senior Executive and Board experience, primarily in retail banking. His expertise spans strategy and planning, corporate governance, risk management, audit and control, financial services regulation and M&A activity. Mr Sharpe has recently returned from the Middle East where he held several Non-Executive Directorships and Board memberships at banks in the UAE, Oman and Turkey. He was also Chief Executive Officer of Diners Club Credit Card Operations.

MR invested £100m in Al Rayan Bank following the acquisition last year, which has enabled it to significantly boost its capabilities and resources. These include senior management appointments, investment in its IT infrastructure and the strengthening of its product range, to encompass Shari’ah-compliant real estate finance, commercial and development finance and a private banking offering for customers based in the GCC region. The Bank will soon be opening a new flagship branch in Knightsbridge to support its private banking operations.

Malaysian 2015 Budget Boosts Islamic Finance

Malaysian Prime Minister and Finance Minister, Datuk Seri Najib Tun Razak, announced in his 2015 budget speech that the Malaysian government would introduce a new Shari’ah-compliant investment product in 2015, the Investment Account Platform (IAP). IAP is designed to provide opportunities to investors in financing entrepreneurial activities and developing viable SMEs. At the same time, IAP aims to be a platform to attract institutional and individual investors including high net worth individuals to invest in the Islamic financial market. Initially, IAP will be implemented with a start-up fund of RM150 million ($45 million). He said that, to encourage investment in IAP, individual investors would be given income tax exemption on profits earned from qualifying investment for three consecutive years.

To boost domestic sukuk and bond issuance and trading, the Government has proposed that Malaysian Government Securities and Government Investment Issues be listed on the ETBS (Exchange Traded Bond and Sukuk) which was introduced in January 2013. In addition, expenses incurred in the issuance of sukuk based on ijarah and wakalah principles will be extended for another three years until year of assessment 2018.
Pakistan’s State Bank Launches KAP Study on Islamic Banking

In October 2014 the State Bank of Pakistan (SBP) launched a survey based report; ‘Knowledge, Attitude and Practices of Islamic Banking in Pakistan’. According to the survey there is an overwhelming demand for Islamic banking in the country that is evenly distributed amongst rural and urban areas, varied income strata and education levels. The study indicates that individuals in rural areas or in low income brackets have relatively limited access to financial services. This highlights a huge opportunity for Islamic microfinance in rural areas.

The study recommends that the role of Shari’ah scholars needs to be further enhanced and made more public in promoting Islamic banking and finance. Lack of general awareness about Islamic banking has emerged as one of the key challenges confronted by the industry.

The study indicates that rural markets, SMEs, agriculture and the microfinance sectors have huge financing needs and are potential markets for Islamic banking. It can also be inferred from the findings of the study that Islamic banks need to significantly improve their outreach to second and third tier cities both to improve their visibility across the country and also to increase their interaction with local businesses and trading communities (69% of respondents said there was no Islamic bank in their area). According to survey findings, given the supply-demand gaps, there is huge potential for further development of Islamic banking in Pakistan, although, when respondents were asked to cite their main reasons for choosing an Islamic bank, religious belief came third behind customer satisfaction and quality of service. There was also widespread distrust of conventional banks offering Islamic window facilities with more than half of all respondents and 63% of non-banked respondents saying that they would never become clients of such services.

The study was based on interviews with 9,000 households and 1,000 businesses. The survey was carried out by London-based Edbiz Consulting and financed by the UK Government’s Department for International Development.

Bahrain to Establish Central Shari’ah Board

Bahrain is the latest country to set up a central Shari’ah board to strengthen the governance of the Islamic finance industry in its country. They will also make it mandatory for Islamic finance institutions to have an independent external Shari’ah audit.

Although Bahrain’s central bank has a Shari’ah board, its activities have until now been confined to the central bank’s own products and services. The move is designed to bring some much needed consistency and also to set framework for new products.

In Brief

Halkbank, a state-run Turkish bank, has announced that it is to set up an Islamic finance operation. This follows the recent regulatory approval for Ziraat Bank to set up an Islamic unit. There are also rumours that another state-run entity, Vakifbank, are actively looking at setting up an Islamic unit. This would almost double the number of Islamic banks or participation banks as they are known in Turkey.

In late November 2014 Morocco approved a finance bill that will allow the establishment of Islamic banks and permit private companies to issue Islamic debt. The bill was passed unanimously. The opportunity to set up Islamic banks will be open to both local and foreign organisations, although it is believed foreign organisations may be actively encouraged to partner with local organisations, rather than setting up wholly owned subsidiaries.

Tunisia has amended its laws governing insurance to provide a legislative framework for takaful. Comments from within the Tunisian insurance industry suggest that takaful will account for between 10% and 12% of all insurance business in Tunisia by 2020.

Tunisia’s Banque Zitouna has raised $9.7 million in capital through an issue of ordinary shares, which have been taken up by the Islamic Development Bank (IDB). This gives the IDB an almost 21% share in the bank, which is Tunisia’s only fully-fledged Islamic lender.

IFAAS, an Islamic financial consultancy, Portillion Capital, an independent financial services provider with a specialism in Islamic finance and Seed Mentors, an independent investment and mentoring specialist in start-up businesses have joined forces to launch the UK’s first Shari’ah-compliant Seed Enterprise Investment Scheme (SEIS). (SEIS was set up by the UK government in 2011 to promote economic growth by fostering new entrepreneurial companies.)

Cameroon’s Afriland First Bank has launched an Islamic window operation. The bank has offered an Islamic deposit facility since 2000, designed to assist Muslims wishing to undertake a pilgrimage to Mecca. They will now be offering a range of Islamic finance contracts including murabahah, musharakah and ijara.

Japan is considering relaxing financial regulations to allow Islamic financial products to be offered in the domestic market. The results of a consultation on the issue are expected in late April.

Turkey’s Bank Asya, the country’s largest participation bank, has been taken over by the banking regulator. The management of the bank is now in the hands of Turkey’s Savings Deposit Insurance Fund, following claims that the bank had ‘failed to meet legal criteria’. There have been suggestions that this move was motivated by a long-running feud between President Erdogan and US-based cleric Fethullah Gulen, who had close historical associations with the bank. The Government deny any political motivation, but the move has rattled investors.
Sukuk Update

According to the Thomson Reuters Group, the first nine months of 2014 saw sukuk issuance grow to $99.3 billion, 25% higher than the first nine months of 2013. It was also a landmark year in that four non-Muslim countries issued their first sovereign sukuk – UK, Hong Kong, South Africa and Luxembourg.

The full year, however, looks as though it will fall short of 2012’s record issuance. One of the major factors at the end of the year was the decision of Malaysia’s sovereign wealth fund to postpone a significant issue in the final quarter of 2014 until the first quarter of 2015. Analysts are also cautious about 2015 because of tumbling oil prices in late 2014 and early 2015. For example, between late September 2014 and the end of the year, Bahrain’s dollar-denominated sukuk maturing in 2018 dropped 1.3%.

This may be balanced by a number of countries who are considering first-time sovereign sukuk. These include Oman, Jordan, Kenya, Kazakhstan and the Philippines.

Goldman Sachs Try Again

Goldman Sachs failed to get sukuk issuance off the ground in 2012, when they were widely criticised for failing to observe Islamic financial principles in the proposed structure. Critics suggested that it was reverse tawarruq, which the International Council of Fiqh Academy have declared impermissible as it is a disguised form of usury. Questions were also raised about how the Irish Stock Exchange, chosen to handle the issuance, would ensure the sukuk traded at par value and thus avoid the accusation of trading in debt, which is forbidden under Shari’ah law. The last nail in the coffin was the suggestion that Goldman Sachs could well divert the proceeds of the sukuk into the financing of conventional banking activities, which is an impermissible activity.

Details of the proposed sukuk are far from certain at the time of writing. Representatives of Goldman Sachs were due to meet potential investors in the Gulf in mid September. Reuters have reported that the issue is expected to be at least $500 million, with a tenor of between five and 10 years and backed by commodities and crude oil. The proceeds of the sukuk will, it is suggested, be used in a commodities business that is part of the Goldman Sachs group of companies.

Oman to Issue Sukuk in Early 2015

Reuters have reported that Oman is set to issue $1.3 billion worth of sovereign debt in 2015. This issue will be a mix of conventional bonds (around $800 million) and Islamic sukuk (around $500 million). A local sovereign sukuk will be welcomed by Oman’s embryonic Islamic banks, which currently have very limited choice of Shari’ah-compliant investment products.

Sukuk Screening Service Launched

San Francisco-based IdealRatings, Inc. has launched what they claim is the first ever screening system for sukuk. They say that their research-based online screening service is designed for Islamic investors and treasuries aiming to balance their portfolios with low-risk, fixed-income instruments, which conform to the mandates defined by their Shari’ah boards. They believe their product addresses one of the key challenges of sukuk, which is the compliance risk due to the disparity in Shari’ah opinions and acceptance of sukuk structures and terms.

IdealRatings’ service allows investors to screen sukuk against different Shari’ah guidelines as well as defining their own custom guidelines. This will enable them to construct a portfolio of sukuk that conforms to both their Shari’ah mandate and their own investment standards. IdealRatings has also designed and launched a series of sukuk indices to support Islamic fixed-income portfolio management.

IdealRatings have developed their solutions with the help of Alinma Bank, a fully Shari’ah-compliant bank in Saudi Arabia and the most recent bank to launch in that country. Speaking on behalf of Alinma, Yasser Al-Marshde, the general manager of Alinma’s Shari’ah group, said, ‘Compiling, analysing and screening sukuk documentation is indeed an enormous effort and this intuitive, intelligent service, with its impressive technical solutions and features, helps sukuk investors screen global sukuk against the requirements set by their Shari’ah Boards.’

Bader Al-Omar, Shari’ah Group Head at Jadwa Investment, a leading Saudi investment firm and one of the principal inspectors to the new service, said, ‘Over the past two years, we have worked closely with IdealRatings to ensure the successful launch of this revolutionary sukuk screening solution. This is part of our overall strategy that focuses on supporting the advancement of Shari’ah-compliant financial and investment tools available in the industry. We are confident that this platform will contribute to a better understanding of sukuk compliance for all.’

Maybank Diversify into US Dollar Denominated Sukuk

In late October 2014 Maybank Asset Management launched the Maybank Global Sukuk Fund, the first they have issued denominated in US dollars. The Maybank Global Sukuk Fund is an open-ended fund, which will initially be available only in Malaysia, although Maybank is talking to overseas counterparts with a view to distributing the Fund in other markets. It is expected to appeal to investors with moderate risk appetite seeking regular income through a portfolio of sukuk and Islamic liquid instruments with a medium to long term investment horizon. The minimum investment amount is $100,000 (US).

The fund will invest in part in Gulf-originated sukuk. This is an unusual move given the fact that the Malaysian sukuk market accounts for more than 60% of the world total.

Indonesia Raise $1.5 billion

In early September the order book for Indonesia’s $1.5 billion 10-year sukuk was more than six times oversubscribed, reducing the yield from 4.625% to 4.35%. This was a remarkable result for a country, which 12 months earlier had been in the grip of a financial crisis that had hit several emerging economies and struggling with a current account deficit of $10 billion. The sukuk was sold to investors in the Middle East (35%), Asia (30%), The US (20%) and Europe (15%).

The success of the sukuk is being attributed in part to hopes that incoming President Joko Widodo will take firm action on the vast fuel subsidies that are considered to be
a significant element in Indonesia's economic problems. Whether he will succeed in cutting these subsidies is a moot point. His predecessor tried and was rewarded with widespread rioting.

In Brief
Turkey’s Dogus Group whose interests range from financial services, through construction and automotive to media and tourism, have been given regulatory approval to raise $370 million through a corporate sukuk.

In late August Hong Kong embarked on a road show taking in Singapore, Doha, Dubai and London to market the sukuk they issued in September. The effort paid off as the $1 billion five-year ijara sukuk was nearly five times oversubscribed. The geographical split of investors was 47% Asia, 36% Middle East, 11% US and 6% Europe. Most investors were financial institutions (55%), with the rest divided between the public sector (30%), fund managers (11%), insurers (3%) and banks (1%).

Several emerging economies are reported to be considering issuing sovereign sukuk following the success of issues by Turkey and Indonesia. Oman has already stated its intention to issue sukuk in early 2015 (see above) and others such as Jordan, Kazakhstan, Tunisia, Bangladesh, Kenya and the Philippines are rumoured to be on the cusp of announcements.

At the beginning of 2015 Bangladesh’s Central Bank launched a programme of weekly sukuk issues. The objective is to provide local lenders with a short-term liquidity tool. Auctions of the profit-sharing sukuk will be held every Thursday.

Pakistan’s Mobilink, the country’s largest mobile communications provider, plans to issue a sukuk worth nearly $70 million in early 2015. The money raised will be used to fund network expansion. The issue is unusual because it includes a partial credit guarantee amounting to about 14% of the total amount to be raised. The profit-sharing ethos of Islamic finance means that credit guarantees are rare.

In the last quarter of 2014 South Africa issued a $500 million sukuk priced at 3.19%. The five-and-three-quarter year sukuk was four times oversubscribed, with 59% of investors coming from the Middle East and Asia.

In November 2014 Pakistan sold a $1 billion five-year, ijara, sovereign sukuk. The profit rate was 6.75%. The issue was made through a Special Purpose Vehicle (SPV), the Second Pakistan International Sukuk Company.

Luxembourg issued the first Eurozone sovereign sukuk in October 2014. While the €200 million, five year ijara sukuk was successful, it was only two-times oversubscribed, which have been disappointing to the Grand Duchy given that the UK’s issue was 10 times oversubscribed, Hong Kong’s five-times and South Africa two times. The profit rate at just below one-half a percent may have had something to do with this relatively modest demand.

In early January 2015 Dubai Islamic Bank issued a $1 billion perpetual Tier 1 sukuk, which was 2.5 times oversubscribed. The issue was initially priced at 7% but following the strong demand was tightened to 6.75%.

The Indonesian Government is planning to broaden the range of assets it uses to back sukuk. To date Indonesia has used infrastructure projects as collateral, but now the Government is looking at the procurement of goods and services such as computers and cars to underpin future issuance.

Aiming to strengthen governance and boost the attractiveness of sukuk to investors, Pakistan’s regulators have published new rules for the issuance of sukuk. The new rules require issuers to structure sukuk in accordance with AAOIFI (Accounting and Auditing Organisation for Islamic Finance Institutions) standards, as well as those set by the local regulator. The rules require issuers to conduct an annual audit to ensure the sukuk conform to Shari’ah requirements. Sukuk must also carry a credit rating not lower than triple BBB.

Standard & Poor's has updated its criteria for Islamic bonds to distinguish more clearly between issuers and sponsors of sukuk. For example, sukuk will be rated on a par with the sponsor’s senior unsecured rating if they provide contractual commitments by the sponsor to make payments that ultimately cover periodic distribution and principal amounts. The agency said it did not expect the new criteria to lead to upgrades or downgrades of the sukuk that it rates, but it might withdraw a rating if terms and conditions did not meet the criteria. It estimated this might happen in fewer than 5% of cases.

The Dubai-based Emirates airline, has hired eight banks to arrange a sukuk that will be guaranteed by Britain’s export credit agency. This is the first time that the UK’s export credit agency has guaranteed an Islamic bond. The chosen banks are Citigroup, HSBC, JP Morgan and National Bank of Abu Dhabi as the joint structuring agents, with Abu Dhabi Islamic Bank, Dubai Islamic Bank, Emirates NBD and Standard Chartered also acting as joint lead managers. It is rumoured that the issue will be upwards of $500 million, with a 5-10 year tenor.
Islamic finance could already claim to be ethical in its approach. The industry is based on adherence to a set of morals and principles enshrined in Shari'ah. It eschews investment in gambling, alcohol, pornography, armaments and tobacco, all of which are considered haram by Islam. It also forbids riba, which it sees as the exploitation of one person or group by another leading to unjust gains.

There is, however, a growing cadre of investors, Muslim and non-Muslim, looking for something more. They are looking for positive discrimination in favour of projects that bring some gain to society rather than simply screening out unacceptable forms of investment. Various terms are used to describe these investments including socially-responsible, sustainable or green, although the term that seems to be gaining the greatest traction currently is socially-responsible investing (SRI), perhaps because it is a more all-encompassing term that better describes a wider range of investments designed to benefit mankind as well as providing a return for investors.

These investors want, for example, to support renewable energy rather than fossil fuels; sustainable agriculture rather than schemes that involve deforestation and affordable housing rather than vanity building projects targeted at the super rich. Such aims sit well with the teachings of the Prophet (PBUH) expressed in the Qur’an, which enjoin believers to do nothing that would cause harm to the environment and to mankind in general.

Clearly, some investments, which would be Shari’ah compliant, would not meet the additional requirements of socially-responsible investments, e.g. investments in fossil fuel extraction and processing. This article is not suggesting that all Islamic funds will want to take the extra steps needed to be able to apply the ‘socially-responsible’ epithet to their funds, but Islamic finance industry is beginning to take an interest in this segment of the market, developing policies and products to meet an apparently growing demand. Those that do go the extra mile are hoping to increase the industry’s footprint in the financial world by appealing to non-Muslim investors as well as to Muslims.

A Brief Historical Background
The concept of socially responsible investing is not new; nor is it exclusive to Islam. For example in the 18th century, the Methodists, a non-conformist Christian sect, discouraged its adherents from investing in tobacco, alcohol and gambling. In the 19th century the Quakers pioneered the idea that profit should not be made at the expense of the people employed in factories, providing decent, affordable accommodation and education for their workforces. It was not until the latter part of the 20th century, however, that people began to be aware of the damage that certain types of human activity could do to the world in which we live. For a long time these early environmentalists were seen as sandal-wearing, bean-eating eccentrics until science began to demonstrate that our exploitation of the planet’s resources were causing such harm to the environment that we were in danger of irreparably damaging the world in which we all live.

In the last 10-15 years the socially-responsible investment industry has been moving slowly out of the shadows and increasingly into the mainstream. For example, the Climate Bond Initiative has reported that $111 billion of green bonds were issued in 2013; by the end of October 2014 the figure was already more than $32 billion, suggesting the market could double by the end of the year. The Climate Bond Initiative is confidently forecasting the market will double again in 2015 to $100 billion and this is just one single element of the broader ‘socially responsible’ investment space.

In the past the Islamic finance industry has often been criticised for being merely emulators of conventional finance, looking for ways to offer conventional finance products in a Shari’ah-compliant form. In the socially-responsible investment space Islamic finance with its declared adherence to certain moral values and principles has a real opportunity to be the trend setter and the latter half of 2014 saw a number of significant announcements designed to position the Islamic finance industry firmly in the forefront of this market trend.

Framework for Socially-Responsible Sukuk
In the late summer of 2014 the Securities Commission Malaysia (SC) launched the Sustainable and Responsible Investment (SRI) Sukuk framework to facilitate the financing of sustainable and responsible investment initiatives. 'The introduction of the SRI sukuk framework is part of the SC’s developmental agenda to facilitate the creation of an eco-system conducive for SRI investors and issuers and is also in line with the rising trend of green bonds and social impact bonds that have been introduced globally to facilitate and promote sustainable and responsible investing. Combined with Malaysia’s leading position in the global sukuk market, this framework will further enhance the country’s value proposition as a centre for Islamic finance and sustainable investments,’ said Datuk Ranjit Ajit Singh, Chairman of the SC.

The SRI sukuk framework is an extension of the existing sukuk framework and therefore, all the other requirements in the Guidelines on Sukuk continue to apply. The additional areas addressed in the framework for the issuance of SRI sukuk include utilisation of proceeds, eligible SRI projects, disclosure requirement, appointment of...
independent party and reporting requirement. The types of projects that are eligible include sustainable land use, sustainable waste management, renewable energy, energy efficiency projects, affordable housing and urban revitalization.

It is likely that the first sukuk to be issued under the new guidelines will come from Malaysia’s state-owned sovereign wealth fund, Khazanah Nasional Bhd., which is reported to be considering an issue in the second half of 2015 to fund expansion in its education and renewable energy businesses.

Dubai’s Green Investment Programme

Dubai launched its Dubai Integrated Energy Strategy 2030 (DIES) in 2010 and began deployment in 2011 under the guidance of His Highness Sheikh Mohammed bin Rashid Al Maktoum, Vice President and Prime Minister of the UAE, and Ruler of Dubai. The DIES sets the strategic direction of Dubai towards securing sustainable supplies of energy and enhancing demand efficiency.

In 2014 the Dubai Supreme Council of Energy (DSCE) and the World Bank signed an advisory services agreement to partner together and design a funding strategy for Dubai’s green investment programme, which is expected to involve green bond and sukuk products.

Sukuk for Vaccines

In December 2014, the International Finance Facility for Immunisation (IFFIm) issued a $500 million, three year sukuk to fund immunisation programmes. It is the largest ever debut issue by a supranational non-profit organisation and the largest Sukuk al-Murabaha issuance in the public markets and is also the largest inaugural Sukuk offering from a Supranational.

The sukuk was oversubscribed, even with its unique structure for sukuk market participants. IFFIm achieved strong diversification in its investor base with 85% of the order book coming from new and primarily Islamic investors. The regional distribution of investors was 21% based in Asia, 11% in Europe and 68% in the Middle East and Africa. Banks took 74% and central banks/official institutions took 26%.

The hope is that it will encourage other similar humanitarian institutions to use the market.

Agricultural Investment Opportunities in Canada

AGInvest Properties is a Canadian-based company that owns and manages farmland in Ontario. In June 2014 they launched a scheme to offer Shari’ah-compliant investment partnership opportunities with the aim of increasing the inflow of capital into the Canadian agricultural sector. To do this they have signed a partnership agreement with Bahrain’s Shari’ah Review Bureau, who provide outsourced Shari’ah certification and advisory services.

The aim is to provide Islamic investors in Canada and elsewhere with investment opportunities in arable farmland, which they believe is a sustainable sector, to some extent insulated against the prevailing somewhat depressed economic environment around the world.

Stimulating Green Sukuk

The Green Sukuk Working Party (GSWP) was established in late 2014 by the Clean Energy Business Council (MENA), the Climate Bonds Initiative and the Gulf Bond and Sukuk Association (GBSA) to promote and develop Shari’ah-compliant financial products to invest in climate change solutions.

GSWP is a collaboration of experts in project development, environmental standards, capital markets, actuarial compliance and Islamic finance.

The GSWP will:
• Design green sukuk architecture, so that product issuers can offer and investors can access products with confidence about their compliance with Shari’ah law and ethical standards.
• Promote the concept of green sukuk and other green Islamic finance products to governments, investors, product originators and other interested parties.
• Engage with governments and development banks about supporting appropriate project development and the growth of a green sukuk market.
• Inform the market by promoting best practice, convening industry forums and developing template models.

