

The Halal and Haram Aspects of Cryptocurrencies



*In The Name of Allah,
The most Beneficent, The most Merciful*

*“O Believers: devour not Riba, doubled and redoubled;
and fear Allah, in the hope that you may get prosperity.”*

Sura Ale-Imran (verse No. 130)

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Editor's Note

In developing countries with weak public and tax administration coupled with limited and concentrated supply of formal financial services, the role of third sector institutions becomes crucial. In such a scenario, there is an opportunity for Islamic institution of Waqf to provide an effective basis of channelizing charitable funds in the private non-profit sector given the high prevalence of voluntary giving in the form of cash throughout the year and the trust deficit between people and the public Zakat agency.

In Pakistan, the incidence of poverty is high, especially in rural areas. As many as 58.7 million people in Pakistan are living in multidimensional poverty with 46% of the rural population and 18% of the urban population falling below the poverty line, according to Social Policy Development Institute. The 2016 United Nations Development Programme report reveals that multi-dimensional poverty in Pakistan stands at 38.8%. Poor people usually depend on their incomes for consumption expenditure given the lack of other endowments in their ownership. In addition to that, the non-availability of other endowments makes them excluded from formal financial services. Indeed, only 3% of the population borrows from banks in Pakistan. There are only 25 borrowers per 1,000 adult people in Pakistan, according to 2014 Global Financial Development Report.

Therefore, the poor have little salvage from exclusive lending criteria of commercial banks, low outreach of microfinance and lack of large-scale pro-poor public sector expenditures and social security programs. Hence, this void is largely filled by private philanthropy in Pakistan. It is estimated that people in Pakistan pay as much as Rs 500 billion per annum in charity.

To give just a glimpse of how important the third sector is in the socio-demography of Pakistan, we list a few major success stories. The Sindh Institute of Urology and Transplantation (SIUT) is a privately funded dialysis and kidney transplant centre in Karachi. It is the country's largest public sector health organisation providing services free of any cost. Shaukat Khanam Cancer Hospital and Research Center is the country's largest cancer hospital with an annual budget of Rs 10 billion (\$ 96 million). The hospital was built through private donation drive in 1994. Edhi Foundation which originated from Karachi holds the Guinness record for world's 'largest volunteer ambulance organization' since 1997. Indus Hospital in Karachi provides free of cost treatment. It is a private hospital working on donations and has treated 2.3 million patients during 2007-2016.

Among the numerous food distribution centres, Saylani Welfare Trust provides meals twice a day to more than 50,000 people in the city of Karachi free of cost. This is just a small account of the vibrant and sizable private philanthropic system of social services in Pakistan, especially in the city of Karachi.

Among the general public, studies suggest that there is inclination to use social intermediaries who can transparently and efficiently mobilize charitable giving. Given the high prevalence of cash based giving and higher trust deficit between people and the public Zakat agency, the Islamic institution of cash Waqf can be suitable for effectively channelizing the charitable giving in the form of cash.

It is important to provide tax incentives to engage more people and corporations towards establishing Waqf. Corporations who engage in corporate philanthropy can effectively establish corporate Waqf. The contributions to these Waqf by individual and corporate donors shall be made eligible for tax credit like it is the case with other recognized institutions in Section 61 of the Income Tax Ordinance 2001. If a donor dedicates real estate to an existing Waqf or to establish a new Waqf, the taxes related to registration and transfer of property shall be exempted.

Finally, it is vital to create social awareness for creating right kind of Waqf at the right place. Given the preference ranking of the respondents and based on social needs, targeted efforts shall be made in sectors and segments of more social priority, such as food security, basic literacy and basic health.

This issue of Journal of Islamic Banking & Finance documents scholarly contributions from authors around the globe. Contributions in this current issue discuss the theoretical underpinnings of an Islamic economy, contemporary issues in Islamic finance and performance based empirical studies on Islamic banking and finance. Below, we introduce the research contributions with their key findings that are selected for inclusion in this issue.

In their article based on primary research, “**Mutual Funds in India - Potential for Islamic Versions**”, *Mustafa Hussain Khan*, Islamic Finance Consultant, and *Dr Syed Ahmed Salman*, PhD- International Islamic University Malaysia, discuss the current Islamic Mutual Fund market in India and the potential for its growth. They look at this from perspective of the overall well developed mutual fund market in India, the investor readiness and the religious angle. The authors present that India has the world’s second largest muslim population and its inclusion in capital markets can boost the Indian economy further. They also present that an Islamic Mutual Fund would be attractive to non-muslims as well. The authors base their conclusions on primary research through interviewing a select sample of professionals from the finance industry. The research is an interesting one and can contribute to being the start of more research in understanding the motivation of investors in their investment decisions.

In his article “**The Achievement, Implementation and Future of a Cooperative Zakat Model in the Inland Empire and Beyond**”, Husam Suleiman describe the issues

besetting the muslim communities and mosques of the Inland Empire area with a dozen mosques and Islamic organizations, which is situated in California USA, in collection and distribution of Zakat and how these issues have so far been sorted out through a cooperative and replicable model to create a more efficient method and what else needs to be done going forward.

In their article **“Corporate Social Responsibility (CSR) in Islamic financial Institutions: the Shariah Adoption and Standardization, UAE and Malaysian Model”**, *Abdul Azeez Maruf Olayemi, Steyn Heckroodt and Schoepp Kevin* all associated with the College of Business, Jumeira University, Dubai, UAE, discuss the lack of a standardized or formal CSR model in IFIs and propose the adoption of the Carrol Model of CSR. They present that the Carrol model is readily adaptable and can easily be synced to requirements of Islamic Shariah. They discuss that with UAE Ministry of Commerce having instituted requirement for all corporate entities to register for mandatory CSR practice therefore according to the authors this is the ideal time for the IFIs to develop a standard practice based on Carrol Model. This they propose for UAE IFIs to do in order to keep their edge in Islamic Banking globally.

“Challenges of Islamic Banking in Nigeria; Legal and Regulatory Perspectives”, an article contributed by *Idris Muhammad Idris and N.M. Gatawa* both from Usmanu Danfodiyo University, Sokoto, Nigeria discusses the challenges of Islamic banking in Nigeria, looking at the legal and regulatory perspective of the industry. They analyze the background of both the Islamic and conventional banking systems from the legal side supported by the major actors in the industry i.e. CBN and NDIC. The research concludes that Islamic banking is an essential sub-sector with potential and has a lot to contribute to the diversification of the Nigerian financial system. However, legal and regulatory challenges hinder its success. To have a robust Islamic banking and finance system, they amongst other suggestions, recommend that the policies guiding the operations of Islamic banking in Nigeria should be restructured to consider the AAOIFI standard, Islamic Financial market should be developed to enable Islamic banks to invest their excess liquidity, capacity building for the regulators and operators in the sub-sector should be intensified.

The article entitled **“Are Shari’ah Governance and Risk Management Important? A case of Islamic Bank Bangladesh Ltd.”** contributed by *Md. Akhter Uddin, Phd.*, Senior Lecturer and Program Coordinator. School of Business, University of Creative Technology, Chittagong, Bangladesh, explores the subject of Shari’ah Governance and Risk Management in Islamic Banks. The author studies the practices of Islamic Banks, Islamic Banking windows and operations in conventional banks vis-à-vis those of Islamic Bank Bangladesh and also explores the regulatory requirements on corporate governance for Islamic Banking. His study shows that while the focal bank has a well defined risk management structure, the regulatory framework is fragmented and not all in the same place. This study is useful for other Islamic Banks setting up their risk structures giving good insights on what works and what may not.

Mustapha Abubakar - PhD, Department of Business Administration, Ahmadu Bello University, Zaria-Nigeria and *Kabiru Jinjiri Ringim*, UTB School of Business, Universiti Teknologi Brunei, Negara Brunei Darussalam, have contributed their article “**Conceptual Approach to identification of Fault lines in Conventional Financial System’s Risk Transfer Mechanism: A case for Risk Sharing in Islamic Finance**” in which they discuss the concept, theory and practice of risk sharing in Islamic Finance and how it can overcome the fault lines that are inherent to Conventional Finance. They talk about how risk sharing in Islamic finance can lead to inclusion of the lower income segments and make them productive members of society. This they say will lead to a harmonized and equitable social structure.

Sudais Asif from Lahore College of Arts and Science, Pakistan presents his paper “**The Halal and Haram Aspect of Cryptocurrencies in Islam**”. In this paper he argues that although the technology of cryptocurrencies in itself is Halal; different aspects contribute in deciding whether the specific digital currency in question is halal or haram. Asif quotes that the Grand Mufti of Egypt, the Turkish government, the Fatwa Center of Palestine and Shaykh Haitam from the UK among others have regarded cryptocurrencies as haram whereas others have regarded them as halal based on individual crypto vehicle, the protocols it uses and its underlying conditions. The basis of deeming it halal according to Asif is that an underlying asset is created when the crypto currency is mined. However the condition of the underlying asset being tangible is not discussed. The article discusses the different crypto currencies in use and how according to author these can be deemed halal or haram by muslim investors. An interesting read and a topic which requires much more research.

Disclaimer

The authors themselves are responsible for the views and opinions expressed by them in their articles published in this Journal.

The opinions, suggestions from our worthy readers are welcome, may be communicated on

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Mutual Funds in India - Potential for Islamic Versions

By
Mustafa Hussain Khan^{**} & Dr. Syed Ahmed Salman^{**}

Abstract

Purpose

This research investigates the prospects of Shari'ah mutual funds in India. India is among the fastest emerging destinations for investment. It has the second highest Muslim population in the world with 180 million representing some 14.4% of India's total population. Having a huge potential and strong regulatory infrastructure, India has the ability to become a hub for Shari'ah compliant funds. In this regard, the Securities Exchange Board of India has thus far approved two Shari'ah mutual funds in India.

Methodology

It adopts a qualitative methodology wherein primary data is sourced through interviews. In addition, purposive, and judgemental sampling methods are employed and the findings are analysed based on thematic analysis. It has been conducted by personal interviews and e-interviews. In total 9 interviews have been conducted of which 4 from mutual funds companies and 5 from Shari'ah finance experts are analysed in this research.

Findings

The findings highlight that Shari'ah mutual funds can play a big role in economic reform and development by including Muslims and other communities into the financial institutions of India. When accompanied

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with a framework for Shari'ah governance, such investments will enjoy enhanced transparency and accountability. Further, the findings show that training, education, and awareness programmes are crucial to increase the confidence in and demand for Shari'ah mutual funds. The nature of Shari'ah investments limiting to areas that are not socially and ethically destructive render it a morally upright and socially responsible investment channel suitable to all religions.

Research Limitations

This research does not cover all Islamic finance experts and mutual fund companies of India. Due to time and other constraints, the researcher managed to interview five Islamic finance experts. Similarly, the researcher approached ten mutual fund companies located in Hyderabad and succeeded in interviewing four mutual fund companies as most of the mutual fund companies did not respond.

Practical Implications

This study is new in the context of India and is relevant to regulators and mutual fund companies towards establishing more Shari'ah compliant mutual funds and to serve as a guide for the future direction of the Shari'ah mutual fund industry of India.

Originality Value

Most of prior research focuses on the conventional mutual funds. As per the researchers' knowledge, no study has been done on the prospects of Shari'ah mutual funds in India. This raises the high demand for various new funds to be launched according to Shari'ah guidelines. This research focuses on prospects of Shari'ah mutual funds in India. Thus, the findings of this research contribute to the existing literature.

Keywords: *Shari'ah Mutual Funds, Prospects, Fund Managers, Islamic finance experts and India*

1.0 Introduction

The mutual fund industry is, to date, the most successful innovation in financial markets. Mutual funds have come to play important roles as financial intermediaries that collect savings and channelize it into diversified investment portfolios such as money market instruments, corporate and government bonds, and equity of joint stock companies (Khan, 2009; Geetha, 2012).

Mutual funds as defined by the American Investment Company Act of 1940, are management companies that invest in diversified asset portfolios. Secondly, they are open-end funds where shares are redeemable at net asset value (Baumol et al., 2012; Khorana, 2005). The European Union defines the same concept under Undertaking for Collective Investment in Transferable Securities (UCITS), while the term unit trust is used in Malaysia and other Asian countries. Less frequently, mutual funds are referred to as "collective investment schemes" as demarcated by the International Organisation of Securities Commissions (IOSCO) (Khorana, 2005; Omar et al., 2013).

The Securities and Exchange Board of India known as SEBI in its 1996 regulations defines mutual fund as, “a fund established in the form of trust to raise money through the sale of units that is, the interest of the unit holders in a scheme to the public or a section of public under one or more schemes for investing in securities including money market instruments consisting of commercial papers, commercial bills, treasury bills, government securities having an unexpired maturity up to one year, call/notice money, certificate of deposits, or gold or gold related instruments or real estate assets” (SEBI Mutual Funds Regulations, 1996, p. 8; Khan, 2009).

Mutual funds are established in the form of trusts sponsored by banks, financial companies, and industries with the objective to mobilise savings by introducing schemes and investing them in various instruments in the capital market and money market. According to Geetha (2012), mutual funds schemes are successful due to their relative advantages over other saving instruments in terms of sound returns, safety, liquidity, and capital appreciation. The mutual fund industry has witnessed significant growth over the decades. According to the International Investment Funds Association (IIFA) (2015), global mutual fund assets increased from \$27.85 in first quarter of 2013, to \$38.38 trillion at the end of the fourth quarter of 2014¹.

India has a huge market potential and the Indian government is focussing on infrastructure development and economic reform. India is inviting local and foreign investors to meet its economic targets. Also, India is the second highest populated country after China with the second largest Muslim population after Indonesia with 14% (180 million). A recent study by Pew Research (2015), indicates that India is projected to have the world’s largest Muslim population in 2050 (311 million)¹. Furthermore, the mutual fund industry has existed for a long time and with Rs.7.66 trillion in assets under management (Chakrabarti et al., 2014), which indicates the robustness and healthiness of mutual fund industry. The active participation of Muslims in the mutual fund industry will develop the Indian economy.

Mutual fund is the fastest growing industry within the capital markets. Islamic mutual funds have become a popular sector in the Islamic capital market and a Shari’ah compliant alternative to conventional mutual funds. A number of countries such as Malaysia, Saudi Arabia, and Luxembourg are reported to lead the world with 71% of global Islamic funds. India being the second largest populated country, introduced Shari’ah compliant mutual funds in 2009 to attract a wider base of investors including Muslims as well non-Muslims. 61% of stocks listed in India are deemed Shari’ah compliant. In addition, 283 out of BSE 500 index, 39 out of 50 stocks of Nifty, and 23 out of 30 stocks of Sensex are approved as Shari’ah compliant (Ghosh and Srinivasan, 2013).

Considering this huge potential, only two companies have managed to launch Shari’ah compliant mutual funds. The prime objective of the mutual fund, as mentioned

¹ http://www.iifa.ca/documents/1432583316_IIFA%202014%20Q4%20Public%20Statistics%20Report.pdf.

¹ <http://www.pewresearch.org/fact-tank/2015/04/21/by-2050-india-to-have-worlds-largest-populations-of-hindus-and-muslims>.

in regulation, is to attract middle and low-income groups and enable them to participate in the capital market. SEBI, being a regulatory authority, shall not have any problem approving further Shari'ah mutual funds.

These funds are insufficient to meet the demand of the Indian Muslim community and to bring them into mainstream financial institutions. There is high demand for new mutual funds to be launched according to Shari'ah guidelines. As per the researchers' knowledge, no study has been done on the prospects of Shari'ah mutual funds in India. This raises the high demand for various new funds to be launched according to Shari'ah guidelines. Therefore, the objective of this research is to identify the prospects of Shari'ah mutual funds in India.

This paper is organised in six sections. Section two discourses the overview of Mutual funds in India and section three literature review. Section four talks about research methodology and section five deliberates the findings and last section concludes the paper.

2.0 Mutual Funds in India

Mutual fund in India is the fastest growing institution particularly in the household saving sector. The existence of complications, high risks in stock market, rising tax rates, and increasing inflation have pushed households towards mutual funds (Sadhak, 1997).

Mutual fund is an investment vehicle for all sections of investors including small, medium, and large, risk averse, risk taking, individuals or institutions. According to Sadhak (1997), the dominating investors are risk averse who expect sound returns through the stock market but do not have enough time and resources to enter it.

The Indian mutual fund industry, since 1964 the year of its commencement, is regulated by the Securities and Exchange Board of India. In 1964, The Unit Trust of India (UTI) was formed to increase capital through mobilisation of small savings from middle and lower income groups, (Geetha, 2013).

The development of mutual funds in India can be divided into three phases. In the first phase from 1964 to 1987, the UTI launched its first product and prepared a strong future for mutual funds in India. Later, in 1970s UTI started offering innovative products and schemes for different classes of investors. The first Indian offshore fund named the India Fund was launched in 1986. Thus, UTI is considered one of the biggest and oldest players in the Indian mutual fund industry and continued to lead and dominate until 1987 (Sharma P. C. et al., 2014; Sundar, 2014; Lohana, 2014; Geetha, 2013; Subrahmanyam, 2008; Sadhak, 1997).

The government of India in 1987 allowed commercial banks to offer mutual funds. Subsequently, during the second phase from 1987 to 1993, many public sector financial institutions established mutual funds in India. The SBI mutual fund was launched in November 1987 followed by Canbank Mutual Fund Scheme launched in December 1987. LIC introduced the Mutual Fund Scheme in 1989. Indian Bank Mutual Fund, Bank of India Mutual Fund, GIC Mutual Fund, and PNB Mutual Fund were among the main players in the market during this period. In 1989, the Reserve Bank of India issued its

first guidelines and in 1990 a comprehensive guideline covering all mutual funds was issued making it mandatory to be registered with SEBI (Sharma P. C. et al., 2014; Sundar, 2014; Lohana, 2014; Geetha, 2013; Subrahmanyam N., 2008; Sadhak, 1997).

The third phase from 1993 to 1996 was the era of competition and enhancement for the mutual fund industry. Private sector funds were permitted to enter the market in 1993. Within one year, five private sector mutual funds namely Kothari Pioneer Mutual Fund, ICICI Mutual Fund, 20th Century Mutual Fund, Morgan Stanley Mutual Fund, and Taurus Mutual Fund launched their schemes. During this phase, the government of India allowed non-resident Indians (NRIs) and overseas corporate bodies to invest in UTI and other mutual funds including primary and secondary markets (Sharma et al., 2014; Sundar, 2014; Lohana, 2014; Geetha, 2013; Subrahmanyam, 2008; Sadhak, 1997).

The mutual fund industry has gained significant momentum in the past two decades. Sundar (2014) states that in 2013, assets under management have almost doubled from Rs 417,300 crores to Rs 816,657 crores. The regulatory environment under SEBI and AMFI has been consistently improving. The frequency of reporting, transparency, and the advanced growth prospects has attracted global players to enter the Indian mutual fund industry.

2.1 Major Mutual Fund Companies in India

According to the Securities and Exchange Board's annual report 2013-2014, there are 1,638 mutual fund schemes offered by more than 40 fund companies in India². The major mutual fund companies with name and year of establishment are given in the following table

Table 1: Major Mutual Fund Companies in India

Mutual Fund Name	Year of Establishment
State Bank of India Mutual Fund	First sponsored mutual fund established in 1987, launched more than 35 schemes
LIC Mutual Fund	Established in 1989, and started its business in 1994
Bank of Baroda Mutual fund	Established in 1992
Prudential ICICI Mutual Fund	Setup in 1993
Birla Sun Life Mutual Fund	Established in 1994
Morgan Stanley Mutual Fund	First scheme was offered in 1994
Alliance Capital Mutual Fund	Established in 1994
Tata Mutual Fund	Established in 1995
Reliance Mutual Fund	Registered in 1995
Chola Mutual Fund	Established in 1997

² http://www.sebi.gov.in/cms/sebi_data/attachdocs/1408513411215.pdf

Kotak Mahindra Mutual Fund	Started operations in 1998
ING Vysya Mutual Fund	Established in 1999
Standard Chartered Mutual Fund	Established in 2000
HDFC Mutual Fund	Established in 2000
HSBC Mutual Fund	Established in 2012
Benchmark Mutual Fund	Established in 2001
ABN AMRO Mutual Fund	Established in 2004

Source: Geetha, (2012)

2.2 Penetration of Mutual Funds in India

A number of studies explored the future potential of mutual funds in India. According to a research by SEBI, in 2013 the total asset under management stood at Rs. 7.66 trillion in spite of low level of penetration in 2000s. The study explores that one of the primary challenge of mutual fund industry is lack of healthy participation from a large part of the country. The largest contribution of funds flows from only 15 states. To illustrate this, among 29 states only 15 actively participate in the mutual fund industry (Chakrabarti et al., 2014).

