

WATCH DOGS FOR CROSS-BORDER ISLAMIC BANKING: IS THERE A NEED FOR AN INTERNATIONAL SHARI'AH ADVISORY BOARD?

Ismail Wisham
wish4m@gmail.com

Aishath Muneeza
mune_2@hotmail.com

Asst. Professor Dr Rusni Hassan
hrusni@iium.edu.my

Abstract

Islamic banking is unique and different from its conventional counterpart. This essentially means that we cannot carry out an apple to apple comparison between the two systems. Islamic banking is a system rooted in Islamic ideology. Overseeing of the whole system, thus naturally rests in the hands of those scholars educated in Islamic Shariah. This is the reason why several of the countries have established domestic Shari'ah advisory bodies, to monitor the administration of Islamic banking and the structuring of its products.

Now, unlike the classical times, Islamic Banking has been spreading as a global phenomenon. Cross-border Islamic banking transactions are not only possible but necessary in today's world. Considerations such as this creates a need globally which calls for the establishment of an International Shari'ah Advisory Council to ensure the Islamicity of these transactions. Without an International Advisory Council, the resulting consequence may be the compromise of the inimitability of the whole Islamic Banking system.

Islamic law lays down firm principles which must be there in a banking instrument. For example, Islamic law requires certainty of the terms of the contract. Given the verity that there are no dependable and internationally accepted ready-reference or Shari'ah texts germane at domestic or global levels on fiqh muamalat or Islamic financial matters, financial institutions and counterparties who go through Shari'ah -based or Shari'ah -compliant contracts. And frequently, they face dilemmas in deciding on the Shari'ah principles applicable to these contracts.¹ And for this, the support from the Islamic law proficient is huge.

Therefore, to inhibit and resolve these disputes which start from the Islamic ideology and to ensure proper Shari'ah governance, the establishment of an International Shari'ah Advisory Council as a watch dog for cross-border Islamic banking transactions is imperative. In this paper the call for an International Shari'ah Advisory Council would be discussed and a viable mechanism to establish an effective Shari'ah governance framework would be recommended. So that the disputes in cross border transactions can be attended properly.

In this paper, the want for an International Shari'ah Advisory Board would be conferred. It is argued here that for the sake of unvarying and standardizing the rules of Islamic Banking across the globe and to resolve the disputes which occur in cross-

¹ Different mazhab or sects have different views regarding the matters, and these lead to confusion and perplex situations.

border Islamic banking transactions, the establishment of International Shari'ah Advisory Board is imperative. The complexity of swapping the "Malaysian" version of Islamic Banking with the "Middle Eastern" way of Islamic banking across the globe can only be harmonized with the intercession of an International Shari'ah Advisory Board. For this indeed there has to be a vigilant watch dog!

Introduction

Islamic banks and banking institutions that offer Islamic banking products and services (IBS banks) are required to establish a Shariah Supervisory Board (SSB) to advise them and to ensure that the operations and activities of the bank comply with Shariah principles. On the other hand, there are also those who believe that no form of banking can ever comply with the Shariah¹. In Malaysia, the National Shariah Advisory Council, which, additionally set up at Bank Negara Malaysia (BNM), advises BNM on the Shariah aspects of the operations of these institutions and on their products and services. In Indonesia the Ulama Council serves a similar purpose.

A number of Shariah advisory firms (either standalone or subsidiaries of larger financial groups) have now emerged to offer Shariah advisory services to the institutions offering Islamic financial services. Issue of independence, impartiality and conflicts of interest have also been recently voiced. In Islam, there is no generally accepted codification of jurisprudence. Shariah law is open to interpretation and scholars frequently hold varying views on key Shariah issues. Furthermore, Islamic jurisdiction is not bound by precedent, and legal opinions may deviate from previous decisions made by other Shariah scholars. A Shariah board has considerable discretion in the interpretation of Islamic law and may choose any school of thought to inform its decision-making process.

This lack of standardization of Shariah boards' rulings is the Achilles heel in the global acceptance and growth of Islamic finance. A consistent ruling on the religious compliance of certain assets and transaction structures in terms of Shariah law has yet to emerge. In the conventional arena, this can lead to uncertainty and confusion. Broadly speaking, the three key functions of Islamic finance Shariah boards are to provide advice to Islamic financial institutions, to supervise and audit transactional procedures, and to supervise and actively participate in the creation of innovative Shariah-compliant investment and financing products and services.