Caveat Emptor

When an idea begins to take off, everyone will want to jump on the bandwagon and get a slice of the action. The food industry is a good example. As people have become more aware of the need to avoid excessive amounts of fat, sugar and salt in their food, the food industry has scattered terms like ‘low fat’ or ‘low sugar’ on their product labels. They should more accurately have labelled them ‘lower fat’ or ‘lower sugar’, because a little research will demonstrate that some of these products are only 5-10% lower than the standard product.

The problem with any plain language term is that it can mean exactly what a product or service provider wants it to mean. A casual search will reveal a number of Islamic financial service providers who are using the term ‘socially responsible’, when in fact they are doing no more than complying with current Shari’ah requirements. Yes, they are avoiding investments in alcohol, tobacco, etc., but there is no positive discrimination in favour of investments that are beneficial to society and no avoidance of industries such as petrochemicals, which may meet Shari’ah requirements, but would be unacceptable to SRI investors.

Obviously, Malaysia’s decision to regulate socially-responsible sukuk is very helpful. The fact that they have defined very clearly the types of projects that can be included and required disclosure of precisely how the proceeds of sukuk issuance will be used provides SRI investors with a high degree of assurance that they are going to get what they want. Other national regulators would do well to consider following Malaysia’s lead and perhaps the Green Sukuk Working Party has a useful role to play here. The sukuk for vaccines from the International Finance Facility for Immunisation offers investors a similar degree of assurance.

Ultimately, however, it is definitely a case of buyer beware. Unscrupulous providers in both conventional and Islamic finance will attempt to cash in on a trend that looks as though it is finally getting off the ground.
Takaful: An Innovative Approach to Insurance and Islamic Finance

By: Hania Masud

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Background
In many of its applications, Islamic finance presents a novel approach to modern financial transactions. It developed outside the current financial industry and therefore the underpinnings of Islamic finance sharply contrast with traditional financial instruments. Yet, the application of Islamic principles to finance brings Islamic finance wholly into the modern era. In fact, modern Islamic financial practice is largely a product of the traditional financial transactions that have developed over time. This does not mean that Islamic finance is indistinguishable from the current financial trends. It is still a unique approach that fulfills a dual purpose: granting Muslims an alternative to traditional financial instruments, while making these instruments an attractive option in modern economies. Adapting Islamic finance in modern economies, however, poses unique challenges. The United States’ corporate and legal structures, in particular, provide interesting examples of some issues confronting corporations that offer Islamic products. Islamic finance covers the full gamut of modern financial areas, from loans to insurance. This paper focuses on insurance, or takaful, the name given to the practice of insurance under principles of Islamic finance.

Takaful insurance is not only an innovative approach to Islamic finance, but also a viable alternative to conventional insurance. This paper will begin with an exploration of the underpinnings of the modern Islamic financial system with regards to its impact on takaful. Next, the paper will lay the foundations and forms of takaful. Finally, the paper will compare takaful as applied in Malaysia with the potential for a takaful market in the United States. Specifically, the paper will examine the viability of takaful in light of potential Entanglement Clause I issues.

Islamic Law and Finance: An Introduction

Islamic Law in General
In understanding Islamic finance, it is important to start with a brief overview of Islamic law, because Islamic finance is the application of Islamic law to financial and commercial transactions. Islamic law (Shari’a) is derived from the Qur’an (Islam’s holy book) and the Sunnah (actions and sayings of Prophet Muhammad). The interpretation and application of Islamic law is known as fiqh.

There are four mainstream schools of Islamic jurisprudence within the Sunni tradition: Hanafi, Maliki, Hanbali and Shafi’i.

Each of these schools has certain nuanced differences in their respective approaches to interpreting Islamic law. Since Islamic law has developed over 1,400 years, there is not always uniformity in application or interpretation of the governing principles.

A third element in Islamic law is ijtihad, or scholarly consensus, in interpreting the Quran and Sunnah. The lack of uniform consensus among scholars voids ijtihad in a particular area of law, thereby allowing for the existence of diverse but equally valid legal holdings. As is the case with many areas of Islamic law, Islamic financial transactions can take many forms depending on the school of thought employed.

This paper will delve into the different applications of Islamic law to financial transactions under each school of thought. Instead, it will focus on the most common financial structures currently in use. Islamic finance, as a viable alternative to traditional finance, grows out of two major shifts.

First, Islamic finance has developed in response to the globalisation of financial markets and the adoption of Western financial institutions throughout the world’s economies. Institutional and contractual practices originating in the Western world have embedded themselves in the economies of the Muslim world. Second, Islamic finance is part of a larger trend that began in the 1970s. That trend is the shift towards reintroducing Islamic law in many parts of the Muslim world. Despite this trend, laws and legal institutions derived from Western legal systems remain the dominant modal system.

One of the challenges in developing and applying Islamic law in a wholly Western financial system is that many of the common financial instruments have no counterpart in Islamic law. So, while classical Islamic law may offer a complete body of commercial and contract law, it is important to note that the current Western system of commercial and contract law does not neatly fit into the pre-existing scheme. Thus, Islamic scholars are required to evaluate and determine which Western modes of financial transactions are acceptable and how Islamic law can be interpreted and applied to modern financial instruments to bring them within the purview of Islamic law. As the demand for certain types of financial products grows, Muslim scholars will be pressed to develop Islamically acceptable alternatives. Islamic finance has become the most innovative element of contemporary Islamic law.

According to Frank Vogel, a former Professor at Harvard Law School and a leading expert on Islamic Law generally, Islamic financial analysis can be broken down into two approaches. First is the Islamic law aspect, which aims to characterise modern financial behaviour in terms of Islamic legal rules. This approach accounts for Islamic law’s concern with individual action and the welfare of the individual as a task delegated to the state.

The second approach is steeped in Islamic economics. Here, the aim is to develop Islamic economics as a viable alternative to the Western economics that predominate. In order to be viable, the Islamic economies must produce more beneficial outcomes than do their Western counterparts. In shaping this new economic theory, economists would, for example, look to Islamic moral principles and legal institutions (e.g., requirements on giving charity). However, since this approach is still in developmental form, Islamic rules ground Islamic finance without much regard for economics. Furthermore, many Muslims are willing to pay a
premium to ensure that their business transactions are in line with Islamic principles without having as much concern for profit-maximising outcomes.

**Islamic Contract Law**

In order to understand modern Islamic law, a brief primer on Islamic contract law is necessary. Islamic contract law centres around rigid nominate contracts that do not have counterparts in conventional finance. Unlike the ideal of freedom of contract, a basic underpinning of the objective theory of contracts adhered to in common law jurisdictions such as the United States, there is no generalised theory of contracts in Islamic law. In particular, the freedom to contract will always be limited by Islamic legal rules that prohibit all transactions involving interest, or riba. Thus, even when the Ottomans introduced a civil code in the 17th century, a general theory of contract was not developed. Instead, jurists developed a number of nominate agreements with their own sets of rules. This structure of nominate contracts grew out of pre-Islamic contracts that were common in the time prior to the 6th century. These nominate contracts were studied and amended to comply with Islamic principles. A number of mechanisms to validate contracts falling outside the nominate scheme were also developed by jurists. An absolute right to contract, however, still remains undeveloped since contracts that violate prohibitions on riba or gharar (uncertainty) cannot be valid.

Contracts under Islamic law were necessary for a limited type of contractual transactional forms under which business was conducted. These contracts led to the development of a set of rigid, trade-based contracts that lay the foundations for contemporary Islamic contracts to be used and developed in the Islamic finance industry.

The prototypical contract was the contract of sale, or bay'. The basic form of the sale contract transferred ownership of some lawful, fixed property immediately deliverable for a determined price. All other contracts derived their form by analogy to the sale contract because Islamic jurisprudence dealt with that method in great detail.

Some typical contracts in Islamic finance included those for loans, gifts, sales, sales at a mark-up (murabaha), leases (ijara), joint ventures and partnerships (musharaka, mudharabah), manufacture and construction contracts (istisna) and agency contracts (wakalah). These contracts are instruments currently in use by Islamic banks and conventional banks offering Islamic products.

The primary focus in this paper will be on mudharabah and wakalah contractual forms. Islamic insurance companies typically use wakalah (agency) and mudharabah (joint-venture partnerships) contracts or a mixed model of a wakalah and mudharabah scheme.

A wakalah contract allows for full representation in most contractual arrangements. The contract can be gratuitous, where the agent provides management without compensation or fee-based. The contract, however, is revocable at will by either party. There are certain rules that militate against the possibility of revocation, but the authority of the agent depends on continued consent from the principal. In the insurance context, this allows an agent to act as manager under a fee-based arrangement.

Another commonly used contract is a murabaha contract. A murabaha contract is essentially the sale of a good with a certain mark-up built into the price. This mark-up can reflect any cost the seller may encounter in the deal. An istisna contract is very similar to a construction loan. It is a payment arrangement between a buyer and seller for a particular good spread out over a period of time, such as the payment for the manufacturing of a house over the period it is being built. Ijara contracts parallel traditional leases. This kind of contract can either be a lease with a purchase option or a lease of an item that will revert back to the owner upon termination.

One key difference between a traditional and Islamic lease is who has responsibility over upkeep of the item. In a traditional lease, the responsibility lies with the lessee; however, in an Islamic lease the responsibility falls to the lessor.

A second key contract form in Islamic insurance is a mudharabah arrangement. A mudharabah contract is an equity investment that is a profit-sharing agreement between two parties. In this type of arrangement, one party supplies the capital, while the other supplies management oversight and entrepreneurial skills. Profit is shared amongst the parties according to an agreed-upon, predetermined formula and risk is carried by each party. The risk carried is in line with the type of investment, money or time each party provides.

Finally, an equity arrangement between two or more parties is known as a musharakh contract. Here, each party contributes both managerial expertise and money according to an agreed-upon formula.

While there is no general theory of contract law, there are certain conditions that agreements must fulfill. In general, there is the requirement of good faith that is derived from the Qur'an: [fulfil the covenant of God when you have entered into it, and break not your oaths after you have confirmed them ...] Islamic finance scholars have interpreted this verse and many others to read an element of good faith into contractual relationships. Good faith, honesty, disclosure, truthfulness and sincerity make up the moral attributes of a contract.

Beyond these requirements, there are three key prohibitions that should not be part of any contract.

The first is a prohibition on interest. While some scholars debate the permission of interest in financial transactions, the vast majority of traditional scholars agree on its total prohibition. The prohibition against interest can be found in both the Qur’an and Sunnah. A Qur'anic verse on this point states, — Allah has permitted trade and has forbidden [interest]. This prohibition’s importance is evinced by the verses directly addressing the impossibility of interest. This concept sets Islamic financial transactions apart from conventional business practices. In conventional finance, interest is part and parcel of the structure of most transactions.

The second obligatory prohibition is that against uncertainty or gharar. A well-known saying of the Prophet elucidates this point, stating: — whoever buys food, let him not sell them until he has possession of them. This rule of fiqh voids the sale of nonexistent or uncertain objects, even if the relative risk is very low. This relates in a sense to the final prohibition that forbids gambling or maysir in Islamically compliant contracts. The Qur’an states, — intoxicants and gambling ... are an abomination ... enshew these such that ye may prosper. The reasoning for this prohibition stems in part from the idea that gambling may create enmity amongst people.

These prohibitions have broad implications and are equally applicable to insurance contracts. Insurance typically involves risk, uncertainty and interest and therefore it poses a unique challenge to Islamic law. Under traditional Islamic law, the game-oriented risk profiles of insurance would not meet the requirements of a legally-valid contract between parties. In order to work around this inherent obstacle, Islamic...
scholars have taken a somewhat unique and innovative approach to insurance, which will be explored in the next section.

**Islamic Insurance or Takaful**

**Overview of Takaful**

Islamic insurance, and, more broadly, Islamic finance, place special emphasis on social welfare as a criterion of business practice. In addition to the importance placed on welfare, there is also a strong focus on discouraging wealth maximisation. Islamic insurance tends to incorporate both of these ideals in its approach to affording security to individuals in the form of insurance. Thus, Islamic insurance is a cooperative model of insurance.

There are no counterparts to conventional insurance in classical Islamic law. Islamic insurance is an innovative modern approach to dealing with demand for an instrument that can reduce one’s exposure to certain types of risk. Under its conventional form, insurance is similar to a gamble and would be a violation of the rules of gharar. In a conventional agreement, an insured person pays a cash premium in exchange for a promise made by the insurer that it will pay a certain amount in case of a given future contingency. There is no guarantee that the future contingency will ever come to pass and disputes about whether the contingency has occurred or pre-existed the contract have bred enormous litigation. Thus, the insured is taking a gamble and the insurer is benefiting from this gamble. Under conventional insurance practice, the operation of insurance is also heavily reliant on principles of interest. Insurance companies often invest their premiums in interest-bearing investments, which also invokes the prohibition against riba.

An influential Islamic scholar, Mustafa al-Zarqa, made an argument for the acceptability of conventional insurance practices as insurance contracts in the aggregate pose very little uncertainty, since the risk for which the parties are contracting can be valued.

This argument was not enough to quell the general unease pious Muslims have with the idea of conventional insurance. Thus, a new approach emerged which shifted the conceptual focus of insurance away from individual contractual agreements and towards the institution of insurance’s benefit to society as a whole.

Islamic insurance shifts the focus to a broader lens—insurance as a collective endeavour, which is an alternative to the bilateral relationship that exists in the conventional model. It is this institutional approach that forms the basis for takaful. This collective model grew out of the social insurance practices that were practiced at the beginning of Islam, such as al-diyyah (blood money), a practice in which the relatives of a killed person are paid money to the heirs of the deceased in order to allow the killer to escape his legal burden. These amounts were to be paid by way of mutual collaborations in which money was set-aside in case the need arose for its use.

Takaful, which literally means solidarity, is a system in which members decide to protect each other from loss. In line with Islamic ideals of welfare and charitable giving, the system is a collective enterprise that allows a community to pool together resources in order to assist members of the community in times of need resulting from casualty or loss. Professor Tom Baker characterised the differences in the theoretical underpinnings between conventional and Islamic insurance: conventional insurance seeks to eliminate risk for the individual, whereas Islamic insurance aims for risk elimination within a given social group.

While the scope of insurance policies within the takaful model may vary, they are governed by the principles of either a wakalah or mudharabah contract or a mixed model borrowing from both. The basic structure of a takaful arrangement is as follows:

1. a takaful company is organised;
2. members make periodic payments that the company maintains in individual accounts for each member;
3. these amounts are invested in Islamically sound financial products. As part of the contract, the members agree that if any of them suffer a covered loss, then each will make a proportionate gift from their accounts to cover that loss.

The legality of this contract is derived from the idea that gratuitous acts allow for a higher degree of uncertainty and from the Malikī (one of the four schools of thought in Sunni Islam) opinion that gift promises can be binding. Under this framework, the insurance pool is more akin to a charitable institution as opposed to a profit-bearing institution, because the insurance company does not act like an insurer in the conventional sense; instead, it manages the business aspect of the cooperative on behalf of the members.

Finally, under a takaful model, there is generally a governing body, known as a Shari'ah board that regulates the takaful company to ensure that the products being offered by the company are within the confines of Islamic law (Shari’ah). The salient characteristic of takaful companies is that profits are shared by the policy holders rather than given to third-party shareholders as is the norm in conventional insurance companies (Figure 1).

**Figure 1: Mudarabah Arrangement**

![Figure 1: Mudarabah Arrangement](image-url)
Elements and Models of Takaful

There are five key considerations for a takaful company. First is the concept of mutual guarantee—the idea that the basis of the insurance contract grows out of a cooperative spirit. So, the Islamic ideals of brotherhood, solidarity, mutual help and shared responsibility play a central role.

The second consideration is ownership of the fund. Since the fund is based on a cooperative model, the fund is simply managed by a corporation, while the actual ownership lies with the participants of the fund who must pay out claims. A takaful operator, however, may be required to ensure the fund is solvent by providing an interest-free loan in case of insolvency, which is paid back by participants' future contributions. A share of the profits, if there are any, is predetermined.

The third is eliminating uncertainty. Fourth, the company must determine how the fund will be managed, whether to employ a wakalah arrangement, a mudharabah contract or a mixed model. Unlike conventional insurance models where underwriting surplus is the primary source of profit, takaful operators receive either an income through a wakalah arrangement, profit sharing through a mudharabah contract or some other compensation depending on the model employed. These models will be further described below. Finally, the investment conditions of a given economy also play a role in determining how best to structure the takaful.

The three major takaful models in the context of general and life insurance are as follows: mudharabah, wakalah, and the mixed model. As life insurance is often treated as a separate subject under Islamic law, it will only be discussed briefly. Life insurance is treated as an independent subject because many scholars have objected to its permissibility on a number of grounds. The argument against life insurance is two-fold. Firstly, it is viewed as a way to insure against death, which would be unlawful under Islamic law, because life and death are in the hands of God.

The second objection arises out of the conventional life insurance policy structure that allows an individual to appoint a nominee as a beneficiary of the policy upon death. This would violate the traditional inheritance laws found in the Qur'an, which outline how funds are to be distributed in case of death. Despite these general objections, life insurance, like other general insurance structures, has been re-conceptualised so it can fit Islamic law principles and be a viable option for practicing Muslims. For example, under Islamically valid life insurance policies, the designated beneficiary is simply responsible for paying out the policy to the deceased's heirs in accordance with Islamic inheritance laws. Life insurance models are very similar to the general insurance models discussed below.

The three most common management options for takaful operators are derived from the contractual arrangements described in previous sections of this paper. These models govern the relationship between the participants in a takaful fund and the operator who manages the funds paid by participants.

The first option is based on the wakalah (agency) contract. Under the wakalah contract in an insurance arrangement, the participants in the takaful arrangement will appoint the takaful operator as their agent or manager to handle all the activities of the takaful fund in accordance with established guidelines. A predetermined fee compensates the agent or manager and the participants, as principals, share all profits and risks.

The second model is derived from the mudharabah contract. Under this model, the takaful operator will share in the returns from the investments of the takaful fund according to a predetermined profit-sharing arrangement. If there is no profit, the operator will receive no compensation for management services (Figure 2).

The third widely used model is known as a mixed model. Under this structure, the takaful operator will be assured compensation under the wakalah contract and will receive a share of profits, if any, under a mudharabah contract.

General Considerations

The application of conventional regulations to takaful operations can be problematic. One such regulation is the capital adequacy requirement found in many countries including the United States. This poses a problem for takaful companies because there is a separation between policyholder and shareholder funds. Depending on how assets and liabilities are valued, takaful operations may fail to meet their regulatory obligations. This will be discussed further in the

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Figure 2: Wakala Arrangement

- **General Takaful**
- **Wakalah (Commercial) Model**
- **Contribution (Tabarru')**
- **Management Cost / Commission**
- **Surplus**
- **Risk Management**
- **Re-takaful Claim Reserve**
- **UE Contribution IBNR**
- **% Company**
- **% Participant (on No Claim Ground)**
- **Gross Profit = Management Cost, Zakat / Income Tax = Net Income**
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**General Considerations**

The application of conventional regulations to takaful operations can be problematic. One such regulation is the capital adequacy requirement found in many countries including the United States. This poses a problem for takaful companies because there is a separation between policyholder and shareholder funds. Depending on how assets and liabilities are valued, takaful operations may fail to meet their regulatory obligations. This will be discussed further in the context of United States’ insurance regulations below.

Another consideration for operating takaful companies is related to the deregulated nature of markets. A Shari’ah board generally governs Islamic insurance companies and Islamic banks. These boards advise companies on how to structure instruments and often place their stamp of approval on those they deem Islamic. While these boards are commonplace in Muslim countries with strong Islamic finance practices, they are not found everywhere. This may lead Muslims in emerging markets to be wary of products being offered as Islamic products because there are no regulations in place to ensure that those products are truly compliant.

Finally, Islamic insurance companies may face stiff competition from conventional insurance companies. While there will always be a group of people willing to pay a premium to guarantee they are fulfilling their religious obligations, competitive pricing is necessary to create a true market for takaful. Some countries have proposed and passed legislation that would offer incentives to takaful operators in the form of tax breaks. This is one method to overcome the pricing barrier that may exist between conventional and Islamic insurance.

**Islamic Insurance Applied: A Comparative Analysis of Malaysia and the United States**

**Malaysia**

In contrast to the United States, Malaysia has a sizeable Muslim population. Like the United States, however, Malaysia has a secular common law system and a secular Western-based economy. Yet, the Malaysian insurance market is able to accommodate both conventional and takaful insurance within the regulatory framework of the country. Additionally, Malaysia was the first country to adopt legislation specifically geared towards takaful operations. As a leading innovator in Islamic financial products, Malaysia has the largest takaful market, totalling just under $1 billion.

While there is a rigid separation between church and state in the United States, Malaysia actively legislates on religious matters. In fact, Islamic insurance was introduced in Malaysia after a federal body declared conventional insurance to be contrary to Islamic law. Takaful insurance practice grew out of a piece of legislation known as the Takaful Act of 1984. The Act covers a wide range of topics including, requirements for carrying out a takaful operation, registration, establishing advisory boards, insolvency and capital requirements. The Act directly addresses the Islamic nature of takaful and imposes a requirement of Shari’ah compliance. Section 8(5)(a) states "The Director General shall also refuse to register an applicant unless ... the aims and operations of the takaful business ... will not involve any element which is not approved by the Shari’ah."

In order to ensure compliance, there are provisions within the Act that govern the establishment of a Shari’ah advisory board for takaful operators. Furthermore, section 53 provides that takaful operators may seek the advice of the Shari’ah advisory council, which was established under the Central Bank of Malaysia Act in 1958. While-established by law in Malaysia, such federal bodies would likely be unconstitutional in the United States.

In addition to seeking advice from the advisory council, the approval of new takaful operators also comes from the Central Bank. Although the Central Bank is responsible for administering both takaful and conventional insurance, the operation of both industries is mutually exclusive. Section 67(2) of the Takaful Act also states that the Insurance Act of 1963, which governs the conventional insurance operations in Malaysia, is not applicable to takaful companies. Takaful, however, remains within the purview of civil law jurisdiction. Disputes over takaful are handled by the Malaysian civil courts and legislation falls under the responsibility of the federal government, even though Shari’ah courts and, to some extent Shari’ah law, exists within the country.

One shortcoming with the Takaful Act is that it does not explain what it means to be compliant with Shari’ah. There is also no definition or explanation for what Shari’ah is, or how it should be enforced. It simply advises takaful operators to seek advice, but does not make this advice binding. Thus, Shari’ah boards operate with discretion to interpret and apply law.

While every element of takaful, as practiced, is not apparent from the text of the legislation, the Takaful Act largely governs contractual obligations arising under takaful arrangements. Furthermore, life insurance, or family takaful as it is called under the Act, and general takaful are treated separately. While some of the following points are applicable to both family and general insurance, the particulars of the takaful contract refer only to general takaful, which is offered for motor vehicle, fire, theft, and accident protection. The following are requirements takaful arrangements must meet under the Act.