In other words, more than half of India's population does not have access to formal banking services. According to a survey by Chakrabarti et al. (2014), 65% of funds are saved in the form of liquid assets such as banks, post office deposits and cash at homes. Similarly, 23% savings are invested in physical investment such as real states and gold. While, only 12% of savings are invested in financial instrument such as mutual funds and stock market.

Nevertheless, the industry has been facing four key challenges as mentioned by PWC's report (2013)³. The first challenge is lack of retail contribution. As mentioned above, a small percentage of the Indian population participate in mutual funds. Secondly, the literacy level of financial institutions is very low. Investors are not completely aware of mutual fund schemes and its benefits. Thirdly, brokers or distributors are not well educated in marketing and distributing the products. Finally, the different cost and charges involved in mutual fund schemes cause confusion and dissatisfaction in investors. However, SEBI conducted a research to measure the challenges and put its efforts to deal with such issues (Chakrabarti et al., 2014).

3.0 Literature Review

There are limited cross country studies on the performance of mutual funds. Ferreira et al. (2012) evaluated open-end funds managed by equity mutual funds from 27 countries. The research connotes that funds around the world during 1997 to 2007 underperform the market. In contrast, funds in such countries with strong regulations and strong market give positive results. A similar research by Sundaram (2013) evaluated the

³ Indian mutual fund industry unearthing the growth potential in untapped markets, PWC, 2013, <https://www.pwc.in/assets/pdfs/publications/2013/indian-mutual-fund-industry-fv.pdf>.

performance of mutual funds in BRIC (Brazil, Russia, India, and China) countries from 1999 to 2010. The progression, development, and prospects are discussed separately for each country. Despite various challenges, this research predicts that the BRIC mutual fund industry can contribute significantly to the global economy as long as it is underpinned by robust regulatory framework and transparency in operations.

There are numerous research works on the performance of Indian mutual funds evaluated for different periods. John et al. (2014) evaluated performance of five private mutual funds such as HDFC Mutual Fund, Reliance Mutual Fund, Franklin Mutual Fund, ICICI Prudential Mutual Fund, and Birla Sun Life Mutual Fund. The performances are measured for five years from 2007 to 2012. The study revealed that private mutual funds have positive correlation with the performance of the mutual fund industry in terms of growth. It also mentioned that due to underperformance of assets under management, customers are not interested in mutual funds that led to a big challenge for private mutual funds to stay in the market.

Similarly, Lohana (2014) examined the growth in five parameters during 2009-2010 to 2013-2014. He found that the number of schemes increased to 1538 in 2014. Similarly, the resource mobilisation and asset under management by mutual funds reached more than 9 trillion (Rs.916393 crores). This study relied heavily on data provided by SEBI.

Subha and Bharti (2013) determined the performance of open-end mutual funds schemes using statistical measures such as Sharp ratio, Treynor ratio, and Jensen differential measure. The findings show that overall 51 open-end schemes during 2004 to 2005 performed well.

Similarly, a comparative research by Nimalathasan and Gandhi (2012) studied awareness among investors in selecting mutual fund schemes. Moreover, Dhanda et al. (2012) evaluated selected mutual fund schemes during 2009 to 2011 and mentioned that all schemes failed to outperform except HDFC capital fund and UTI opportunity funds in terms of risk and return.

Geetha (2012) explained that mutual funds have various advantages while comparing with other types of investments. In qualitative evaluation, mutual funds are found to be better in terms of high returns, safety, liquidity, volatility, and capital appreciation. Indian mutual funds have existed since 1964. However, after 1993 the industry was privatised and foreign management companies were allowed to operate mutual funds in India. Among the leading players in mutual funds, 18 mutual fund companies are key players.

4.0 Methodology

This study adopts a qualitative research method. In this study, the primary data is resourced through conducting interviews comprising semi-structured interview questions. The researcher has adopted non-probability sampling among others (Sekaran and Bougie

(2013). Further, convenience sampling and purposive sampling were employed. Since the answers and information needed through the research questions can be given only by mutual fund companies such as managers and Islamic finance experts, the researcher further employed judgement sampling to obtain first-hand information on the topic. Sekaran and Bougie (2013) explain that judgement sampling is a viable sampling method for obtaining the type of information required from very specific pockets of people who can provide needed facts and enlighten opinions, views, and knowledge that constitute a rich data source. The semi-structured interview in the study consists of 10 well phrased questions as it is deemed a suitable approach to focus on the research objective. The content of research questions was developed from a review of literature and other reading materials, and from other sources such as discussions and feedback from experts. The interviews were conducted using the face-to-face technique. According to Sekaran and Bougie (2013), researchers can take advantage of this technique to directly clarify doubts, get inside information by asking other relevant questions, and ensure that the questions and answers are properly understood. Similarly, in this research the e-interview technique was used as suggested by Bampton and Cowton (2002). Further, Berg et al. (2004), mentioned that the major advantage of e-interview can be realised as it does not require identifying mutually convenient times to interview and it solves the distance problem and travel problems. In this study, the researcher performed face-to-face interviews with four respondents and the remaining interviews were conducted using later the e-interview technique. The respondents comprise Islamic finance experts and Muslim and non-Muslim managers of mutual fund companies. In addition, existing Shari'ah mutual fund companies in India have been interviewed. The interview is conducted to ascertain the views of respondents regarding the prospects of Shari'ah mutual funds in India. Thematic method is used to scrutinise the contents of the interview information.

5.0 Findings

The primary objective of the study is to examine prospects of Shari'ah mutual funds in India. The researchers believe that Shari'ah mutual funds have a high potential in the Indian market that will result in financial inclusion of the Indian Muslim community and boost the Indian economy. Therefore, the researcher conducted interviews with Islamic finance experts from India and mutual fund companies including Shari'ah mutual fund companies.

5.1 Profile of the Respondents

The researcher approached five Islamic finance experts from India. To ensure the results are robust, the researcher preferred Islamic finance experts hailing from India despite serving in different countries. In addition to their distinguished expertise in Shari'ah, law, Islamic capital, market products, they are the preferred reference in the development of Shari'ah mutual funds and other Islamic finance products in India. Five among the six Islamic finance experts were successfully interviewed. Further, the researcher approached ten mutual fund companies. The respondents from this category shall not be confined to a certain religion. Only four mutual fund companies were successfully interviewed of which three respondents were non-Muslims.

Table 2: Profile of The Respondents

Respondents	Position	Area of expertise	Region
1	Director and Advisor	Islamic capital market and Economics	India
2	Member of International Islamic Fiqh Academy, Mecca, Kingdom of Saudi Arabia	Shari'ah and Islamic Finance	India
3	Officer of Structuring and Coordination	Islamic Banking and Islamic Capital Market	United Arab Emirates
4	Shari'ah Advisor	Islamic Banking and Finance	United Arab Emirates
5	Advisor and Researcher in Islamic Finance	Islamic Finance, Takaful and Re-Takaful	India
6	Advisor, Promoter and Managing Director	Fund Management, Mutual funds Islamic Fund Management	India
7	Branch Manager	Fund Management, Mutual funds	India
8	Branch Manager	Mutual Funds, Shari'ah Mutual funds	India
9	Product Manager	Mutual Funds, Shari'ah Mutual funds	India

5.2 Analysis and Discussion on the Findings

The responses gathered through interviews on “Shari’ah Mutual Funds in India: “Prospects” are presented based on thematic analysis in the next section.

5.2.1 Mutual Funds in India: An Important Sector for Economic Development

Do you think that mutual fund is one of the important investment sectors in India that will support the development of the Indian economy?

In response to this question, all of the interviewees unanimously believe that mutual funds are an important sector capable of supporting the Indian economy. The mutual fund sector enables people, especially middle to low classes to be a part of the Indian economy. India is the second largest country in terms of population and the majority of its people belong to middle to low class families. The other capital market instruments such as bonds, derivatives, and money market instruments are usually meant for big players or big investors. The stock market is considered unpredictable where common people lacking expertise could encounter huge losses. Mutual fund plays the vital role to pool funds and channel into diversified portfolios of investment avenues. There was a pressing need to introduce such products in order to tap investments from middle to low class people. The investments circulate through mutual funds to the capital market. A strong capital market directly supports and develops the Indian economy.

The present government of India is emphasising the financial inclusion of every Indian through financial institutions. The majority of Indians deposit their savings in banks. Economic growth depends on the accumulation of wealth that needs savings to be mobilised in investments. Mutual funds are considered a preferable sector as it ensures good returns with low risks. All respondents highlighted the importance of mutual funds and its correlation with economic growth and development.

5.2.2 The Role of Mutual Fund in Development of Indian Economy

What is the role of mutual funds in the development of India's economy?

All respondents highlighted different roles of mutual funds with regard to the development of the Indian economy. For instance, one of the respondents expressed his view that every country's economy and its development is linked to its people's participation in the capital market. The more developed the capital market, the more developed the economy. Subsequently, the capital market can be sustained and developed as long as the people actively participate through their investments that results in resilience of the market and economy. A respondent differentiated between banks' returns and mutual funds' returns. According to him, the returns generated from banks are not linked to the growth and prospects of the economy while profits generated from mutual funds can be linked to economic growth.

Another respondent mentioned that mutual funds can be used for investment in equities of various corporate companies as well as state-owned companies. Further, the investments through mutual funds can be used for financing infrastructure projects. The big infrastructure projects require large investments and this can be done by raising investments from the public. Infrastructure development is the agenda of the current government and people are encouraged to accumulate their investments.

Another respondent opines that mutual funds provide avenue for investors with small amounts of money making more funds available for various sectors of the economy.

5.2.3 The Future Development of Mutual Fund Industry

In your opinion, how does this industry grow further?

In response to this question, the respondents concurred with different approaches and strategies in order for the mutual fund industry to be robust and developed. According to an interviewee, the industry needs more players and investors in the market. Further, diversity and a large economy is required for growth and prospects while, "small economies with restricted or limited activities will remain prone to exploitation by few large and influential investors".

The other three respondents expressed their view that the industry can grow by leaps and bounds by financial inclusion of India's biggest minority, i.e. the Muslim community. This goal can be achieved through the introduction of more Shari'ah compliant mutual funds into the existing market. One of them further added that this industry can grow by, "catering to financial needs of faith-conscious communities such as Muslims and Jains". For instance, similar to Muslims, there are other communities that

avoid interest based banking and finance. Owing to this, many communities avoid investing in financial instruments. Thus, financial inclusion of those communities through mutual funds ensures the bright prospects of the industry. A similar view was expressed by another respondent. He added that there is a dire need to liberalise the regulations in order to attract new players in the market. Further, the market should be transparent and responsive and speculation should be eliminated from the market.

The other three respondents viewed that the industry is in its infancy where only three lac crores Indian rupees goes to mutual funds while the deposits in banking are more than 70 to 80 lac crores Indian rupees. In other words, 6% to 7% growth of mutual funds in India is seen so far while comparing to America, around 80% of savings are channelled into mutual funds. A huge gap was observed while comparing both countries, however it shows the great scope for growth and development. All three respondents expressed that the industry should be friendly, as the majority of the people are unaware of mutual funds and the benefits of investing in such products.

A collective contribution is needed for this industry to grow further, for instance, regulators, fund companies, and distributors should come up with innovative products that result in profound growth of mutual funds.

The other two respondents provided few practical suggestions. They emphasised that proper advertisement of mutual fund products is crucial. “The industry has become sales oriented and people have become sales oriented. Thus, sales need comprehensive advertisements and promotions”.

It was also suggested by the same respondents that mutual fund companies should expand their business by opening more branches in urban as well as in rural areas. Further, distributors should be well educated and able to create awareness and knowledge among people. The government should show its full support to mutual funds which is not the case compared to the insurance sector of India.

5.2.4 Opportunities of Shari’ah Mutual Funds

Do Shari’ah mutual funds provide similar opportunities compared to conventional mutual funds?

The majority of the respondents expressed their view positively. According to them, Shari’ah mutual funds have similar features and provide the same opportunities. Two interviewees expressed that Shari’ah mutual funds are governed by main sources of Shari’ah law and regulations. In this context, “Shari’ah mutual funds have certain restrictions resulting from compliance with Shari’ah tenets”. However, “a large segment of the economy still remains within the reach of Shari’ah compliant investment”.

The two respondents highlighted that, “certain restrictions make such funds more sustainable and less vulnerable due to the fact that Shari’ah disapproves investment in sectors such as tobacco, alcohol, gambling, pornography, speculation, uncertainty, and other non-Shari’ah compliant financial instruments and investments”.

Both respondents tend to disagree with the question asked. According to one respondent, there is no comparison between both funds as they both have their own

advantages and disadvantages and this all depends on the market. The other respondent added that Shari'ah mutual funds have a diversification feature, but in the Indian contexts such restrictions due to Shari'ah compliance limits the opportunities. For instance, Shari'ah mutual funds cannot be invested in financial instruments as they are deemed non-Shari'ah compliant in India.

5.2.5 The Role of Shari'ah Mutual Funds in The Development of Indian Economy

Do you think that Shari'ah mutual funds can support the Indian economy to grow further?

There was a consensus among seven respondents on the view that a large number of the Muslim population is still reluctant to invest in mutual funds. Introducing more Shari'ah mutual funds will bring back their savings into financial markets. One of the respondents expressed that many people from the Muslim community are waiting for more Shari'ah compliant mutual funds. Another interviewee felt that the, "Shari'ah compliant products shall have attractive features that ultimately bring the investments into mutual funds". The end result according to them can be seen in economic growth. However, having analysed the responses mentioned above it can be concluded that the respondents are very hopeful and expressed their views from theoretical aspects.

One of the respondents expressed his disagreement with the view of others. According to him, "In the current scenario of India, Shari'ah mutual funds do not give such a big impact on economic growth. The industry is very small and only two Shari'ah compliant mutual funds are available in India". This view is expressed based on practical aspect as the respondent felt that though the potential exists the practical reality does not confirm the theoretical fact.

A similar expression was observed by a respondent. He mentioned that, "It is still premature to suggest that. Currently there are only two Shari'ah compliant mutual fund schemes available in the country and none of them have been successful in penetrating the masses. A good knowledge of financial literacy is needed to convince the people about the capital market and also more products are needed to increase the competition among the fund managers".

With sustained efforts, it is very much possible that the Indian economy in general and capital market will immensely benefit from Shari'ah compliant mutual fund schemes.

5.2.6 Shari'ah Mutual Funds: A New Business Opportunity

Do you think that Shari'ah mutual funds will provide a new business opportunity? If yes, how?

The opinions gathered in this regard revealed that the respondents inclined to consent on the point that introducing Shari'ah compliant mutual funds will drive the business and market. The industry will enter into a new era of growth and development.

According to four respondents, an enormous number of investors are willing to make investments in sectors where ethical values are reflected and considered. Such

funds available on the ground will create a business opportunity for such stakeholders in the market. One respondent added that ethical and socially responsible funds are in demand and other communities are willing to invest in such funds where satisfaction is guaranteed. Shari'ah compliant funds have ethical values in investment and ensures high profits.

Further, a respondent opined that the vast majority of the Indians invest in mutual funds to avoid taxes as they are tax free funds. However, due to non-Shari'ah compliance, Muslims end up at paying taxes. Therefore, Shari'ah compliant funds can have a new customer base. Apart from the fact that Shari'ah compliant funds are ethically established, these funds can give high profits in addition to the security of funds.

A respondent felt that, "Shari'ah mutual funds will provide new business opportunities to fund managers, brokers, other distributors and most importantly open new avenues of funding for Shari'ah compliant companies. This will also benefit the investors who have hitherto been hesitant in coming to the capital market for fear of Shari'ah non-compliance".

Another respondent confidently expressed that by introducing Shari'ah compliant mutual funds, India would be one of the biggest contributors to mutual funds globally. Further, he highlighted that Shari'ah screening business will be increased given the fact that India has the largest Shari'ah compliant stocks. The penetration of Indian mutual funds will increase resulting in economic growth. He further added that a substantial number of Muslims who migrated to other countries or work abroad are willing to invest in the Indian market. Having Shari'ah compliant funds available, local as well as foreign investments would be mobilised into the Indian capital market. Ultimately, this would help the government's goal to "make in India".

5.2.7 Shari'ah Mutual Funds in Other Countries and India

Shari'ah mutual funds exist in many countries and it is showing a remarkable profit, how do you see it in the Indian context?

In response, five interviewees did not see any variance in terms of profits. They expressed their confidence that the Indian economy will experience significant growth given the fact that India is an emerging country and the Indian financial sector in recent years was very profitable. Two respondents expressed that if the government encourages such Shari'ah compliant products, India has the ability to become a hub for Shari'ah compliant products.

It was also expressed that political parties should abstain from creating hurdles for this business. The respondent expressed that India has fully supported the insurance sector and amended in insurance act in order to invite foreign investments up to 49%. The insurance sector has shown above 150% remarkable profit.

One of the respondents viewed that very low percentage of people tend to invest in mutual funds and people do not know about existing Shari'ah mutual funds available in India. Therefore, the results would be different irrespective of huge potential and the large Muslim population.

Another respondent viewed that this all depends on the market and business. If the market is doing well and the Shari'ah compliant product is innovative and attractive, it would definitely give sound returns.

One of the respondents felt that SEBI has recently made many changes in acts that might slowdown the penetration of mutual fund industry. The acts and regulator's amendments are not in favour of distributors, brokers, and fund companies. These could affect the Shari'ah mutual funds as well.

One respondent showed his disappointment with existing Shari'ah mutual funds. According to him, "Indian Shari'ah mutual funds have attained negative growth. The reasons are many:

According to him most of the fund managers are still not convinced of the market potential, community lacks trust in the existing schemes, markets over the past many years have been volatile and there is no distribution network for Shari'ah compliant schemes".

5.2.8 Attitude of Regulators Towards Shari'ah Mutual Funds in India

What is the viewpoint of the authorities towards the development of Shari'ah mutual funds in India?

This question was put forward in order to know the attitude of regulators and authorities towards Shari'ah mutual funds. In response, the majority of the respondents felt that as long as the product is structured in compliance with regulations and guidelines, there are no restrictions or barriers from their side in terms of approval. In addition, it was opined that the product shall not be promoted or highlighted based on a religious name. Such products were structured in compliance with Shari'ah and were able to get approval from authorities.

A respondent added that, "the recent report launched by a committee appointed by Reserve Bank of India has not only recommended Shari'ah mutual funds but Islamic banking windows at large".

Two respondents viewed that there shall be forceful demand from researchers, investors, and fund companies in order to get the attention and encouragement of regulators and authorities. In addition, education and awareness among investors can play a significant role at this juncture. According to them, this is the right time to take initiative steps and decisions to encourage such funds.

One respondent tended to avoid this question but another respondent mentioned that though the regulators have been positive about approving Shari'ah compliant schemes but according to him, "there are regulatory apprehensions about Shari'ah compliant financing mechanism in the country at regulatory and policymakers level".

5.2.9 Shari'ah Mutual Funds: An Interest of Muslims and Non-Muslims

Can Shari'ah mutual funds attract Muslims and non-Muslims?