The absence of a universally accepted central religious authority is largely a result of the lack of uniformity in religious principles applied in different Islamic countries across the world. Shariah boards at individual banks have their own way of defining what is and is not Islamic banking. This results in different transactions being interpreted differently and causes uncertainty about what is the acceptable way to do business in the Islamic banking and finance system. Furthermore, because of this lack of consistency, an accurate assessment of risk for both the financial institution and the customer can be difficult to make.

The differences in interpretation of Shariah laws also means that one Islamic bank may not be able to "copy" another Islamic bank's products, and this can stifle the growth and integration of Islamic finance at both national and international levels.

Lack of standardization is also a contributory factor in the sluggish trading levels on the Sukuk market. It prevents investors from knowing what risks they are assuming when they invest and increases the costs associated with Sukuk issuance.

Conformity or similarity among the Shariah supervisory boards of Islamic financial institutions is urgently required to extend the possibilities of concept and application in the industry. Establishing Shariah boards at a global and central bank level is needed to expedite and develop some standard guidelines on the conduct of Islamic financial transactions. Standardization will help avoid contradictions or inconsistencies between different Fatwa rulings and their application by these institutions. The other important factor is the mutual recognition of financial standards and products across jurisdictions. The progressive harmonization of Shariah, in this respect, needs to be viewed as a step towards greater international financial integration. Moreover, supervision and regulation at the national and regional levels are necessary safeguards against potential improper practices, which can cast doubt on the credibility of all participants. Shariah scholars from around the world should contribute towards greater understanding and international convergence. Such convergence and harmonization can only happen with greater engagement among the regulators, practitioners and scholars in Islamic finance in the international community.

Part One: Practice Around the World

Islamic banking and finance has become a force to be reckoned with in the global economic scenario. It often forms part of the equation in international finance, whether at a government-to-government or the private sector levels. Its significance has grown over the years and is now present in over 60 countries. Islamic finance markets are concentrated in the Middle East and South Asia but spreading rapidly to other developing and developed markets. The Gulf Cooperation Council (GCC) states (Saudi Arabia, Kuwait, the United Arab Emirates, Bahrain, Oman, and Qatar) account for almost 36 percent of the total market of \$500 billion as measured by the Banker.⁴ The non-GCC Middle East and North Africa (MENA) region (35 percent of the total), is dominated by Iran, with Lebanon and Egypt acting at significantly lower levels. Asia represents 24 percent of the total and is dominated by Malaysia, Pakistan and Indonesia.

The Islamic finance market is not confined to developing countries. The United Kingdom, with \$10.4 billion in Shariah-compliant Assets (SCA) is the 10th largest country in the Banker's ranking.⁸ The United Kingdom is actively promoting London as a major center for Islamic finance.⁹ France, with a large Islamic immigrant community, is also developing its Islamic finance sector. The United States has a proportionately smaller Muslim community, but due to its overall size is also a potentially large market.

In certain jurisdictions, such as Malaysia and Sudan, Shariah Supervisory Boards are at the Central Bank; in Iran they have a Committee within the Council of Guardians, which sets the rules for the Banking and Financial sector. In other jurisdictions, individual Islamic financial institutions and Islamic banking units in conventional financial institutions have appointed their own qualified Shariah Supervisory Boards or Advisors.

Despite their different regulatory structures, the UK, Malaysia and Bahrain provide examples of best practice. In 2006, for example, the UK issued standards on capital adequacy and risk management and its high courts have significantly accommodated the growth in this market. These reforms have made Islamic financial services including mortgages and bonds more competitive with their conventional equivalents. Ultimately, banks and regulators could look toward international standards to harmonize and advance their regulatory frameworks.ⁱⁱ

The growth of Shariah-compliant lending extends beyond the financial sector to influence the adaptation of new technologies and access to the financial sector by the unbanked. Banking technology companies are rapidly developing products to meet the growing demand of Shariah compatible products. Banks are working with software companies to adapt their products to provide the documentation and audit capability the banks' Shariah boards require, or to introduce Shariah-compliant products to the market. Technology companies can take advantage of opportunities in this sector if their products encourage more efficient operations, attract and engage customers toward a bank's brand, and meet the specific needs of Islamic commercial ventures.