First, the Act codifies the requirement of utmost good faith through a strict duty to disclose, imposed on both participants and operators. While this element is detailed in the Act, the origins of the requirement can be found in the common law rules that govern in Malaysia. Failure to disclose, as defined under the Act, can lead to a fine and/or imprisonment.

Second, Malaysian takaful is based on the model of the mudharabah contract scheme. Both parties in the insurance contract share in the profit and risk involved in the contract. Under the mudharabah scheme, the participants in the takaful operation are entitled to a return on the premium or contribution as determined by the contract. While the contribution paid by the participant is considered charity to fulfill the Islamic law rules, takaful operators often provide bonuses if no claim has been filed under the policy. This bonus is either paid upon renewal of the policy for five years or as a bonus upon the maturity period of each policy. Third, in practice, regulations for capital adequacy are relaxed.

Furthermore, Islamically speaking, the takaful operators do not bear underwriting risk in the conventional sense of the term. This is because the operators’fund
is obligated to provide a loan in case of insolvency. Under current regulations, there is a minimum capital requirement; however, this will change as Malaysia recently passed a comprehensive plan to phase in a risk-based capital (RBC) framework. While conventional insurers have been required to comply with this regulation since early 2009, takaful insurers have been given additional time to adopt this system. This framework may pose a challenge to takaful insurers. As mentioned previously, under takaful arrangements, there is a division between policyholder and shareholder funds. Furthermore, in case of a deficit, the shareholder fund is to provide a loan to the policyholder fund to meet its claims obligations. The RBC framework may undervalue the hedging of the risk, as currently practiced.

The Takaful Act, through various measures, incentivises the development of takaful. The specific incentives provided to takaful operators in the Takaful Act make Islamic insurance an economically attractive financial product for insurance companies to offer. Creating similar legislation in the United States, however, would contravene the Establishment Clause.

On a macro level, Malaysia has introduced a few key regulations in order to encourage the growth of the takaful industry. Incentives are necessary to enable takaful operators to competitively price their products when compared to conventional insurers. The first incentive offered for takaful operators is tax incentives and neutrality. Section 2(8) of the Income Tax Act of 1967 allows Shari’ah-compliant institutions, including takaful operators, to apply for tax neutrality or incentives. Any financing scheme necessary to ensure Shari’ah compliance would be eligible under this section to apply for tax neutrality. In essence, this offers takaful companies a level playing field with their conventional counterparts.

The second incentive Malaysia offers is aimed at encouraging foreign corporations to offer Islamic products. The country has opened up takaful licenses for businesses transacting in foreign currency and also established a Shari’ah tax exemption for any company registered under the Takaful Act of 1984 on income derived from transactions carried out in foreign currencies. These provisions would likely run afoul of the First Amendment in the United States.

Malaysia has been a front runner in Islamic finance and it continues to offer innovative products and solutions to encourage expansion and investment in the field. By introducing the Takaful Act of 1984, Malaysia codified the acceptability of takaful as an alternative to conventional insurance. While ensuring that takaful operations would be Shari’ah compliant, it also created a regulatory framework that would work in its secular economic context. Furthermore, Malaysia complemented this innovative Islamic financial product with regulations that make takaful an attractive option for foreign and local investment. Malaysia paved the way for introducing takaful into the mainstream. The United States, on the other hand, has just begun its exploration of the viability of takaful, as detailed below. The Malaysian experience, however, may provide U.S. takaful operators with a useful example.

**United States**

The United States provides an interesting case study because of the potential for First Amendment conflicts with regards to Islamic financial regulations. While conventional Islamic finance has found a niche within the United States regulatory framework, it is unclear where takaful stands.

Takaful insurance is just emerging as a viable alternative to traditional insurance in the United States. It is offered as a service for Muslims who wish to abide by Shari’ah principles in their financial dealings. While takaful insurance is an innovative Islamic financial product, it is not wholly unfamiliar to the United States. Mutual insurance, as well as insurance pools, can serve as useful comparisons to the takaful model because both models provide for a degree of risk pooling by the policyholder. In fact, the structure for takaful may have been inspired by the Protection and Indemnity (P&I) Clubs founded in England used to protect the shipping industry from loss. These clubs were a form of mutual insurance where the members agreed to pool their money and provide funds in case of loss to any one member. Such P&I clubs still exist in the United States in order to provide a source of mutual marine insurance.

**The Regulatory Environment**

Since takaful products are a new entry on the U.S. insurance scene, it is unclear how readily they will fit into the regulatory framework. It is also unknown whether there will be enough demand to support their growth. Furthermore, the First Amendment concerns mentioned above complicate the prospects for the viability and growth of Islamic insurance. The United States, however, can still look to Malaysia as an example of a Westernised economy that has embraced Islamic insurance.

In contrast to the federal system in Malaysia, the United States has a state-regulated insurance system, though there is some support for an optional federal insurance regulatory framework. Indeed, there is a National Association of Insurance Commissioners that seeks to achieve uniform regulations by voluntary cooperation amongst the states. This paper, however, will speak on a generalised level about insurance regulations in the United States in order to explore regulatory alternatives that would support the growth of takaful insurance.

Essentially, each state determines its own insuring requirements for insurance companies. In order to obtain a license, a company must demonstrate that it has the experience and management capability to run the company and show that it is financially sound. In addition, companies must fulfill the solvency regulations set by the state. Solvency requirements ensure that companies are able to retain adequate reserves to meet the promises they have made. Capital requirements, financial reporting and accounting requirements determine solvency. There may also be limits on the types and concentration of investments made with held reserves. Finally, insurance companies are required to justify their premium rates. Some states may set insurance rates at a premium that values insurance as a social tool; a goal also underlying takaful models of insurance. In these states, premiums are determined by calculating the underlying costs of providing the insurance and the rate of return on capital needed by investors.

There are also a number of substantive insurance regulations, including insurance guaranty funds, residual market mechanisms and insurance risk classifications. Insurance guaranty funds became widespread in the 1960s as a tool to assure the solvency of an insurance company. It is an emergency measure that requires any surviving insurers to provide funds to cover an insolvent...
A second regulation that states have enacted is a residual market mechanism, which ensures high-risk customers will have access to insurance. This is accomplished by setting a ceiling on the rates these customers can be charged.

A final common substantive insurance regulation is insurance risk classification. This is a process by which insurance companies apply judgments about the future claiming behavior of a group to the individuals who are classed within the group. The potential for this tool to lead to a race to exclude higher-risk individuals from the pool is high; a company will lower its pricing to the remaining members, which simultaneously increases the potential for greater profit. As higher-risk individuals turn to other companies for insurance, those companies raise their risk profile and become less competitive in the market.

While many of the above-stated regulations will not negatively impact takaful providers, there are a few regulations that may pose a problem for takaful insurers trying to establish business in the United States. In terms of licensing, takaful companies may have problems demonstrating their financial soundness as compared to conventional insurance companies. Since the members in a takaful arrangement agree to insure one another and share in risk and profits, there may be some obstacles in establishing the company as a financially sound insurance provider; the financial soundness would depend on the number of participants, as well as the risk and profit sharing structure agreed upon by participants and management. The United States would likely be constitutionally precluded from passing regulations that would relax financial soundness standards only for takaful companies. Second, in terms of solvency, capital requirements in the United States may not take account of the separation between policyholder and shareholder funds. Under takaful, in case of potential insolvency, the shareholders fund must provide an emergency loan to meet the existing claim obligations. Yet, it is unclear whether solvency requirements will take into account the back-up sources of funding, which resemble insurance guaranty funds, in that they ensure claims will be paid. It is also uncertain how competitive a takaful insurer will be in comparison to a conventional insurance company.

Constitutional Issues
An advisory board often handles oversight of companies that offer takaful insurance in Muslim countries, including Malaysia. While these boards are statutorily authorised in Malaysia, setting up a state or federal regulatory board would contravene the separation of church and state. The purpose of having such boards in the United States would be the same as it is in Malaysia. They would be able to provide consumers reassurance that the product being offered is truly Shari’ah compliant. Another justification for a Shari’ah board would be that it would be able to work with regulators to explain the function and structure of the takaful contracts so solvency or capital adequacy requirements can be tailored to meet the needs of takaful companies. As mentioned previously, however, setting up a separate regulatory structure for takaful would be problematic under the First Amendment.

Under First Amendment jurisprudence, the government cannot draft legislation that gives preferential treatment to any one religion. Granting takaful companies certain allowances to put them on equal footing with traditional insurance companies may be subject to constitutional challenges; takaful would be classified as a religious service, because it is considered Shari’ah compliant. One way to work around this obstacle would be to draft neutral legislation that would redefine solvency requirements, taking into account that certain insurance companies may choose to structure the division between shareholder and policyholder funds differently.

Takaful Products in the US
Islamic insurance has already entered the United States insurance market without any substantive changes to insurance regulations. In late 2008, AIG introduced the Takaful Homeowners Policy as a first step in bringing takaful to the United States with plans to expand their offerings to include car and life insurance. Legal challenges, such as the challenge posed by Murray v. Geithner, however, may prevent further expansion. A fundamental misunderstanding of what Shari’ah is and how it is applied further complicates the expansion of takaful. As an example, Congressman Tancredo (R-CO) had put forth legislation that would make it illegal to advocate Shari’ah law. While, the legislation fails to define Shari’ah law and would have been improperly titled as the

The United States would likely be constitutionally precluded from passing regulations that would relax financial soundness standards only for takaful companies.
The First Amendment's Establishment Clause provides that Congress shall make no law respecting an establishment of religion or prohibiting the free exercise thereof.

In any case, takaful companies should be aware of the challenge raised against AIG under the Establishment clause. While this should not normally have any effect on a company that is privately owned, the current economic crisis has led the government to be more heavily involved in financial institutions like AIG. There has been a legal challenge to AIG’s takaful product under the Establishment Clause because takaful is explicitly described as a Shari’ah-compliant product. While AIG is a unique situation, there is always the possibility that companies considering takaful or any other Islamic financial products would be wary of offering such products in the United States because of fear of litigation.

**The First Amendment**

The First Amendment’s Establishment Clause provides that Congress shall make no law respecting an establishment of religion or prohibiting the free exercise thereof. This provision has been construed as a bar against statutes that may advance or inhibit religion. The Establishment Clause challenges are analysed under a three-part test: first, the statute must have a secular legislative purpose; second, its principal or primary effect must be one that neither advances nor inhibits religion; finally, the statute must not foster an excessive government entanglement with religion.

The challenge to AIG’s takaful offering was not directed at AIG, but instead it was a suit against the federal government. Murray v. Geithner, in effect, challenged AIG’s takaful-based products as a violation of the Establishment Clause. AIG was given bailout money by the government under the Emergency Economic Stabilisation Act of 2008 (EESA). While on its face, the act does not violate the Establishment Clause since it gives the Treasury the ability to purchase troubled assets from any institution, EESA was used to purchase $40 billion worth of AIG shares. AIG is considered the market leader in Shari’ah-compliant financing; therefore, tax dollars would indirectly be going towards the financing of Shari’ah-based products. The suit specifically mentioned AIG’s takaful operations, including AIG-Takaful-Erraya in Bahrain and the Takaful Homeowners Policy. If, on appeal, the court found that the funds appropriated under EESA were being used to fund, and thereby advance, Shari’ah-based religious activities, then the funds advanced to AIG would have contravened the Establishment Clause. At the motion to dismiss stage, the United States’ majority interest in AIG was an important part of the analysis. The fact that Shari’ah products, including takaful, were only a minor part of AIG’s business was dispositive, on summary judgment, in determining whether the funds granted to AIG would be in violation of the First Amendment. Hence, while Murray v. Geithner survived the motion to dismiss, it did not survive as a matter of law at summary judgment and in 2012, the Sixth Circuit denied the Plaintiff’s petition that the case be reviewed by the full court. While the plaintiff’s have filed a petition for a writ of certiorari in the United States Supreme Court to challenge the decision rendered by the Sixth Circuit, it is unlikely that any court would have found in favour of the plaintiffs in this case, because they were unable to meet the burden of showing excessive entanglement between the government and AIG’s Islamic products. An adverse outcome in this case could have impacted the ability and willingness of financial institutions to serve the Islamic market in several ways. First, it would serve as an obstacle to meeting the needs of the Islamic market, since it is necessary for financial institutions to be able to access federal funds to survive a financial crisis. Second, it would pose compliance issues that warrant more relaxed regulatory standards to facilitate Shari’ah-compliant insurance and other financial instruments. Finally, risk-averse corporations may seek to avoid similar litigation and decline to offer takaful and other Islamic financial products.

There are, however, a number of ways that companies can frame takaful in order to avoid the pitfalls of litigation and challenge the assertions made in Murray v. Geithner. One potential method would be to frame Islamic insurance as a service that is needed for practicing Muslims. A useful comparison would be the provision of kosher or halal (food that fits the Jewish or Muslim dietary requirements respectively) meals in the armed forces or in public school cafeterias. These provisions are largely seen as services to religious groups that do not violate the First Amendment. Setting up or evaluating standards that govern such food would, however, be problematic under the decision in Commmack. Thus, while it is likely that a U.S. government-sponsored Shari’ah board or direct government consultation of such a board in Bahrain would likely constitute a First Amendment violation, it is unlikely that AIG’s takaful product itself would violate the First Amendment. AIG and other such corporations, as profit driven companies, should be allowed to create and promote financial products that further their bottom line. Since public institutions are able to offer halal and kosher food as a service to individuals who have a preference for religiously-
sound meals, Shari’ah-compliant financial products should also be available for purchase by individuals with a preference for such instruments, regardless of whether the corporation receives public funds.

Secondly, whether or not a financial product is Shari’ah compliant should not affect the analysis of whether it is a religious product. Unlike the specific appeal of halal or kosher food, takaful insurance may be an attractive option for anyone who is interested in socially-sound insurance products. A useful comparison would be of a governmental incentive that indiscriminately applies to both religious and non-religious institutions, such as those with 501(c)(3) status. Section 501(c)(3) of the Internal Revenue Code provides that a charity can benefit from the non-profit status under the law regardless of religious status. Thus, takaful can be construed simply as an innovative financial product that is acceptable to anyone, but also fits the parameters of Islamic finance. The fact that it is Shari’ah compliant does not make it contrary to the religious tenants of any other religion. In fact, the coverage, terms, commissions and sales of takaful homeowners’ insurance by AIG are identical to the coverage, terms, commissions and sales of its traditional homeowners’ policy. The differences between the policies lie in how AIG has structured the separation and investment of the funds.

Malaysia and the United States both have secular governmental structures in place. Malaysia, however, affirmatively acknowledges the acceptability of Shari’ah through its regulatory framework. The Establishment Clause prohibits the Federal Government from advancing any religion. Any statute, therefore, that would allow for affirmatively setting up a separate regulatory framework for takaful would be invalid on its face. A statutorily authorised regulatory framework, however, while beneficial, is not necessary for establishing a takaful product in the United States. AIG was able to begin offering takaful products without any changes to the existing regulatory framework. Thus, while the United States will likely be unable to provide tax incentives and Shari’ah advisory councils to takaful operators, takaful operators can still work with pre-existing regulation to create a viable option for those interested in takaful as an alternative to conventional insurance. Additionally, regulations that are neutral on their face but also beneficial to takaful operators may not pose a constitutional issue. Instead, such regulation may redefine the boundaries of insurance to include insurance companies that separate policyholder and shareholder funds since this is a financially sound practice.

Finally, the Establishment Clause could be used to challenge any regulations that would inhibit Shari’ah-compliant takaful products from being successfully introduced to consumers who believe it is a religious obligation to only use such products. Regulations such as the Jihad Prevention Act single out a religious group as a target of prosecution. This type of regulation would prevent companies like AIG or other private institutions from offering takaful insurance or any Islamic financial product simply because it is Shari’ah compliant.

In Conclusion
Takaful is a financially sound alternative to conventional insurance. This is evidenced by the fact it is currently offered across the Middle East, Malaysia, the United Kingdom and even in the United States. Takaful serves as a socially responsible model of risk management and, thus, should appeal to anyone who prefers this approach to the conventional opportunistic model that currently dominates the global insurance market.

Takaful serves as a socially responsible model of risk management and, thus, should appeal to anyone who prefers this approach to the conventional opportunistic model that currently dominates the global insurance market.
Riba, Bank Interest, and Islamic Banking: A Summarised Response to Fundamental Questions

By: Mezbah Uddin Ahmed

Background

Prohibition of riba in the Qur'an and in the hadiths of the Prophet Muhammad (peace be upon him) is the central principle that necessitates the establishment of Islamic banking to serve the financial needs of present day Muslims. There are twelve verses in the Qur'an that directly deal with the prohibition. The word riba itself occurs eight times in the Qur'an. Many of the hadiths expressly and implicitly condemn any dealing in riba. It is a known fact that riba is prohibited in Islam. More often than not, however, many of people misunderstand the meaning of riba and the extent of its prohibition. Some argue that the interest charged by traditional banks is not the riba referred in the Qur'an and in the hadiths. Some argue that riba as practiced during the time of the Prophet (pbuh) was only usury, i.e. the excessive form of interest, whereas riba implies all forms of increase in a loan contract. Similarly, translating riba as interest does not provide a comprehensive meaning of riba as the word interest captures only a type of riba, not all forms of it (Engku Ali & P. Odierno, 2008). Traditionally, interest only refers to the riba in a loan contract and this form of riba is more relevant to the present day banking interest. Some argue that commercial interest is acceptable as it is taken for profitable purposes.

So, what really is riba and, to what extent is it prohibited?

Literally, the Arabic word riba means excess, increase or addition. Linguistically, the word riba has been used by the Arabs to denote the increase in a loan in exchange for time (Engku Ali, n.d.). Riba exists in a loan contract where the lender charges an additional amount on the principal and also in an exchange contract where commodities are exchanged at unequal counter values. Riba may arise in different forms. According to a hadith of the Prophet (pbuh) there are seventy-three types of riba (Ibn Majah, v.2, p.764:2274). Due to lack of a better word, some tend to translate riba as usury. Usury generally, however, implies only the excessive form of increase, whereas riba implies all forms of increase in a loan contract. Similarly, translating riba as interest does not provide a comprehensive meaning of riba as the word interest captures only a type of riba, not all forms of it (Engku Ali & P. Odierno, 2008). Traditionally, interest only refers to the riba in a loan contract and this form of riba is more relevant to the present day banking system. The prohibition of riba occurred in the Qur'an in four stages (Engku Ali & P. Odierno, 2008). According to some Islamic scholars, the four stages indicate the graduation in prohibiting riba, starting with judgment of value and ending with total and clear prohibition. (To avoid reader's confusion – Revelation of the Qur'an did not follow the Surat-based sequence.) At the first stage, in Surat Ar-Rum, verse 39, prohibition of riba is not directly stated, but Allah showed His discontent in the wealth that is acquired by acceptance of riba. At the second stage, in Surat An-Nisa', verse 161, the prohibition is also not specific, but the practice of riba is condemned and the riba-takers are juxtaposed with those who will be severely punished. At the third stage, in Surat 'Ali `Imran, verse 130-132, the prohibition is made clear for riba that is double and multiple amounts, but not confined only to these types. At the fourth and final stage, in Surat Al-Baqarah, verse 275-281, all forms of riba are conclusively prohibited and believers were commanded to give up what remains from riba. From these verses it is clear that only the principal is eligible for repayment and any amount of increase (riba) over that is prohibited. In verse 278-279 of Surat Al-Baqarah, Allah says, 'O you who believe! Be afraid of Allah and give up what remains (due to you) from riba (from now onward), if you are (really) believers. And if you do not do it, then take a notice of war from Allah and His Messenger but if you repent, you shall have your capital sums (principal).

The Four Stages of Prohibition of Riba

There are many hadiths that explain different types of riba and give rulings on total prohibition of any
type of riba. During the farewell hajj, the Prophet (pbuh) gave a speech saying, 'All riba is annulled. But you will get back your principal amounts. Neither shall you wrong nor shall you be wronged against Allah has decreed that there shall be no riba' (Ibn Hisham, v.2, p.603). The prohibition is not limited to any monetary increase over the borrowing. To avoid the risk of riba, the Prophet (pbuh) asked the lender not to receive any form of gift or favour from the borrower. The Prophet (pbuh) said, 'When one of you grants a loan and the borrower offers him a dish, he should not accept it; and if the borrower offers him a ride on an animal, he should not ride, unless the two of them have been previously accustomed to exchanging such favours mutually (Sunan al-Bayhaqi, v.5, p.350).

It must be well understood by now that any amount above principal is considered as riba and, therefore, prohibited in Islam. But, one must ask why riba is prohibited and how it is relevant to present day banking system?

Interest in the Past and Today
Aristotle writes in Politics, 'The most hated sort, and with the greatest reason, is usury, which makes a gain out of money itself, and not from the natural object of it. For money was intended to be used in exchange, but not to increase at interest. And this term interest, which means the birth of money from money, is applied to the breeding of money because the offspring resembles the parent. Wherefore of all modes of money making this is the most unnatural.'

Banking practice as we know it emerged probably only around 300 years ago in the 17th century, but the roots of lending and borrowing can be traced back to the roots of civilization. A 3,000-year-old written loan contract found in Mesopotamia confirms the existence of a lending and borrowing system that included the concept of interest. Yet, the charging of interest has always been considered as an unnatural, unjust, immoral and evil way of making money.

Not only Islam, but all other major religions (Christianity, Judaism, Hinduism) assert its prohibition (Vincent, 2014). This is due to the fact that interest allows an unjust increase in a lender’s wealth at the expense of the borrower. If interest is charged, the borrower is burdened with a higher amount than the actual borrowing even if the reason for borrowing fails.

The nature of interest today is very much same as it was during the Prophet’s (pbuh) time, and before. According to World Bank data, in 2013, the interest rates of 71 countries were equal to or above 10%. In 10 countries, they were above 20%. For some loans, including credit cards and micro-credits, the interest rate is often significantly higher than these rates. The unjust and unnatural increase in the lender's claim at the expense of the borrower's obligation can easily be understood from the pyramids below.
If a borrower fails to repay, at a 10% compound interest rate, a simple $1 obligation will increase by 13,781 times in 100 years. At 15% the obligation will increase by more than 1.17 million times. At a 20% rate it will increase by an astounding 82.8 million times.

The borrower's obligation will be doubled (the specific prohibition declared in the Qur'an before complete prohibition) at 10% in just 7.3 years; at 15% in just five years and at 20% in just 3.8 years.

According to a report by the Guardian, payday loans in the UK – a form of short-term, small and unsecured loan – can carry a rate as high as 1,509% Annual Percentage Rate (APR) (Jones, 2015).