This important question was raised to know the viewpoint of the fund companies as well as investors. All of the respondents unanimously felt that Shari'ah mutual funds not

only fascinate Muslims but also non-Muslims given that they are based on ethical values and socially responsible. One respondent expressed that, “such funds should not be branded with heavy Islamic terminologies making other communities understand that it’s something exclusively for Muslims”.

It is worth to highlight that a similar expression was felt while interviewing non-Muslim respondents. They expressed that as long as the product is innovative, attractive, and competitive the product can undeniably attract any investor from any religion. A non-Muslim respondent mentioned further that there are enormous number of investors from other religions who seek their own satisfaction by not investing in such products and avenues that might cause harm to the society.

Another two respondents explored the fact that, “investors from other religion are more than Muslims”. In addition, the company’s data was shown to support this surprising fact. The respondents further said that many non-Muslims tend to invest in Shari’ah compliant product and are satisfied with the performance of the portfolio.

5.2.10 Shari’ah Mutual Funds and Regulatory Infrastructure of India

Are the current legal and regulatory infrastructures sufficient to ensure a smooth operation of Shari’ah mutual funds in India?

In this regard, the majority of respondents collectively believed that the existing regulations provided by SEBI and further guidelines provided by AMFI are sufficient in order to get the approval. While one of the respondents added that not only Shari’ah compliant products but other structured products, exchange traded funds, and many other funds can be introduced in India. Shari’ah compliant mutual funds do not require the taxation act to be changed as these funds are deemed relaxed from taxation.

Another respondent highlighted the potential features of the Indian capital market regulations. He mentioned that, “there is no problem at regulatory infrastructure. India has a thriving capital market which provides one of the largest Shari’ah compliant capital market investment opportunities. The regulation is reasonable transparent and fair. Shari’ah advisory services along with several Shari’ah indexes are also available at both the prominent stock exchanges”.

On the other hand, two Islamic finance experts responded negatively. According to them, “it is not sufficient for couple of reasons which includes that there is no compulsion on having Shari’ah governance under the existing regulation. However, such inefficiency can be substituted by market force which will force fund managers to have such infrastructure in the place before claiming such funds Shari’ah-compliant”.

However, at this juncture, a respondent further explained that Shari’ah governance and screening process system is not transparent nor disclosed. The Shari’ah review and audit report or any disclosure regarding Shari’ah compliance has never been seen on any website of existing Shari’ah mutual funds.

6.0 Summary, Conclusions and Recommendations

The research findings connote that the mutual fund industry is a very important sector that enables low-to-middle class investors to strengthen the Indian economy.

Hence, the participation of investors from all communities including Muslims, can drive the industry by leaps and bounds. This end objective can be achieved by financial inclusion of all communities particularly the biggest minority of the country which is Muslims. Financial inclusion would certainly take place if the government caters for the financial needs of faith-conscious communities and allow mutual fund companies to introduce more Shari'ah mutual funds.

The interviews revealed that an enormous number of investors are willing to invest in sectors where ethical values are reflected and considered. Such funds available on the ground will create a business opportunity for such stakeholders in the market. Further, the ethical and socially responsible funds are in demand and other communities are willing to invest in such funds where satisfaction is guaranteed. Shari'ah compliant funds fortunately have ethical values that can play a great complimentary role for socially responsible investment industry.

The research findings endorse that Muslims in India do not contribute in strengthening the Indian economy through capital market due to the non-Shari'ah compliance issue. Hence, introducing more Shari'ah mutual funds across the country will strengthen the mutual fund industry and result in economic growth and reform.

However, Shari'ah mutual funds in India have experienced negative growth due to unexplored market potential and lack of trust in the existing schemes. Owing to market volatility, the Shari'ah mutual funds were confronted with an undesirable development. The recent regulations and amendments by SEBI restricted distributors and brokers of mutual funds. Ultimately, the overall mutual fund industry has faced an unfavourable circumstance.

With regard to the prospects of Shari'ah mutual funds in India, with sustained efforts, Shari'ah mutual funds can play a prospective role in development of the Indian economy. Shari'ah compliant mutual funds have the ability to drive the mutual fund business and market. The industry will see a new era of growth and development.

India is one an emerging and developing country and its financial sector has witnessed significant growth. It is among the favourable countries where foreign investors from Gulf countries for instance are willing to invest in its infrastructure and development projects. This is evident by recent agreements between India and United Arab Emirates where India has managed successfully to bring USD 1 trillion investments for various infrastructure developments. This is the ideal opportunity for India to encourage such Shari'ah based products in order to enable constant inflow of investment from GCC countries.

With respect to the concern over the attitude of authorities towards Shari'ah mutual funds, the findings connote that as long as the Shari'ah mutual fund is structured in compliance with regulations and guidelines, no restrictions or barriers from regulatory authorities would be evident. This is evident by the past practices and attitude of regulators towards approving Shari'ah mutual funds in India.

The findings also elucidate that Shari'ah mutual funds are not exclusively for a particular community rather they invite all communities to invest. To achieve this end, it was suggested that the primary emphasis should be on features of the product rather than

Islamic name or religion based terminologies. The legal and regulatory structures are sufficient in order for Shari'ah mutual funds to operate efficiently. Hence, it was suggested that Shari'ah governance should be included in existing regulations. The demand for Shari'ah governance and its compulsion by regulations is crucial in order to give complete assurance and satisfaction that these funds are Shari'ah compliant.

This research is anticipated to help Muslim as well as non-Muslim investors become aware of Shari'ah compliant investment opportunities. It should draw the attention of fund managers, mutual fund companies, and regulators towards establishing more Shari'ah compliant mutual funds throughout India particularly Muslim dominated states and cities.

Likewise, the undertaken research is expected to enable the public and all investors to better understand the Shari'ah mutual funds. It is expected to make them aware that these funds are ethically and socially responsible and open for all communities.

The research is expected to draw the attention of the education ministry, universities and colleges to prepare and introduce literature on Islamic finance as part of the finance syllabus. It calls on Shari'ah mutual fund companies and Islamic fund companies to enhance their products by marketing and conducting workshops and conferences.

Last but not least, this research draws the attention of Shari'ah scholars and practitioners from the industry to come on board and bridge the gap through meetings, discussions, and training sessions.

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The Achievement, Implementation and Future of a Cooperative Zakat Model in the Inland Empire and Beyond

By
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Abstract

The course of this submission is to detail the creation and implementation of a cooperative zakat distribution model in a geographic area encompassing over a dozen mosques and Islamic organizations. The first section opens by outlining the initial state of zakat management in the given region, resulting from the implementation of a decentralized model. The section concludes by highlighting the respective strengths and weakness of the initial model in the region. The second section defines a set of objectives and procedures aimed at correcting the zakat management in the region by capitalizing on a unified approach. The third section describes the attempted implementation of a centralized system in the region with the newly created process, ultimately resulting in an unsustainable model. Having failed with a decentralized and centralized model, the fourth section details the creation of a hybrid; the cooperative model. This section summarizes the beneficial attributes of the centralized and decentralized methods ultimately incorporated into the hybrid. The section closes outlining the initial results of the hybrid model, which was very encouraging as zakat distribution was standardized and efficiency was increased. The fifth section concludes the paper with suggestions to further improve zakat management within, and beyond, the geographic region with the continued use of a cooperative model.

Keywords: Zakat management, distribution, decentralized model, centralized mode, cooperative model

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1 Introduction

The essence of Islam is an all-inclusive system of life with guidelines set by The Creator, covering all aspects life; from business dealings to relationships with our neighbors. Included therein are the matters of charity and the rights of the destitute in society. Zakat, being part of the larger socioeconomic system in Islam, is the method decreed to support and maintain the poor and needy.

Historically, zakat management has taken a low priority in mosque administration and subsequently, puts a formidable strain on local mosques. The unaddressed component ultimately affects the contributor and those who are seeking assistance.

The Inland Empire¹ boasts over a dozen mosques and Islamic social service organizations, within a relatively confined geographic area. However, it also ranked the highest, among the nation's largest 25 metropolitan areas, for residents living below the poverty line². As a result, the declared recipients of zakat are often neglected. Not so surprisingly, zakat administrators across the world observe the same dilemma. Accordingly, a reliable and robust system to handle the collection and distribution is of utmost importance.

In order to correct the deficiencies, a group of zakat administrators, determined to resolve the inadequacies in the local zakat system, created a sustainable procedure and model which encapsulates the region. The core of this article, therefore, revolves around the strides taken to creating a viable, effective and legitimate zakat system for the geographic area of the Inland Empire with the aspiration of making is a viable domestic model.

1.1 Initial Assessment

The commission³ initiated the undertaking by conducting interviews with regional mosque administrators to better understand the current state of zakat distribution and collection.

The cumulative strengths and deficiencies are below:

1. Every mosque had a sincere group of volunteers and/or employees that genuinely cared about the best interest of their community. They worked tirelessly and had a commitment hardly rivaled. The cumulative knowledge and experience is a true blessing and benefit to the community.
2. An intimate relationship with constituents was present in smaller mosques, as well as those with stable management (less turnaround). They had firsthand knowledge of the challenges, needs and threats to the community.

¹ The Inland Empire is a region in Southern California, USA, encompassing the cities of western Riverside County and southwestern San Bernardino County

² 2013 US Census Bureau report

³ Comprised of several mosque and zakat administrators in the region

3. The religious injunction and socioeconomic status of Muslims in the regions translates into increased donations and the giving of charity. The specific act of giving zakat by the constituents of a mosque is practically guaranteed as it is a pillar of Islam. There also exists a vast range of constituents who donated professional services, commodities, and time to their local mosques.
4. There exists a large amount of mosques and organizations in a limited geographic area, making it easy for individuals to frequent. This is particularly beneficial for those without reliable forms of transportation.

The deficiencies in the local zakat sector are in three main areas; zakat collection, handling, and distribution.

1. Zakat collections did not take place at every mosque; or the collection boxes were not specifically earmarked for zakat, e.g., sadaqa, mosque donations or operations. An interesting correlation exists with zakat receipts and the stage of mosque development; several mosques opted not to collect zakat to encourage funding of building projects or mosque maintenance.
2. Zakat handling was haphazard in the majority of mosques. The primary method of mishandling observed was the commingling of zakat funds with other funds, e.g., operations. There also existed a lack of transparency with the funds. Proper handling and transparency of funds can increase receipts and quell mistrust by building confidence^{4,4}.
3. Zakat distribution occurred in most mosques; if the administrators deemed an individual fit to receive and if funds were available. However, there were notable concerns in this area; specifically two subsets - managerial as well as legal issues.

a. Managerial

The vast majority of zakat administrators are volunteers; yet they are all overworked. Compounding the phenomena, there exists a culture of administrator turnaround in mosques; primarily those with elected managers and board members. The turnaround typically replaces experienced individuals with others who have little or no [Islamic] organizational experience. This not only affects management effectiveness and synergy but also impacts the knowledge and implementation of rules and requirements pertaining to zakat. Hence, an unsustainable model resulted.

Several mosques had a defined procedure in place to assess applicants. However, the typical mosque benchmark was long turnaround times (also impacted by the overworked volunteers) and inconsistencies with distribution policies.

⁴ Wajihuddin, Mohammed "Zakat is being misused." The Times of India [Mumbai] August 6, 2012

⁴ Ahssan, M. H. "Investigation: India's Multi-Core 'Zakat' Scam Exposed". (2013, July 20). Retrieved from <https://innlivenetwork.wordpress.com>

Several mosques could not distribute, or experienced severely limited distribution, due to limited zakat collections; primarily mosques in destitute areas. This highlighted a more severe issue; a vicious cycle in which mosques, unable to collect, could not meet demands for distribution. Ironically the opposite scenario also existed.

No mosque had any form of internal or external auditing [of any funds or procedure] in place. The lack of such could lead to mishandling of funds or mistrust of the zakat procedure. Several mosques did have financial figures posted, however, they were typically outdated.

The majority of mosques did not have a physical office or one that is not commonly open, making the application process progressively difficult.

b. Legal

There exists a large deficiency regarding the edifice of zakat law. Administrators, with earnest intention, are simply never educated pertaining to such laws. The result is a system which contradicted and violated several clear sharia principles, e.g., incorrect distribution of zakat al fitrah or lack of distribution out of a fear of creating dependency.

There also exists a level of hesitation from the zakat applicant. This may result from dealing with a few harsh administrators or an underlying sense of shame caused by applying; both arising out of a lack of understanding of the specific rights of zakat. Mosque administrators, as well as constituents, neglected the right of zakat upon the recipient. The Prophet(saw), as well as subsequent leaders, would teach congregants about their respective rights⁵ quelling any shame associated with zakat receipt. However, in the modern era, the impression of zakat is merely a charity given to the poor at the discretion of an administrator.

Mosque administrators also expressed a fear of fraudulent applications, or multiple requests in surrounding cities, resulting with a presumption of guilt towards the applicant. There currently exist no method in place to verify or cross-reference applicants at neighboring mosques. There exists a coalition of mosques (Shura Council of Southern California⁶), however, zakat is not yet included in their activities. Chicago boasts a council of Islamic Organization with an offshoot dealing specifically with zakat.

2 Delineation of objectives

Following the assessment of the region, the aspiration of this venture was to create objectives that would not only resolve the impasse in the local zakat sector but ensure that the ensuing program is expandable⁷ and easily reproducible⁸. Consequently, the classification of the objectives fell into several main areas;

⁵ Abu'Ubaid, A. Q. I. S. "Kitab al-Amwal (The Book of Wealth)." (1969).
p. 599 - Illustrates how constituents were educated about their rights and how freely they could approach leadership in pursuit of said rights.

⁶ <http://www.shuracouncil.org/>

⁷ the continued addition of local mosques is straightforward and encouraged

⁸ the intent is not only to expand our local area of cooperation, but to create a system that could be easily duplicated elsewhere

General [mission]

- To advance the field of study and research in the area of American Islamic Finance; specifically zakat management [collection, handling and distribution].
- To create and achieve an effective, efficient and expandable working model for zakat management.

Management [targeted]

- To foster a working relationship between mosques and Islamic organizations in the IE specifically on the zakat (and possibly social service) sector.
- Implementation a transparent system for the a) collections b) handling c) distribution of zakat.
- Educate [zakat administrators and constituents] on zakat rules and rights.

Platform [targeted]

- Design a platform that would influence and address the large-scale behavior.
- Create a welcoming and encouraged feedback system where the findings and suggestions can be implemented.
- Devising and implementing regulation and control mechanisms.
- Standardized and transparent accounting and operating procedures.
- To create a distribution model that ensures the most efficient and robust distribution method which balances invasiveness and ease [for the applicant] yet ensures diligence in the review process.

Legal [targeted]

- To ensure the correct implementation of the specific rights of zakat.
- To ensure proper handling of the zakat funds.
- To resolve jurisprudence issues by implementing views and rulings that fit our community best while attempting to retaining and respecting the divergence of views among different schools of thought.
- To prioritize distribution to the poor and needy in the vicinity.

Strategy [Method of implementation]

- Capitalize on the wealth of cumulative knowledge and experience in the region.
- Capitalize on volunteers in existing mosques and organizations.
- Encourage mosques and organizations to collaborate and coordinate versus creating a new organization.

2.2 Review of Zakat Procedure

With consultation, the creation and implementation of a dynamic process succeeded in incorporating the bulk of the targeted goals. The resulting quagmire was that a potential zakat procedure is directly related to a viable structure. Subsequently, the development and analysis of a preliminary structure and procedural configurations were simultaneous. As a result, there were several policy revisions and alterations that corresponded with structural changes, hence, a complete understanding of the process will become evident following the discussion of the structure.

The focus of the review process was the standardization, as well as consistency and uniformity, in the process. The creation and implementation of a zakat manual, which delves into detail pertaining the distribution process, introduced uniformity and order. The manual also intended to educate the administrators and express the responsibility thereupon entailed with zakat law.

The process implemented currently involves the completion of an application. The application facilitates the documenting and tracking of applicants. However, there was concern regarding the identification of those who need assistance and are undetected⁹, or hesitant to apply. This continues to be an area which needs improvement.

Despite that, we were unable to form a non-application based system. In smaller mosques, where the Imam and administrators intimately know the constituents, they were able to clearly identify those in need and provide. However on a larger scale, we could not formulate a method. This will continue to be one area that we plan on revisiting. Furthermore, upon Consultation with a CPA advisor, an application was highly recommended in order to track distributions and segregate the duties, as needed for an auditable process.

An outline of the review process, as well as notes particular to the process¹⁰, is outlined below;

a. Application¹¹

We recommend that the mosque post a Zakat Policy¹², in a conspicuous location, to inform constituents of the process for the receipt of zakat. This posted policy plays a greater significance in mosques without offices, as lack of disclosure pertaining to the zakat procedure often bewildered constituents.

The application consists of the most relevant items with the intent of keeping it short and easy to complete. Currently, it stands at one page; with the back (second) page

⁹ The Quran references those who do not ask for assistance; [Charity is] for the poor who have been restricted for the cause of Allah, unable to move about in the land. An ignorant [person] would think them self-sufficient because of their restraint, but you will know them by their [characteristic] sign. They do not ask people persistently [or at all]. And whatever you spend of good - indeed, Allah is knowing of it. [2:273]

¹⁰ The Zakat Review Process can be viewed at www.iezakat.com/p/forms.html

¹¹ The application can be viewed at www.iezakat.com/p/forms.html

¹² The recommended Zakat Policy for posting can be viewed at ww.iezakat.com/p/forms.html

solely for office use. Also taken into consideration with the application was the ease of scanning and or inputting information to a database, as well as the environmental impact; several applications observed were in excess of four pages.

The application is currently being used in over half of the locations we surveyed.

One particular mosque without an office resolved this issue with a zakat application drop box. Subsequently, administrators would contact applicants and schedule an appointment at an unassuming time.

The policy required the applicant to apply at their nearest mosque. This condition appeared significantly later in the process. The section pertaining to the structure will discuss the reasoning leading up the change.

An interview is also a requirement; the substitution of an interview via an email or form submissions is not adequate.

Lastly, the administrator, conducting the interview, was advised to jot down notes, thoughts and recommendations pertaining to the applicant and situation. This helps overcome any language barriers and nuances otherwise difficult to determine when reviewing paper applications.

b. Review process threshold

A large number of applicants in our initial trial were requesting amounts under \$350. In an attempt to expedite applications below this limit, an administrator could process the applications without committee review. The cornerstone of this method would be the safekeeping and periodic reviews of completed applications to ensure compliance.

c. Establishment of need

The heart of this process is situated in this nuance area. The goal is to fulfill the request of those eligible without overburdening. However, equally important was the safeguarding of zakat funds. This entailed sifting through the information to ensure legitimacy. Typically, the process was fairly smooth and simple, however there were several common trends noticed. Often experienced was the negligent spending and saving habits of individuals; ultimately leading the working poor into a deficiency. Despite that, applicants were not interested in financial counseling or recommendations pertaining to their financial well-being; they simply needed an overdue bill paid. More often than not, the administrator commonly authorized said payment. An intervention pertaining to spending habits was warranted with the establishment of a trend; evident by repeated requests for similar items.

The ensuing protocol, which would guarantee a consistent process, focused on defining the categories of recipients, primarily the 'poor and needy,' as well as 'essential needs;' which is essential in determination of eligibility.

d. Type and amount of need

We are fortunate to live in a country and society that offer plenty of social services and methods of assistance. However, the majority of these programs take quite a bit of

time to implement, making them unfeasible in the short term. Applicants were forwarded to outside agencies if a long-term issue was identified and a social service program could assist to remedy the situation, e.g., health insurance and general relief. Similarly, the applicant would be forwarded if the request lay outside the realm of our assistance, e.g., legal assistance. Currently we do not have a protocol to follow up with applicants to ensure successful agency assistance.

3 Survey of the structure

Typically, zakat structures are either centralized or decentralized. Centralized models rely on one body to execute decisions and provide direction for all sites; a single point of input and output. They successfully control such issues as protocol, operating procedure, accounting systems and the resolution of jurisprudence issues.