The Malaysian Islamic financial sector is seen as one of the most progressive and attractive in the world given the numerous incentives planned and further liberation in the coming years. Malaysia is the Largest Islamic Banking and Financial Market with estimated Islamic banking assets valued at RM113.5 billion (US\$30.9 billion), Takaful assets: RM6.2 billion (US\$1.7 billion), with active Islamic money market channeling about RM30 billion - RM40 billion monthly and a critical mass of diversified players - Islamic banks, investment banks, takaful companies, development financial institutions, savings institution, fund management companies, stock brokers and unit trusts.

The international financial community has taken note of Malaysia's strategic direction in developing and nurturing Islamic banking and finance. With this, they have acknowledged Malaysia as the leading Islamic financial centre. The strategies are being implemented through clear and deliberate policies spelt out in both the Financial Sector Master Plan as well as the Capital Market Master Plan. Its progressive industry developments include:

- Pioneering many Global Islamic Banking and Finance initiatives
- Robust regulatory framework
- Malaysia has a comprehensive regulatory and supervisory framework that caters to the unique characteristics of Islamic finance. Stronger standards have been set for corporate governance, transparency, disclosure, accountability, market discipline, risk management and customer protection.
- Shariah Framework
- Operate in an environment that offers conducive and effective legal and Shariah framework. The Islamic Banking Act 1983 and Takaful Act 1984 were enacted to govern the conduct of Islamic banking institutions and takaful operators respectively.
- Liberal Foreign Exchange Regime

- Resources
- This includes the establishment of the:
 - Institute of Islamic Banking and Finance Malaysia (IBFIM)
 - International Centre for Leadership in Finance (ICLIF)
 - International Centre for Education in Islamic Finance (INCEIF)
 - A wide range of tax exemptions across the Islamic finance spectrum

As mentioned earlier, the growth rate of Islamic Finance in Malaysia is impressive by any standards. Malaysia, therefore, has the capacity to retain its leadership in global Islamic finance despite the emergence of competition from centers such as Hong Kong and Dubai. He said despite the stiff competition that Malaysia was facing, it was way ahead of other countries in terms of product offerings and its sophistication, having been developing the market for the last 40 years. The increased popularity and visibility of the sector was especially evident in the 1990s when Islamic finance grew rapidly as Islamic and non-Islamic financial institutions devised new instruments and both Muslims and non-Muslim clients alike began to embrace and utilize Shariah compliant features such al-Muddarabah, al-Muassasah etcetera in their daily banking transactions. Furthermore, Islamic banking expanded as western banks themselves (such as HSBC and Citibank) created a number of financial innovations consistent with Shariah in order to capitalize on the increased demand for Islamic capital investment products. The existence of such Islamic features in the Western banking sector served as a catalyst to draw financing from countries such as Saudi Arabia and Kuwait. Consequently, a number of predominantly Islamic countries such as Iran, Malaysia, Pakistan, Saudi Arabia, and Sudan Islamized their banking systems using highly innovative banking initiatives.

Malaysia has dedicated Shariah Advisory Councils for the Islamic banking and takaful sectors, as well as for the Islamic Capital Market (ICM). The Shariah Advisory Council of Bank Negara Malaysia (BNM) is responsible to advise on matters in relation to Islamic banking and takaful businesses or any other Islamic finance area that is supervised and regulated by BNM.

The Shariah Advisory Council of the Securities Commission Malaysia (SC) is responsible to advise on matters pertaining to the ICM. Consisting of prominent Shariah scholars, jurists and market practitioners, members of the two SAC are qualified individuals who can present Shariah opinions and have vast experience in banking, finance, economics, law and application of Shariah, particularly in the areas of Islamic economics and finance. In executing its duties and responsibilities, both SAC examine and endorse the validity of application of Shariah in Islamic financial products which are submitted by Islamic financial institutions. The SAC would also issue Shariah resolutions and decisions relating to their relevant jurisdictions from time to time. Both SAC have published their resolution, which have been translated into various languages and is being used as a reference point by industry and academia around the world.