Allah commands justice and good conduct, and forbids oppression (Surat An-Naĥl, verse 90). The charging of interest is unjust even when the loan is taken for profit-oriented investment purposes. This is unjust to the borrower because even if the investment fails the borrower will have to pay the interest, a sum greater than the original borrowing. Failure of repayment will only increase the burden which undeniably signifies oppression.

The primary function of a traditional bank is to receive deposits in the form of borrowings from individuals and entities with surplus funds and then to lend to individuals and entities who are in deficit. The traditional banks make profit by borrowing at a lower rate and lending at a higher rate of interest.

They deal with interest at both ends of the arrangement and normally the interest rate is compound in nature. While compounding interest is the worst form, any amount of interest on a loan is prohibited in Islam. The council of Islamic scholars around the world, including the International Fiqh Academy and the European Fatwa and Research Council, has unanimously agreed on the existence of riba in the conventional banking system (Abd Rahman, 2012).

JAK Members Bank in Sweden, an interest-free financial institution, listed a number of values that led them to establishing the interest-free bank. Some of their values are:

- We are against making money only from having money.
- Money shall work as an interest-free means of exchange.
- The interest system is unfair since it redistributes money from those who have less to those who already have a lot.
- Interest-free financing promotes long-term investments, which are a prerequisite for sustainable development. (JAK Medlemsbank, n.d.)

In an interest-based financial system at any given point of time there is not enough money in the system to pay off all the liabilities that arise from borrowings, which makes the concept of charging interest fundamentally flawed.

The prohibition of interest may cause one to ponder, what is the point of giving a loan if there is no benefit from it? On spiritual grounds, to Allah, giving an interest-free loan to those who are in need is a better form of charity. According to a hadith, the reward of charity is multiplied by ten times, but the reward of giving an interest-free loan is multiplied by eighteen times (Ibn Majah, Eng. v.3, b.15:2431). In addition, the Qur’an and the hadiths ask lenders to be lenient when asking for repayment from borrowers. Allah says in Surat Al-Baqarah, verse 280, ‘If the debtor is in a difficulty, grant him time till it is easy for him to repay. But if ye remit it by way of charity, that is best for you if ye only knew.’ The Prophet (pbuh) said, ‘That person who desires that Allah relieves him of difficulty and worry on the Day of Judgment, let him grant respite or forgive a debtor’ (Sahih Muslim, v.12, p.18).

Islam is a complete way of life; each of its religious rulings...
results in benefits that go beyond spiritual and very much practical. Similarly, the benefits of interest-free loans extend to social and economic factors as well. While the spiritual benefits are more individual-specific, the social and economic benefits are far reaching and serve wider communities.

At the social level, interest-free loans deter individuals from unjustly devouring another’s wealth (Surat An-Nisa’, verse 29), thus avoiding social injustice. As there is no additional benefit involved, one gives such a loan out of compassion towards another, shunning greed and strengthening social solidarity. An interest-free loan kindles mutual respect as the borrower remains thankful for the lender’s generosity. An interest-free loan also necessitates more human interaction than in the case of an interest-based loan as in the former case the lender will want to know more about the borrower’s hardship, which results in a greater level of mutual concern and care.

Many articles have been written by both Muslims and non-Muslims in support of an interest-free economy. In brief, in the case of an interest-free loan, a lender will only be interested in giving a loan to help a borrower with real needs, thus, will deterring a borrower from irresponsible and wasteful spending. As the idea of giving interest-free loans is economically unattractive, there will be more human endeavour towards profit-oriented real investments that will produce real products, provide real services and create real jobs. Instead of having an economic bubble, which is only waiting to burst, the result will be a fundamentally strong economy.

So, how are Islamic banks different from tradition banks and, is there any validity to banking in Islam?

In Islam, money itself is not a commodity; rather it is simply a mean of investment in buying or selling real commodities and services. Islam promotes real economic activities by means of trade and business. Allah says in Surat Al-Baqarah, verse 275, ‘Allah has permitted trading and forbidden riba.’ Trading implies not only buying and selling; it includes all forms of permissible business activities. In an interest-based loan, one party gains at the expense of another; but, in a permissible trade both parties gain as they exchange commodities or services for a price that is of equal counter-value. One must not, however, confuse profit with riba. Profit from a permissible trade is allowed, whereas riba is not.

While interest-based borrowing and lending is at the core of traditional banking, the Islamic banks applies the concepts of partnership (mudarabah, musharakah), sale (murabaha, musawamah, salam, istisna, muajjal), lease (ijarah), agency (wakalah), and interest-free loan and safekeeping (qard, wadiah, rahn).

Though the commercial banking was absent during the time of the Prophet (pbuh), the fundamental principles of permissible commercial and financial dealings have already been laid out in the Qur’an and the hadiths. There is much evidence in the Qur’an and especially in the hadiths that establish the foundation and principles for present-day Islamic banking contracts. In some cases the Prophet (pbuh) was himself engaged in commercial contracts and in some other cases he (pbuh) gave rulings regarding the permissibility of contracts. Some principles are deduced by Islamic scholars from the Qur’an and the hadiths applying permissible scientific methodologies.

Furthermore, the Shari’ah norm regarding commercial transactions and contracts is that they are permissible unless there is a clear injunction to the contrary. The position is precisely the opposite with regard to devotional matters (‘ibadat), because the basic presumption here, as Ibn Qayyim stated, is that they are forbidden unless there is a clear text to validate them (Haji Hassan, 2007). Ibn Taymiyya said in Al-Fatawa (3:474), ‘The underlying principle in contracts and stipulations is permissibility and validity. Any (contract or stipulation) is prohibited and void only if there is an explicit text (from the Qur’an, the Sunnah or the consensus) or a qiyas (analogy) proving its prohibition and voiding’ (E. Vogel & L. Hayes, III, 2006).
But, some argue, are not Islamic banks simply mimics of the traditional interest-based banks?

During the period of European colonial empires, most countries adopted Western-style practices. From banking systems to legal systems, colonial rules became dominant and replaced Islamic principle-based practices. Subsequent to World War II, in the mid-nineteen hundreds, the Muslim majority countries started to gain independence from the colonial powers and got the opportunity, after several hundred years, to reshape the systems based on their particular needs. We can, therefore, only trace the beginning of modern Islamic banking back for a few decades.

The Dubai Islamic Bank, established in 1975, is the world's first commercial Islamic bank. It was only in the 1980s that Islamic banking started to expand worldwide. There were a number of experimental efforts before that to establish Islamic principle-based financial institutions, but coming up with a viable and sustainable model that could compete with already well-established traditional banking appeared to be a great challenge and some early initiatives failed. As the new entrants in a highly competitive financial industry, the primary concern of the Islamic banks is naturally survival, in addition to being Shari’ah-compliant. Customers’ expectations from banks and their willingness to participate in risk is one of the major challenges in implementing a truly profit-and-loss sharing banking system, as not all customers are willing to take the risk of loss. To ensure the sustainability of the banking model at the initial stage, therefore, Islamic banks came up with Shari’ah-compliant financial products that in substance are not significantly different from traditional products. The apparent similarity between the two banking systems allowed the Islamic banks to gain acceptance among traditional banking customers, therefore giving it the opportunity to grow. A regulatory framework that caters primarily for the traditional banking system is another primary factor that forces Islamic banks to structure their financial services in a particular way, often resembling traditional banking services. Even though significant regulatory improvement has already occurred in some countries to accommodate specific needs of Islamic banking, there is a long way to go.

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Mezbah Uddin Ahmed is a Member of the Association of Chartered Certified Accountants and BSc in Applied Accounting graduate from Oxford Brookes University, UK. He is currently a Master's researcher at Institute of Islamic Banking and Finance, International Islamic University Malaysia.
The Nature of the Shari’ah Screening Process in Investment Operations

By: Caroline Alexandra Hagg
Graduate in European Social and Political Studies, University College London
Studying for IIBI Diploma in Islamic Banking

What is Shari’ah screening? Why is it necessary?
Islamic investors are keen to put their money to productive ends and ethical economic activity: hoarding is both frowned upon on a moral and religious level and will ultimately lead to unused funds diminishing due to the annual zakat obligation. Investors, however, cannot seek to make money at any cost. Due to their strong convictions, Muslims look to invest in either individual companies or wider funds that follow the same religious principles as they do. Screening is an essential part of ensuring that the individuals or institutions receiving investments are halal so Muslims can be sure that their earnings from such investments are legitimate.

Screening: A Two-Step Process:
First, the company’s business is analysed in detail. Analysts look for evidence that the business is involved in economic activities that are prohibited in Islam. Red flags at this stage include companies:
• where transactions are based on the Islamic prohibitions of riba, maysir, and gharar (e.g. conventional banks, conventional insurers, lottery funds, casinos, etc.)
• whose products are unfit for consumption by Muslims (e.g. food manufacturers handling pork, alcoholic beverage companies, etc.)
• whose products are detrimental to social harmony through negative health effects (e.g. tobacco manufacturers, illegal drugs producers, etc.)
• are involved in various forms of adult entertainment (e.g. pornographic magazine companies or film production companies)
• which produce weapons of mass destruction (e.g. arms dealers and arms manufacturers)
• are involved in genetic modification or embryonic cloning (e.g. laboratories or scientific research organisations, some charities looking for cures to terminal illnesses, etc.)

Second, the company’s financial state is evaluated. This is because companies suitable for Shari’ah-compliant investments must be financially ‘healthy’ and not liable to sudden failure
• the company’s debt to equity ratio must be 30-33%
• the company’s income based on interest alone must be less than 5%
• the company must achieve a balance between liquid and illiquid assets (different funds have different benchmarks and requirements for liquid and illiquid transactions)

Why are Some Elements of Non-Compliance Permitted in Shari’ah Investments?
Although the two-step (qualitative, then quantitative) process seems relatively simple, the reality of global business today means few companies are 100% Shari’ah-compliant. In fact, if Islamic investors only chose companies that ticked every single box of in the list of Shari’ah-compliant criteria, the pool of investments Muslims could actually make would be very small.

To avoid this very limiting scenario, scholars accept that certain elements of non-compliance are permitted. For example, scholars have accepted that most companies fund their assets by using equity and interest-bearing debt: while riba is haram, Islamic investors have to engage with these companies. Thus a benchmark can be set which allows a certain level of debt to be considered acceptable.

The same sort of principle applies to investors who may wish to provide funds to hotel chains or retail centres, whose primary business activity is providing a service that is halal, but whose secondary activities may lead to some engagement with haram transactions (e.g. selling alcohol and cigarettes to customers, providing gambling facilities, serving pork in restaurants, etc.). Some analysts will consider these viable investment opportunities, even though they are not 100% Shari’ah compliant, in order to offer clients greater choice and better returns on their investments.

Furthermore, in some instances these elements of non-compliance can be cleansed after the investment has produced profit for the investor. For example, companies may have some income that results from interest: when an investor receives money from the investment, he can then choose to cleanse this money by deducting the percentage that would have come from interest and donating this sum to charity.

Should Tolerance of Non-Compliance Continue Indefinitely?
At the present time, some degree of non-compliance is an inevitable feature of Islamic investments. This is because the conventional banking system has been dominant for so long that there are few companies that can fully meet strict Shari’ah compliance requirements. For Islamic investors to have a realistic and varied range of choices, scholars and fund managers alike have to exercise a degree of tolerance in the selections they make for investors to choose from.

That said, tolerance should not extend into the realm of becoming lax or failing to review the Shari’ah compliance level of businesses. For example, once benchmarks are set, companies must adhere to them or be removed from the investment fund or Islamic index. (This was the case with Entron being removed from the Islamic investment scene once it debt-to-equity ratio became unsustainable).

Moreover, as Islamic banking becomes more popular and more companies are keen to attract Shari’ah-minded investors, tolerance of non-compliance can gradually diminish. With more options available, requirements can become stricter and funds can be consistently purged of any non-compliant elements. There is no reason not to aim for 100% Shari’ah-compliant investments at some future stage.

Caroline Hagg holds a first class BA in European Social and Political Studies from University College London (UCL). In 2014 she was a UCL Arts and Humanities faculty medal winner. She is currently studying for a Graduate Diploma in Law (LLB) at BPP University, London, sponsored by Herbert Smith Freehills, where she will begin work as a trainee solicitor in September 2016.
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“O my Lord! Increase me in knowledge.”

[Holy Qur’an 2:114]

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Professor (retired) Rodney Wilson,
School of Government and International Affairs
Member of the Durham Centre for Islamic Economics and Finance, Durham University, Durham, United Kingdom

“Deal not unjustly, And ye shall not be dealt with unjustly”

[2:179 The Holy Qur’an]
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*Richard Thomas, OBE, Chief Executive*  
*Gatehouse Bank, London, United Kingdom. 2011*

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*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 IIBI. With its dedicated work over the decades, the IIBI has become the first port of call for anybody exploring Islamic finance in the UK and worldwide.”**
*Mohamed Iqbal Asaria, CBE Visiting Faculty, CASS Business School, Teaching Fellow Aston Business School, Visiting Faculty, Bangor Business School, UK. 2013*
Shari’ah in Modern Legal Systems

By: Julio C. Colón, Attorney

Background
Shari’ah is the name for all the laws of Islam including Islam’s whole religious and liturgical, ethical and jurisprudential systems. Shari’ah decisions are arrived at through consideration of legal proofs and evidence that lead to certain knowledge of a Shari’ah ruling or a reasonable assumption concerning the same, made by those qualified to make such rulings. The primary sources of proof used to arrive at these rulings are the Qur’an and the Sunnah. Jurists may use these sources to arrive at verdicts by referring to precedential authority in the opinions of the Companions along with scholarly consensus, analogous reasoning and policy-related considerations such as public interest, precautionary measures and custom.

Within Shari’ah law, some laws are immutable while others are interpreted according to the particularities of the situation, including the relative good that a specific decision may bring to the community. This grey area is the province of al-ijtihad, which is the use of legal reasoning to arrive at a correct opinion when there is no clear text on the issue. In a dispute arising from a financial transaction, the status of a specific issue will fall within one of the following categories:
1. obligatory;
2. recommended;
3. merely permissible;
4. ill-advised;
5. unlawful.

The term ‘unlawful’ may be roughly equated, in the mind of the western lawyer, as being ‘unconstitutional’. In fact, several Muslim-majority countries adopt Shari’ah as the primary source of legislation. For example, Saudi Arabia’s Basic Law of the Government states that ‘the Kingdom of Saudi Arabia is a sovereign Arab Islamic state with Islam as its religion; God’s Book and the Sunnah of His Prophet, God’s prayers and peace be upon him, are its constitution.’ Likewise, Oman does not have an official constitution, but its Basic Law of the Sultanate proclaims that ‘the religion of the State is Islam and the Islamic Shari’ah is the basis of legislation.’ Other nations incorporate Shari’ah into their legal systems to varying degrees. The United Arab Emirates (UAE), Sudan, Yemen, Syria, Egypt, Kuwait, Iraq, Pakistan, Iran and Qatar regard Shari’ah as the primary source of law. In other countries, such as Malaysia, Indonesia, Libya, Algeria and Morocco, Shari’ah law is highly influential and remains a source of legislation. Judging from the various levels of incorporation, in the modern legal system Shari’ah law acts as:
1. an immutable source of constitutional law;
2. a precedential source of common actions and defences;
3. a source of treatise for the interpretation of civil codes.

Additionally, and perhaps more importantly, in the case of national jurisprudence related to Shari’ah-compliance in financial transactions, international associations have launched standards which are critical for the agreements governing billions of dollars worth of investments, such as the ISDA IIFM Tahawat Master Agreement, which sets out arrangements parties can enter into relating to privately negotiated Shari’ah-compliant hedging products.

Global Practices in Islamic Finance Dispute Resolution
The present environment in the law of Shari’ah-compliant finance is unprecedented in that non-scholars of Shari’ah are being called upon to interpret Islamic law. Those versed in business and finance laws draft contracts to agree with Shari’ah principles to the best of their ability. Of course, the realities of life cannot be drafted out of a contract and disputes do arise.

All of the major players in the sukuk market are parties to the New York Convention of 1958 that governs the enforcement of foreign arbitral awards. The ‘Seventh Circuit of the United States addressed the interpretation of a generally applicable arbitration clause in a Shari’ah-compliant transaction, which requires the parties to negotiate with each other to agree on the resolution of disputes arising from conflicts.

The present environment in the law of Shari’ah-compliant finance is unprecedented in that non-scholars of Shari’ah are being called upon to interpret Islamic law.
between the Islamic Bank and its investors or shareholders. This regulation provided that members of the Islamic Bank’s Shari’ah Advisory Council will also act as the Shari’ah Arbitration Council and will have authority to adjudicate controversies involving less than $100,000. The Islamic Bank does not have authority to operate except within the authority granted to it by a primarily non-Muslim body and the Shari’ah Arbitration Council is bound to act within national limits of due process, however, the Shari’ah Arbitration Council’s primary function is still to aid in ‘maintaining [the Islamic Bank’s] unique Islamic cultures and operating policies that are Shari’ah compliant.’

In Indonesia, Islamic banking disputes also are decided through a mix of Shari’ah and civil law. In fact, conflicts that emerged with the rise of Islamic banking have contributed to that country’s legal development in what it categorises as religious and civil law, as well as to the development of the Indonesian commercial arbitration system. Indonesia maintains a dual system of courts one for civil matters and one for Shari’ah matters. During the initial growth of Islamic banking in Indonesia, there was confusion as to which court would have competence to hear cases related to Islamic finance. Civil courts were generally not academically qualified to judge financial matters pertaining to Shari’ah law, but the jurisdiction granted to religious courts was limited to hearing cases relating to marriage, probate, wills, and endowments. Religious scholars took the first step to set up a qualified body to hear such disputes, creating an ad hoc tribunal known as ‘Basyarnas’, or the National Shari’ah Arbitration Body. While the creation of an official Shari’ah tribunal enjoyed positive favour from the people of Indonesia, the Basyarnas system was characterised by poor accessibility due to lack of full-time personnel and permanent, widespread infrastructure. Despite its known deficiencies, the Basyarnas was able to serve the ends for which it was created in that it used ‘Islamic law . . . as the basic principle’ in settling disputes arising from financial disagreements that also involved the civic laws. Eventually, the competence of religious courts was increased to hear ‘any act or business activity which is undertaken in accordance with Islamic principles which consists of Shari’ah banks, Shari’ah micro financing institutions, Shari’ah insurance, Shari’ah reinsurance, Shari’ah portfolio management, Shari’ah bonds and medium-term securities, the Shari’ah security market, Shari’ah finance, Shari’ah pawn broking, Shari’ah retired fund institutions and Shari’ah business.’ This new regulation extended the authority of religious courts to non-Muslims, provided that they were involved in a dispute concerning Islamic economic matters. In such disputes the religious courts, like the Basyarnas, must rely on both the ‘material law’ related to Islamic financial transactions and Shari’ah law.

It is standard practice for better-established arbitral tribunals to utilise a combined-law approach to hear cases involving Islamic finance. Indeed, acceptance of a mixed choice of law is written into the rules of many of these specialised bodies.

The Kuala Lumpur Regional Centre for Arbitration (KL RCA) houses a specialised department to arbitrate Islamic financial disputes. The Asian-African Legal Consultative Organisation (AALCO) established KL RCA in 1978 to facilitate commerce between its 47 member states. AALCO membership includes preeminent nations in Islamic finance, such as the UAE, Bahrain, Qatar, Saudi Arabia, Malaysia, Brunei Darussalam and emerging economic power Nigeria. The KL RCA promulgated the Rules for Islamic Banking and Finance Arbitration (KL RCA Rules), a specialised regulation applicable to any ‘commercial contract, business arrangement or transaction which is based on Shari’ah principles.’ The KL RCA Rules suggest a model arbitration clause, to which they add, ‘Parties may wish to consider adding [] The law applicable to this agreement/contract shall be that of . . . ’ Rule 38 states that ‘if the arbitration law of the country where the award is made requires that the award be filed or registered by the arbitral tribunal, the tribunal shall comply with this requirement within the period of time required by the law.’ It is obvious that, as with any modern arbitral tribunal, the KL RCA allows parties to choose the law which shall govern the arbitration. As a forum specialised in Islamic finance, the KL RCA also provides in its rules that ‘the arbitral tribunal shall apply Shari’ah principles and the law designated by the parties as applicable to the substance of the dispute.’ This statement explicitly provides for the application of Shari’ah law in combination with the chosen law of the parties as necessitated by the terms of the contract and facts surrounding the conflict. The KL RCA, however, presupposes that, when a Shari’ah principle is in dispute, the arbitrator will not be competent to judge the matter. In such cases where a Shari’ah principle is in dispute, Rule 33 provides that the arbitrator shall adjourn the proceedings and refer the issue to either the Shari’ah Advisory Council of the Central Bank of Malaysia or a Shari’ah expert agreed upon by the parties.

The United Arab Emirates houses three main arbitration centres that routinely hear disputes regarding Islamic finance matters. Among its institutions are the Dubai International Arbitration Centre (DIAC), the Abu Dhabi Commercial Conciliation and Arbitration Centre (ADCCAC), and the International Islamic Centre for Reconciliation and Commercial Arbitration (IICRCA), the last of which is a specialty forum created by the Islamic Development Bank to cater to the Islamic finance industry. The practices of the ADCCAC are ambiguous, however, its charter does provide for a relaxed requirement of professional experience for one who seeks to apply to the ‘Conciliator’s Panel’ if the applicant is a university graduate of "economics, commerce, law or Islamic law Shari’ah." This may allude to the centre being a friendly forum for the combined-law approach. The IICRCA will apply the procedural and substantive laws chosen by the parties and its rules explicitly state that the centre will not apply laws which it judges to be ‘incompatible with the Shari’ah.’ The said rules define Shari’ah as ‘the various Islamic schools of thought and the opinions of Fiqh academies and Shari’ah boards of Islamic financial institutions.’ The DIAC does not purport to specialise in Islamic financial dispute resolution, but it is housed within the Jebel Ali Free Zone and in the same city as the Dubai International Financial Centre, both Islamic banking hubs and renowned free-trade zones. The Dubai International Arbitration Centre’s Rules and Procedures allow parties to
choose the law that governs the arbitration, and the centre is staffed with legal scholars widely published in the fields of Shari'ah and Islamic finance.

Judging Under Shari’ah: The U.S. Experience

There is concern by U.S. scholars that a choice of law that necessitates looking into Shari’ah law will run afoul of the First Amendment prohibition of state endorsement of a particular religion. From an arbitration standpoint, the fear is that the recognition of an arbitration award will be attacked on public policy grounds in the enforcing courts.

The U.S. has traditionally prevented the government apparatus from promoting, meddling in or inhibiting religion. In fact, groups exist within the country with the singular purpose of policing this invisible barrier between church and state. Thus, it is the case that Shari’ah-compliant business must carry on in such a way as to respect this principle. This is necessary in order to promote Islamic finance within this large and promising market, as well as to protect U.S. investors.