There are several centralized organizations operating nationally [Islamic Relief, Zakat Foundation of America] with local collection presence. However the modus operandi observed was to assist those in need primarily overseas.

Conversely, decentralized models are independent operating entities; each autonomous location dictates the respective terms of protocol, procedure, jurisprudence, etc.

At the inception of this venture, all surveyed mosques and organizations were decentralized. The result of the decentralized structure is what ultimately initiated the attempt to correct the noted deficiencies. This quandary left the zakat payer with several peculiar options; give zakat to an inefficient local mosque, an organization that primarily distributes internationally or embarking on their own independent distribution. Similarly, the zakat requestor had several, just as idiosyncratic options; an inefficient local mosque or a distant, often inaccessible, larger organization.

3.1 Centralized Distribution System

The initial inclination was to create a centralized system that would envelop the stated objectives.

The apparent advantages of a centralized system were:

- Complete control of the review process; to ensure uniformity and consistency.
- Creation and use of a central database to facilitate efficiency and diligence.
- Prompt review of applications at a central location [and/or virtual review process].
- Cooperating zakat administrators could participate in the review process, if so desired.
- Ease of integration at mosques; administrators would simply forward the application.

- Minimal involvement and commitment by the administrators; not much time requirement.

The centralized model concept relied upon the use of technology to expedite the process. A centralized database was created, with the corresponding procedure, in which applications were scanned and uploaded for review. This became problematic as several mosques lacked the infrastructure to deliver applications electronically; the majority of mosques do not have an office, let alone a computer, scanner and internet connect. Hand delivery of applications, and resulting checks upon approval, attempted to correct the deficiency; although it was time intensive. This system flourished initially, however, as applications increased from surrounding areas, we discovered several issues that made the review process difficult;

- Reviewing and deciding applications on paper, in lieu of an interview, was rather difficult. Often times there was a communication barrier preventing applicants from completing the application and/or there existed nuances which were difficult to specify.
- In the event of an inconsistency, deeming clarification, the application would be sent back to the mosque, which greatly delayed the review process; administrators had to contact the applicant for an explanation or clarification. Initially, a large percentage of applications were returned for clarification.
- The time required by a centralized committee to review applications was considerable. As mosques collaborated, the amount of application grew significantly. The resulting review meeting would take an exponential amount of time - ultimately rushing the review the process.
- Payment deadlines and due dates were often missed as a result of the delayed processing time and delivery mechanism.

In an attempt to circumvent longer wait times, applicants would avoid applying at their local mosque and travel to apply at the centralized location [mosque] where the review process took place. This burdensome step has often been difficult for applicants; many of whom lacked transportation methods to go out of their community.

Consequently, the developed centralized model significantly increased review times and often forced applicants to seek assistance at mosques outside their immediate area. The result was a regression of the zakat distribution process in the region.

We further attempted to rectify the performance gap witnessed and the optimal model that we had envisioned by making several adjustments to the policies, e.g., submission of only complete applications and attachments; however the results continued to be sub-par.

It was appearing, rather obviously, that the centralized model would be difficult to operate when not utilizing technology to the fullest extent. In addition, a decentralized model demonstrated, for years, it's ineffectiveness. This interesting predicament forced us to examine and consider other distribution systems that could help accomplish the stated goals.

In the event mosque infrastructure is improved, the panel may revisit the implementation of a centralized system. However, moving forward, if an advance in the zakat procedure was to be observed, the process had to move beyond the centralized or decentralized model.

4 Cooperative Zakat Distribution Model

Despite the fact that we could not get a decentralized or centralized system to work efficiently in the region, each had its recognizable advantages. In an attempt to develop an effective and viable structure, we attempted to merge the respective benefits of each structure into a hybrid model. The thought, in essence, was to take the good, leave the bad and attempt to resolve the design of a feasible structure.

Mohammed Mahmood, Professor of Political Science (Retired), Aligarh Muslim University (India) had a similar observation and an interesting approach to solving the problem¹³.

"The intent of the Shariah is to support and maintain the indigent, disabled, sick, old and unemployed of a local community by pooling the zakat proceeds in a locally managed Zakat Fund/Baitul Mal. But it is possible that some local communities fall short of funds to meet their obligations. In that case other affluent communities may redirect their funds to the deficit communities. Since Muslim communities are dispersed and unorganized in a continental country centralization of collection of zakat funds or their centralized dispersal is neither desirable nor possible. Let us evolve a confederal approach to management and distribution of zakat funds with different regional and local communities cooperating with and aiding each other. This naturally implies transfer of funds from the developed rich regions to the underdeveloped poor regions on a voluntary and humanitarian basis."

As a result, the potential cooperative structure took the following form:

Features incorporated from a decentralized system

- Local application
 - Ease of application for individual seeking zakat; less distance to travel.
 - Encourages (re)integration with local mosque and leadership.
 - Builds confidence and trust in local mosque distribution.
- Local review
 - Speed and efficiency between all party in the process; applicant, interviewer, and potential reviewer.
- Local disbursement

¹³ Obaidullah, Mohammed, "Towards better zakat management in India: Where and how to begin." February 24, 2014

- Speed and efficiency as the distribution took place locally.
- Use of local knowledge to identify specific issues affecting the respective area.
- Use of local administrators knowledge of constituents
 - Benefiting from the relationship between local members and constituents.
 - Helps to identify individuals who are zakat eligible and unable, or unwilling due to social pressure, to apply.

Features incorporated from a centralized system

- Standard application form at all mosques:
 - Outward display of uniformity across the region.
 - Facilitates ease of transfer between local mosques, i.e., application will be forwarded to applicant's local mosque for processing.
- Standard review process at all mosques
 - Transparency and clarification as to zakat eligibility.
 - Removing inconsistency in the review process; which often led to applicants going out of area.
- A common distribution database:
 - Standardization of distribution record keeping.
 - Can assist in minimizing fraud.
 - Can identify dependency which could be used to address any root causes.
- Single platform for communication between administrators:
 - Ease of communication between regions.
 - Facilitates ease of training and standardization of relevant items.
 - Feedback loop to continually improve efficiency across region.
- Increase of distribution performance could be leveraged to increase zakat collection across the region.
- Ease of buy-in as the community and could measure and monitor performance .

Features of the cooperative system

- Create an atmosphere encapsulating the Islamic principles of mutual cooperation and consultation:
 - syndication method in which funds and knowledge from nearby mosques could flow between each other in lieu of a centralized pool.

- Creates a working relationship between zakat administrators.
- Local mosques retained full control of locally collected funds.

The zakat review process was therefore amended to be reflective of the cooperative model.

4.1 Initial Results

Initial results were extremely promising. Immediately noted was the speed and robustness of local application and distribution. As a result, a number of applicants venturing outside of their respective region instantly decreased. Applicants were redirected to their local mosque if it was in the cooperative structure; unless an extenuating circumstance was present.

Following implementation of this policy, applicants no longer had to travel to distance mosques for assistance; the benefit was immediate for those who were unable to travel outside of their respective area for assistance. Nonetheless, the benefit of having a local mosque capable of administering assistance, versus directing people to other mosques or organizations, built confidence and trust in the mosque environment. Such practices could potentially reintroduce disenfranchised individuals to local mosques. Enabling mosques in destitute areas by providing funds conversely benefited the organizations in affluent areas by giving them an avenue to distribute funds locally.

The increase in communication between mosques could have also helped in reducing applicants frequenting neighboring mosques. Other benefits of communication emerged as the lines of communication would lead to other non-zakat related items, such as resource sharing.

A factor that greatly increased the speed of the entire process was the conducting of the review in the respective region; a review process conducted by individuals outside of the immediate area was extremely difficult as the specific situation was often difficult to convey. Not only was robustness increased, but fraudulent applications decreased; which could have also been a result of a standard application.

An additional key finding was that the amounts requested were relatively small; under \$350. In an attempt to expedite the process, a streamlined review process substituted a formal review.

There were challenges experienced with the cooperative structure as well. The primary obstacle was the addition of policies and procedures, to an already overworked administrative body, was not warmly welcomed. Several (overworked) mosque administrators, respectfully declined any cooperative dealings because of the additional work. As a result, the process was continually condensed in order to increase appeal to mosques. There did exist a correlation between mosques that were willing to cooperate and the respective benefit realized. Receptive mosques benefited their constituency by significantly increasing the amount of funds available for distribution as well as improved handling of funds, i.e., separate accounts for zakat funds and clearly designated collection boxes for zakat. However, said recommendations often took quite a bit of time for implementation. Several other mosques simply chose not to make adjustments.

Despite being a component of considerable interest, the additional workload required for the utilization of the central database caused it to stagnate. The facilitation of a simple input method is required for a database to gain widespread input.

As with making any long-term change, new process and procedure often result in a regression towards the previous method. To counter the phenomena, a large investment of time with the mosque administration was required. The demand became exponentially difficult with the individual courting of mosques; which resulted in slower growth and stagnation.

Although there were complications with the implementation of the process, the successes were more exceptional than we could have imagined. The adaptable and robust process served well in the advancement of the process and structure. With the adjustment of a few items, the benefit could be extended to a far greater area.

5 Recommendations and conclusion

Moving forward, there are several recommendations and courses of action that would benefit the cooperative.

The success of the project relies upon the expansion and increased participation of mosques. Accordingly, the barriers to additions are the primary concern, as cooperation and collaboration become impractical otherwise. The primary barrier was the additional work required from the administrators. Despite the fact that the process had been continually streamlined, any additional reduction would be welcome. There are also several proposed revisions to the database that would considerably reduce the amount of time required to input or search applicants. It is anticipated that a reduction of items to input would reinvigorate the use the database.

Several administrators also encountered difficulties due to the vast range of requests received; a certain level of expertise is required pertaining to a wide array of areas, e.g., social services policies and the rental eviction procedure. A suggestion was to include common scenarios in a training manual to help familiarize administrators with common scenarios.

Currently, there exists no protocol to follow up with applicants to ensure a successful resolution of the request. Furthermore, other applicants often had concerns that were relatively easy to correct, often requiring action from the applicant. A simple follow up would ensure the issue had been resolved. Logistically, the additional step is challenging to incorporate.

Incumbent upon the mutual participation of mosques would be the creation and routine use of a control process to ensure compliance. This would include compliance audits of all participating organizations involved; pertaining to all areas of zakat management. Stern assessment will demonstrate compliance with zakat law and also emanate confidence in the system, potentially spurring growth. The compliance must also assess the collection and handling of zakat funds, as discrepancies often occur and are relatively easy to correct.

Along with overcoming the barriers of entry, proactive measures may be implemented as well. An affiliation with a larger organization can increase participation, by mandate, as well as lend credibility, which may help reluctant mosques to join. An added benefit would be the ability to leverage the economies of scale by conducting large zakat administrator training as well as introduce and educate mosques of the process.

Leveraging with a larger group can facilitate improved communication across a larger region, which could serve to identify and address developing trends and collective resolution of difficult scenarios, e.g., the influx of Syrian refugees.

Lastly, any affiliation would need to include other social service organizations in the region; mental health providers, food banks, and legal services. Despite being outside the realm of zakat, many applicants need assistance that a mosque simply cannot provide.

Although zakat management realized significant gains in the geographic area, a far larger benefit can be realized with the continued improvement and recommendations mentioned. The bulk of the recommendations are straightforward to apply. Increasing the amount of mosques cooperating, or affiliation with a larger organization, will take the priority as the impact would be the largest and ultimately benefit all parties involved.

Corporate Social Responsibility (CSR) in Islamic financial Institutions: the Shariah Adoption and Standardization, UAE and Malaysian Model

By

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Abstract

This paper proposes a standardized ‘Corporate Social Responsibility (CSR)’ framework for the Islamic financial institution queing from the idea of the proposed UAE framework. The development of CSR framework in UAE is the newest contribution of the country to the growth of Islamic finance, after being the cradle of the industry. The Emirates’ Ministry of Commerce has instructed corporations in the country to register for a mandatory CSR practice, including the Islamic financial institutions. However, the Islamic financial institutions lack a standardized CSR framework. This is also the case with Malaysia. Individual financial institutions use separate framework for CSR. The current study adopts a qualitative approach and it proposes a standardized CSR framework for the Islamic financial institutions. In addition, interviews was conducted to extract valuable information from the Islamic finance practitioners in both UAE and Malaysia on the CSR practice in the countries. The interviewees agree that the Islamic financial institutions are lacking standardized CSR framework and suggest the development of a unified framework. More so, majority of the interviewees agreed that the Carroll Model of CSR can be adopted and adapted to the Shari’ah practice of the Islamic financial institutions. The current paper highlights areas that require attention while developing a standardized Islamic finance CSR.

Keywords: Corporate Social Responsibility, Islamic Finance, Carroll Model

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Research paper

1. Introduction

To start with, the resolve of the Government of United Arab Emirates (UAE) to introduce a mandatory practice of corporate social responsibility to the entire corporations in the country is commendable. CSR will benefit the host communities and the citizens in general. It is worthy to remark that the application of the mandatory CSR does not exclude the Islamic financial institutions. However, the concern is that, the practice of CSR is yet to be standardized in the Islamic financial institutions. Thus, this article presents a model standardized CSR framework for the institution. It recommends the adoption and Shari'ah-adaptation of the Carroll Model of CSR. The study advocates for the prioritization of educational development and skill acquisition programme in the CSR of the Islamic financial institutions. The method of the study is qualitative. It relies on published journal articles for its secondary data and interviews for its primary data. The interviews are conducted to collect information on the current practices of CSR in the Islamic financial institution. It equally proposes a standardized Shari'ah compliant CSR framework as modeled from Carroll model, (The Archive, 2017) .

2. Literature Review

The available literature on the practice of CSR, (corporate social responsibility), in the Islamic Financial Institutions shows that, the Islamic financial institutions are active as far as CSR is concerned. That is, despite the absence of a standardized CSR framework in the institution. One of the most prominent reports on Islamic financial CSR is the Emirates NBD Sustainability Report, 2015.' The report submits that in 2015, the bank integrated its CSR into its existing PAL program. That is, the '*Program for Accelerated Learning*.' The CSR activities included the training of two batches of teachers of the Manzil center for the people with disability in Sharjah. The teachers were sponsored to acquire skills in IT and finance under the programme, (NBD, Sustainability Report, 2015 - 2016).

Correspondingly, the programme gave opportunity to candidates who have degrees with specialization in banking, finance, accounting and IT, to acquire necessary skills. Thus, some of the trainees received professional training in management and leadership. The approach of the programme was collaborative. There were classes of essential banking systems, product development, management and motivational theories. Consequently, the CSR - PAL programme has graduated more than five hundred talented young emirates professionals. The CSR programme was very successful, . (NBD, Sustainability Report, 2015 – 2016).

Furthermore, in the year 2016, Abu Dhabi Islamic Bank extended its sustainability commitments to various communities in the UAE as part of its CSR maneuver. Thus, the bank introduced several new initiatives that are meant for the benefit of the host community. These include programme for the financing of education, support for sport in the UAE as well as many community outreach programme, and the sponsorship of humanitarian and cultural activities during the Holy Month of Ramadan, Abu-Dhabi-Islamic-Bank, 2016).

However, there is a need for the development of a standardized special Shari'ah compliant framework for the CSR practice for the unification of the system. This fact is supported by the majority of participants in the current research interview. The participants posit that the adoption of numerous unstandardized CSR frameworks by the various Islamic banks suggests the indispensable need for Islamic banks to adopt a standardized CSR framework to avoid discrepancies in its practices. They emphasized that the standardization of the Islamic financial CSR is important for the growth of Islamic banks, other Islamic financial institutions, (Ibrahim, a Corporate Social Responsibility of Islamic Banks: Malaysian Practitioners' Perspective , 2015).

Furthermore, it is important to learn that, *Alhali bank* has resolved to utilize its CSR for the improving of the life quality of the people in the UAE communities, and therefore, launched programme the is labelled '*Heart to Heart*' in the holy month of Ramadan. The programme was carried out under the slogan of '*JoudBilKhair*' ('do good') in order to promote the spirit of giving in the holy month. The CSR programme included the provision of medical facilities and financial support for children with congenital and heart disease, (Al-Hilal-Bank, 2015). In summary, the practice of CSR is not actually alien to the Islamic financial institutions. However, although, the institution has been very active in the practice of CSR, nevertheless, there is a need for the standardization of the practices. The CSR practices in the Islamic financial institutions will be more sustainable and beneficial if the framework is standardized. Having reviewed some of the available articles on CSR in the UAE, the current proposed mandatory CSR practice in UAE is seen in the light of Islamic financial institutions and is discussed below.

3. Mandatory CSR in UAE

In the UAE, companies and corporations are enforced to register for a mandatory CSR practice. The initiative is expected to generate up to five million AED which will be used for the benefit of the residents, in the forms of philanthropic gesture, humanitarian initiative and charitable activities. The initiative is enshrined in the current promulgated CSR Law in the country, (www.csruae.ae). However, a token of appreciation will be extended by the government to the companies, and the participating companies will be indexed for ranking. More so, the initiative will culminate in the granting of CSR Passport to their employees, which will be regarded as special privilege and reward for their performance in the CSR activities, (Mansour, 2017). Having said this, it is pertinent to know what actually CSR means.

4. Concept of Corporate Social Responsibility (CSR)

Social egalitarianism is the dream of all society. '*Corporate Social Responsibility (CSR)*' is a strategic method that is adopted for the purpose of achieving the dream by corporations and institutions, and to indicate their commitment to growth through their obligation to the development and sustainability of their host community. To achieve this

objective, a financial bank will contribute to the development of the community through the improvement of educational organizations, healthcare facilities etc. This will be done to assuage the quality of living of the less privileged members of the community. Having said this, the CSR framework in the Islamic financial institutions is discussed as follows.

5. Standardization of CSR Framework of Islamic Financial Institutions:

The CSR framework in the Islamic financial institution is not yet standardized contrary to that of the conventional financial institutions. Thus, in order to carry out the obligation of CSR, an individual Islamic financial institution must embark on the development of its framework for its CSR practice. Thus, since the operations of financial institutions are based on standardized practices, it is opined that the Shari'ah experts in the various Islamic financial institutions needs to come together to develop or adopt a standardized suitable best practice and a CSR framework for their Shari'ah compliant practices. The available conventional framework can be modified to suit the CSR practices of the Islamic financial institutions.

In order to achieve this initiative, a study was conducted on the feasibility of CSR in the Islamic financial institutions. The findings of the study show the practice of CSR is feasible in the institutions. More so, the most adaptable CSR framework to the practices of Islamic financial institutions is the Carrol Model of the CSR. This decision was reached after studying the availability of CSR frameworks in the conventional institutions. As a result, the CSR standards that were considered include Friedman Model, (Coleman, 2017) Ackerman model, (Repaul Kanji, 2016) Environmental integrity and community model, (Feminella, 2000) corporate citizenship model, (Mirshak, 2007) Stakeholders and shareholder model, (Carrol) as well as the Carrol model, (Carroll, 2003). For instance, all the models, except the Carrol model, give importance to the shareholders profit over any social responsibility. They generally implied that the objective of a financial institution is to satisfy their shareholders and other stakeholders by maximizing their profits.

However, the Carroll Model, on its part suggests that CSR should be inclusive of four factors. These are the legal responsibility, economic responsibility, ethical responsibility, and philanthropic responsibility. Accordingly, a financial institution is required to abide by the laws and regulations of its host community regarding its practices, as well as upholding the moral and the ethical values. More so, what makes the model unique is the inclusion of philanthropic responsibility in its CSR activities. This is regarded as the highest requirement of the CSR given the fact that it provides succor to the host community. This is attributable to the fact that the Carrol model of CSR represents a platform for the provision of social welfare package to the poor and the needy in the society. Thus, the Carroll model is adaptable to the CSR practices of the Islamic financial institutions. The pyramid of the pure CSR model is presented below.