The SAC, in their respective capacity as advisory bodies, can make pronouncements; respond to inquiries and proposals from the industry as well as encourage innovation through progressive guideline formulation. The progressive approach of the SAC has allowed the banking and takaful and ICM sectors to flourish by cultivating an environment for product innovation and flexibility while ensuring compliance with

Shariah principles. Growth in Islamic financial services presents significant growth opportunities for U.S. financial service companies and providers of banking technology. At the end of 2006 global Islamic financial services exceeded \$530 billion and are growing faster than assets in conventional finance. The Islamic finance market extends beyond its largest markets in the Middle East and Southeast Asia. Islamic banking regulators have prudential and developmental roles. Depository insurance and interbank funding are two significant challenges facing Islamic finance regulators. International qualifications and standards could harmonize the application and development of Islamic financial services.

The coming into force of the Central Bank of Malaysia Act 2009 has granted the authority to the Central Bank of Malaysia for the establishment of the Shari'ah Advisory Council as the highest and sole authority to be referred by the civil courts in dealing with Islamic banking and finance cases in Malaysia. It is settled that the civil courts and not the Shariah courts shall have the jurisdiction to deal with Islamic banking and finance cases in Malaysia. The effect of the legislation is to ensure that any deliberation of the Shariah Advisory Council will bind the courts and should be followed by all Islamic financial institutions in Malaysia. This newly passed legislation is intended to ratify the defunct provision of section 16B of the Central Bank of Malaysia Act 1958 (Amended 2003) which merely provides that the Shariah rulings given by the Shariah Advisory Council are binding on the arbitrator but not on the civil courts.

Worldwide Islamic Capitals are at well over \$1 Trillion and Islamic-held assets are estimated to be worth more than \$275 billion much of which is managed by Middle East based advisers to Shariah Compliant Public and Private Establishments.

The Arab Chamber of Commerce & Industry's (ARABCCI) Shariah Committee has endeavored to provide pre-eminent independent value-added Shariah compliance solutions to the Greater China Region Islamic legal, commercial, banking, finance and insurance sectors, thereby contributing to the on-going development of the Islamic system of financial management. Services are commonly customized and/or syndicated in concert with modus operandi, subject to prevailing constraints of market place, jurisdictional architectures, and financial infrastructures.

ARABCCI's services and certifications are accompanied by relevant compliance certificates, duly executed by the Shariah Advisory Council. These certificates, where required, may be further endorsed by a fatwa (Islamic legal opinion). As such, a core component of the Islamic system of financial management is Shariah compliance. There can be no compromise in Shariah compliance, otherwise product(s) or service(s) may be deemed unacceptable.

The relatively recent resurgence of Islamic finance has complicated measuring the size of this market. However, according to the International Financial Services London (IFSL), the global market for Islamic financial services, as measured by Shariah compliant assets, is estimated to have reached \$531bn at the end of 2006. This represents over a 10 percent a year growth rate in the last decade.²

² Islamic commercial banks, investment banks, bond, and insurance account for 75, 13, 9 and 3 percent of total assets, respectively.

A dispute between the Shamil Bank of Bahrain and Beximco Pharmaceuticals of Bangladesh over a failure by the latter to make the agreed payments under a murabahah contract was settled through the English High Court in favor of the Shamil Bank, with the international law firm, Norton Rose, acting on behalf of the bank³. Beximco disputed the verdict and lodged an objection to the English Court of Appeal in 2004, but the latter confirmed the judgment made by the English High Court, and in the end Beximco had to make the payments it had agreed in the original contract. Although English law has become the preferred choice for cross-border Islamic financing contracts, this does not mean that the FSA will scrutinize agreements that are entered into offshore. Only banks in the U.K. that are registered onshore are subject to domestic regulation, although this does apply to all Middle Eastern banks operating branches in London even when they are offering services to overseas clients. Ultimately the FSA is concerned with maintaining the financial reputation of the City of London and ensure that scandals such as those resulting from the BCCI collapse over a decade ago are not repeated.

Composition and Context

By appointing a Shariah advisor or a committee of such advisors a bank gives assurance of compliance with Islamic law. Muslim perceptions of the bank will be determined by the reputation of these advisors, and how well respected they are in their local communities. Although there are thousands, if not millions of Shariah scholars with varying degrees of expertise, there are few with knowledge of modern finance. Regulatory authorities do not usually attempt to provide Shariah assurances, as the consensus is that it is beyond their remit and best left in the hands of individual banks. In the U.K., the FSA takes an active interest in Islamic finance, and sends delegates and speakers to many conferences on the subject, but it would not presume to give Shariah assurances.