With such considerations in mind, at least one U.S. court has rejected the notion that the federal government’s investment in Shari’ah-compliant assets amounts to an unconstitutional endorsement of religion.

In the wake of the largest financial crisis in history, the U.S. Congress approved what has come to be known as the ‘Wall Street Bail-Out’. Properly known as the Emergency Economic Stabilisation Act (EESA), the bail-out established among other things the Troubled Asset Relief Programme, or TARP. One beneficiary of the programme was American International Group, Inc., famously known as AIG. As one of the world’s largest financial groups, the Board of the Federal Reserve Bank predicted that its failure would be catastrophic. As part of the bail-out, AIG was granted a line of credit to the tune of $85 million U.S. Subsequently, the Federal Reserve Bank purchased another $40 billion U.S. in preferred stock from the investment giant.

At the same time, AIG had already marketed itself as a leader in Shari’ah-compliant finance, itself defining ‘Shari’ah’ as

- ‘Islamic law based on Quran [sic] and the teachings of the Prophet (PBUH).’ Indeed, AIG was a forerunner of Shari’ah-compliant finance, both domestically and abroad, offering the only takaful opportunity within the entire nation. Furthermore, its international Shari’ah-compliant investments stretched throughout Saudi Arabia, Europe and India. A suit was brought in federal court by the Michigan-based Thomas More Law Centre on the basis that the use of appropriated funds was in violation of the Establishment Clause of the U.S. Constitution. Specifically, the group reasoned that because part of AIG’s business was Shari-ah-compliant finance, by purchasing its stock, the federal government in one way or the other,

1. endorsed Shari’ah-compliant financing, and thus promoted Islam;
2. became excessively entangled in religious affairs;
3. engaged in religious indoctrination.

To support its argument, the Thomas More Law Centre summoned as evidence several programmes and publications of federal commissions that were aimed at promoting discussion of Islamic finance. Such publications included, ‘Overview of Islamic Finance’, among others. In its own defence, the U.S. Department of Treasury argued that the mere sale of Shari’ah-compliant financial products ‘does not result in religious indoctrination because consumers are not provided religious instruction and that AIG does not develop or sell Shari’ah-compliant financial products with the purpose or effect of instilling religious beliefs in consumers or furthering a religious mission.’

Despite the fact that American taxpayer money had in one way or another supported the promotion of Shari’ah-compliant finance, a practice defined by AIG itself as supported by ‘Islamic law based on Quran [sic] and the teachings of the Prophet (PBUH),’ the district court granted a summary judgment to the defence, holding decisively that the federal government’s purchase of stock did not have any unlawful purpose or effect under the U.S. Constitution. In so holding, the judge noted that the amount of AIG investments dubbed ‘Shari’ah-compliant’ comprised but a fraction of a percent of its total business. The court, however, did not entirely dismiss the plaintiff’s line of reasoning; in fact, the presiding judge wrote in his opinion that the plaintiff could have possibly succeeded in its complaint had it proved that federal funds were actually invested in Shari’ah-compliant activities and that the amount was not insignificant. In regard to the various conferences and publications of the government that specifically dealt with the subject of Islamic finance, the court found it significant that the publications specifically mention that they do not ‘reflect statements of the U.S. Government, the Department of the Treasury, or Administration policy ....’

The importance of this decision should not be underestimated, as it strikes the tone of future litigation concerning the same issue. Thus, one must consider the reasoning of the district court as favourable for two main reasons. The first is that the court required that a plaintiff bring forth evidence that government funds were used for the specific purpose of promoting Shari’ah-compliant investments. In the absence of such evidence, the plaintiff exposes himself to an easy dismissal on summary judgment. It can, therefore, be said that in respect to federal

Bad publicity for Islamic law in the United States has not prevented even state courts from enforcing agreements to arbitrate before Shari’ah tribunals even in the controversial family law setting.
support, institutions that invest in Shari’ah-compliant finance stand on an equal footing with their competitors that do not. The second important issue to take from this case is that the court did not find at all persuasive the argument that the federal government actively engaged in and promoted research in the field of Islamic finance and economies.

Bad publicity for Islamic law in the United States has not prevented even state courts from enforcing agreements to arbitrate before Shari’ah tribunals even in the controversial family law setting. In Jabri v. Qaddura, a Texas Appellate Court enforced an agreement to arbitrate on behalf of a woman in a divorce. The wife, Jabri, was seeking the fulfilment of what is often labelled in Islamic law as a ‘deferred mahra’. In such arrangements, a dowry is agreed upon, but a portion of it is deferred from payment unless there is a divorce. Jabri claimed she was owed one-half the value of the couple’s home and $40,000 of her dowry. During divorce proceedings, the parties submitted the dispute to the Texas Islamic Court, but during the arbitration, a disagreement arose as to the scope of the arbitrator’s authority. The wife motioned the district court to stay proceedings and compel arbitration, which the court denied. The Court of Appeals ruled that the district court abused its discretion by finding that the agreement was not valid, in part because the Court found that arbitration is strongly favoured by state and federal law and that doubts should be resolved in favour of arbitration. The Court of Appeals, however, did not mention any public policy concerns that would prevent it from enforcing an agreement to arbitrate issues concerning conservatorship of children, child support, division of property and even a protective order before an Islamic tribunal.

Enforcement of Islamic arbitration awards has proven to be relatively uncontroversial in U.S. courts. More compelling is that the application of Islamic Law is not out of bounds for a U.S. court to apply. In National Group for Communications & Computers v. Lucent Technologies International, National Group filed suit against Lucent Technologies in a U.S. district court for breach of contract. National Group, a Saudi Arabia-based company, contracted Lucent Technologies to assist in a multi-million dollar project to design, engineer, and install emergency and pay telephones throughout Saudi Arabia. Lucent Technologies terminated its subcontract, and National Group was forced to liquidate its Project Department, which it had created specifically to implement the telecommunications contract. National Group then brought suit against Lucent Technologies seeking actual and expectation damages. Both National Group and Lucent Technologies agreed that Saudi Arabian law governed the terms of the dispute. The district court acknowledged that in order to judge the case it would first have to determine how Saudi Arabian law would decide the claim for loss of the plaintiff’s Projects Department; in doing so, the court analysed tenets of Shari’ah. In its opinion, the district court cited some rules from the ‘Basic Regulation of the Kingdom of Saudi Arabia’, including Article 48, which states that ‘the courts shall apply in cases brought before them the rules of the Islamic Shari’ah in agreement with the indications in the Book [The Qur’an] and the Sunnah and the regulations issued by the ruler that do not contradict the Book or the Sunnah.’ The district court stated its understanding that Shari’ah is the Islamic ‘divine law’ and that in deciding disputes, a Saudi Arabian judge will turn to the ‘Qur’an, the Sunnah, and Fiqh to guide his legal determination.’

Turning to the parties’ dispute, the district court began to analyse the issue of whether expectation damages would be allowable against Lucent Technologies under Saudi Arabian law. In doing so, the district court heard expert witnesses from both parties and detailed its own research concerning damages under Islamic law. The district court stated, ‘several historical . . . statements of the Prophet Muhammed . . . are instructive on this issue’ and then proceeded to quote the Prophet Muhammed’s prohibition of gharar transactions:

‘Do not buy fish in the sea, for it is gharar. The Prophet forbade sale of what is in the wombs, sales of the contents of the udders, sale of a slave when he is runaway … The Messenger of God forbade the [sale of] the copulation of the stallion. He who purchases food shall not sell it until he weighs it.’

The district court then resolved the dispute in favour of the defendants, finding that expectation damages under Saudi Arabian law, and thus Shari’ah, constitute a form of gharar. The district court went on to say that to award expectation damages based on the plaintiff’s valuation of the Projects Department ‘would be equivalent to placing a value on fish in the sea or purchasing food that has not yet been weighed.’ Moreover, ‘book value is an accounting convention that would not produce an accurate picture of actual losses as defined under Islamic law.’ It has been argued that the judge’s use of Islamic law violated the First Amendment. Despite the window of opportunity, there was no argument on appeal to this effect.

The above-mentioned cases do not show that every court is enthusiastic about interpreting the policy-basis of Shari’ah-compliant transactions, however. For example, when the United State Bankruptcy Court for the Southern District of New York approved a Shari’ah-compliant debtor-in-possession and exit-financing package in Arcapita Bank’s bankruptcy cases, the judge reasoned that the compliance of the debtor—in-possession financing with the Shari’ah cannot be before the court, but rather must be judged by the standards outlined in the U.S. Bankruptcy Code. This court made this decision although the financing was structured as a murabaha transaction and Arcapita Bank brands itself as a company that invests according to Shari’ah principals.

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Julio C. Colón holds a Juris Doctorate from the University of Texas School of Law and is a practicing attorney in Texas, specialising in indigent defence. His research focuses on conflict of law and Shari’ah-compliant deals in the U.S. and Latin American markets. He has also interned at the Inter-American Court of Human Rights and advocates for responsible growth based on the model of community partnership.
Reflections on the Mid-Term Review (MTR) of the 10-Year Framework and Strategies for Islamic Financial Services Industry: A Joint Initiative by IRTI and IFSB

By: Hylmun Izhar, PhD

Background
The most anticipated Mid Term Review (MTR) of the 10-Year Framework and Strategies was launched in 2014 in conjunction with the 11th IFSB Summit, hosted by the Bank of Mauritius. It discussed the proposed measures to address the gaps or challenges in meeting the objectives of the 10-Year Framework, as well as the roles of the public and private sectors and other stakeholders of the IFSI in carrying out the 16 recommendations, taking into account the state of development of the IFSI in the respective jurisdictions. It is important to note that the Ten-Year Framework, which initially consists of 13 core recommendations, was first published by the Islamic Research and Training Institute (IRTI) of Islamic Development Bank (IDB) in collaboration with Islamic Financial Services Board (IFSB) in March 2007. The main idea which underlies the creation of such a document is to have a strategic framework document to systematically study, discuss and propose policy responses for the orderly development of the Islamic Financial Services Industry. It was primarily expected that the framework document could ultimately provide a general blueprint or guideline for new and existing Islamic finance jurisdictions in designing and developing their national plans and major initiatives as part of their financial sector development policies.

The 10-Year Framework Document: How did it come into being?
The idea of preparing such a strategic framework document was first considered during the Seminar on Challenges Facing the Islamic Financial Industry, held on 1 April 2004 in Bali, Indonesia. The seminar, which was jointly organised by IRTI and IFSB was held in conjunction with the meeting of the IFSB Council hosted by Bank Indonesia. As a follow up on the issues discussed in the seminar, IRTI and IFSB undertook a joint initiative to address the challenges in a systematic manner in the form of a comprehensive document. Subsequently, preparation of the document was formally initiated by IRTI and IFSB.

As a first step, a number of leading specialists and practitioners were requested to prepare technical papers on various themes. These were presented in a technical workshop jointly organised by IRTI and IFSB, held on 31 May-1 June 2005 in Dubai, hosted by the Dubai Financial Services Authority. Subsequently, IRTI and IFSB jointly organised a policy dialogue on the same theme on 22 June 2005 in Putrajaya, Malaysia, which was facilitated by Bank Negara Malaysia. A drafting committee was as a result formed, which held three meetings and finalised a draft document. The draft document was distributed by IFSB to solicit feedback from its members and other interested parties. It was also discussed in the Islamic Banks’ Forum held on 28 May 2006 in Kuwait, jointly organised by IRTI, IFSB and the General Council for Islamic Banks and Financial Institutions (CIBAFI). At its final meeting held on 17 August 2006 in Kuala Lumpur, Malaysia, the drafting committee reviewed all the comments and the feedback received and reached a consensus on the revised document.

Why a Mid-Term Review (MTR)?
In 2013, IRTI and IFSB initiated a mid-term review of the 10-Year Framework (Mid-Term Review) as more than half of the period had passed since its publication in 2007. The Mid-Term Review was aimed at assessing the impact of macroeconomic events, to monitor progress in implementing the recommendations and to propose additions or modifications to the recommendations to guide the industry. Such a pivotal effort was considered crucial due to the increasingly challenging economic and financial environments as well as the significant developments taking place in the international financial landscape, particularly after the 2008 global financial crisis; and more importantly is to ensure that the 10-Y framework document remains relevant as a platform for various Islamic finance jurisdictions to assist them in orchestrating the future direction of the industry. Throughout the process of conducting the MTR, the following objectives were targeted:

• to identify the gaps involved in implementing the priorities and initiatives;
• to assess the need of a re-orientation of such priorities and initiatives

The Mid-Term Review thus seeks to both assess the progress made by the industry in implementing the 2007 recommendations and amend the recommended 10-Year Framework in the light of developments since its publication.

In conducting the MTR, IRTI and IFSB were supported by a number of prominent research institutions and have engaged with leading regulators, market players, academicians and Shari’ah scholars through various intensive discussions during the roundtables held in Qatar, Malaysia and Turkey whereby IRTI and IFSB had an opportunity to obtain further insights from the key stakeholders and the panel of the Review Committee.

MTR’s Key Findings
Following in-depth research and engagement with key stakeholders in the industry, the MTR document has generated the following key findings:

(i) The industry has shown growth and resilience, with growing market share and profitability, an expanding number of institutions, and numerous industry-level initiatives underway, reflecting customer confidence in the sector, whose concept is proven in many markets.
(ii) Macroeconomic events or external factors have brought both challenges and opportunities to the sector, which has not been immune to the effects of the global financial crisis, by way of the economic impact, the approach to financial regulation, the strength of partners and counterparties and the value of assets and investments. Nevertheless, some countries have acted as important centres of growth as the global economy has stumbled. Political developments in recent years have also made several countries more open to Islamic financial services. Technological innovations such as branchless financial services are now available, and can allow the industry to broaden its future reach.

(iii) The development of the industry has varied by sector, while estimates of its total asset size and growth rate vary significantly (either near or well above $1 trillion US). As a key example, Islamic microfinance has transitioned from a concept with isolated case studies to a fledgling sector across multiple markets. Moreover, although the market values of certain Shari’ah-compliant instruments have shown mixed performance due to overall capital market challenges and Shari’ah-related challenges remain, the breadth and sophistication of such instruments has improved.

What are the Distinct Features of MTR?

Inevitable modifications on the original document have therefore been made, in order to reflect the current status of the Islamic Financial Services Industry (IFSI), which distinctively characterise the current MTR document. They are as follows:

1. The introduction of three additional recommendations (in addition to the existing 13 recommendations in the original document); which state:
   a. (recommendation no. 14): develop an understanding of the linkages and dependencies between different components of Islamic financial services to enable more informed strategic planning to be undertaken
   b. (recommendation no. 15): foster and embrace innovative business models, including new technologies and delivery channels, in offering Islamic financial services
   c. (recommendation no. 16): strengthen contributions to the global dialogue on financial services, offering principles and perspectives to enhance the global financial system.

2. The introduction of a three-pillar framework, namely Enablement, Performance, and Reach. Whilst the original document categorised the recommendations into institutional and infrastructural; the new categorisation puts more emphasis on the outcome desired from the framework. While the first pillar (enablement) was meant to reflect fostering conditions for the industry to thrive; the second pillar (performance) was set up to essentially enhance the effectiveness of institutions active in the industry and the third pillar (reach) was established to substantially increase the commitment in expanding the set of potential beneficiaries in the industry.

3. The development of Key Performance Indicators (KPIs) to help address weaknesses and monitor progress in a more focused manner. As mentioned earlier the progress made on the original recommendations has been mixed. For instance, many countries have adopted international standards specific to Islamic financial services; however, many have not yet fully done so. At this mid-term juncture, most recommendations require greater focus from various countries in order to fulfil the aspirations envisioned. Metrics for tracking progress; which initially were not articulated are, therefore, now considered crucial for assessing progress. Consequently, the MTR proposes a set of Key Performance Indicators (KPIs), for which different countries are urged to set national targets.

4. The establishment of a stronger Implementation Plan to be undertaken by a range of stakeholders. Amongst the stakeholders, it is suggested that the role of central banks and governments are especially important in driving implementation.

5. The identification of 20 Key Initiatives which have been synthesised and prioritised based on their potential impact and the feasibility of implementation.

The 20 key initiatives are classified based on the three pillars of the framework – Enablement, Performance, and Reach; summarised as follows:

<table>
<thead>
<tr>
<th>Enablement</th>
<th>Performance</th>
<th>Reach</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduce national Islamic financial services master plans</td>
<td>Harmonise, where possible, regulation and regulatory frameworks across borders</td>
<td>Link Islamic financial markets across borders</td>
</tr>
<tr>
<td>Enhance regulatory implementation and enforcement</td>
<td>Adopt and strengthen national Shari’ah governance frameworks</td>
<td>Form a ‘Technical Assistance and Linkage Network’</td>
</tr>
<tr>
<td>Integrate Islamic finance in national development plans</td>
<td>Where mandates overlap, align the positions of industry bodies</td>
<td>Form regional working groups</td>
</tr>
<tr>
<td>Foster information-providing institutions that support the provision of Islamic finance</td>
<td>Incorporate Islamic finance data in statistical and official reporting</td>
<td></td>
</tr>
</tbody>
</table>
| Performance | Institute centralised R&D for Islamic financial products in addition to decentralised R&D  
| --- | ---  
|   | Establish diversified financial institutions  
|   | Demonstrate the industry’s distinctive value proposition  
|   | Fund public infrastructure projects to build Islamic capital markets  

| Reach | Revitalise zakah and awqaf for greater financial inclusion and make them an integrated part of the Islamic financial system  
| --- | ---  
|   | Ensure that regulations allow for the use of new technology to provide affordable services  
|   | Engage with newly-opened markets  
|   | Foster the financing of a wider set of economic sectors  

**It is vividly depicted in the figure above that the spirit of three main pillars; namely enablement, performance and reach permeates into the 16 core recommendations, implementation plan and identified key initiatives in order to achieve the desired outcome.**

**Lessons Learnt**

The world consists of a diverse group of nations, which span a range of regions, cultures and stages of economic development in which Islamic law, common law and civil law jurisdictions are adopted.

In conducting the Mid-Term Review, it was observed that diverse views were particularly salient in regards to:

- whether countries should have specific laws for Islamic financial services or rather fit Islamic structures into a single set of financial services laws;
- whether countries should adopt national-level Shari’ah boards or retain Shari’ah governance solely at the institutional level;
- whether central banks should allow conventional institutions to offer Islamic financial services;
- whether the adoption of international standards specific to Islamic finance is essential; and
- whether product standardisation should be a policy objective or not.

While diversity of use in these areas is appreciated, a key underlying theme is that a supportive public policy stance is essential for enabling the industry to reach its full potential. Different countries have been successful under various models; each choice brings benefits and drawbacks. Nevertheless, a strong and supportive public policy stance can help contribute to greater confidence that energises the private sector.

The MTR therefore does not seek to prescribe specific approaches to the choices above. It does, however, urge various jurisdictions to deliberate carefully on these matters and form well-considered strategies. The MTR also suggests that Islamic financial services offer benefits to the people and economies of the public at large and advocate thoughtful strategies on how best these benefits can be realised.

Prior to joining IRTI IDB, Hylmun Izhar was a lecturer at the Markfield Institute of Higher Education (MIHE) in the UK where he taught Islamic Financial Instruments, Economic Development and Finance and Cross Culture Management. He was also a Research Associate in Islamic Finance at Oxford Islamic Finance in the UK. He has a master’s degree from Loughborough University and a PhD in Islamic Finance from Durham University. He has also presented numerous papers in various international conferences and has conducted professional training courses for regulators, bankers and university professors in the area of Islamic economics and Islamic finance.
Shari’ah Compliant Credit Unions in the United Kingdom, an Analysis of the Opportunity for Growth

By: David Evans, Evans Consulting

Introduction
In today's financial services industry in the United Kingdom the influence of credit unions has continued to fall short of the performance that we see in the Irish Republic where they currently manage in excess of $17.9 billion in assets compared to the United Kingdom’s $1.6 billion (WOCCU, 2012). The figures published by the World Council of Credit Unions (WOCCU) go further in reflecting that in Ireland credit union penetration reached 73.2% against the UK’s 2.5% highlighting that there is a lot to be learned from the performance of Irish credit unions. The market in the Republic of Ireland, however, must be seen as an anomaly given that WOCCU further disclose that across Europe the total assets of all credit unions is $26.5 billion highlighting that Ireland holds 67.5% of all assets, a distinct market anomaly.

WOCCU have recognised specific areas of potential growth within their expansion strategy highlighting Islamic finance as a key area of interest. To support this opportunity they have produce an operating manual to support their development of the Shari'ah-compliant credit union services model (WOCCU, 2013). The inclusion of Islamic finance is an interesting perspective when examining the United Kingdom given that Islamic finance faces its own challenges surrounding the issue of low market penetration. Today there is only one Shari'ah-compliant retail financial institution, Al Rayan Bank (formerly the Islamic Bank of Britain) that offers traditional high-street banking deposit and lending facilities and a limited number of credit unions including Ansar who operate a Shari'ah-compliant business model and others including the Swansea-based LASA (Loans and Savings Aberawe) and the London Community Credit Union who offer a Shari’ah-compliant offering amongst their credit union deposit product portfolio utilising a 'window' approach.

The challenges offered in undertaking a review of UK-based, Shari’ah-compliant credit unions and their alignment with conventional credit unions lies in the lack of research undertaken and material available to date. Unfortunately the author has been unable to locate any substantive reference material drawing the conclusion that this is not an area of key research at this current time. As such, the approach taken in this analysis is to examine the two models drawing parallels where possible examining both the opportunities and challenges such that we are able to form an opinion as to the opportunities for the two models to come together in support of each other.

The Current Challenges for Credit Union Growth
There are many theories as to why credit unions have not seen the same levels of success as their cousins in the Irish Republic; that reasoning however comes in many contradictory forms. Edmunds (2013) in his House of Commons guidance paper to MPs, argues that a Credit Union is seen as a ‘Poor Man's Bank’ and this reputation is a primary cause of their inability to attract the right balance of customers. A contradictory argument presented by Jones (1999) discusses the fact that credit unions’ dependence upon a largely volunteer workforce and management structure has resulted in poor stewardship of credit unions, which in turn has limited their growth. This view is supported by earlier research undertaken by Clutton-Brock (1996), although Jones takes this further to argue that credit unions have further suffered by the focus upon and allocation of societal objectives as a higher concern and priority than that of fundamental business objectives and needs such as operating margin and profitability.

There are further contradictory arguments as to the limited growth of credit unions including the views of Thomas and Balloch (1994), who in argue that the typical low-income customer demographics have either seriously limited or halted the objective of distributing the wealth from the haves to the have-nots. It is clear, however, that the existing theories surrounding the limited growth of credit unions in the United Kingdom fail to offer a consistent argument albeit there are identifiable themes beginning with low-income customers and limited management experience.