Figure 1: Carrol Model of CSR

Thus, as it was explained above, a close study of the Carrol model shows that it obviously encourages corporate contribution to the host community, and it is adaptable to the Shariah compliant practices of the Islamic financial institutions. Nevertheless, the contribution must be in tandem with ethical activities, good conduct and corporate responsibilities of the Islamic financial institutions. Thus, it is worthy to note that the Carroll Model is comprised of all the values that are expected in the Islamic financial services. It is upon this that the current paper proposes its adoption and adaptation to Shariah compliance practices of the Islamic financial institution.

Furthermore, all the four components of the model are adaptable to Shariah. Thus, the first component of the model which is economic responsibility can be adapted to Shariah by eliminating the capitalistic ideology and immoral activities and be substituted with Shari'ah compliance economic responsibility toward the host community. This is due to the fact that the objective of Islamic banks is to make profits by means of Shariah compliance. Additionally, the second component of the model purports the legal responsibility of the financial institution and it refers to the legal obligation of the institutions to the authority and host community which is tandem with Shariah requirement of compliance with the law and regulations of Islamic financial practices. Therefore, the adaptation of this component to the Islamic finance CSR is an ordinary act of assimilation, since it is alien to the Islamic finance.

Moreover, the third component of the Carroll model, that is, the ethical responsibility is similarly in tandem with the Shariah practice. This is given the fact that, ethical practice (Rice, 1999) is a major requirement in the Islamic financial institutions. Nevertheless, the supposition of ethical practice in Islamic financial institutions differs from that of the conventional institutions, in the sense, that ethical practice in Islamic finance includes the abolition of interests based practices, gambling, uncertainty. It means complete compliance with Shariah rules and requirements. Therefore, Shariah requirements and principles that are related to finance should take precedence in the situation of any conflicts of principles.

Lastly, the fourth component of the Carroll model is the requirement for philanthropic responsibility toward the host community. This is considered as the height of the obligation of the Islamic financial institutions as corporate citizens. Consequently, the institution has a responsibility toward its host communities. The responsibility of the financial institution is depicted in the CSR pyramid below *vis-à-vis* the proposed Shariah framework of the Islamic financial institutions.



Figure 2: Proposed Shariah Compliant CSR Model

In summary, the Shari'ah adapted CSR model framework from the Carroll model demonstrates the responsibilities of the Islamic financial institution to the general public. The first component which is the 'economic responsibility' includes the obligation of eliminating practices that are incompatible with the Islamic financial system, such as 'Riba' interest based practices, 'Gharar' or uncertainty and gambling or 'Maysir.' from the CSR of the institution. Consequently, the second element of the model indicates 'legal responsibility' of the institutions and this can be extended to the compliance with the Shari'ah rules and principles in the practices of Islamic finance. As well, the requirement of 'ethical responsibility' in Islamic finance covers the entire Shariah ethical responsibility. Finally, the fourth component which is 'the philanthropic responsibility' denotes the payment of *Zakat*, *Sadaqah* etc. This is the most important component of the Shari'ah compliant CSR practice, given the fact that it is the component that is meant to assuage the condition of the needy and the less privileged in the society. The study on the quest for CSR practice in the Islamic financial institutions cannot be conclusive without consultation with the experts in the Islamic financial institutions. The following part is the analysis of the interviews that were conducted on the CSR practices in the Islamic financial institutions in UAE and Malaysia.

6. CSR - Interview

A face-to-face semi-structured interview was conducted to collect information from the Islamic banking and finance practitioners on CSR practices in their various institutions. It involved 25 participants who are from members of the management, Shariah board and operation practitioners of the Islamic banking and finance. The interviewees cooperated with the researchers and provided valuable information in respect of the CSR practices in the Islamic financial institutions. The face-to-face interviews allowed for real interaction between the researchers and the interviewees. The information that was collected from the interviewees is based on their experience, expertise, and informed opinion. Thus, it is reliable and valuable.

Table No. 1: Interviewees Background

Serial No.	1	2	3
Occupation	Management	Shariah Compliance	Banking Operations
Population	14	08	03

Table No. 2: Findings

Availability of CSR Standard		Adoption of Carrol Standard		Prioritization of Education	
Available	Not available	Agreed	Disagreed	Agreed	Disagreed
0	25	17	8	20	5
0%	100%	68%	32%	80%	20%

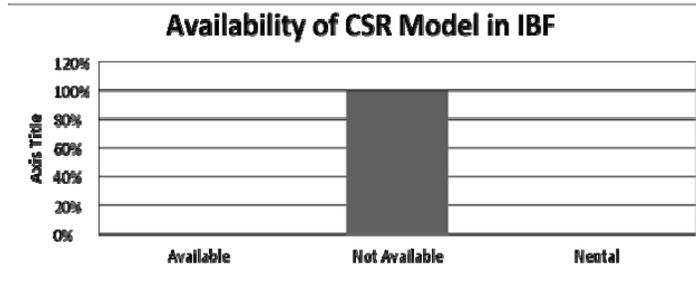
7. Findings

The interview was conducted in two different banks. That is, the Mitsubishi Islamic Bank in Dubai, UAE, and CIMB Islamic Bank in Malaysia. Both banks are operating locally and internationally. The *Mitsubishi* Islamic Bank is a Japanese foreign bank in UAE. The interviewees answered questions on *whether there is a standard framework for the CSR of Islamic banking institutions, whether the Islamic financial institutions can adopt the Carrol model of CSR, and whether education can be prioritized in the implementation of the proposed CSR of the Islamic financial institutions*. The findings of the interview are as follows:

(1) Availability of Standard

All the interviewees agree that there is no standardized CSR framework in the Islamic financial institutions. They lamented that, the standardized framework of CSR of Islamic banking and finance is still under development, (Manager, 2017). They included that, although individual banks developed CSR framework, (Project manager, 2017) there is a need for the development of a standardized CSR framework of the institutions as a whole, (CIMB Executive, 2017). Nevertheless, a respondent contended that although some Islamic banks are currently applying self-developed CSR framework, nevertheless, there is subjectivity in their practices. They, therefore, submitted that for the CSR practice to be objective the banking management must determine, (Shariah-Officer-CIMB, 2017) how the model in the individual bank should be applied, (Assistant-Manager-Shariah-and-Governance-Department-CIMB.,2017). In brief, all the respondents virtually agreed that there is no standardized CSR framework in the Islamic financial institutions and that there is a need for its development. The following chart gives the distribution of the positive and negative respondents to the question of 'whether there is a standardized CSR framework for Islamic financial institutions, (Director-CIMB., 2017).

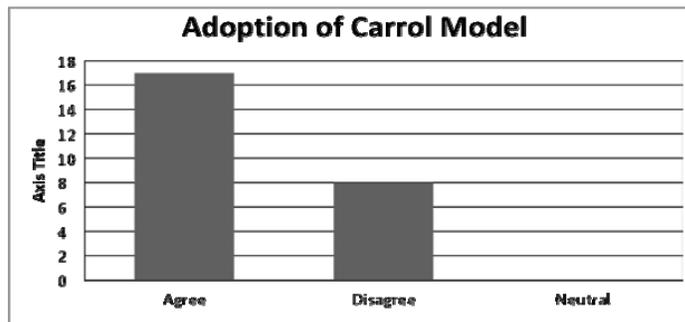
Availability of Standard



(2) Adoption of Carrol Standard

Moreover, as to the question of ‘whether Islamic banks can adopt the Carrol Model of CSR for adaptation to Shariah practices of the Islamic financial institutions.’ 68% of the interviewees agreed that the Carrol model is compatible with the practices of Islamic finance and it can be adopted and adapted to the Shariah-compliant practices of the Islamic financial institutions. However, 32% of the interviewees disagreed. They argue that the Carrol model is not compatible with Shariah-compliant practices of the Islamic banking and finance due to the fact that it was primarily developed for conventional practice. However, those who suggested that the Carrol Model of the CSR can be adapted asserted that there is no need for the development of a new model since the Carrol model is malleable to Shari’ah compliant practice of the Islamic financial institutions. In short, the majority of the interviewees agreed with the proposition of adapting the Carrol model of the CSR to the Shariah practices of Islamic financial institutions.

Adoption of Carrol Standard

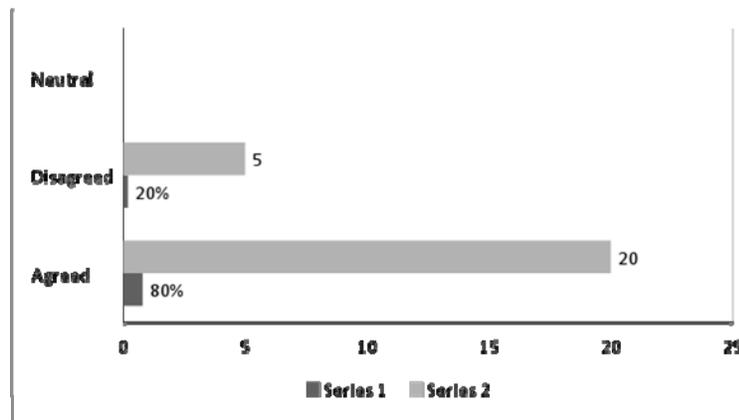


(3) Prioritization of Education and Skill Acquisition

In addition, the question of whether the Islamic financial CSR should prioritize the sponsorship of educational development and skill acquisition, 80% of the interviewees agreed with the proposition. They emphasized that the sponsoring of educational development and skill acquisition will aid the development of Islamic finance as well as the general public. Nonetheless, the remaining 20% of the interviewees disagree with the proposition. They argued that there is no need for the prioritization of education or skill acquisition in the CSR, and postulated that the CSR should be made to only aid the

development of the Islamic financial industry and that should be given priority over any other goal. However, the majority maintained that further development of the industry is based on knowledge acquisition. Consequently, the disagreement is cosmetic since it is only reaffirming the opinion of the majority in another manner. Thus, the interview is considered successful, given the fact that the proponents of the adaptation of the Carrol Model of CSR for the Islamic financial institutions and the diverting of the generated funds from the practice for the sponsoring of educational development and skill acquisition are the majority.

Prioritization of Education and Skill Acquisition



8. Conclusion

To sum up, the current study reviewed the existing CSR framework in the Islamic financial institutions *vis-à-vis* the conventional institutions, with the goal of proposing a best practice model for adaptation into Shariah practice for the Islamic financial institutions. The interview was conducted to collect information on the subject in both UAE and Malaysia. The interviews show that there is no standardized Islamic financial CSR framework and that the Islamic financial institutions practice of CSR is based on their individual model. This study proposed a standardized model for the institutions which will be applied across the world. Accordingly, since the UAE is the cradle of Islamic financial institutions, it is recommended that the country should take the lead in the standardization of Islamic financial CSR framework to serve as a model for other jurisdictions. More so, it is commendable to learn that the UAE authority has mandated the entire corporations in the country to register for the CSR in 2017 while the practice will take-off in 2018. The initiative should be welcome by Islamic financial institutions, given the fact that the full-fledged practices of the Islamic banking and finance actually started in the country, with the development of Dubai Islamic Bank, which was established in 1975 and becomes a model for all the Islamic financial institutions across the world today, (Foucart, 2013).¹⁴ Therefore, the standardizing of Islamic financial CSR will be generally welcomed since it is from UAE, the pioneer of Islamic banking and finance.

¹⁴ Foucart, E. S. (2013, February 28). Western Financial Agents and Islamic Ethics. *Journal Bus Ethics*, 5.

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Challenges of Islamic Banking in Nigeria; Legal and Regulatory Perspectives

By

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N.M. Gatawa

Abstract

This research paper discussed the challenges of Islamic banking in Nigeria, looking at the legal and regulatory perspective of the industry. The background of both the Islamic and Conventional banking system was analyzed, the legal background supporting the major actors in the industry i.e. (CBN and NDIC) functions was also analyzed. The research concluded that Islamic banking is an essential sub-sector with prospect and has a lot to contribute to the diversification of the Nigerian financial system. However, legal and regulatory challenges would hinder the success of this financial system. It is recommended that the policies guiding the operations of Islamic banking in Nigeria should be restructured to consider the AAOIFI standard. Islamic Financial market should be developed so that Islamic banks could invest their excess liquidity. FRACE should be a unit within the CBN that will oversee the activities of the ACE on day to day basis. The ACE tenure should be a non-renewable one term of four (4) years to enhance their independence. Advanced trainings on Islamic banking should be conducted for the regulators of the industry in order to meet their regulatory challenges and the global best practice of Islamic banking. Capacity building for the regulators and operators in the sub-sector should be intensified. To have a robust Islamic banking and finance system, these challenges need to be addressed in order to achieve the objectives and goals of Islamic banking.

Keywords: Islamic Banking, CBN, NDIC, BOFIA, CAMA, Sharia, FRACE, ACE, NIFI

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1.0 Introduction

Nigeria's financial system is dominated by the conventional system. Before the establishment of the Central Bank of Nigeria in 1958, the financial system experienced instability due to the Laissez faire approach and poor level of awareness. However, the industry witnessed significant changes and transformation in the mid-nineteenth century, with more stability measures taken by supervision and regulation of the industry, and this led to a more advanced and clear way of granting banking license where integrity is a major factor in granting banking license in the country. Minor players in the industry such as non-interest banking as well as the insurance and pension sub-sectors were also regulated due to the interconnectivity of the systems (Bala and Victor, 2013).

It is an established fact that, Islamic banking as a product was strengthened by the majority Muslim population as an avenue for them to avoid interest based dealings which are prohibited in Islam. Although, even the non-Muslims keyed into it especially after the global economic crisis of 2008 which started from the USA in the mortgage industry, countries such UK and Germany have keyed into it, while others began to show interest in Islamic banking, Islamic finance and *takaful* (Aliyu, 2012).

Aliyu (2012), Bala and Victor (2013) and Oshodi (2014) have identified various challenges in the Islamic banking sub-sector of the Nigerian banking industry. These challenges include:

- (i) Monetary and fiscal policies guiding the economic environment in Nigeria are conventional in nature dealing largely with interest which is prohibited in Islam.
- (ii) There is a gap between the Advisory Council of Experts (ACE) who are the experts on the religious part and the bankers who knows more about the banking products. Religious advisors don't have enough technical experience on day to day operational needs of the bankers, meanwhile, bankers do not have sufficient understanding of the principles of Islamic Jurisprudence guiding the Islamic banking model. This creates a communication vacuum for the Financial Stability Advisory Council of Experts, (FSACE), the regulators and the operators. (Aliyu,2012).
- (iii) Public awareness is also an obstacle to the sub-sector, where the majority of the people especially those that are non-muslims look at the sub-sector as a religious product, and strictly made for Muslims.

Considering the above challenges, this research work reviewed the legal and regulatory framework guiding the Islamic banking in Nigeria and identified the problems in the laws that regulate or govern the operation of Islamic banking and proffer reasonable solutions. This paper is structured into four sections, section two deals with the literature review, section three discusses the legal and regulatory challenges of Islamic banking, and the last section highlights the summary, conclusion and recommendations.

2.0 Literature review and Conceptual Issues

2.1 Islamic and Conventional Banking in Nigeria

Islamic banking refers to a banking system that is based on the teachings of Islamic law (*Shari'ah*) which is guided by the holy Qura'an and the teachings of the prophet Muhammad (peace be upon him) as the primary source. Secondary sources include opinions collectively agreed by Islamic jurists, analogy or personal reasoning (Institute of Islamic Banking, 1993). It is based on the principle of sharing of profit and loss.

History has shown that Islamic banking system has a strong root in most of the Muslim dominated countries in North Africa, Middle-East and South Asia. However, in West Africa and specifically Nigeria with more than 70 million Muslims, the industry is yet to establish itself to full capacity (Sampson, 2013). However, the enactments of the Banks and Other Financial Institutions Act (BOFIA) in 1991, set the stage for the institutionalization of "profit and loss sharing banking", where the Governor of the Central Bank has the power to issue guidelines for the operation, supervision and regulation of banks (BOFIA, 1991). Consequently, the CBN issued license to banks to operate either a full-fledged Islamic bank such as Jaiz International Bank, or Islamic banking window to Sterling Bank, Stanbic IBTC (Samson, 2013). The establishment of a CBN Sharia Council (FRACE) to advise the CBN on the regulation of NIFIs and a *Shari'ah* Advisory Committee (SAC) knowledgeable in Islamic Law and Jurisprudence, to be established by all licensed NIFIs (CBN, 2015).

For Islamic banks to operate in a country that is built on the conventional banking system, the model will be confronted with challenges of the domination of the industry by conventional banks where they put fear into the mind of people (especially non-Muslims) that it is an attempt to Islamise Nigeria. The CBN Governor introduced non interest financial institutions (NIFI) with various degrees of threats and intimidations. However, looking at the history, the structure of the Nigerian economy, regions, the tribes, the culture and the religions, one will appreciate the level of accommodation and sacrifice made in keeping the nation together. Furthermore, corporate governance is an issue, as it also affects the conventional banks where the board and senior management abuse their power and fail to comply by the standard of governance. The fear that Islamic banks are not insulated from this attitudinal fact may also lead to failure (Oloyode, 2009).

Moreover, Islamic banks discriminate in their deposit taking whereby, deposits and investments with interest elements are not allowed. Dealings within the industry among other conventional banks either to float its excess liquidity or make gains in safe keeping in the CBN are not allowed. This discrimination leads people to worry on how it will operate in a secular environment dominated by interest based transactions. The capacity of the regulators in the new mode of banking is also an issue (Aliyu, 2012).

In conventional banking, one of the basic principles is capital guarantee. The capital given to the bank by the depositor must be returned to him in full with interest. According to Gafoor (Gafoor, 2004) whilst proposing an Islamic banking system which fully complies with this requirement, he states that Islamic banking as practiced today does not provide capital guarantee in all its deposit accounts. Which is one of the major reasons why establishing Islamic banks is prohibited in some countries. There is usually

no objection to paying zero interest on deposits. However, by not paying interest and giving guarantee on the deposits, the Islamic banking system satisfies both the *riba*-prohibition rule of Islamic law and the capital guarantee requirements of conventional Banking system. This is to bring a balance between the conventional commercial banking system and the Islamic commercial banking system wherein both practices can be wholesome and acceptable to all.

3.0 Legal and regulatory challenges of Islamic banking in Nigeria

Capitalism is the major economic system practiced in Nigeria, it guides the business activities where the main aim is profit maximization neglecting the welfare of the masses. Conventional Banking system is a typical example where capitalism is practiced. However, Islamic banking as contained in the CBN (2013) guidelines states that Islamic banking is one of the specialized banks contained in the BOFIA 1991 (as amended). It is one of the models of non-interest banking, and it serves the same purpose of providing financial services as do conventional financial institutions save that they operate in accordance with the principles and rules of Islamic commercial jurisprudence that generally recognizes profit and loss sharing and the prohibition of interest (*riba*). It also aims to make profit but not at the expense of others. It considers social issues unlike the conventional banking (Lukman, 2013).

The fundamental determinants of health and soundness of a financial system, its stability and continued survival, are public confidence and trust in its institutions, markets, and the regulators of the industry. As the apex regulatory institution, the Central Bank of Nigeria's major role, among others, is the maintenance of financial stability and creation of confidence in Nigeria's financial industry. Critics from other quarters challenge the specific features of the operations of the Islamic bank wondering how a banking system will operate without charging of interest on transactions. Other challenges and concerns were to do with the ability of the regulators (CBN, Nigerian Deposit Insurance Corporation (NDIC)), in ensuring effective regulation and ensuring a risk-free management system in Non-interest Islamic Finance Institutions (NIFIs) at the same time achieving good corporate governance standards, honesty, transparency and accountability supported by an efficient court system that can effectively deal with all Islamic banking and finance cases, whose decisions are enforceable over the range of financial issues such as contracts, bankruptcy, collateral and loan recovery all of which are essential for business to operate (Aliyu, 2012).