Shariah supervision may be thought of as the single most important distinction between a conventional and a truly Islamic financial venture. For, while a business may attempt to represent itself as “Islamic,” unless it has qualified Shariah supervision, it has no way of certifying that its services, products, and operations are actually Shariah-compliant. In the emerging Islamic financial sector, therefore, Shariah supervision is not a matter to be taken lightly. Public confidence, in any sector, is always an important consideration; and in the financial sector its importance is paramount. Shari`ah supervision signifies a real commitment on the part of management to the principles of transparency and accountability in the matter of Shari`ah compliance. The ideal International Shariah Advisor must have

- an experience of at least 5 years giving religious rulings.
- He should have knowledge of or at-least be familiar with the banking industry. Minimum qualification is Dars-e-Nizami. Higher education like M.A. Islamiyat, economics or in the discipline of banking and finance may be an added qualification. Relaxation in number of years of experience may be considered in case of experience as teacher of

³ Norton Rose, 2005, “*Islamic finance: dispute resolution*,” Islamic Finance News, Kuala Lumpur, 4th April

Islamic Fiqh in a reputable institution other than banking institutions, for a period of not less than three years with a proven track record.

- The Shariah Advisor must have an impeccable track record in the companies he/she has served either in the capacity of an employee or director/chief executive or as chairman. Has not been terminated or dismissed in the capacity of employee, director/chairman of a company.
- Has not been associated with any illegal activity especially relating to banking business. Has not been in default of payment of dues owed to any financial institution and/or default in payment of any taxes individual capacity or as proprietary concern or any partnership firm or in any private unlisted and listed company.
- Has sufficient means to discharge his/her financial obligations.
- Has not been convicted in any criminal offence, involved in any fraud/forgery, financial crime etc.
- Has not been subject to any adverse findings or any settlement in civil/criminal proceedings particularly with regard to investments, financial misconduct, fraud, formation or management of a corporate body etc.

The most obvious and immediate purpose of Shari`ah supervision is to certify for practicing Muslim consumers and clients that the financial product or service being offered to them is acceptable from an Islamic legal perspective and is therefore lawful to them. Such certification, generally documented in a formal fatwa (Shariah position paper), may be thought of as a form of due diligence. In effect, the Shari`ah supervisor, or supervisory board, performs this due diligence on behalf of consumers who are without access to the details of what is offered to them and, likewise, without the experience or qualifications to evaluate those details in light of Shariah teachings. By assuming responsibility for the Shariah compliance of an Islamic financial institution, including its policies and practices, Shari`ah supervision places itself in a position of directly representing the religious interests of the Muslim investor or consumer; and by making every possible effort to ensure that an Islamic financial product is halal, the services performed by Shariah supervisors are directed toward the investor, or the consumer.

Towards an International Watchdog

Shariah compliance requires IFIs to meet lending and investment standards not required by conventional banks. It is this convergence of Islamic principals and finance that attracts Muslims to IFIs. There are private and public models to ensure that financial services labeled ‘Islamic’ or ‘Shariah-compliant’ comply with these principals. In some countries, private banks maintain their own Shariah advisers to ensure Shariah compatibility. In others, consultative boards at the supervisory level increase the predictability and conformity of Shariah board decisions⁴. A regulator’s adaptation will depend on the relationship between civil and religious law in the country. Countries that maintain a greater separation between civil and religious law might find it more difficult to assign a government role to adjudicate what are

⁴ Juan Solé, “*Introducing Islamic Banks into Conventional Banking Systems*” IMF Working Paper WP/07/175 (July 2007).

essentially religious questions. According to some scholars, countries with less separation might more easily enter into or consolidate the supervisory role of Shariah compliance. Consumers in both types of countries would still have recourse when IFIs fail to comply with promised services.ⁱⁱⁱ

A fully Islamic banking system only permits Shariah-compliant financial services. Governments in countries with large Muslim populations, such as Iran and Sudan may find it expedient to abolish interest-based financial services. In other Muslim countries Shariah compliant institutions have existed in a variety of forms. In Malaysia and Bahrain this mix has created a highly competitive banking sector that offers a larger variety of more complex and cost-efficient products.