A limited research study was undertaken by the then Islamic Bank of Britain into the interests of the consumer in adopting Shari’ah-compliant financial services (Zawya, 2014) in which they reached the conclusion that 81% would be open to utilising such services. To date the research methodology and subsequent data-set has not been published in full so these results are at best indicative and are unsubstantiated albeit they propose that there is an appetite for further expansion within the United Kingdom for Shari’ah-compliant financial services and product offerings.

The Commonality between Credit Unions and Islamic Finance
When examining the establishing/ operating objectives of both credit unions and Shari’ah-compliant financial institutions there are the common goals of customer and institutional equitability, social responsibility and ethical behaviour such as the earlier mentioned concept of profit and loss sharing that aligns with the credit union participatory share ownership scheme as highlighted in earlier work by Al-Muharammi and Hardy (2013), a perspective supported in the earlier works of El-Gamal (2006) when highlighting the need for ‘true’ equity sharing through mutuality. The position of member ownership is discussed by R. Wilson who argues, in his 2011 work examining the drivers for the growth of Islamic finance, that adopting the position of investor ownership avoids the issues of conflict of interest when considering the needs of shareholders and their desire for profitability (Wilson, 2011).

A key differentiator between conventional finance and Islamic/ Shari’ah finance is based upon the need for Shari’ah compliance in both the design of products and the day-to-day operating model of a financial institution. This is a differentiator that would also apply to the operations of a Shari’ah-compliant credit union
model. Shari’ah compliance within the United Kingdom is not a regulated position, rather it is one of a moralistic perspective where compliance is not formed in legal statute and instead is one controlled by the potential risk to reputation alone. The compliance regime for Shari’ah-compliant financial organisations is based upon the avoidance of haram (impermissible activities and products) including pork, pornography, arms, alcohol and entertainment (Schoon, 2009), the avoidance of uncertainty (gharar) or chance/gambling (maysir) and it must ensure equality of transactions and their outputs and must avoid the application of excess/usury/interest (riba), constraints that dictate both product design and the activities of potential customers. To ensure product design and day-to-day operations operate under the religious constraints presented, the guidance of an independent Shari’ah supervisory board is utilised to provide the necessary structures and external opinion to help manage the reputation of an organisation.

When examining the underlying objectives of both credit unions and Islamic financial services organisations, we are able to draw parallels indicating common synergies namely that of equitability, profit equalisation, social responsibility, ethical behaviour and financial inclusion. Islamic finance holds at its core the concept of ‘true’ profit and loss sharing (PLS) that marries well with the credit union’s account holder/share ownership model highlighting that both enter into a customer/institutional partnership relationship. This concept is examined by Al-Muharammi and Hardy (2013) in their IMF (International Monetary Fund) working paper when comparing the potential synergies between the two models of Shari’ah finance and cooperatives. Their work draws parallels between cooperative finance and credit unions concluding that the two models from an analytical perspective can be considered as one. Their work concludes that there are indeed many synergies between credit unions and Islamic finance such that their ideology, customer reward and risk sharing are equal in nature supporting their coming together for expansionist purposes.

Shari’ah Supervisory Boards and Regulatory Compliance

In analysing the role of a Shari’ah supervisory board (SSB) a key consideration for a Shari’ah-compliant credit union is that of the overheads generated from the operating costs of an SSB, which in turn is a level of governance, compliance and cost that is not present for conventional credit unions. In his 2009 analysis of Shari’ah boards Bernardo Vizcaino examined their financial impact highlighting that Shari’ah boards can often have fees in excess of $40,000 associated with the approval of products and the issuance of fatwas or religious opinions (Vizcaino, 2009), a cost that may have negative impacts upon the financial feasibility of an organisation.

In an attempt to simplify the establishment of Shari’ah complaint credit unions and their product offerings the World Council of Credit Unions has developed a set of guiding principles for the design and operation of a Shari’ah credit union (WCUCU, 2013) that are aimed at reducing the need, influence and costs associated with Shari’ah boards. The WCUCU perspective, however well intended, will not remove the need for Shari’ah boards in part due to the need to provide an ongoing external and independent opinion as to the compliance status of day-to-day activities, but also in part due to the commercial interests of these boards, which may see levels of undue pressure to continue to engage with their services despite the quality and relevance of the existing guidance offered by others.

A 2001 report presented by Nicholas Ryder (Ryder, 2001) examined the impact of increasing regulation upon credit unions highlighting the introduction of deposit protection, the need for ‘approved persons’ in the management structure and the increased need for capital reserves as serious constraints around the ease upon which a credit union can be established, will operate and its financial viability. Whilst Ryder’s work may be viewed as somewhat out of date, its relevance as an early indicator of the restrictive influence of regulatory bodies can be seen as a seminal or foundational work when examining the potential negative influence of regulation and regulatory bodies upon what are in essence, community-based financial bodies which simply do not share the same economies of scale when compared to their more conventional cousins.

Whilst little work has been undertaken into the role of the UK regulators and their influence over Shari’ah-complaint credit unions, we can examine the 2007 paper by Michael Ainley et al. (2007) in the FSA (Financial Services Authority) paper ‘Islamic Finance in the UK: Regulation and Challenges’ in which they examine the influence of dual standards of institutional governance. In the paper they highlight that it is neither appropriate nor legal to vary standards between conventional and Islamic financial institutions in order to generate a ‘level playing field’ for all market participants. The authors go further, issuing words of caution over the role of the supervisory boards highlighting the need for them to remain independent, working in an advisory and not an executive capacity in order that the influence of the Shari’ah and religious needs do not override the need for regulatory compliance.

The regulator’s stance upon market equality or the provision of a ‘level playing field’, however, does not in reality provide the desired levels of equality. The need for legal compliance is met by both. The need, however, for Shari’ah compliance and its governance structures is an operating model cost not faced by conventional institutions. Unfortunately the paper by Ainley et al. fails to address this additional level of governance.

The Potential Market for Shari’ah-Compliant Credit Unions

Islamic/Shari’ah-compliant financial services and their products are universal in nature in that they are available to both Muslim and non-Muslim alike, although one must question the true appeal of retail/consumer aligned Islamic finance given the provision of high-street financial services through a single provider, Al Rayan Bank. As discussed earlier, the 2014 survey (Zawy, 2014) highlighted that 81% of those surveyed would be interested in receiving Shari’ah-compliant financial services, which, when utilising the 2011 census (ONS, 2013 or Nomisweb, 2011), highlights a potential customer base of 2.2 million Muslims based upon a UK Muslim population of 2.7 million. Given the lack of insight, however, into the survey, it is not possible to leverage their results to extrapolate in a meaningful manner, that there is indeed a potential customer base of 2.2 million and as such, one can only make a limited set of assumptions as to the potential growth. We can see, however, that despite a 5% fall in the number of UK-based credit unions from 596 in 1997 to 567 in 2005 (Collard and Smith, 2006), we can see a positive upwards trend from 224,674 customers in 1997 to...
be that guidance would best be provided through a combination of the WOCCU guidelines and the leveraging of previous activities such as the retail financial services offerings from Al Rayan Bank. This would not only make the best of what previous experience there is, but also avoid any cost implications associated with employing Shari’ah supervisory boards.

The growth in credit union membership despite the reduction in the number of credit union institutions highlights that, on the face of it, consumer take-up has continued to grow. The gaps in credit union market coverage between the United Kingdom and the Republic of Ireland highlights that where appetite is strong, expansion is indeed possible. Despite the lack of sophistication utilised in the Al Rayan (Islamic Bank of Britain) survey, we can draw assumptions that there is an appetite for increased take up of Shari’ah-compliant financial services and as such there may be potential for the two industries to support and assist the growth of each other. There is common ground as highlighted by Al-Muharrami and Hardy (2013) in the areas of ethical approaches, equality of outcomes, profit equalisation and financial inclusion drawing many comparable avenues across the two financial structures, which makes in turn makes for a relationship of potentially beneficial ‘bed fellows’.

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Prior to undertaking his MA, David was The Interim Head of Projects at the Bank of London and the Middle East and previously the Senior Vice President of Business Change and Process Re-Engineering at the Bank of America where he researched in Islamic financial services. David is a member of The Chartered Management Institute (FCMI - Fellow) and the Institute of Engineering and Technology (MIET – Member). He holds an MA in Islamic Banking Finance and Management from the University of Gloucestershire/Markfield Institute and certifications in Islamic Banking, Insurance and Commercial Law from the Chartered Institute of Management and Accounting (CIMA).
The Use and Abuse of Limited Liabilities

By: S Nazim Ali¹, Professor and Director, Centre for Islamic Economics and Finance, Qatar Faculty of Islamic Studies, Hamad Bin Khalifa University, Qatar Foundation, Doha, Qatar

The 7th London School of Economics (LSE) Islamic Finance workshop was organised (2013) against the backdrop of the global financial crisis that had impacted all and sundry. The workshop had focussed on 'Insolvency and Debt Restructuring in Islamic Finance'. At the conclusion of the workshop many of the participants shared their feeling that the issue of debt and restructuring is closely linked to the concept of limited liability for corporate, hence the majority of the participants decided to vote in favour of 'Use and Abuse of Limited Liability' for the 8th LSE Workshop.

The topic of the workshop, 'Use and Abuse of Limited Liability' was examined from the following angles:

• Juridical person and limited liability: separate concepts or interdependent. What is the extent of justification for them under Islamic law?
• Similarities, differences and implications of a ‘juridical person’ in Shari’ah. Does the concept violate Islamic principle of al-kharaj bi al-daman?
• Can examples of ‘juridical person’ be emulated in and extended to other areas?

The main purpose of the workshop was to envisage various models or structures of organising business that retain the beneficial aspects of limited liability while avoiding the misuse of the concept. Accordingly the objectives set for the workshop were as follows:

1. Revisiting the debate on the Shari’ah viewpoint of juridical person and limited liability;
2. Understanding advantages and benefits of limited liability to economy and business (public) in general and to promoters, shareholders, and employees in particular;
3. Discussing disadvantages and misuses: causes and extent;
4. Exploring remedies and options.

Professor Frank Vogel, the moderator of the workshop, re-emphasised the importance of gathering five key stakeholder groups at the workshop, namely: Shari’ah scholars, economists, practitioners, lawyers and industry organisations. He said that every time we pick a worthwhile and substantive issue the real purpose is to use the issue to debate how the industry itself makes decisions – how it weighs considerations that are ethical, religious, legal, economic, financial, professional, political, reputational, and purely pragmatic to come to a conclusion on a specific issue.

The main purpose of the workshop was to envisage various models or structures of organising business that retain the beneficial aspects of limited liability while avoiding the misuse of the concept.

Professor Vogel divided the agenda of the day-long workshop into three parts.

1. The Shari’ah issues and positions on juridical person and limited liability;
2. The economic issues and consequences of the use (maslaha) and abuse (mafsada) of the limited liability concept and how to manage the costs and benefits;
3. Shari’ah compliant optimal organisational forms in the context of the benefits and misuses of limited liability.

Limited Liability and Legal Personality: Benefits, Costs and Concerns

The workshop began by listing several benefits of limited liability such as ability to bring together large groups of investors as one body, providing continuity for the enterprise regardless of the changing circumstances of shareholders and shielding the shareholders from unanticipated liabilities arising from the running of the business. It also provides investors an opportunity to diversify their investments across various projects rather than just in projects that they can manage themselves. Limited liability also enables small savers to invest in businesses that otherwise may be confined to wealthier investors.

¹This write-up is based on the comments received on the subject from various experts followed by in-depth closed-door discussions held on February 13, 2014 at the London School of Economics and Political Science, London. The author acknowledges the contributions made by all commentators and participants.
These benefits, however, come with certain disadvantages. For example; it allows business managers to sometimes indulge in excessive risk taking by borrowing huge amounts of money to increase profits and hide behind the corporate veil if the venture fails, which results in the privatisation of gains and socialisation of losses. Many of the ills in today's financial system, such as short-termism in the financial markets, excessive indebtedness and speculative risk-taking can be attributed to the concept of limited liability as those responsible are able to protect their personal wealth regardless of what happens to the venture for which they are responsible.

The presenter also posed certain questions to the participants. For example:

- When can the corporate veil be pierced? And should it be automatic or should it be looked at on a case-by-case basis?
- What are the implications for bankruptcy and defaults within limited liability? Should we go for a regulated limited liability regime or should it be limited liability as a rule?
- Whether limited liability and legal person can be separated in Shari'ah or it has to be combined for a Shari'ah ruling.
- How to deal with different shades of limited liability company (LLC)? In different countries and at different times the limited liability concept can be applied differently.
- Can an LLC by itself create other LLCs and what are the parameters for it? Where to put a stop to this process and on what basis?
- What are the different shades of legal personality?

Scope of Limited Liability and Legal Personality in Shari'ah
The participants agreed that interpretations of Shari'ah have allowed the concept of juridical person and limited liability and their use is widespread in Islamic finance and in Muslim countries in general. More importantly the concept has been accepted across the world including by the Islamic standards setting bodies such as AAOIFI and Majma Fiqh al-Islami, etc.

One participant highlighted the concept of separation between ownership and management. Referring to the mudaraba contract it was pointed out that any liability incurred by the mudarib without the express permission of the rabbal maal is the responsibility of the mudarib. Therefore, to shift the responsibility onto the rabbal maal (beyond his capital), it has to be proved that all the actions of the mudarib were conducted keeping the maslahah of the rabbal maal. For example, if an Islamic bank fails, its creditors cannot have any recourse to the mudaraba fund (or investments accounts) managed by the Islamic bank as the fund does not belong to the bank. The debate on this issue concluded that overall there are many more benefits in limited liability that serve maqasid al Shari'ah than causes for disquiet. A hadith related to Saeed ibn Mohal was also quoted in this context where the Prophet Muhammad allowed his creditors to take recourse to the garden that he had and beyond which they had no claim. Taking a cue from this ruling it was argued that creditors have no claim over the future earnings of the bankrupt, let alone having any claim in the Hereafter.

A participant then questioned what stopped classical fuqaha from not starting a joint partnership with limited liability? This was clarified: since the concept of juridical personality was not established at that time, any business was actually a personal company owned by its partners, who were liable for the responsibilities through their personal wealth. After the concept of juridical personality was introduced and developed, however, it was adopted under Shari'ah.

Many of the ills in today's financial system, such as short-termism in the financial markets, excessive indebtedness and speculative risk-taking can be attributed to the concept of limited liability as those responsible are able to protect their personal wealth regardless of what happens to the venture for which they are responsible.
proceeded without any serious engagement by Muslim jurists and scholars. The association of the limited liability corporate with colonial forerunners such as the East India Company led to the development of many negative connotations about this emerging structure to facilitate commerce. This is very similar to negative sentiments about capitalism due to its close association in Muslim minds with colonialism. There is, therefore, a need to separate these negative sentiments from the arguments based on the usefulness or otherwise of the underlying substance of the limited liability corporate.

It was also suggested that profit sharing is the opposite of lending money at interest or the prohibited riba. Profit sharing requires business partnerships and it is these business partnerships, which early on did not have limited liability, that have evolved into limited liability companies.

Managing Abuses in Limited Liability

The discussion then veered toward managing abuses. The moderator posed the question: what is required from an Islamic point of view to rectify abuses and whether it is sufficient to just rely on western legal systems, which focus more on managers and majority shareholders when it comes to managing abuses?

A participant pointed out that the real question in this regard is who controls decisions and who is responsible for abuses. In a small private company shareholders make decisions and should be liable. In a large company, however, it is managers and not shareholders who run the business. The moderator then asked, if you are in a position to control the actions of your company, does Shari’ah say you should also face the consequences even beyond limited liability? Two of the Shari’ah scholars answered that if the shareholders are represented by a board of directors then the directors shall be responsible for any act of omission or commission as per the corporate governance code, which covers potential misuse of limited liability. If, however, the board of directors has been acting according to the articles of association and terms and conditions of their appointment then the responsibility for their actions will fall on the shareholders.

It was also highlighted that economic development requires risk-taking. If there is too onerous a burden imposed on those running limited liability corporations, putting their personal wealth and by implication the well-being of their families at risk, it may dissuade risk-taking to the detriment of economic development.

Piercing the Corporate Veil: When and How

This session began with issues related to piercing the corporate veil and under what conditions it may be pierced in the United Kingdom. It was suggested that the only possibility of piercing the veil is in a situation where the corporate form is used to avoid an existing liability. As far as future obligations are concerned it is acceptable to use the form to limit your liability, even in cases which appear unacceptable. For example, a pharmaceutical company that has a product that they think will hurt people, yet they develop it in a subsidiary, the corporate veil will not be pierced. When asked about the possibility of managers/directors being held responsible for their actions, it was clarified that, save in the situation where the company is already in insolvency, the directors have an obligation to use the powers they have to promote shareholder value. As long as the company is a going concern, those directors are not burdened with the interests of creditors. The moderator then asked the scholars if they would be satisfied with the corporate governance rules as practiced in the United Kingdom. One Shari’ah scholar suggested that rules for piercing the veil should be made clear and objective rather than left to the sole interpretation of judges. Another participant noted that limited liability companies did not grow organically in Islamic culture. The SPV (special purpose vehicle) model is also imported from the West. Instead of trying to find Islamically unique solutions to those problems, therefore, we should accept the solutions that are applicable in those countries. Another participant refuted this assertion on the ground that Shari’ah allows borrowing outside the realm of rituals. He argued, ‘You can use a tool you have not developed, but it must conform to the rules of Shari’ah. It is important to develop necessary sensors to detect specific pitfalls and dangers to be able to protect yourself’.

The Role of SPVs and Limited Liability in Sukuk

Many participants raised the question of the growing use of SPVs in issuing sukuk (Islamic debt securities). Some of them were very critical of the miniscule capital base of these SPVs and called for restrictive use of these structures. One participant suggested AAOIFI should come up with a Shari’ah standard on SPVs. Another participant noted that the demand for restrictive use of SPVs is not because of its limited liability feature nor are SPVs invented on the advice of Shari’ah scholars, but lawyers need them for various reasons including tax benefits and bankruptcy remoteness. He cautioned that the concern should actually be how these SPVs are used as a tool and whether they are used for private gains or for the benefit of society at large. If these vehicles are used to defraud people then they should be dealt with accordingly.

Another participant pointed out that the issue of transfer of ownership of assets into SPVs is not clear and therefore the ultimate responsibility still lies with the corporate (originator). It was also noted that many sukuk holders are concerned it is acceptable to use the corporate form to avoid an existing liability. As far as future obligations are concerned it is acceptable to use the form to limit your liability, even in cases which appear unacceptable. For example, a pharmaceutical company that has a product that they think will hurt people, yet they develop it in a subsidiary, the corporate veil will not be pierced. When asked about the possibility of managers/directors being held responsible for their actions, it was clarified that, save in the situation where the company is already in insolvency, the directors have an obligation to use the powers they have to promote shareholder value. As long as the company is a going concern, those directors are not burdened with the interests of creditors. The moderator then asked the scholars if they would be satisfied with the corporate governance rules as practiced in the United Kingdom. One Shari’ah scholar suggested that rules for piercing the veil should be made clear and objective rather than left to the sole interpretation of judges. Another participant noted that limited liability companies did not grow organically in Islamic culture. The SPV (special purpose vehicle) model is also imported from the West. Instead of trying to find Islamically unique solutions to those problems, therefore, we should accept the solutions that are applicable in those countries. Another participant refuted this assertion on the ground that Shari’ah allows borrowing outside the realm of rituals. He argued, ‘You can use a tool you have not developed, but it must conform to the rules of Shari’ah. It is important to develop necessary sensors to detect specific pitfalls and dangers to be able to protect yourself’.

The emergence and development of the limited liability corporate structure proceeded without any serious engagement by Muslim jurists and scholars.
The SPV structure also plays an important role in acquiring high-risk assets, where the financiers want to ring fence the liability by creating an orphan SPV, where the shares are held in trust for some charity. A charity is brought into the picture because it cannot be sued. In case of something going wrong the banks have a first priority charge over the asset and if a third party claim is enforced, you say the ultimate owner is a charity which cannot be sued. It was argued that in the absence of limited liability, nobody would finance aircraft. The SPV, therefore, is a standalone entity without any ulterior motive or purpose.

Summary and Conclusion

The last session of the workshop was devoted to summarising the day-long discussions and drawing some conclusions from it. The moderator invited responses to the idea of imposing liability on the shareholders and managers for the misuse of limited liability. He also suggested the institution of non-legally-binding but ethical standards or industry standards under the corporate governance rules. He wanted to know if the discussion could be enlarged to include trusts and mutuals as they too are reported to have been used inappropriately. He asked participants to highlight whether there is any Shari’ah-specific suggestion and criteria or it is acceptable to work with the existing system. He further asked participants their views on whether transparency in disclosure is a sufficient requirement to justify limited liability or whether the existence of a separate legal person underlying the concept of dhimmah is also required as a basis and what is the logic behind the Shari’ah acceptance of these notions. What is the possibility under Islamic law of imposing additional obligations of disclosure? Who will enforce them and in what context will they be enforceable?

Participants reacted to these queries in different manners. One noted that any new structure that is developed is for a purpose, but over a period it starts getting misused. The message is to remain vigilant, therefore, as the issue is more of a regulatory than statutory nature. Some others tried to cite real life examples. For instance, Malaysians have a statutory provision for piercing the veil in case of tax evasion. One participant highlighted the role of credit bureaus in providing disclosures and making available the necessary information about the creditworthiness of the borrower. On the other hand some contended that a credit history is not available for all transactions and more importantly it is not accessible to all. One participant highlighting the Shari’ah aspect referred to a hadith describing delayed payment as an injustice punishable by exposing the delinquent.

A suggestion was made to put some sort of restrictions on limited liability. One participant tried to highlight the difference between natural factors leading to failure and fraudulent behaviour. Another suggested providing incentives to those who are cautious in incurring obligations or taking too much risk. To control the misdemeanour, especially in the context of overleveraged banks it was suggested that a look should be taken at the German mutual and cooperative bank model, where shareholders could be made liable beyond their share capital. The moderator highlighted Saudi corporate practices where shareholders are required to provide guarantees if their company’s capital drops to one quarter of its total obligation. One participant drew attention to the new Malaysian Companies Act imposing higher duties on managers and increasing shareholders’ responsibility.