In Nigeria, the major frameworks guiding the supervision and regulation of non-interest banks have been reviewed, and they are as follows:

3.1 Companies and Allied Matters ACT

Companies and Allied Matters Act is one of the fundamental laws guiding banking industry in Nigeria. Before an institution carries out any form of business, it must first be incorporated by the Corporate Affairs Commission (CAC). The Companies and Allied

Matters Act is the basic law governing all companies. The Act makes it compulsory that any company operating or carrying on business in Nigeria must either be registered as a private limited company or as a public limited company. The term company is defined by CAMA in its interpretation section as “company means a company formed and registered in Nigeria before and in existence on the commencement of this Act (CAMA, 2003).

Every bank in Nigeria is an incorporated company. For this reason, a bank has the same attributes and basic features as any other incorporated company and is subject to the same principles of company law. However, looking at the specialised nature of banks, specific banking legislation called (BOFIA) is added to its operation, and to avoid any confusion, the BOFIA expressly provides that in the event of any conflict between its provisions and those of the CAMA, the former will prevail, thus effectively making it superior to CAMA (BOFIA, 1993). There is no question that CAMA provisions supplemented by the general principles of common law and doctrines of equity are more embracing than those of BOFIA.

CAMA under section 30 provides for prohibited and restricted names. A company seeking incorporation with the Corporate Affairs Commission (CAC) can choose any name to register with subject to the provision of section 30. The first leg of the CAMA provision states the categories of prohibited names a company cannot choose to be registered with thus: No company shall be registered with a name that is already registered, calculated to deceive, contains Chamber of Commerce, contrary to public policy or trade mark. All company names must be approved by Corporate Affairs Commission (CAC).

The second tier of the CAMA states the categories of names restricted unless appropriate permission is obtained. These names include:

“Except with the consent of the commission, no company shall be registered by a name which includes, Federal, National, Regional, State, Government, cooperative, group or holding”.

Considering the prohibited and restricted names provided by the act, it is clear that no restriction was made on Islamic as a name. However, this is covered by the restriction from BOFIA which states that:

“Except with the written consent of the Governor of Central Bank, no bank shall as from the commencement of this Act be registered or incorporated with a name which includes the words “Central”, “Federal”, “Federation”, “National”, “Nigeria”, “Reserve”, “State”, “Christian”, “Islamic”, “Moslem”, “Quranic”, or “Biblical”.

From the above quotation of the act it does not mean that the word Islamic cannot be used by a non-interest (Islamic Bank), because the restriction is not absolute. The name Islamic Bank can be used, registered or incorporated, with the consent of the Governor of the Central bank and such consent from all indications, cannot be unreasonably withheld (Olatoye, 2013).

Also, names such as Central, Federal, Federation, National, Reserve, State, or a name with religious connotation such as Christian, Islamic, Moslem, Quranic or Biblical are restricted by BOFIA except with the prior consent of the CBN Governor (BOFIA, 1991). Prior to its amendment, the CBN carried the same restriction on words, but this has now been amended with effect that only words like Reserved, Christian, Moslem, Islamic, Quranic, or Biblical and any other word with religious connotations are now prohibited (CBN, 2007). It is curious that the BOFIA amendments left its section 43 unchanged.

3.2 CBN ACT 2007

The CBN Act created the office of the CBN Governor and empowers him to issue guidelines; thereby delegating law making powers to the CBN Governor who issues guidelines from time to time to regulate economic policies and interest rates in order to properly supervise banking and other allied matters. The CBN Act charges the Central bank with responsibility of the overall administration of the monetary and banking policies of the Federal Government both within and outside Nigeria.

The Central bank is saddled with the responsibility of supervising other banks in the country and it makes it responsible for monetary policies of government. Its major responsibility is to issue legal tender, manage the country's foreign reserves and promote a healthy financial system. The CBN is described as the Banker's bank and it is the bankers to the Federal government of Nigeria. It is also responsible for the regulation, supervision and control of other banks and financial institutions. Section 51 of the Act mandates the CBN to supervise and control every other bank in the country by way of issuing guidelines and regulations for their operation in the country. It also enforces rules and regulation meant for the good operation of banking activities in Nigeria. The combined effect of section 31 - 40 BOFIA is that the CBN is empowered to approve auditors for banks, order investigation of any bank in the interest of the public, or on the application of a shareholder, depositor or creditor of the bank.

Section 31 of the CBN Act empowers CBN to subscribe to the shares of any bank in Nigeria. This is beneficial to Islamic banks as it has the benefit of ensuring the provisions of the needed equity finance for Islamic banks and on the other hand it enables CBN to directly control such banks as holder of substantial equity in such bank (Abikan, 2002). It is worthy of note that in the supervision of banks by the CBN, one prerequisite is that assets of banks must be assessed and value ascribed to them in order for CBN to fix and assess the liquidity of such banks (Abdul, 2010). However, this may be difficult with Islamic banks due to the fact that unlike conventional banks it is difficult to value some assets of Islamic bank like its contribution in a joint venture. This will then require the services of professionals to cautiously and properly value the assets of Islamic banks under the CBN supervision (Abdul Gafoor, 1995). This is however not insuperable. The challenge of evaluating or putting value on asset of Islamic banks is reduced by s 25 of BOFIA which provides:

- (1) Every bank shall submit to the Bank not later than 28 days after the last day of each month or such other interval as the Bank may specify, a statement showing

- (a) “The assets and liabilities of the bank;” and
- (b) “An analysis of advances and other assets, at its head office and branches in and outside Nigeria in such form as the Bank may specify, from time to time”.

“Every bank shall submit such other information, documents, statistics or returns as the Bank may deem necessary for the proper understanding of the statements supplied under subsection (1) of this section”.

“Any bank which fails to comply with any of the requirements of subsection (1) or (2) of this section is, in respect of each such failure, guilty of an offence and liable to a fine not exceeding N25,000 for each day during which the offence continues”.

This means that every bank shall submit a statement in a prescribed form to the CBN not later than 28 days after the last day of each month or such other interval as the bank may specify. It further provides that the statement shall include the assets and liabilities of the bank and the analysis of advances and other assets at its head office and branches in and outside Nigeria. This provision along with CBN’s regulatory power to periodically examine books of banks under its supervision are capable of eliminating the problems envisaged in relation to putting figures on the assets of Islamic banks for the purpose of supervision by the CBN.

From the foregoing, an Islamic bank must of necessity be under the watchful eyes of the Central Bank albeit with the difficulties that may be encountered on the relationship between the two banks by the provisions of the Act because the operations of the Central bank are still interest oriented.

3.3 BOFIA 1991

The promulgation of BOFIA marked the beginning of deviation from solely conventional banking system. It was the deviant Law. In its categorisation of banks in Nigeria, the BOFIA made provisions for the President on the recommendation of the Central Bank shall from time to time determine as he may deem appropriate minimum paid up share capital of each category of banks. It also made the Profit and Loss sharing bank a category of Nigerian banks with a minimum paid up share capital to be determined from time to time. In recognition of its peculiarities, the law made provisions for a number of exceptions to facilitate the smooth operations of the bank. Chief among which is the non-applicability of the need to display the interest rate in the banking premises of a PLS bank. Section 23 (1) of BOFIA provides thus: “every bank shall display at its offices, its lending and deposit interest rates and shall render to the bank information of such rates as may be specified from time to time by the bank. Provided, that the provisions of this section shall not apply to the profit and loss sharing banks.”

A careful perusal of the BOFIA would reveal that there is no place where a provision was made in recognition of the establishment of Islamic banking system. Its provisions only recognised PLS banks as a category of banks in the country (Abikan, 2010). PLS banking was conceived in Nigeria in line with the current international trends

in the provision of banking services whereby major international banks set up non-interest profit or loss arm or window internationally or start new brand banks wholly based on this principle. A PLS bank is defined as a bank which transacts investments or commercial banking business and maintains profit and loss sharing accounts. This definition is in recognition of the nature of Islamic banking which combines the operations of both commercial and merchant banks in its contracts and practises.

No other type of bank can swerve between commercial and merchant banking under the law. This casts a shadow on any conventional bank operating an Islamic banking window offering Islamic banking products. This is more so as the law envisages the registration of PLS banks as a specialised category of banks and made all the various exceptions relating thereto as such. The operation of PLS banks is thus a unique characteristic of an Islamic bank which has attained the status of being synonymous to the banking system itself.

S. 9(1) and (2) of the Act made provisions for a PLS banks as a category of banks which may be established and operated in Nigeria and went ahead to state its minimum paid-up share capital. Similarly, s 52 of the Act empowered the CBN governor to further exempt the profit and loss sharing banks from other provisions of the Act. The necessary interpretation of these provisions of the Act is that it has come to offer the needed enabling environment for Islamic banking in the country. This is because the major departure between the conventional banks and Islamic banks is the charging of interest. This section which had provided for the exemption of profit and loss sharing banks from certain requirements of the Act has now been repealed. This brings all specialised banks under the Act and the powers of the Governor to make further exemptions for the PLS banks other than those contained in the Act has been withdrawn.

In all the foregoing provisions , there are clear indications that Islamic banking and finance is recognized under the Nigerian banking laws, particularly section 23 and 66 which makes reference to banking institutions running and maintaining profits and loss accounts which is an important feature of Islamic banking. The CBN relied heavily on the highlighted statutory provisions to prove the legality of its establishment of Non-interest Financial Institutions in its regulatory Guidelines of 2011 thus:

These guidelines are issued pursuant to the No-Interest banking regime under section 33(1)(b) of the CBN Act 2007; sections 23(1); 52; 55(2), 59(1)(a); 61 of Banks and Other Financial Institutions Act (BOFIA) 1991 (as amended and section 4 (1)(c) of the regulation on the scope of Banking activities and ancillary matters, No. 3, 3 2010. It shall be read together with the provisions of other relevant sections of BOFIA 1991 (as amended, the CBN Act, 2007, Companies and Allied Matters Act (CAMA) 1990) as amended and circulars/ Guidelines issued by the CBN from time to time (CBN, 2011).

The 1998 amendments eroded the foundation and the first reference ever made to the Profit and Loss bank in the Nigerian banking laws. While the principal Act exempted PLS banks from obtaining prior consent of the governor to purchase, acquire or lease real estate as necessary products to its type of business, the amended Act removed the exemption. The implication is that it enlarges the scope of the restricted transactions for

Islamic banks to also include purchase, acquisition or lease of real property. Written permission from the CBN first has to be obtained now in these transactions.

Evident from the Act is the absence of the provision for the constitution of the Shariah Advisory Board; making of which a prerequisite to the grant of a license would go a long way to retain the trust and confidence of the general public whilst protecting the integrity of the new system which is one rooted in trust and faith. The power of the CBN Governor to make rules and regulations for the effectuation of the objects of the law contained in section 57 of the Act are not sufficient for this important requirement (CBM, 2009). Such power can only cover the areas of practice and procedure of banking. The Islamic banking Act of Malaysia for instance, provides a lead on the importance of this requirement to granting of operation license where it made issuance of operational license subject to establishment of Shariah Advisory body in the articles of association of the bank concerned. This is to ensure that they do not involve any element which is not approved by the religion of Islam (ABikan, 1983). However in the Guidelines on Shariah Governance for Non-interest Financial Institutions in Nigeria, 2011, the stipulation of the roles of the board, qualification and procedure of their appointment would fall within the powers of the Governor to make regulations (CBN, 2011).

3.4 NDIC ACT

The NDIC was established by the NDIC Act 2006 as a government owned Deposit Insurance Corporation (NDIC, 2006). Following the Structural Adjustment Programme, the Nigerian economy was liberalised. This development led to rapid increase in the number of licensed banks which has put a pressure on available experienced labour force and caused precarious and unsound practices in the banking industry (NDIC, 1991). The NDIC was established to administer the insurance scheme to reduce the negative effects of bank failure. Thus, the NDIC was created to stabilise the nation's banking industry by means of the deposit insurance scheme thereby building public confidence in the industry (Danjuma, 1993).

The main mandate of NDIC is deposit insurance, however, the agency has the supervisory powers to regulate banks in order to avoid banking failure which might lead to loss of confidence in the financial system (NDIC, 2004). The NDIC can also take over the management of such bank. When a bank is facing a danger of failing, it can order the bank to cease and desist from certain practices, and suspend or remove bank officers. For a bank on verge of failure and in need of greater assistance, the NDIC has the authority to provide monetary assistance to facilitate a merger, consolidation, or sale of assets to another insured bank, and provide monetary assistance to the failing bank.

The NDIC act is applicable to both the conventional and Islamic banking, therefore, establishment of non-interest (Islamic) bank has necessitated the extension of Deposit Insurance coverage to the depositors of the banks in order to provide a level playing field for all deposit-taking financial institutions and ensure that the holders of Shari'ah compliant products are adequately protected, and they also enjoy the same support from the regulatory authorities (NDIC, 2016). However, as discussed Islamic bank cannot access liquidity support that is having interest element, also the premium paid by the NIFI by NDIC is not invested due to lack of Islamic financial products. This

constitutes a great challenge to the Islamic banking deposit insurance. Also, the knowledge gap in the identification of Islamically accepted financial products is a challenge.

3.5 Shari'ah Supervisory Board in Nigeria

The CBN under its power to regulate non-interest banks issued a guideline which clearly stated that an advisory board should be constituted to advise the CBN and be called Financial Regulation Advisory Council of Experts (FRACE) which will be responsible for advising the CBN on Islamic banking and finance products in Nigeria in compliance with the Islamic commercial jurisprudence. While the bank operators should constitute an advisory body called Advisory Council of Experts (ACE) with the responsibility of advising the NIFIs board and management on the banking products in compliance with Islamic commercial jurisprudence. The AAOIFI standards call it *Shari'ah* Supervisory Boards (SSB, 2013), while Malaysia call it *Shari'ah* Advisory Council for the Central Bank and Securities Commission call it *Shari'ah* Councils, while for similar body in other banks, it is known as the *Shari'ah* Advisory Committee (CBM, 2004).

It is considered very essential for the supervision of Islamic Bank's management by the *Shari'ah* supervisory board to ensure compliance with *Shari'ah* principles for the success of Islamic financial institutions. This is because the success of any Islamic financial institution is largely based on the shareholders' belief that the system is *Shari'ah* compliant. Therefore, to have efficient regulation, it is important to note that qualified and competent people of impeccable character occupy the advisory board (Olatoye, 2013). Competence is determined by the roles that a *Shari'ah* board member is expected to perform.

With a view to ensuring independence among other aims, the AAOIFI issued a standard known as Governance Standard by which every Islamic financial institution is required to have an SSB and observe certain governance issues. The standard provides that an SSB:

- a. Is an independent body of specialized jurists in fiqh al muamalat (Islamic commercial jurisprudence) (AAOIFI, 2016).
- b. Is entrusted with the duty of directing, reviewing and supervising the activities of the Islamic financial Institution in order to ensure that they are in compliance with Islamic *Shari'ah* rules and principles.
- c. Can issue fatwas and rulings which shall be binding on the Islamic financial institution
- d. Shall consist of at least three members who are appointed by the shareholders, upon the recommendation of the board of directors (not including directors or significant shareholders of the Islamic financial institution).
- e. Shall prepare a report on the compliance of all contracts, transactions and dealings with the *Shari'ah* rules and principles.

- f. Shall state that the allocation of profits and charging of losses related to investment accounts conform to the basis that has been approved by the SSB.
- g. Shareholders may authorize the board of directors to fix the remuneration of the Supervisory Board.

As an independent body, the SSB is not subject to take instructions from the management, the board of directors or shareholders before taking their decision. They are free to express their own opinion in line with Islamic law and to give appropriate advice on banking practices techniques, contracts, dealings and transactions that are not *Shari'ah* compliant (Nienhaus, 2015).

In analyzing the AAOIFI provisions compared to Nigeria, it is clear that the regulatory guidelines which seeks to ensure the independence of ACE under paragraph 11.0 on the one hand, has taken away its independence on the other hand under paragraph 5.1 which deals with the appointment of members of ACE. The CBN provisions stated that, the power to appoint the ACE members is conferred on the Board of Directors of the NIFI, subject to the approval of the CBN, and they are expected to provide checks and balances and ensure compliance with Islamic commercial jurisprudence. Under the regulatory guideline, the specification and adoption of the process for formal assessment of the effectiveness of the ACE and of the contribution of each ACE member to its effectiveness is to be carried out by the NIFI.

Looking at the CBN provision it will be difficult for the ACE to perform effectively if the NIFIs are the one to determine their appointment. The issue of compliance with the Islamic law in all its dealings will be difficult to determine. And if the NIFIs are not happy with ACE's position on some Shariah compliance issue, it might affect the ACE's assessment by NIFI's negatively. The NIFI's have the power to appoint and assess the effectiveness of ACE, this contradicts the global standard of independence. And in addition to that the provision stated that the appointment of ACE is for four years and renewable for three terms.

This gives room for interested ACE's members to dance to the tune of the NIFIs to have their tenure renewed. This will affect their independence. The board of directors and the management which wield the power of composition of the ACE and the financial and non-financial rewards for ACE members, in line with the saying: "He who pays the piper dictates the tune", will certainly have a strong nuance on the *Shari'ah* opinions and eventual decisions of the ACE. This has led in some cases to serious questions being asked regarding the intent of the bank authorities which normally handpick their favourites to serve in such sensitive position. Some even believe that the shady appointments made by certain banks are done purposely to relegate the *Shari'ah* boards into mere rubber stamps of the banks decisions and innovations (Alaro, 2009). This situation will clearly defeat the purpose of having *Shari'ah* Supervisory Board, in the status of the ACE, in place in the first instance.

4.0 Conclusion and Recommendations

Islamic banking in Nigeria came at a time the Nigerian economy needed it. The uncertainty and the high level of risk involved in the conventional banking system and the fundamental shock in the economy as a result of the 2008 financial crisis made it mandatory for the support of the Islamic financial system. However, some people are against it looking at it as a religious issue, the system is still gaining more acceptance with the awareness people gaining. The regulators are also adjusting to meet-up with their primary responsibilities, but still the knowledge gap is a serious issue of concern. The legal aspect has lacunae that need to be filled. Provision for Islamic financial instrument in the money and capital market is necessary for the growth of the Islamic banking. The excess liquidity in the Islamic banking industry is as a result of unavailability of acceptable instruments to invest in.

It is therefore, recommended that,

- The Islamic financial products developed in the market should be supported and advanced with full legislation to give the industry the opportunity to also grow and achieve its goals.
- The FRACE members should be full time staff in a unit within the CBN instead of outsourcing it to private individuals, since issues might come that need emergency attention.
- The ACE members renewable term of four years subject to a maximum of three terms, should be changed to a one non-renewable term of five years. This will reduce the pressure of looking for re-appointment and it will enhance the independence of the ACE.
- The regulators (CBN and NDIC) should train their staff more in order to meet their regulatory challenges and the international standard.
- The use of media needs to be looked into by Islamic financial institutions. Even some Muslims are not aware of the existence Islamic banking. The public needs to be informed some about the nature, objectives, and working of Islamic economics and banks.

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Are Shari'ah Governance and Risk Management Important? A case of Islami Bank Bangladesh Ltd

By
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Abstract

This paper studies Shari'ah governance and risk management practices in the biggest Islamic bank in Bangladesh, Islami Bank Bangladesh Ltd (IBBL). The study is descriptive and comparative in nature. We have analyzed existing literature to compare Shari'ah governance framework and used secondary data to understand the risk management practices in IBBL. The results indicate that Shari'ah governance differ across regions and legal institutions but uniformity is recommended to further develop the Islamic Financial Institutions (IFIs) in both Muslim and non-Muslim countries. In Bangladesh, IBBL follows the AAOIFI standards in Shari'ah governance and has maintained high standard so far. However, the situations in other Islamic banks are not very satisfactory. IBBL has developed comprehensive risk management framework but still face significant investment and credit risk with growing non-performing loan and excess liquidity risk due to limited short-term investment opportunities. The study could help policy makers to develop comprehensive shari'ah governance and risk management framework in IFIs across the world.