Standards provide essential guidelines and a frame of reference for performance. Often, they become mandatory after adoption into a country's legal system. In 1990 the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) was created. Its main goals included the design and dissemination of accounting and auditing standards for Islamic institutions. These standards are based on the best practices of Shariah supervisory panels and boards. The AAOIFI plays a critical role in harmonizing the frequently different standards applied at the national and local levels. Universal acceptance of new products is important to convince many Muslim and non-Muslims to participate in the Shariah-compliant market. In 2002, central banks from several Islamic countries created the Islamic Financial Services Board (IFSB) in Kuala Lumpur. The IFSB is the AAOIFI equivalent for the development of capital adequacy, risk management, corporate governance, transparency, disclosure, and supervision standards. The inclusion of many financial regulatory institutions within the AAOIFI and the IFSB promote transparency, soundness, and stability standards for IFIS. These standards, however, have yet to fill the transparency gap between Shariah and conventional banks. There are still gaps in the reporting of Shariah activities on balance and income statements.

Political factors ultimately determine the regulatory environment. In some countries, notably in North Africa, Islamic banks are perceived, rightly or wrongly, to be linked to Islamic political parties, and are therefore refused banking licenses, as in Libya or Morocco. Elsewhere, such as Egypt, Algeria, and Tunisia, governments are extremely cautious, and although Islamic banks are tolerated on the fringes, there has been little official help or encouragement. In contrast, in Bahrain and Malaysia there has been much official support and encouragement which has been reflected in a positive regulatory approach, while in Iran and the Sudan, laws have been passed to ensure that all domestic retail and commercial banking is undertaken on an interest free basis^{iv}.

The position in countries with non-Muslim majorities is generally less favorable, although the regulators in some western countries, notably the Financial Services Authority (FSA) in the U.K., have played a helpful role. In the United States, despite the negative fallout for the Muslim community from the events of September 2001, regulators have also been generally helpful, as there is the desire to not be perceived as discriminating against any group on religious grounds. In more monocultural and secularist societies, such as France, however, there is skepticism and even hostility towards Islamic banking, and it is unlikely that any licenses would be granted to permit Islamic banks to operate^v. Similarly in developing countries, such as Nigeria or

India, with histories of conflict between Muslims and other religious groups, no Islamic banks are allowed.

One important factor to consider in appointment of International Counselors is the degree of their qualifications. The pillar here is human capital and thought leadership. Several important human capital development projects have been implemented to foster Islamic finance thought leadership and to create a supply of talent for the Islamic finance industry. Having a sufficient pool of the talent and expertise has been key to the development of the Islamic financial hub in Malaysia. The International Centre for Education in Islamic Finance (INCEIF) which has an international faculty and students from more than 40 countries is focused on programmes for Islamic finance professionals and specialists to meet the human capital requirements of the global Islamic financial services industry.

Human capital development is crucial, as the current lack of qualified young Islamic scholars looks set to hamper the development of the sector should it not be addressed. In part, this low investment in the industry stems from the fact that the sector lacks a global industry body to oversee standardization of continuous education and training. The lack of human capital in the sector affects all regions, including nascent markets such as the U.K. Training of Islamic bankers has not kept pace with the rapid growth of the sector and, as a result, there are shortages throughout the industry. The two centers for training have been KFH and Bank Islam Malaysia, which between them have been responsible for training many Islamic bankers. In 2006, for example, Bank Negara set up an RM500m endowment fund to support The International Centre for Education in Islamic Finance (INCEIF), with the main objectives of making Malaysia the leading center for Islamic finance education and developing human capital for the global Islamic finance industry. Similarly in 2006, The Central Bank of Bahrain set up a US\$4.6m Islamic Finance Education scheme in cooperation with eight IFIs based in Bahrain.

Conclusion

The existence of a unified Shariah board *via* a council representing different Islamic schools of thought, nationally and internationally, would facilitate the conformity of different types of financial services to Islamic law. This would also define cohesive rules to expedite the process of introducing new products. The early engagement of a Shariah supervisory board in the creation of a new Sukuk is of utmost importance so as to build a solid Islamic foundation. It also paves the way for speedier creation of the Sukuk. It is crucial that the Shariah board actively participates in the creation of Sukuk, in addition to its supervisory role. In order to promote a global standard for Islamic finance instruments, there are a couple of key steps that must be taken.