One participant argued that the business known as the John Lewis Partnership in the United Kingdom could be a model for Islamic enterprises. John Lewis is owned on trust for the benefit of its members. Every employee of John Lewis becomes a member on the day they join. The trustee of the settlements is the John Lewis Partnership Trust Limited. Its chairman is the partnership chairman and its other directors are the deputy chairmen. The Partnership is governed according to a written constitution, which is subordinate to and must not conflict with the settlements. Power in the partnership is shared between three governing authorities: the Partnership Council, the Partnership Board and the Chairman. Profits are used to sustain commercial vitality and distribute to the members. Each year every employee receives a percentage of their salary as a bonus. The company also provides benefits such as holiday houses that the partnership maintains. Employees who have worked at the company for 10 years or more also continue to receive benefits after they retire such as 20% off John Lewis products. The John Lewis partnership with its happy customers, employees and management may be what we would want Shari’ah businesses to consider as a model.

Looking from another perspective it was observed by participants that the current financial system has a deep influence on the capital structure used by companies. Since debt is made cheaper than equity, it is unlikely that reliance on debt will change unless equity and debt are brought to a level playing field. The systematic preference of debt over equity runs like an underlying theme behind abuse of limited liability.

S. Nazim Ali, now Professor and Director, Centre for Islamic Economics and Finance, Qatar Faculty of Islamic Studies, Hamad Bin Khalifa University, was the Director of the Islamic Finance Project (IFP) at Harvard Law School, Harvard University from 1995 until 2014. For the last thirty years, he has focused his research efforts exclusively on the field of Islamic finance. He has played a lead role in organising several conferences, workshops and symposia, including the Harvard University Forum on Islamic Finance and the annual workshop at the London School of Economics. He also led the effort that resulted in the publication of the world’s first academic software database covering the Islamic finance sector, the IFP DataBank http://www.ifpprogram.com/
April 2015

1: Global Investment Trends and Outlook for Islamic Financial Markets, Dubai
A one-day forum addressing the latest trends in Shariah-compliant investing, including global real estate trends, private equity funds, i-ETFs, REITs, wealth management and other asset management products. The keynote speaker is Dr Mark Mobius, Executive Chairman, Templeton Emerging Markets Group, Franklin Templeton Investments.
Contact: Florence Loo
Tel: +603 2162 7800 ext 43
Email: Florence.Loo@REDmoneygroup.com
www.redmoneyevents.com

13-14: The 10th World Takaful Conference, Dubai
The conference is titled ‘Revitalising the Industry: A New Way Forward for Takaful’. It will look at issues such as how the regulatory environment can better serve the takaful industry; what practical strategies can turn potential into real growth and how the industry can strike a better balance between risk transfer and risk retention.
Contact: Yasmeen Shah
Email: yasmeen@megaevents.net
www.megaevents.net

May 2015

18-19: 11th Annual World Islamic Funds and Financial Markets Conference, Bahrain
‘Addressing New Challenges and Opportunities for Islamic Investments’ is the theme for 2015. Among other topics to be discussed is the impact of the recent dramatic fall in oil prices and the significance of this for GCC countries in particular when they are looking at new sukuk issuance. It will also consider issues such as attracting more international investors to Islamic financial markets and strengthening liquidity.
Contact: Imran Vohra
Email: imran@megaevents.net
www.megaevents.net

19-21: 12th Islamic Financial Services Board Summit, Kazakhstan
The conference focuses on integrating Islamic banking with the global regulatory framework.

June 2015

2-4: 6th Annual World Islamic Banking Conference, Singapore
The pre-conference briefing on 2 June will be conducted by the IIFM (International Islamic Financial Market). It will review the technical framework designed to boost the growth of Islamic finance through standardised products and documentation. The theme of the main conference will be revitalising growth and setting the stage for the next phase of growth in Asia.
Contact: Imran Vohra
Email: imran@megaevents.net
www.megaevents.net

3-4: The London Sukuk Summit, London
Launched in 2007, the London Sukuk Summit is now in its ninth year. It will take place at the Jumeirah Carlton Tower Hotel in London. It will look particularly at issues that may change the sukuk landscape such as Basel III, the Islamic Development Bank’s plans to double its sukuk issuance and the Bank of England’s study into the feasibility of establishing a Shari’ah-compliant facility.
Tel: +44(0) 20 8200 9002
Email: info@icg-events.com
www.sukuksummit.com

10: Islamic Finance Prospects, Challenges and Potential Traction in Europe, Luxembourg
This one-day forum will focus on key growth markets in Europe; how Shari’ah funds fit in to the overall context of the European asset management industry; the impact of European regulation on Islamic finance and the growth of cross-border activity. The keynote address will be given by Pierre Gramegna, Luxembourg’s Minister of Finance.
Contact: Florence Loo
Tel: +603 2162 7800 ext 43
Email: Florence.Loo@REDmoneygroup.com
www.redmoneyevents.com
Access to Liquidity in Islamic Financial Markets

IIBI Monthly Lecture Series - May 2015

Introduction
Mr. Asim Khan began by saying that the Middle East has been playing a very important role in the development of Islamic finance. He observed that Islamic finance to date has been largely demand based, whereas conventional finance has always been there to fulfill needs.

The Middle East, particularly the GCC states, earn something in the region of $46 billion every day from the sale of oil. (This lecture was given in May 2014, before the fall in oil prices.) These funds need to be invested and over time the way these funds are being invested is more and more Islamic. It is, therefore, becoming important for all the conventional businesses operating in the Middle East or reliant on Middle Eastern investment to consider Islamic finance.

During the recent financial crisis liquidity in the US and Europe was significantly impacted. The problems were exacerbated by the introduction of Basel III with its stricter capital requirements. Over the last five years, therefore, a lot of conventional players – governments, financial institutions and corporates, have come into the Islamic market to tap Islamic liquidity.

The Evolution of Islamic Finance
In 1975 the Bahrain Islamic Bank and the Dubai Islamic Bank were set up in the Middle East. Initially the focus was solely on commercial banking and some syndications. From 1991 onwards asset management and private equity entered the Islamic space. It was only from 1991 that Islamic capital markets came into existence and the term ‘sukuk’ was heard for the first time.

Key Factors for New Entrants to Islamic Finance
• Islamic finance is open to everyone.
• Islamic finance is transaction focused, rather than counterparty focused unless you are looking at equity assurance, i.e. as long as the transaction is Shari'ah compliant, the counterparty does not need to be Shari'ah compliant.
• Islamic finance is perceived to be very restrictive, although this is not actually the case. It is principle based and has certain restrictions.

IIBI NEWS

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prohibitions, but as long as you steer clear of those prohibitions, it can do everything else.

**Key Factors in Islamic Transactions**

- The transaction needs to make economic sense for all the counterparties.
- The purpose of the transaction should be Shari'ah compliant. For example, if you are trying to open a casino it would be very difficult to find a Shari’ah-compliant solution.
- The underlying asset and the method of executing the transaction should be Shari’ah compliant.
- The legal documents that support the transaction’s structure need to be Shari’ah compliant and be enforceable.

**Key Factors in Raising Capital**

- Who is the obligor – a company, a financial institution or a sovereign and do they have a track record? Well-established obligors will inspire more confidence in investors.
- What is the proposed use of the funds to be raised?
- How much funding is to be raised and what is the maturity?
- What is the underlying asset/collateral? Critically what is the jurisdiction? There are some new and upcoming jurisdictions to which investors may not wish to be exposed. For example if a US company is trying to undertake a project in a very small, emerging country, where the investors feel they cannot rely on the legal framework in the country where the asset is located, that can be a challenge.

Investors will be concerned about getting hold of the asset and liquidating it and the time that might take in cases where something goes wrong.

- In which jurisdiction are existing lenders located?
- What are the obligor’s future plans in relation to funding? Any plans for future fund raising will have a significant effect on the sales strategy.

**Factors for the Client to Consider**

**Understanding the Local Framework**
There are two aspects to understanding the local framework. First where is the company based; where is it incorporated? Second, where is the asset based and if the collateral is in a third jurisdiction, where is this? The regulatory requirements and tax in all the jurisdictions must be considered.

The structure is also important. Some structures in certain jurisdictions have tax advantages.

**Developing the Structure**
An important aspect of developing the structure is identifying the Shari’ah advisor, because he becomes a key member of the team. Who are you going to appoint and what is their experience?

The target market is also important, because the Shari’ah board that will have to approve the fatwa, must be acceptable in those chosen markets. For example, if a company is trying to sell a transaction in Saudi Arabia and you have a fatwa approved by scholars in the GCC, unknown in Saudi Arabia, it will not be very successful.

The regulatory framework needs to be considered when choosing the structure. For example there are certain jurisdictions that facilitate murabaha, whereas an ijarah transaction would be heavily taxed.

The legal advisors appointed for the transaction should be internationally acceptable, but local legal advice may also be required. For example, with a Saudi Arabian transaction most of the legal documents will be drawn up under English law, but certain aspects of the transaction will relate to the asset, which is based in Saudi Arabia and will be subject to Saudi Arabian law. The client will, therefore, need a legal firm in Saudi Arabia to provide legal opinion on Saudi law and an international law firm providing an opinion on English law. The client, therefore, needs to consider whether the legal advisors are represented in a local jurisdiction either through their own subsidiary or through an affiliate.

Islamic legal documents tend to be very different from those for a conventional bond. For example, the legal documents for a conventional bond do not need to state the use to which the finance will be put, but purpose needs to be disclosed in sukuk. There will be ongoing Shari’ah monitoring to ensure that the obligor does use the funds for the purpose stated in the legal documents.

Pre-marketing is an essential tool in developing the structure and assures the obligor that the eventual product is likely to have a high degree of acceptance. Once there is a structure and before it has been finalised, it is vital to approach a handful of potential investors and discuss that transaction on a no-names basis. The discussions will involve the jurisdiction, the structure and the key aspects of the transaction. These investors will then be asked for feedback on the coupon, the acceptability of the collateral and the structure. If those investors say they are not interested, the obligor needs to find out why and what they can build into the structure to make them interested.

That is the stage at which credit enhancement comes into the equation.

**Sales and Distribution**

It is important for the obligor to identify with whom they want to partner. The partner needs to have a decent track record in the jurisdiction involved.

The sales team needs to understand the Shari’ah aspects of the transaction. Mr Khan said that this is the aspect that has given his own organisation, Khalij Islamic, the greatest grief over the last three years. There have been certain products in which Khalij Islamic have been involved where a third party or the obligor’s own in-house sales team has taken on the sales role, but when they went to Islamic investors they flopped, because selling Islamic products is very different from selling conventional products. For conventional bonds the salesman only needs the term sheet; he is selling the return, the credit risk and the maturity. When you meet an Islamic investor, the first question that will be asked is ‘who are the scholars that approved the structure?’ The second question is then going to be what is the structure?

These are questions to which a conventional sales team has never been exposed and if these questions cannot be answered, the result will be no sale. It is, therefore, essential to have someone who understands and can explain these issues at the point of sale. Some very good products have failed when these issues have not been understood.

The final point is the importance of ongoing oversight of Shari’ah
IIBI LECTURES

June: Shifting from Murabaha to Mudarabah Based Finance

Introduction
Mr Raza, Managing Director of IFAAS, said that the challenge Islamic finance is facing is its significant growth, but, at the same time, Islamic banks are relying on murabaha/commodity murabaha/tawarug solutions to avoid risks associated with mudarabah, musharakah and to some extent wakala. Murabaha is a very straightforward, Shari'ah-compliant sales contract, however, when it is used in a certain way, in tawarug, reverse murabaha or commodity murabaha, its compliance with the spirit of Shari’ah becomes rather controversial and questionable. Due, however, to certain limitations the industry has faced over the last 20 30 years, banks have favoured murabaha, which is quite close to conventional banking products offering fixed rate returns.

Islamic finance products need to fulfil the spirit of Shari’ah, as well as meeting client needs, being competitive in the market and profitable. The industry, however, has to move on and so there is a move to develop products based on mudarabah, musharakah and wakala.

The Problems with Traditional Mudarabah
Mudarabah is a partnership agreement, where one party provides the capital (rab ul-Mal) and the other party provides the labour, work or expertise (mudarib). This type of contract is very much preferred from the Shari’ah point of view, because the majority of scholars believe this represents the true spirit of Islamic Shari’ah, however there are issues that make the banks reluctant to use it for three main reasons.

Moral Hazard
There is a high probability of fraud or falsified financial disclosures, because the financial institution is only providing the capital and the client is deploying the funds and has no financial input into the structure. The possibility of the client committing fraud by, for example, having one set of books for the tax authorities, one for the bank and one for themselves, is high. Mr Raza said that such practices have been seen in the Islamic finance industry. He cited an example from his own experience, where a London-based Islamic lender had been persuaded to try out mudarabah. The client, a high-street retailer, presented a balance sheet showing the costs of running the business going up and income falling resulting in a loss, which the bank as rab ul-mal has no choice but to accept.

Agency Problems
When the money is coming from a third party and the client has no financial stake, the client tends to become more aggressive in their risk taking; they do things they would not do if their own money was at stake. They also start to make uninformed decisions.

Adverse Selection
Mudarabah is a profit-sharing instrument, but clients sometimes see it as a loss-sharing instrument. When an organisation is anticipating a profit, they will go to a conventional financial institution and take out a fixed rate loan. When, however, they are anticipating a loss they may go an Islamic lender and try to get a mudarabah agreement, because they know they will then be able to share the losses with the lender. Islamic lenders need, therefore, to be very careful and vigilant about how they select their clients.

A New Mudarabah Solution
In response to these problems IFAAS has developed a new solution. IFAAS has looked critically at the limitations and problems of traditional mudarabah and has developed a new mudarabah solution that meets the needs of clients and complies with Shari’ah principles.
at the three problems outlined above and ways to control them, while keeping strictly to the requirements of mudarabah.

The solution allows the client to use any amount of funds up to an agreed limit as either working capital or as an overdraft facility; risks are reduced by control functions that have been embedded in this solution and it is efficient reducing transactional costs inherent in certain instruments.

There are, of course, some limitations. The solution is targeted mainly at well-established, medium and large-sized businesses with a proven track record and a good accounting structure in place. This solution is not for individuals raising a personal loan, nor for start-up businesses or small businesses that lack a robust accounting structure.

How the Process Works

The client will approach the bank and following due diligence an agreement will be reached on the borrowing limit and the profit-sharing arrangements. They will also reach agreement on the expected profit rate, because mudarabah by its very nature cannot guarantee a specific return.

The facility is made available to the client and can use the bank’s funds up to the agreed limit, as and when required. The bank will send a monthly statement to the client showing the amount of the facility used during the month and the advance profit. Under the IFAAS solution the client will be asked to pay the agreed expected profit rate for that month in advance of the mudarabah’s maturity, when the final calculation will be made. If at that time the profit does not reach the expected rate, the bank will have to return any over payments to the client.

The client will also be required to send the headline figures from the quarterly management accounts to the bank and a statement about the achievability of the expected profit based on current business performance. The IFAAS solution contractually obliges the client to send these documents to the bank, which is why it is important for the client to have a robust accounting structure, because without it they will not be able to fulfil this requirement. This proactive approach is designed to ensure that they can be stopped before they go into a loss-making situation.

The Profit Calculation

Profit will be calculated in three stages. In the first instance, say the facility limit granted was £40,000 and the mudarabah profit-sharing ratio is 99% for the bank and 1% for the client, if there is a profit. The bank, however, is expecting a profit rate of 5%. The client’s existing business already has assets deployed in the business and they are generating profits and this capital consisting of the current assets – cash and inventory, not the fixed assets – will be taken into account.

What will happen then is, say the client has drawn down £30,000 out of the possible £40,000 and their own capital is £70,000, the total capital of the mudarabah becomes £100,000. Say the gross profit for the period is £10,000, the gross profit will be split according to the capital ratio, so the client will get a £7,000 share of the profit and the mudarabah profit will be £3,000. The mudarabah profit will be shared according to the capital ratio, so £30 for the client and £2,970 for the bank, which is way above the 5% expected profit rate.

If the bank takes that £2,970 from the client, the product is simply not viable. IFAAS have, therefore, created a profit stabilisation reserve. At a profit rate of 5% for a £30,000 loan, the profit going to the bank should be £1,500, so the client pays £1,500 to the bank and the balance of £1,470 will be put into a profit reserve, which is retained by the client to use or not as they see fit, but if the profit rate falls below the expected rate of 5% later during the period of the mudarabah the bank can call on that reserve in its entirety or in part. The client will have the obligation of paying the reserve to the bank if there are any losses and this debt will take priority over any other debts the client may have.

Controls

There are controls around this structure. Firstly, the client’s business must be an established business with a good track record and a robust accounting system including projected accounts. Second, there will be ongoing monitoring through quarterly accounts, which will have to be presented to the bank. Third, there will be a stream of monthly income to the bank. This is unlike most other mudarabah agreements, where a lump sum is payable at the end of the term.

There is also a control designed to reduce any potential loss. Under the contract the client will be unable to sell their goods or services below cost. This is critical, because that is where the majority of the fraud and moral hazard lies. We understand that in some businesses, such as those dealing in perishable goods, there is a need to sell products before they go off. In this case the client, under the contract, must inform the bank that they are going to sell at below cost. The profit calculation is strictly based on gross profit, so that the client cannot manipulate the accounts by artificially inflating expenses. This again is aimed at reducing moral hazard.

In Conclusion

We believe this is a Shari’ah-compliant, commercially-viable and practical solution. From a risk management point of view we have made it a contractual obligation not to sell the goods or services below cost price thus minimising fraud and moral issues; the use of gross profit rather than net profit also minimises fraud and the creation of a profit reserve to offset losses or lower than expected profits is a further protection for the lender. These controls can be used not only in mudarabah, but in any sort of transaction, for example musharakah or wakala.

The benefits for the customer are that it is very convenient to have an agreed facility that can be used as and when required. It is very flexible in that it is not tied to financing, say a certain item of equipment; it can be used for anything in the customer’s business. It is very easy; there are no complex procedures to follow. The customer is simply required to submit four or five headline figures from their monthly or quarterly accounts.

The benefits for the bank are that it requires minimal management – perhaps 15 minutes a month to review the accounts submitted by the customer. It also allows Islamic banks to be very competitive with the conventional market, by getting rid of all the onerous transactional costs of murabahah. The risk profile is also much more moderate, because of the profit reserve and also a regular income.

This product has already been implemented in a number of banks. It has received Shari’ah approval
October: Waqf – An Instrument for Shari’ah-Compliant Raising of Capital

Farrukh Raza is the founder and managing director of IFAAS (Islamic Finance and Advisory Services). He has considerable experience advising key stakeholders and regulatory authorities on developing the regulatory, legal and tax frameworks for implementing Islamic finance in several markets. He has held senior roles at Islamic Bank of Britain, the first Islamic bank in Europe and also played a key role in rolling out the first takaful company in Europe. He holds an MBA in Strategic Management and is a member of the Chartered Institute of Marketing (UK). He is also a member of the UKIFS, Islamic Finance Experts Group (UK), Islamic Finance Commission at Paris Europlace (France), Business & Economics Committee of Muslim Council of Britain (UK) and Mosaic Network of The Prince’s Trust (UK).

A History
Mr Benedikt Koehler explained that waqf provide welfare in its widest sense in Islamic communities. He said that he believes waqf were a tremendous financial innovation, notwithstanding the fact that welfare can be traced as far back as ancient Babylon. There is in fact a legal deed dating to 1,300BC for the endowment of a temple building and there were probably deeds before that.

How did provision of welfare work in Islam? The operative text is the Qu’ran, which has quite a lot to say about providing welfare, usually using the term zakat. It explains how people are supposed to raise money for zakat and what its purposes should be, but the Qu’ran does not mention waqf. Many scholars argue, therefore, that waqf do not go back to the very beginnings of Islam, but Mr Koehler said he disagreed.

Muhammad (pbuh) was born in Mecca; left Mecca and set up his own community in Medina. The community was expanding and in 628 he launched an expeditionary task force that occupied Hudaybiyyah, which had a lot of land. Why is this important? In previous raids and conquests, the booty was in the form of mobile property, but the occupation of Hudaybiyyah changed everything at a stroke, because now the community was in control of land. Land yields an agricultural harvest year after year, what an accountant would describe as recurring income from a capital asset. This has very different implications from taking control of a moveable asset that you can sell.

After a battle or conquest Muhammad (pbuh) was in the habit of distributing bonuses to people who were close to him. One of his key companions was Umar, a critical figure in the development of Islamic economics. When he received gifts of land from Muhammad (pbuh), he asked what he ought to do with it. Muhammad (pbuh) suggested he should use it for zakat, so four years before Muhammad (pbuh) died there is evidence of the first waqf for zakat.

Why does that matter? It matters because of the claims that waqf was something bolted on to Islam at a much later date. It was not.

Muhammad (pbuh) was not the only economist and innovator at that period. The people who surrounded him were active in taking his ideas forward. Umar, who vested the first waqf, has already been mentioned, but there was also Abu Bakr, the first caliph. When he reached that stage in life when he was settling his affairs, he also used waqf and designated its beneficiaries, his wider family. Effectively he set up a family trust. These two types of waqf – public welfare and family trusts are bound by the legal agreement. Between the donor and the beneficiary, there was a manager who made sure the funds were used as the donor intended.

Waqf have parallels with trusts, but Mr Koehler maintained that was because trusts derive from waqf. For example, waqf operated in Jerusalem; many Europeans came to Jerusalem and it is easy to see how the ideas embodied in waqf were spread and morphed into trusts. In both cases there are trilateral arrangements and legal agreements that bind the participants. This is totally unlike a simple donation to a good cause.

The managers of both waqf and trusts are bound by the legal agreement to do certain things and, indeed, to avoid doing certain things according to the wishes of the donor as expressed in the legal agreement. Neither the manager, the lawyers responsible for drawing up the agreement nor the donors can unilaterally vary the terms of that agreement.

The introduction of waqf had widespread ramifications for civil society in the Middle Ages. It stimulated civil creativity that could express itself through legally protected assets that funded innovative activities. There is a corollary to this. The more philanthropy is managed by the private sector, the less is the requirement for the public sector, the state, to be involved in welfare. It is easy to see how waqf became one of the engines of urban growth in Muslim cities.
In summary, waqf date back to the very beginnings of Islam; they were outside state control; they were commercial entities deriving income from farms or shops and like corporate taxes today, the use to which these funds were put was public welfare.

In the 19th and early 20th century the assets of most waqf were nationalised. (At the end of the Ottoman Empire two-thirds of arable land was in the hands of waqf.) The result has been that today waqf are used very generally to provide welfare by both the public and private sectors.

The Present
Two of the ways in which waqf today are used today are in microfinance and in insurance.

Microfinance
Most people understand microfinance and are generally aware of the social issue involved, which is one of social exclusion. There are many reasons for social exclusion, but one of them is lack of finance for people who are on the fringes of society. There are several reasons why these people have difficulty accessing funds. For example it is much easier for a lender to build up a loan book by lending to a few big borrowers than many, very small borrowers resulting in high unit costs. Poor people are also more likely to default on their loans.