Keywords: Shari'ah governance, risk management, Islami Bank Bangladesh Ltd.

Introduction

Islamic finance has shown tremendous potential for the last two decades and it has become a formidable and sustainable counterpart of conventional banking system in many Muslim and non-Muslim countries. At the same time, the importance of Shari'ah

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Governance (SG) has come up and over the past few years, many countries have developed a comprehensive governance framework for Shari'ah issues responding to the needs of Islamic Financial Institutions (IFIs). However, the absence of well conceptualized framework hinders the development of unified, universal, and formalized system. If Islamic financial institutions are to be acceptable to their clients, IFIs need to have a formalized system to ensure all their activities are Shari'ah compliant (Wilson, 2009; Hassan, 2010; Grassa, 2013).

Banking industry is one of the most highly regulated industries in the world. Risks, financial and non- financial, are inherent for banks and financial intermediaries which mobilize fund from surplus unit to deficit unit of an economy. Financial risks consist of market risk and credit risk, whereas non-financial risk include, but are not limited to operational risk, regulatory risk and legal risk (Khan and Ahmed, 2001). Islamic banks, an integral part of a financial system, are not excluded from these risks. The establishment of the Islamic Finance Standard Board's (IFSB) guiding principles on Risk Management in 2005 reflects the growing importance of prudent risk management in Islamic banking industry. Consequently, the survival and success of Islamic banks depend on the efficiency in which they can manage risk, and thus, effective risk management is critical for maximizing shareholders wealth (Akkizidis and Khandelwal, 2008).

Islamic Banking Industry has been playing a crucial role in mobilizing deposits and financing key sectors of the economy in Bangladesh since its inception in 1983. At present Islamic banking industry is comprised of 8 full-fledged Islamic banks, 19 Islamic banking branches of 9 conventional commercial banks and 25 Islamic banking windows of 7 conventional commercial banks are also providing Islamic banking services in Bangladesh (Bangladesh Bank, 2015). Islamic Banking Industry accounted for more than one- fifth share of the entire banking industry in terms of deposits and investments. Total deposits in Islamic banking industry reached BDT 1467.34 Bln or USD 18.72 Bln (USD 1=78.4 BDT) at the end of January- March 2015 quarter, which increased by BDT 25840.78 million or by 1.79% compared to previous quarter and by BDT 201410.21 million or by 15.91% compared to corresponding quarter of the last year. Total investments in Islamic banking sector stood at BDT 1267.05 Bln or USD 16.16 Bln (USD 1=78.4 BDT) at the end of January-March 2015 quarter, which went up by BDT 27540.68 million or by 2.22% and by BDT 191050.02 million or by 17.76% compared to previous quarter and same quarter of the preceding year respectively (Bangladesh Bank, 2015).

Islamic finance, more specifically, Islamic banking industry has flourished in Bangladesh in spite of non-existence of comprehensive regulatory framework and sometimes non-cooperation from all sides. Non- existence of Islamic financial service act and standard Shari'ah governance framework could hinder further growth of the potential of this industry. To analyze the Shari'ah governance framework and risk management in Bangladesh we have chosen Islami Bank Bangladesh Ltd (IBBL), the largest Islamic and private commercial bank in Bangladesh established in 1983, is a Joint Venture Public Limited Company engaged in commercial banking business based on Islamic *Shari'ah* with 63.09% foreign shareholding having the largest branch network (total 301 Branches)

among the private sector Banks in Bangladesh. It was established on 13th March 1983 as the first Islamic Bank in the South East Asia. The total assets of the bank are USD 7.1 Bln, which is 39.29% of total Islamic banks deposit and Investment of USD 7.2 Bln, which is 38.04% of the total Islamic banks investment (Annual Report, 2014). Currently, IBBL is the biggest private lender overall, with 14,000 staff, 12 million depositors and a balance sheet of USD 10 billion, but recent restructuring of the bank's governing body has put a tremendous pressure on governance as well as on profitability and sustainability of the bank (The Economist, 2017).

The study is descriptive in nature and used primary and secondary data from various sources, including the Bangladesh Bank, the central bank of Bangladesh, annual reports of IBBL and seven others full-fledged Islamic banks in Bangladesh, Datastream, and published research journals. The analysis indicates that Islamic banks in Bangladesh are facing major challenge in Shari'ah governance issues and risk management is a vital issue where excess liquidity put downward pressure on bottom line of Islamic banks. In the presence of information asymmetry and moral hazard issues IBBL like other Islamic banks prefers to invest in a cost-plus, *Murabaha* financing to minimize its investment and credit risk. In order to accommodate the growing Islamic finance industry namely banking, takaful, mutual fund, Islamic stock market a comprehensive Islamic financial service act is the order of the day.

The rest of the paper is organized as follows. Section 2 discusses the existing literature. The data and the research methodology are explained in section 3. The empirical results and discussions are presented in section 4. The last section ends with the concluding remarks and policy implications.

2. Literature Review

2.1 Shari'ah Governance

Good corporate governance has become a prime issue again among industry practitioners and academia since 2008's financial crisis, when corporate fraud, poor governance and manipulation in earnings happened to be widespread. In a recent award winning Harvard Business Review article, William Lazonick criticizes existing Anglo-Saxon Corporate Governance (CG) model, which is based on the shareholder's wealth maximization theory, as this instigates many top executives in the U.S. to manipulate earnings, he highlights the issue of buying back of shares in order to artificially inflate the share price to gain lucrative incentives: bonus and right shares (Lazonick, 2014). Even though this model of corporate governance has been highly criticized, Franco-German model of CG has so far failed to find valid logic to include stakeholders' interest in decision making (Iqbal & Mirakhor, 2004).

In order to define Shari'ah Governance, first, we need to define Corporate Governance as they exist side by side in Islamic Banks (IBs). The OECD has defined Corporate Governance as the "set of relationships between a company's management, its board, its stakeholders and other stakeholders" (OECD, 1999). The dimension of Islamic perspectives of corporate governance has broader horizon and cannot compartmentalize the roles and responsibilities in which all actions and obligations fall under the jurisdiction of the divine law of Islam, whereas, the OECD principles

implements a firm with six different issue and obligation (Abu Tapanjeh, 2007; Hassan et al., 2014). Shari'ah governance is a unique characteristic of corporate governance in financial architecture and it is concerned with the religious aspects and the Islamicity of the activities and conducts of IFIs (Hasan, 2010).

The definition above illustrates the extensive duties of Shari'ah Supervisory Board (SSB) to oversee and supervise the Shari'ah compliance of the Islamic financial institutions, as such, their competence is essential to form a robust Shari'ah board. It also implies that the institution of the Shari'ah board is crucial to the Shari'ah governance system as an authoritative body ensuring Shari'ah compliance (Haqqi, 2014).

A Conceptual framework of Shari'ah Governance framework

Principle 3.1 of the IFSB Guiding Principles on Corporate Governance states that an appropriate mechanism must be created to ensure compliance with the Shari'ah principles. The foundational dimension of Islamic corporate governance is rooted in the fundamental principles of tawhid (the Oneness of Allah), the process of shura (Consultation), property rights and contractual obligations (Travers, 2010).

While explaining the conceptual framework of corporate governance from Islamic perspective, Iqbal & Mirakhor (2004) argue that Shari'ah Governance covers overall governance issues, protection of stakeholders rights and compliance with the divine rules guided by Shari'ah, which actually broaden the area of governance issue from merely stakeholders model, where scholars have not yet found the logical foundation to include various interest groups in corporate governance model which are indirectly affected by corporations' activities, while Shari'ah governance affirms the inclusion of not only human well-being but also surroundings and environment. Moreover, the foundation of stakeholder model is found in Islam's principles of property rights, commitment to explicit and implicit contractual agreements and implementation of an effective incentive system (Iqbal and Mirakhor, 2004).

By analyzing stakeholder model of corporate governance from Islamic perspective proposed by Iqbal & Mirakhor (2004), Zulkifli Hasan concludes that little work has been done on corporate governance from Islamic economic perspective (Hasan, 2008). It seems logical as Islamic economics had been in hibernation for an unexpectedly long time and only four decades ago it woke up and has gained some kind of momentum for the last few decades.

Existing Shari'ah Governance Practice

As the importance of Shari'ah Governance is recognized much research has been conducted to study Shari'ah Governance framework, existing practice of SG in Islamic Banks and IFIs, contemporary issues and how to improve Shari'ah Governance system in leading Islamic Finance hubs like in Malaysia, Indonesia, GCC, MENA, UK, and other OIC member countries.

Ginena (2014) states that (as cited in Alhabashi and Bakar, 2008) variations in shari'ah governance practices between IFIs in 11 countries to be significantly different; thus, they recommended the establishment of a comprehensive Shari'ah Governance

framework that would promote good governance. Corroborating Alhabashi and Bakar's results, Hasan's (2011) survey on Shari'ah Governance Practices found that operational aspects were significantly different between IFIs with only 39 per cent in Malaysia, 3 per cent in the UK (UK), and none in the Gulf Cooperative Council reporting to have standard Shari'ah Governance operating procedures.

As confirmed earlier, different Shari'ah Governance structures exist in different jurisprudence depending on different legal frameworks governing Islamic banks and financial operations and can be divided into two broad categories: centralized and decentralized. The countries approaches on SG can either be strict, moderate or flexible; Malaysia and Pakistan belong to the first category, characterized by the provision of comprehensive guidelines on detailed implementations of SG. Countries like, Bahrain, Brunei and the UAE have adopted the moderate approach, providing the main provisions on the process but still leaving some aspects to the discretion of institutions or the authorities. On the other hand, Singapore and the U.K tend to adopt the flexible approach in this matter whereby most aspects of SG are left to the discretion of Islamic banks (Hassan et al., 2014). Wilson (2009) discusses the merits of centralized versus devolved Shari'ah governance and considers what competences and experience Shari'ah Board members should have. He mentions the four key attributes identified by the IFSB for sound and effective Shari'ah Governance are competence, independence, confidentiality and consistency (Wilson, 2009).

The OECD has issued Guidelines on Corporate Governance, the IOSCO on capital market and the BCBS on Basel Committee I, II and III. Nevertheless these standards and guidelines failed to address specific issues of Islamic finance (Dusuki, 2011). However, Hassan et al. (2014) argue that Shari'ah Governance structure must be in line with internationally recognized corporate governance standards such as those issued by the OECD in order to ensure effective implementation, in addition to that, conserve the fulfillment of fiduciary duties that include good faith, care, skill and diligence towards all their stakeholders. Moreover, it is necessary to appreciate the comprehensive nature that Shari'ah Governance provides to supervise the services of IFIs, the policy makers of a country have to focus on its key elements.

In the following section, a brief description of Bank Negara Malaysia Shari'ah Governance Framework (BNM SGF) 2010 is going to be discussed.

3. Data and methodology

The study is descriptive in nature and used secondary data from various sources including the Bangladesh Bank, the central bank of Bangladesh, annual reports of IBBL and seven others full-fledged Islamic banks in Bangladesh, Datastream, and published research journals. At first, for Shari'ah governance issue we have conducted comparative analysis of Shari'ah Governance Framework. Then we looked at the practice in Bangladesh. In the second stage, we have analyzed the financial reports of the IBBL and other Islamic banks operating in Bangladesh to see the risk management practices with the help of ratio analysis and other descriptive statistics.

4. Analysis and Discussion

Comparative Analysis of Shari'ah Governance Framework

In order to have a clear idea about differences in Shari'ah Governance practice across the region and countries, a comparative analysis is used in this section. Kasim et al. (2013) compare AAOIFI, IFSB and BNM Shari'ah Governance guidelines and argue that all the guidelines discuss and emphasize on independence, competence, responsibility, accountability, confidentiality of Shari'ah board members, also, the importance of Shari'ah review and audit functions is highlighted in all the guidelines although AAOIFI discuss in more detail, Shari'ah risk management and research function have been discussed only in BNM Shari'ah Governance framework (Kasim et al., 2013). The difference between the IFSB Prudential Standards and the AAOIFI Governance Standards is that the IFSB approach is more concerned towards regulators while the AAOIFI, to individual IFIs (Dusuki, 2011). Shari'ah Governance framework provided by AAOIFI has seven sections, the framework of IFSB includes scope and approach of SG system and the qualitative characteristics of Shari'ah Supervisory Committee, at the same time, BNM provides the general requirements of the framework, qualitative characteristics and provide the guidelines on Shari'ah review and Shari'ah audit, in addition to that, BNM provides the guideline on the functions of Shari'ah risk management and Shari'ah research in Islamic Finance (Kasim et al., 2013). As Shari'ah Governance is new, they propose that respective regulators should implement the prescriptive approach like the first approach taken by the U.K while implementing the corporate governance code. They conclude by suggesting standardized and comprehensive guideline or framework for easy reference for industry practitioners, regulators, Shari'ah advisors and investors.

Table 1: Comparative analysis among Shari'ah Governance guidelines

No	Discussion	AAOIFI*	IFSB†	BNM‡
1.	Definition of shari'ah governance	Not provided	Provided	Not provided
2.	Independence, competence, responsibility of Shari'ah Supervisory Board	Discussed	Discussed	Discussed
3.	Shari'ah review and Shari'ah audit	Discussed	Discussed	Discussed
4.	Risk Management	Not discussed	Not discussed	Discussed
5.	Research function	Not discussed	Not discussed	Discussed

*Accounting and Auditing Organization for Islamic Financial Institutions AAOIFI

†Islamic Financial Services Board and ‡Bank Negara Malaysia Shari'ah Governance Framework 2010

Note: From Kasim et al. (2013). *Comparative Analysis on AAOIFI, IFSB and BNM Shari'ah Governance*. International Journal of Business and Social Science. 4(15), p. 226

As a member of AAOIFI Islamic banks in Bangladesh follow its standards. IBBL is stringent about compliance *Shari'ah* rules in all of its operations. Since IBBL is performing in the mixed economic system (i.e., Islamic and Interest Based economy), *Shari'ah* compliance is one of the vital factors particularly for IBBL. The independent *Shari'ah* Board keeps keen observations on the day to day transactions of the Bank and they declare doubtful transactions as suspended. Ahmed and Khatun (2013) study the *Shari'ah* compliance of Islamic banks in Bangladesh.

Table 2: *Shari'ah* compliance level of Islamic banks in Bangladesh

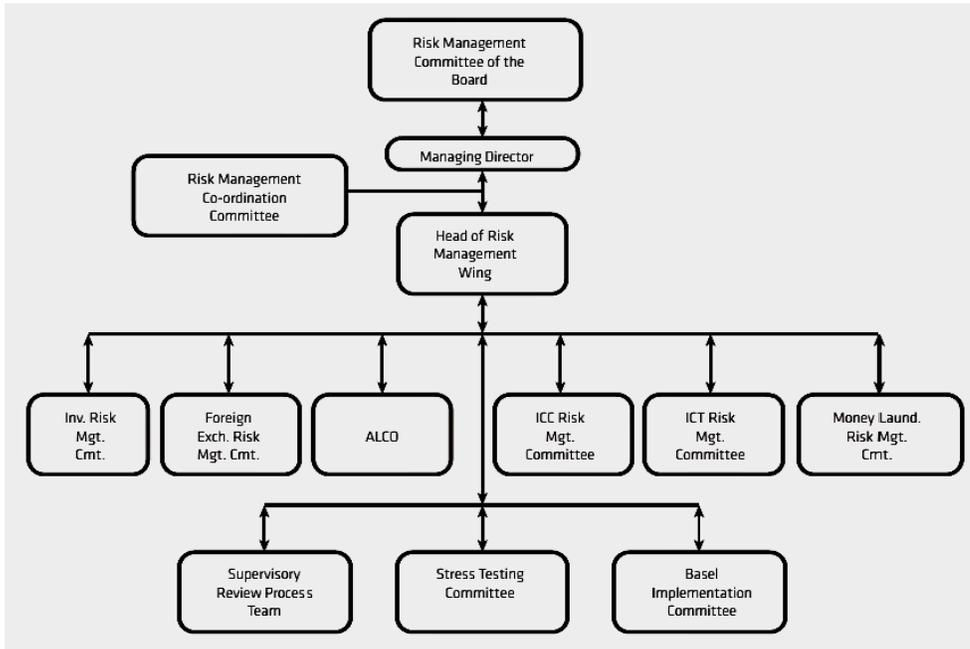
			Compliance level of the banks								
AAOIFI Standard No.		Required Issues in Standard (No.)	IBBL (No.)	SIBL (No.)	SJIBL (No.)	EXIM (No.)	ICBI (No.)	AIBL (No.)	FSIBL (No.)	Mean	Standard Deviation
	1	5	5	5	4	4	5	4	5	4.57	0.53
	2	3	3	3	3	3	3	3	3	3.00	0.00
	3	6	6	6	6	6	5	5	6	5.71	0.49
	4	2	0	0	0	0	0	0	0	0.00	0.00
	5	2	2	2	2	2	2	2	2	2.00	0.00
Total		18	16	16	15	15	15	14	16	15.29	0.76
Compliance (No.)											
Compliance %			89	89	83	83	83	78	89	85	4

Source: Ahmed & Khatun (2013) p.187

Risk Management Framework and Process in IBBL

Risk management is the overall process that a financial institution follows to define a business strategy, to identify the risks to which it is exposed, to quantify those risks, and to understand and control the nature of risks it faces (Cumming and Hirtle, 2001:3). Risk management is invoked to ensure that banking operations undergo a process of risk identification, risk measurement and risk mitigation in their financial offerings (Rosly, 2014). Fundamentals of the risk management process comprise of three main features: i) establishing an appropriate risk management environment, sound policies, and procedures ii) maintaining an appropriate risk measurement, mitigating, and monitoring process, and iii) adequate internal controls (Khan and Ahmed, 2001). Islamic banks face many unique risks due to the nature of their operations, particularly *Shari'ah* compliance requirements (Rosman and Rahman, 2014).

As a *Shari'ah* based bank, IBBLs risks are mainly mitigated by observing *Shari'ah* rules and regulations. The bank has its own risk management philosophy for giving proper attention to risk management. Based on its philosophy and guideline from the Bangladesh Bank, the central bank of Bangladesh, IBBL



The Risk Management process, as shown in the following diagram, is segregated into five steps:

Establishing the context, risk identification, risk analysis, risk evaluation and risk treatment. From each step of the risk management process, there is sufficient option for communication, consultation, reporting, monitoring, and review system.

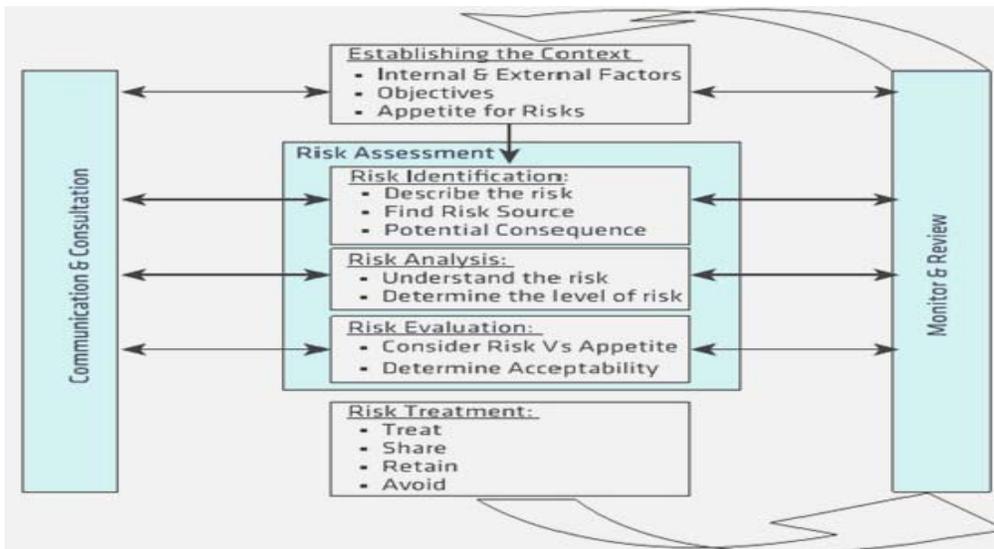


Figure 2: IBBL Risk Management Process (Source: Annual Report 2014)

The risk management framework of IBBL (Figure 2) shows that the Board is responsible for approving risk appetite, the level of risk the bank chooses to take, in pursuit of its business objectives. The following table shows the extract of balance sheet composition of types of financing against total assets which would give us a better picture of overall risk appetite of the bank.