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has taken the lead by preparing Shariah standards. These have been adopted by a number of government authorities and central banks, which provides an avenue for Shariah compliance as well as product innovation. Collective efforts towards international collaboration among major Islamic financial regulatory bodies such as the Islamic Financial Services Board (IFSB), AAOIFI and the central banks in Islamic countries is important in strengthening the fabric of Islamic finance.

Islamic finance instruments, particularly Sukuk, are becoming an increasingly important consideration – for both Muslims and non-Muslims – from the perspective of investment and product innovation. Shariah boards need to keep up with the growth and sophistication of the industry and make sure they are as effective as possible. Some recommendations:

- More training in economics, investments and legal issues related to investments and product innovation. The lack of knowledge about modern economic and legal issues can weigh down the ability of Shariah scholars to issue well-informed rulings on financial products and investment activities.
- Placing specialized Shariah scholars on separate Shariah boards for different projects to work more efficiently on projects best suited to their particular areas of expertise. This process will ensure that the right scholars in the right numbers develop, certify and supervise the financial products and services endorsed by Islamic financial institutions.
- Shariah boards should be independent from financial institutions in order to ensure transparency and efficiency when giving opinions on proposed contracts and transactions.
- Shariah advisors should work closely with financial institutions and lawyers in developing new Islamic financial instruments.
- There is a nagging concern about the availability of suitably qualified Shariah advisors. Their numbers need to be increased. This will allow more Shariah-compliant transactional procedures and more time for advisors to spend with economists and investment practitioners to develop new Islamic financial products.
- Financial institutions need to develop operating procedures to ensure that no form of investment or business activity is undertaken that has not been approved in advance by the religious board.
- From the outset of structuring a Sukuk, Shariah advisors should scrutinize to ensure that the product concept and its process flow is fully implemented according to Shariah. Shariah advisors and lawyers should work hand in hand to thoroughly review the terms and conditions of the Sukuk contract.

Flexibility is a major strength of Islamic finance, and this implies that a broad variety of products can be tailored to each client's needs. The differences in rulings by different Shariah boards is advantageous in a way, as it brings about more innovation and creates new room for Sukuk structures and Islamic finance instruments. In the process of providing remedies, the principles of Shariah are not to be compromised, as they are essential to a dynamic market.

Regulatory authorities worldwide can seek advice about Shariah issues related to banking from the Islamic Financial Services Board (IFSB), which is based in Kuala Lumpur, the closest thing the world has to an internationally recognized Shariah Advisory Council for Islamic Finance. This is the official organization where the Central Banks of many Muslim countries are represented, and is recognized by the Bank for International Settlements and the International Monetary Fund. The U.K.'s

FSA cooperates with this new Board. Although at present there is much diversity in Islamic finance, some of which is healthy, bodies such as the IFSB and the Bahrain-based Auditing and Accounting Organization for Islamic Financial Services (AAOIFI) are bringing some degree of standardization to the Islamic banking industry, thus making the regulators' task easier.

Notes:

¹ Subhi Y. Labib (1969), "*Capitalism in Medieval Islam*", The Journal of Economic History 29 (1), pp. 79–96]

¹ Mufti Barkatulla. "*Islamic Report - Sharia Raises Its Profile - Islamic Sharia Law Is Emerging As An Alternative Means Of Dispute Resolution For Business And Commerce In The Secular World*" The Banker (Apr. 2008).

¹ Islamic commercial banks, investment banks, bond, and insurance account for 75, 13, 9 and 3 percent of total assets, respectively.

¹ Norton Rose, 2005, "*Islamic finance: dispute resolution*," Islamic Finance News, Kuala Lumpur, 4th April

¹ Juan Solé, "*Introducing Islamic Banks into Conventional Banking Systems*" IMF Working Paper WP/07/175 (July 2007).

¹ Dahlia El-Hawary, Wafik Grais, and Zamir Iqbal. "*Diversity in the Regulation of Islamic Financial Institutions*." The Quarterly Review of Economics and Finance 46, (2007): 778-800.

¹ Clement H., and R. Wilson, 2004, "*The politics of Islamic Finance*," (eds.) Edinburgh University Press and Columbia University Press, New York, pp. vi+307 (reprinted by Oxford University Press, Karachi, 2005), pp. 286-295

¹ Rutledge, W., 2005, "Regulation and supervision of Islamic banking in the United States", Speech to the Arab Bankers Association of North America, New York, 19th April