Concessionary lending to the socially excluded, however, goes back as long way. In London, in 1361 a bishop set up a bank to lend at zero interest, but the biggest sector for concessionary lending in Europe in the Middle Ages was in Italy. These movements were called Monte di Pietà and were backed by the Vatican. They were very similar to waqf.

Today, typically, concessionary banks include supranational banks such as the World Bank and the Islamic Development Bank. It is evident, therefore, that waqf are not the only way of reaching out to the socially excluded.

How do you link concessionary lending and waqf? It is possible to see how banks could offset the higher costs of lending to the socially excluded through a waqf, thus avoiding the need for punitive rates of interest on small, risky loans.

Insurance/Takaful
Insurance is a very complicated business. It is a business where participants raise funds in the form of premiums from individuals or organisations who want to protect themselves against the possibility of certain adverse events occurring. The insurers invest those premiums to derive an income, which will build up a reserve against the possibility of having to pay out when one of those possible adverse events occurs. The insurers also have equity, money raised from shareholders, which they use in the same way as premiums.

Takaful is very similar to an insurance company that is a mutual rather than a PLC. In this case the people who are insured are stakeholders. This is another instance where a waqf can be used, but it takes waqf into a new arena. The classical waqf had income coming in from commercial activities to be used for a strictly defined charitable purpose. Here the concept of the waqf has been extended, so that the mutual company itself provides welfare by sharing risks.

In Conclusion
The key date for waqf is 628 when Muhammad (pbuh) and his companions invented the concept and established the principles for the two key forms of waqf – providing public welfare and family trusts. This was a legal innovation that anticipates trusts by several centuries. Although it has never been proven, there is circumstantial evidence that trusts actually derive from waqf.

In compliance with Shari’ah guidelines waqf became very important instigators of growth in medieval cities in the Middle East and in Islamic societies.

These cities were organised very differently from those in Europe.

Waqf were largely nationalised in the 19th and 20th centuries and have now taken on new connotations with two specific areas – microfinance and insurance/takaful – where they have been out to use.

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Benedikt Koehler, now retired, spent his career involved in financial innovation in both the City of London and as a former economic adviser in the UK government. In retirement he has turned his attention to the history of finance and has authored several books on both conventional and Islamic finance including Early Islam and the Birth of Capitalism published in 2014. He was educated at the Universities of Yale and Tübingen.

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November: The Shari’ah Compliance Audit in Islamic Banking

Defining Shari’ah
Mr Alamad opened this lecture by defining Shari’ah compliance. Shari’ah is the divine law as revealed in the Qu’ran and Sunnah, the prophetic traditions of Muhammad (pbuh) consisting of his sayings, practices and tacit approvals and disapprovals of the actions of his companions at that time. That leads us to the sources of Shari’ah, which are important, because they are used by Shari’ah scholars and Islamic jurists to extract Shari’ah rulings or address issues in relation to Islamic finance. They will refer, first and foremost to the primary sources, the Qu’ran and the Sunnah and also to secondary sources.

The Qu’ran and Sunnah contain the constant rules that do not change and are unaffected by time or place. For example, the Qu’ran states clearly that usury is prohibited. There are also some flexible Shari’ah rulings that Islamic scholars can use to address new issues.

Sunnah as a primary source of Shari’ah addresses some of the issues raised in the Qu’ran and expands on them to some extent. It provides the tools to address new issues raised by Islamic finance.

The secondary sources of Shari’ah are contained in Ijma, which is the consensus of qualified scholars. There are some Islamic bodies, which to
some extent represent the concept of Ijma such as AAOIFI and the Islamic Fiqh Academy. Both of these bodies comprise Islamic scholars representing the Muslim world. They meet on a regular basis to discuss new issues that they need to research and make Shari’ah rulings about them. As a result of their activities around 50 standards have been issued by AAOIFI regarding Islamic financial institutions. Those standards, however, do not address every issue that Islamic banks may face. For example, Islamic banks operating in the UK may face issues different from those faced by their counterparts in the GCC or Malaysia. It is then the role of the bank’s Shari’ah supervisory committee to address those issues based on the constant Shari’ah rules set out in the Qur’an and Sunnah.

Another instrument is analogical reasoning or qiyas. It is based on taking an existing issue in the Qur’an and Sunnah, analysing the rationale of this issue and comparing it to the new issue. If the new issue has the same rationale as the existing issue, it will have the same ruling. Take for example the drinking of alcohol. It is clearly forbidden in the Qur’an and Sunnah. Scholars at the time explored the rationale for forbidding alcohol and concluded that intoxication led to people being unaware of their surroundings, becoming aggressive, etc.; drinking alcohol has negative consequences. The Qur’an, however, recognised that there are some benefits. People trade in it and make profits, but the harm coming from drinking outweighs these benefits and that is why Muslims were forbidden to drink alcohol.

Today there are different kinds of drugs such as heroin and cocaine, but there is no specific ruling in the Qur’an or Sunnah regarding these drugs. When the rationale was examined, however, it was very similar to alcohol, so scholars applied the ruling relating to alcohol to drugs.

Qiyas could be used in Islamic finance to deduce a Shari’ah ruling say for new products. Islamic banks, for example, have to manage risks. Conventional banks use interest rate swap agreements to manage risk, but on the basis of qiyas Islamic banks cannot use these because of the ban on riba.

There is also ijtihad or personal interpretation. That is basically the ijtihad of a bank’s Shari’ah supervisory committee relating to a particular issue. The committee will issue a fatwa for the bank to follow.

There are some other secondary sources which say that if there are benefits to be derived from a products or service, a social good and there is nothing in Shari’ah specifically forbidding it, then that will be permitted.

Two Types of Shari’ah
Islamic jurists define Shari’ah into two types. The first is called fiqh or jurisprudence and defines the relationship between man and God. The other type relates to transactions, buying and selling and that is the one that relates to Islamic finance.

The difference between the two is that Shari’ah is the law and jurisprudence or fiqh is the understanding of this law. To take a simple example, the NHS bill currently negotiating its way through the UK Parliament will eventually become a law, but that law will not address every single detail of the day-to-day operation of the NHS. When it passes into the hands of NHS Trusts for implementation, they will interpret how this law will affect each Trust and its practices. Shari’ah operates in a very similar way.

Shari’ah Governance in Islamic Banks
The chart below shows the Shari’ah governance structure for an Islamic bank.

The Shari’ah supervisory committee will usually consist of at least three scholars, who are experienced in the field of...
Islamic financial transactions and in Shari’ah. This is an independent committee; it does not report to the board, the management committee, the executive or anyone else in the business.

There is also a Shari’ah compliance department and that too does not report to anybody in the business. Their direct report is to the Shari’ah supervisory committee. The Shari’ah compliance department monitors the day-to-day operations of the Islamic bank, advising senior management and the different operational departments on Shari’ah and any issues. Part of their role is to conduct a Shari’ah compliance audit. Effectively this means that Islamic banks have an extra layer of compliance compared to conventional banks.

**The Concept of Shari’ah Compliance**

The concept of Shari’ah compliance is nothing new in Islam; it dates back to the time of the Prophet (pbuh) more than 1,400 years ago. It is known as al-hisbah and it is in the Qu’ran in Surah al Nisa, verse 82. At the time of the Prophet Muhammad (pbuh), he was the point of reference and he conducted the supervision of markets himself. For example, he was once in a market and saw a man selling wheat. He put his hand in the sack of wheat and found that it was wet. He asked the seller what was wrong with his wheat. The man said it was wet because of the rain. Obviously wet wheat weighs heavier than dry wheat, so it was a way of cheating. The Prophet (pbuh) said, ‘Whoever cheats is not of us’. This is one of the constant rules of Shari’ah and it is very important in Islamic finance, because, if Islamic banks try to mislead their customers or give them a product that is not suitable for them, it is a form of cheating. Auditors need to be aware of such things in any product offered by Islamic banks. The task of market supervision continued after the time of the Prophet (pbuh). In the first instance it was his companions, the caliphs, who used the same methods to supervise markets. There is one famous story about a mother and daughter who used to sell milk. One of the caliphs, Umar overheard the mother telling the daughter to add water to the milk. The daughter replied that they should not do that. The mother responded that Caliph Umar was not there, but the daughter said, ‘but God is seeing us’.

It is not just about supervision; it is the conscience of people working within the Islamic finance industry that is important. Supervision can achieve the objective to a certain extent, but if people in Islamic finance are not trained to the right level and made aware of the extent of compliance with Shari’ah and ethical values, they will not have a conscience. This is the problem with the banking system. If we have a banking system with the right ethical values, we would not be where we are now with all the banking scandals and crises.

Part of the Shari’ah-compliance framework is that people joining an Islamic bank must have Shari’ah-compliance training, so that they are aware of the values and ethics to be observed. It is a bank’s duty to train them, because you cannot hold them responsible if you do not train them. After that time the concept of hisbah or market supervision started to be more constitutionalised. The state became responsible for supervision. The supervisor would be chosen by the state on the basis of certain qualifications, which were similar to the qualifications of Shari’ah scholars or jurists, who need to understand Shari’ah and assess what is right or wrong in the market. When Islamic banks began to emerge 40 years ago, there were no established rules about how Islamic finance should operate and so they needed supervision in the form of a Shari’ah supervisory committee and an internal Shari’ah compliance department to work with the bank’s management and staff on a daily basis, guiding them and ensuring there is a Shari’ah risk.
Shari’ah-compliance needs to find a middle way between being too lax and overly inflexible

framework in place. The biggest risk for Islamic banks is Shari’ah non-compliance.

The concept of Shari’ah supervision is based on the Shari’ah ruling of commanding the good and forbidding the bad, but that can only be done by qualified people. That is why Islamic banks have to have this sort of governance framework.

Shari’ah Compliance Audits

The term Shari’ah compliance audit is a new term and it is derived from the concept of hisbah. The Shari’ah audit process is similar to the normal internal audit process, although they are two different functions with the Shari’ah audit covering issues not covered by the normal audit.

As the graphic shows, the Shari’ah audit process starts with a plan. The audit is then carried out and the findings and recommendations are discussed with a view to strengthening Shari’ah compliance. The findings are then discussed with the Shari’ah supervisory committee and finally there are follow-up discussions with management and the different departments in the bank. This is a continuous cycle.

The findings will be classified as good, satisfactory, room for improvement or unsatisfactory. To be classified as good the bank must be able to demonstrate a proactive approach that identifies issues before they become problems.

Shari’ah Compliance Audit Methods

The first method is financial concentration of undertaken financial transactions. Let us say the bank concentrate on commercial property finance, particularly big deals. This is an area where there might be short cuts or errors on which the auditor can focus.

The second method is typical and untypical transactions. A current account is fairly automated and so manual involvement is minimal. This process would be initially signed off and approved for Shari’ah compliance. It will be audited, but the auditor will focus on untypical transactions, e.g. products that are tailored for particular customers, because they are more prone to breaches and errors.

The third method is core and business methods. If a bank, as many financial institutions do, outsource to a third party, the likelihood of breaches is greater than in internal processes, so there is a good reason to focus on this type of transaction.

The Scope of the Shari’ah Compliance Audit

The main scope of the Shari’ah audit is to review all contracts and agreements within the scope of the Shari’ah compliance audit, all regular reporting, internal communication between the department being audited and other business areas, investments and the associated documentation being managed by the department being audited, reports from internal and external auditors, invoices and purchase orders, foreign exchange transactions, investment certificate transactions, review of all shares being purchased, profit calculation and distributions for investment clients and shareholders (this is a particular issue as core banking systems work around the concept of interest payments and the basis of calculation in Islamic banks is obviously very different), disposal of non-Shari’ah-compliant income, review of expenses and fees charged, ensuring new and amended products are signed off and a review of all procedures and policies.

Main Challenges

Regulations in the UK are issued for banks in general. It may, however, be difficult for Islamic banks to comply with some of those regulations. Mr Alamad said that banks had been able to raise some of these issues with the regulator and develop a solution that has then been incorporated into the regulations. There are also legal challenges.

Market constraints are another factor that affects Islamic banks. For example, conventional banks can charge redemption fees of 2-3% on a mortgage; Islamic banks cannot do this, because the structure that they use for home finance is different.

At many conferences attendees will hear speakers say that Islamic banks should incorporate Shari’ah objectives, Maqasid, in their products, but they do not tell you how to do this. For example, one Shari’ah objective is protecting the religion of Islam. By offering Shari’ah-compliant alternatives to conventional banking products, Islamic banks are effectively meeting this objective.

Another key challenge is developing the next generation of experts. If we do not have the right experts, Islamic banking will not grow in the right way or at the right pace.

Liquidity is also a big issue for Islamic banks. This is one that is being addressed with the regulator.

Finally, Shari’ah-compliance needs to find a middle way between being too lax and overly inflexible. Scholars and other experts need to understand both Shari’ah and the way the financial system works to understand how best to implement Shari’ah in the world of finance.
On the Move

**Bahrain Islamic Bank** (BisB) has appointed **Mohammed Ahmed Hassan** as Acting CEO in place of Mohammed Ebrahim Mohammed who resigned from his job as CEO starting 1st September 2014. Mr. Mohammed Ahmed Hassan is a veteran banker with 40 years’ experience. He joined BisB in 2007 as GM Support after assuming various leading roles in NBB, Al Baraka Bank and Gulf Air.

**Al Baraka Banking Group** B.S.C (ABG) has announced the appointment of Mr. Mohammed Abdullah El-Qaq as a Senior Vice President and Head of the Commercial Banking Department. He brings more than 22 years of commercial and finance industry experience of GCC and Middle Eastern markets to ABG.

**Qatar International Islamic Bank** (QIIB) has announced the appointment of Mr. Ehab Eshehawi as Chief Operating Officer. He has more than 25 years’ experience in managing technology and operation in the US, Europe, Asia and the Middle East. The last 15 years were spent at the Arab Banking Corporation and Ahli United Bank.

**National Bank of Oman** has announced the appointment of His Excellency Abdul Rahman bin Hamad Al Attiyah and Mr. Mohammed Ismail Mandani Al Emadi to the Board. HE Abdul Rahman bin Hamad Al Attiyah is now a member of National Bank of Oman’s Board Risk Committee (BRC) bringing a wealth of experience and expertise to the role. He is currently Minister of State for Qatar and, since March 2014, sits as a member of the board of The Commercial Bank of Qatar.

**Kuwait Finance House** (KFH) has appointed a new CEO, Mazin Saad Al-Nadedh. He has more than 21 years’ experience in the banking industry. He previously held several positions at the National Bank of Kuwait. He holds a degree in Business Administration (Finance) from the University of California.

**Al Rayan Bank**, formerly known as Islamic Bank of Britain (IBB), has announced the appointment of Tim Sinclair as Senior Head of Marketing and Retail Sales. The appointment of Mr. Sinclair to the newly created post recognises his achievements during his three years as Head of Marketing at Al Rayan Bank. In his new role, Mr. Sinclair will continue to oversee Al Rayan Bank’s marketing team. He will also be responsible for the Bank’s branch and agency network, its contact centre and customer excellence team, as well as its intermediaries and community banking teams.

**Kenya’s KCB Group** has appointed three banking experts to run the Bank’s Shar‘ah Advisory Committee as part of their roll out of Islamic banking services in Kenya. The scholars and religious leaders are Sheikh Ahmed M Msallam, Sheikh Ibrahim Lethome and Dr Ahmed Sheikh Abdulatif Osman.
Takaful Investment Portfolios: A Study of the Composition of Takaful Funds in the GCC and Malaysia

By: Abdulrahman Khalil Tolefat and Mehmet Asutay. Publisher: John Wiley & Sons (2013)
Reviewed by: Camille Paldi, CEO, FAAIF Limited and Events DMCC
Managing Director, ilovetheuae.com

The study may also reveal gaps in the asset classes for the takaful industry. After conducting a thorough analysis of the investments of takaful funds of the GCC and Malaysia from 2002-2005, the author concludes that convergence is likely in the investment behaviours of takaful companies in the GCC and Malaysia once the primary and secondary markets for sukuk develop in the GCC and an international regulatory framework is practiced. This book may be highly useful and relevant for students and academics and those practitioners wishing to get a glimpse of past industry trends.

Chapter 1: Introduction provides an overview explaining the rationale for the research aims and objectives, scope and delimitation and research methodology.

I enjoyed the academic and scholarly discussion of the takaful concept in Chapter Two: Insurance and Islamic Law: An Introduction to Takaful. There are some interesting references to the Qu’ran and Sunnah as well as to scholars of the past. I prefer, however, to see more of the author’s original opinions rather than heavy reliance on other authors. Furthermore, I want to see an explanation of the cited statement as the author is relying on another author to relay his point. For example, in Chapter Two, the author writes: ‘Moreover, it is also claimed that commercial insurance leads to negligence (Moghaizel, 1991), murder (Al-Sayed, 1986; Hassan, 1979) and is exploitative of people’s needs (Mawlawi, 1996) and that the control of government may fall to powerful insurance companies (Abdu, 1987).’ I would like to see some kind of original and authentic explanation of this statement from the viewpoint of the author. For instance, how does commercial insurance lead to negligence, murder and exploitation? Furthermore, why and how would control of government fall into the hands of powerful insurance companies and what then would these insurance companies do with the government under their control? In addition, it is always an interesting scenario to witness secular-trained academics incorporating religion into their work. The religious references are presented in quite a secular and neutral manner, which makes the book quite easy to understand and digest by anyone whether they are religious or not.

Chapter Three contains a comprehensive academic explanation of the various takaful models. In addition the author explains the differences between takaful, commercial and mutual insurance and trends and developments in the takaful industry. The entirety of Chapter Four discusses research methodology, which is geared for academics rather than industry practitioners.

Chapter Five on Exploring Investment Behaviours and Investment Portfolios of Takaful Operating Companies in the GCC and Malaysia is where I finally found the hidden treasure. The chapter is full of interesting facts and figures, analysis and comparisons regarding the investment of takaful funds in equities, sukuk, and real estate in the years 2002 – 2005. This information, however, may or may not be indicative of present and/or future trends as we are now in 2015, ten years past the period of this study. It is, however, interesting information and may be useful to academics. This book may also provide a rough idea on how to perform a feasibility study at the inception of a takaful company in a particular jurisdiction or geography or serve as a guide in conducting another similar academic study.

Although Chapter Six: Locating the Differences Between Actual and Desired Investment Portfolios contains some interesting discussion about the actual and desired investment portfolios of the GCC and Malaysia, I found that much of this chapter could be skim read and probably should have been deleted from the book.

In Chapter Seven: Contextualising the Findings, the only pertinent information includes the discussion on how takaful funds manage their liquidity and the figures for return on investment for the GCC and Malaysian Takaful Funds for the period 2002-2005.
Chapter Eight: Conclusions and Recommendations provides recommendations for regulatory authorities, takaful operating companies and Islamic banks/ windows. I found these quite interesting and highly useful especially in regard to who should be making the investment decisions and the need for more legislation and regulation of the takaful industry in the UAE and globally. The author also explains the research limitations in this study. The author states that focusing the research only on the initial period of the takaful industry during the years 2002-2005 could perhaps be considered a shortcoming. Furthermore, the author explains that another limitation may lie in the sample size that was chosen. The author says that the sample is so small – less than 30 companies – that parametric statistical tests could not be used in this study. Second, even using nonparametric statistical tests, the small number of takaful companies operating in Malaysia limited the author to performing a comparison between the GCC and Malaysia. This can be seen where the author tried to study the differences between levels of actual and desired investment portfolios between the GCC and Malaysia. The author was not able to adopt the Wilcoxon Signed-Rank Test for Malaysian companies.

GUIDELINES FOR INVESTMENT MANAGEMENT FOR TAKAFUL OPERATORS
(The following is based on a paper produced by the Islamic Banking and Takaful Department at Bank Negara Malaysia)

The approach for investment management adopted by each takaful operator may vary depending on a wide range of factors, including the size, level of sophistication and complexity of the takaful operator's investment activities. Basic principles such as accountability and responsibility of the board of directors and senior management are needed for robust risk management policy and adequate monitoring and controls by all takaful operators.

- Takaful operators should ensure that the objectives, management and activities of investments comply with Shari’ah principles at all times.
- Takaful operators should have in place investment and risk management policies describing the overall investment framework. The overall investment policies and strategies should be communicated to all staff involved in investment activities.
- In developing the investment strategy of the takaful fund, takaful operators should take into account the reasonable expectations of participants and that the investment strategy is consistent with the disclosure made under the respective products.
- Due to the different nature of the liabilities, takaful operators should have separate investment strategies for family and general takaful business in situations where both businesses are undertaken by the same entity. For family takaful business, takaful operators will also need to consider separate investment strategies for participants’ investment funds and participants’ risk funds due to potential differences in objectives of both funds. The investment strategy for participants’ risk funds would need to take into account the ability of the fund to meet takaful liabilities. The investment strategy for the participants’ investment fund would need to take into account the ability of the fund to meet future tabarru’ deductions and reasonable expectations of an investment return as well as consider whether certain products need to have a specific investment strategy which is commensurate with the risk and liability profile of such products.
- Takaful operators should have a comprehensive risk management framework that include, amongst others, the setting of investment strategies and policies, developing an oversight mechanism with appropriate review and monitoring and control procedures. The risk management framework must also cover the risks associated with investment activities that may affect the coverage of takaful liabilities and capital positions. The main risks include market, credit and liquidity risks.
- Takaful operators should have in place clear governance procedures over investment decision-making processes and ensure a proper segregation of duties to ensure sufficient checks and balances are in place within the organisation.
- As a part of good risk management and for proper monitoring and control of the investments, takaful operators should establish adequate internal controls to ensure that assets are managed in accordance with the takaful operator’s approved investment policies and in compliance with legal, accounting and relevant risk management requirements. These controls should ensure that investment procedures are subject to effective oversight – a function that is responsible for ensuring the effectiveness of the investment policies and procedures of the takaful operator as well as ensuring the implementation of investment policies is in line with approval from the board of directors. Takaful operators would need to ensure that the personnel in this oversight function are suitably qualified to perform such responsibilities.
- Takaful operators must establish contingency plans to mitigate the effects arising from deteriorating market conditions and procedures to monitor and control a takaful fund’s exposure to fluctuations in profit rates, foreign exchange rates and market prices.
- The roles of the Shari’ah Committee of takaful operators should be clearly set out to ensure the effectiveness of the Shari’ah governance framework including appropriate procedures to ensure that investment portfolios are Shari’ah-compliant and screening processes to identify returns from tainted/ non-halal income and the disposal of such income.
- The board of directors of the takaful operator has the ultimate accountability for the investment of takaful funds.

Camille Paldi is a UK Commonwealth and US trained lawyer certified in EU and Chinese legal systems from the European University Institute in Italy and the East China University of Law and Politics in Shanghai. Ms. Paldi founded the Franco-American Alliance for Islamic Finance and illegalbeauc.com (UAE Laws and Islamic Finance).
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