Table 3: Mode wise investment of IBBL

	2014	% of Total Assets
Bai-Murabaha	2,53,916.69	54.79
Bai-Muajjal	29,797.76	6.43
Hire Purchase under Shirkatul Melk	1,03,940.76	22.43
Bai-Murabaha Import Bills	5,861.48	1.26
Bai FC Bills	9,498.99	2.05
Musharaka	484.38	0.10
Mudaraba Investment	3,000.00	0.65
Bai -Salam	4,807.60	1.04
Murabaha Foreign Currency Investment	6,952.88	1.50
Quard	15,478.09	3.34
Investment in Khidmah Card	16.99	0.00
Overseas Investment (outside of Bangladesh)	2,338.48	0.50
Bills Purchased and Discounted	27,381.37	5.91
Total	4,63,475.47	100.00

Source: Annual Report, 2014

As IBBL's risk appetite is evident from the above discussion, moreover, in order to identify, measure, manage and mitigate risks, it has developed its own risk governance framework based on risk appetite of the bank. The bank has an active risk management and coordination committee at the top of the framework (figure 2) to look after the overall risk management of the bank. IBBL has developed risk management culture starting from relationship officer at the branch level to the head of risk management wing. It is evident from the table that low risk and fixed rate investment modes dominate the list which is a common phenomenon in Islamic banks not only in Bangladesh but also other countries. Information asymmetry and moral hazard are the key reasons behind falling in risk sharing investment mode of Islamic banks all over the world.

In order to mitigate investment risks IBBL has taken active measure like, regular investment review, revaluation of securitized assets, and financial performance of the clients. In addition to that, as per regulatory requirements bank maintains provision for investments including bad and doubtful investments. In the following table detailed provisioning for investments are shown.

Table 4: Provision for investments including bad & doubtful investments

	BDT	
	2014	2013
General provision		
Unclassified investments excluding OBU	3,30,79,26,000	3,04,15,38,171
Unclassified investments - OBU	12,31,93,000	16,21,34,829
Special mention account	19,43,61,000	16,79,27,000
Sub-total	3,62,54,80,000	3,37,16,00,000
Off-balance sheet items	1,12,82,00,000	1,13,72,00,000
Sub-total (General provision)	4,75,36,80,000	4,50,88,00,000
Specific provision		
Substandard	10,10,45,936	13,03,47,000
Doubtful	25,58,09,525	11,32,65,000
Bad and loss	12,99,78,64,539	8,79,41,88,000
Sub-total (Specific provision)	13,35,47,20,000	9,03,78,00,000
Total provision held at the end of the year	18,10,84,00,000	13,54,66,00,000

Source: Annual Report, 2014

On the one hand, it is evident from the above table that general provisioning remained more or less same in 2014 compare to 2013, on other hand, specific provisioning for doubtful investment increased by two times. More worryingly, specific provisioning for bad and loss investment increased by BDT 4203.7 million from 2013 to 2014. All in all, Non Performing Investments (NPIs) creates pressure on the balance sheet as massive capital erosion is evident in case of increasing default in investments which has been growing for overall banking industry.

In our previous sections we have discussed various types of risks associated with Islami Bank Bangladesh Ltd. One of the key risks that many Islamic banks face is mismatch in variable rate assets and variable rate liabilities. This imposes a great threat to the earning potentials of Islami bank. The inherent structure of Islamic bank tends to have higher variable rate liabilities than assets. In the following table we show the income gap analysis for Islami Bank Bangladesh Ltd.

From the analysis of IBBL balance sheet, we have observed that fixed rate finance (FRF) constitutes the dominant portion of Islamic banking financing as evidenced in many murabaha, *bai-al-muajjal* and HPSM contracts. On the other hand, variable rate deposits (VRL), mostly *al-wadiah* and *mudarbah* deposits remain high as theoretically Islamic bank cannot give guarantee on fixed rate earnings. In this circumstance, although inter-bank offer rate and subsequently base lending rate (BLR) changed, *murabaha*, *muajjal* and *HPSM* profit rates cannot be changed accordingly. This imposes a great threat to Islamic bank's earnings capacity in increasing interest rate environment.

Table 5: Income gap analysis of IBBL

As on December 31, 2014

	BDT in million			
	1-90 days	Over 3 6 months	Over 6 9 months	Over 9 12 months
Rate Sensitive Assets	1,10,619.68	61,780.38	76,192.23	77,087.72
Rate Sensitive Liabilities	1,05,740.27	60,812.00	75,306.78	76,685.80
GAP	4,879.40	968.37	885.45	401.92
Cumulative GAP	4,879.40	5,847.78	6,733.22	7,135.15
Adjusted profit rate changes (PRC)	0.50%	0.50%	0.50%	0.50%
Quarterly earnings impact (Cum.Gap*PRC)	6.10	7.31	8.42	8.92
Accumulate earning impact to date	6.10	13.41	21.83	30.74

Source: Annual Report, 2014

However, in case of IBBL, we observed that rate sensitive assets are higher than rate sensitive liabilities (VRA \square VRL), i.e. a Positive income Gap which is favorable for the conventional bank in current decreasing interest rate/profit rate environment in Bangladesh. Evidently we found cost of fund for IBBL decreased to 8.55% in 2014 from 9.45% in 2013. In other words, a decline in profit rate will not reduce income on *murabaha* financing (fixed rate financing) as much as the reduction in cost of funds. Consequently, net income earnings will increase. For example, 50 basis points decrease in the level of interest rate would increase the profit by BDT 30.74 million and vice-versa for increase in the level of interest rate/profit rate. However, it can be further argued that, in the recent past as decreasing interest-rate trend has significantly affected earnings of IBBL, for example, ROA and ROE has dropped from 19% and 1.47% in 2014 from 9% and 0.67% in 2010 respectively. Consequently, at the same time period, EPS has declined to BDT 2.48 from BDT 6.02. It can be argued that dual banking system, central bank policy and money market instruments undoubtedly favor conventional banks consequently, Islamic banks mimic them. Therefore, positive income gap in IBBL and other Islamic banks in Bangladesh is market driven but this strategy does not suit well for Islamic banks as they heavily rely on fixed rate financing and floating rate deposits.

Islamic Financial Market in Bangladesh is not strong enough and there are inadequate Islamic financial instruments, IBBL has limited scope for placement of fund with the desired return from the market at the time of surplus liquidity and similarly limited scope in receiving fund complying *Shari'ah* rules at the time of liquidity crisis. However, during the long 31 years of banking operations, IBBL did not face any liquidity crisis since it remains vigilant enough to address the issue.

Table 6: Liquidity risk and industry comparison

Islamic Banks	Y-O-Y growth TD(%)	Y-O-Y growth cost of fund (%)	Growth in Net Profit after Tax	CSTA/TA	MTD/TD
IBBL	18.51%	-9.52%	-19.19	10.72	30.19
SJIBL	2.20%	-11.24%	-42.76	12.45	46.22
SIBL	21.97%	-14.50%	56.02	9.79	60.51
FSIBL	30.81%	-0.25%	-15.58	8.24	67.04
AIBL	18.35%	-1.54%	2.12	11.83	59.42
EXIM	20.85%	-12.63%	29.66	13.77	61.52
ICBI	0.38%	-5.68%	-57.91	8.50	84.10
Union	185.79%	58.87%	84.92	23.75	86.76
Industry Average	37.36%	0.44%	4.66	12.38	61.97

Source: Author's own calculation based on Annual reports of 8 full-fledged Islamic banks for 2014 TD = Total Deposit, CSTA=Cash and Short Term Asset, MTD=Mid-term Deposit, TD=Total Deposit

IBBL has MTD/TD at 30.19%, the lowest among all Islamic banks in Bangladesh which explains somewhat proportional increase in the growth of deposits but decrease in cost of funds at 18.51% and 9.52% respectively. This has produced decrease of net profit at 19.19% even though IBBL held lower cash and short-term assets compared to industry players. Decreasing interest rate environment in Bangladesh for last couple of years gave edge on both asset and liability sides of IBBL its asset side is dominated by fixed-rate murabaha financing while liability side is dominated by floating rate mudaraba deposits.

IBBL is a listed company in Dhaka Stock Exchange and Chittagong Stock Exchange. Efficient market hypothesis assume market price reflects the fundamental value of the company, that is why, it is necessary to study the equity price of IBBL to have an idea about investors' perception and potential of the bank. The following graph shows the stock performance of IBBL in 2014.

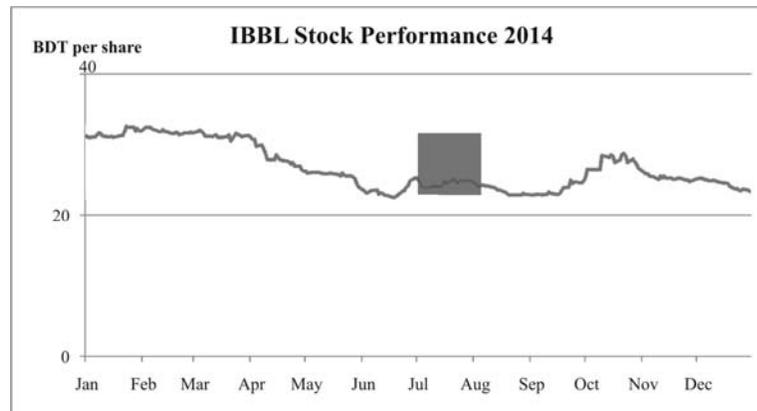


Figure 3: IBBL stock performance 2014 (Daily data from Datastream)

Conclusion and Recommendation

Grassa (2013) argues that even if Southeast Asian model of Shari'ah supervision seems to be most efficient and effective in achieving the Shari'ah compliant purpose than the GCC model, it cannot be considered as a perfect model. A lot of work is required to improve it (Grassa, 2013). Hassan et al. (2014) recommend the following mechanisms in order to ensure a sound Shari'ah Governance system: a) a Shari'ah board with qualified members; b) a well-defined and adequately qualified and staffed organizational structure; c) clear lines of authority and accountability; d) policies and procedures pertaining to the approval of products and activities that require adherence to Shari'ah rules and principles; and e) an independent and regular review of Shari'ah compliance (Hassan et al., 2014). While analyzing four key attributes identified by IFSB: competence, independence, confidentiality and consistency, Wilson (2009) recommends following to improve Shari'ah Governance practice: professional development with modern finance and contemporary legal contract (Ghayad, 2008), renewable contract with Shari'ah board members, compensation of Shari'ah board members by the government but not idealistic for all countries, consistency between IFIs within a single jurisdiction, and coordination between AAOIFI, OIC Fiqh Academy, IFSB. Moreover, clear organizational charts, showing the remit and accountability of different stakeholder groups would help explaining role and working of Shari'ah boards. In addition, scholars from economics, finance, law and political science should be included in Shari'ah board as practised in Sudan in order for making well-informed decisions, while there exist arguments for and against this as well. A framework including structures and processes internal and external to the IIFS can be expected to enhance public understanding of the requirements of Shari'ah. It would be conducive to the development of market discipline as it would permit an effective utilization of exit and participatory actions (Grais & Pellegrini, 2006).

The phenomenal growth of Islamic banking industry has forced regulators, industry players and academics to take comprehensive look at overall structure of Islamic bank risks associated with it. Risk is inherent in banking business as the bank acts as an intermediary between surplus and deficit units in a financial system. Frictional reserve mechanism gives excessive leverage to the bank to raise fund and invest multiple times

against minimum core capital requirement. Based on this principle, the bank usually borrows short/long and invests short/long depending on the interest rate environment and other key macroeconomic variables. The study shows that Islamic banks inherently rely on too much fixed rate financing like *murabaha* due to lower risks associated which are predominately collected from floating rate *mudaraba* deposits. By nature there are various types of risk emanating from existing Islamic banking practices. In this paper, a comprehensive analysis of risk management practices in Islami Bank Bangladesh has been discussed. Islami Bank Bangladesh Limited is the largest and leading Islamic bank among eight full-fledged Islamic banks. It is found that the bank has an extensive risk management framework and process from the top to the bottom.

The analysis of bank's financial statements shows that the risk appetite is moderate to low and it is reflected in their risk management framework and processes. Even though the bank mobilizes funds on profit and loss sharing principle, but study observes that all risks are actually borne by the bank e.g., financing impairment are charged to shareholders only. Income gap analysis of the bank shows that its rate sensitive assets are higher than rate sensitive liabilities which seem not favorable in decreasing interest rate environment. The spread between funding cost and financing income is above 5%. The inclination towards *murabaha* financing is evident from the analysis and 72% of the exposure of the Bank lies under the Risk weight category of 50% or below, which is considered to be one of the significant strengths of IBBL. The bank also faces other risks namely, fiduciary risk, displaced commercial risk, *shari'ah* compliance risk, excess liquidity risk and equity price risk. Displaced commercial risk and excess liquidity risk tend to impact significantly the bank's efficiency and profitability. It can be concluded that risk management is not a project but a process, therefore, a comprehensive risk management framework and process is the order of the day for sustainability of financial industry more importantly Islamic banking industry.

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Conceptual Approach to Identification of Fault lines in Conventional Financial System's Risk Transfer Mechanism: A Case for Risk Sharing in Islamic Finance

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Abstract

The concepts, theory and practice of risk sharing as enshrined in Islamic finance remain a real mechanism for widening the space for participation in economic activities for growth and development. The perceived propensity for greater risk sharing derivable benefits, which mutual efforts enjoyed in Islamic finance, is a process of risk transfer in a conventional financial system. Indeed, risk sharing takes center stage in Islamic finance as a catalyst for business inclusion, thus accommodating the poor more in economic activities. Many fault lines have been identified in existing practices in conventional systems, through risk transfer, which voids the essence of its institution as a nebulous structure to fund economic activities. The dysfunctional outing of conventional finance risk transfer mechanism is rarely documented. Hence, the efficacy of Islamic finance risk sharing mechanism that ought to be harnessed has not been adequately brought to the limelight. Consequently, the primary objective of this paper is to present a conceptual discussion on risk, arguments about Islamic risk sharing practice, and fault lines that inherently characterize conventional risk transfer mechanism. The paper argues for a reintroduction and strengthening of other crucial players' relevant activities for such to be harmonized in the interest of the overall financial system stability.

Keywords: Risk Sharing, Islamic Finance, Risk Transfer.

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1.0 Introduction

The risk is broadly seen as something that is about the probability of the negative outcome or potential losses that could bring an adverse impact to a firm's business. Such negative outcome could be as a result of an unexpected event arising, either from factors within the organisation/business such as staff negligence, mismanagement, or external forces outside the organisation/business such as sudden or drastic regulatory changes, unfavourable economic situations, as well as other changes in tax or interest rate structure that have significant impact on the business's performance.. Risk can also be viewed in terms of uncertainties of future events happening which might influence the successful achievement of an organizations objectives and targets. The risk is again defined as exposure to the uncertainty of outcome or the possibility that the actual returns will deviate from the expected returns (Ahmad, 2003). In many conventional finance studies, risk relates to uncertainties that could result in financial loss. Risks may come from uncertainties in unexpected fluctuations in assets prices, in interest rates, project failures, legal liabilities, accidents, natural causes and disasters as well as deliberate attacks from an adversary.

In Islamic perspective, *Mukhatharah* is an Arabic word that means *risk* (Elgari, 2003). Previous scholars have provided a more definite distinction between *Mukhatharah* and *Gharar*. *Mukhatharah* implies risk; *Gharar* is uncertainty (Gruining & Iqbal 2008). Thus prohibition of *Gharar* is seen as a way of mitigating risk by avoiding deals with high informational asymmetry. (Elgari, 2003). But the risk in Islamic parlance goes far beyond financial loss because it may start from the failure of fulfilling the promise or the *aqad* between two parties in a contract. When the two sides or individuals agreed, each team has agreed or promised to deliver their respective responsibilities arising holistically, as laid down in the approved contract. Thus, failure by one side to honor its obligation is tantamount to the risk of breaching the contract. In Islam, violating an agreement has far-reaching repercussions regarding fear of the wrath of Allah. Also, the breach of the contract would bring in injustice to the other party and possibly more negative implications to the *ummah*.

Risk sharing being a mechanism for shared prosperity among humans has attracted a plethora of discourses in Islamic finance scholars' community, which view it as the defining principle of Islamic finance, with its many benefits and potentials. The potential benefits include its capacity for bringing about growth in economic activities, ensuring financial stability, as well as enhancing business inclusion of many segments of human societies, by way of creating opportunities for entrepreneurship and its development. This general view on the true nature of risk sharing in Islamic finance is however not shared by few scholars. One of the arguments made was that *Mudarabah*, being a point of reference in depicting risk-sharing nature of Islamic finance, was an economic institution born of temporal compulsions not only in Arabia but across the world (Hassan, 2014). The central theme of this argument was that Islam encourages profit sharing of which sharing of risk becomes an arising consequence and not the cause in itself. This view is however alien and incorrect given the fact that what is relevant here is the endorsement of the institution of *Mudarabah* in Islam, in the face of its risk-sharing attribute emanating from information asymmetry problem, even though it originated from the pre-Islamic era. This is more glaring given that where financial losses arise; the entrepreneur unless found negligent, loses not the money but his efforts and time that goes to waste.

In the light of the preceding discussion thus, this paper seeks to explain the concept of risk and risk sharing as enshrined in Islamic finance on one hand, and to highlight the fault lines in the operation of risk transfer as in conventional system on the other hand. Also, the paper seeks to stress on the imperative for insertion of vital institutions such as governments and other participants into active collaboration in Islamic finance operations- measures that could bring financial stability to the global economy.

2.0 Principles of Islamic Finance

Dealing with risks is an integral part of the banking business. As financial intermediaries, banks are placed in central positions to mobilize funds from depositors to generate returns from lending and other operations (Abubakar, 2014). Financial assets such as loans, overdrafts and advances are forms of financing offered by conventional banks and exposed to credit and operational risk. However, Islamic banks are faced with the same kind of risks as conventional banks except for some risks which are unique to them only. The major common risks include credit risk, market risk, liquidity risk and operational risk. The risks that are unique to Islamic banks are in the form of rate of return risk, Shari'ah compliant risk, displaced commercial risk and equity investment risk arising from the nature of the Islamic financing and investment principles

We note here that one of the underlying intentions of *Shari'ah* is to meet the financial needs of market participants with integrity, transparency, honesty, and fairness while ensuring an equitable distribution of wealth among the participants. Islam also forbids exploitation but encourages the promotion of the well-being of all human beings on this earth and hereafter. Imam Al-Ghazali, a renowned Muslim scholar, cited the following:

“The very objective of the Shari'ah is to promote the well-being of the people, which lie in the safeguarding of their faith (deen), themselves (nafs), their intellect (aql), their posterior (nasl) and their wealth (mal).”Imam Al-Ghazali,

The main principles of integrity, transparency, fairness and good corporate governance which *sharia* upholds, sets Islamic finance in a great position different from conventional one as embedded in religious foundations of Islam. As Islam means submission to the will of Allah, it thus encompasses all aspects of human lives including the essence of economic well-being and development of humanity at individual, family, community and national levels. Thus there are three foundations that govern the Islamic way of life which are; *Akidah*, *Akhlaq* and *Shariah*. (Ayub, 2007). *Akidah* means the fundamental beliefs or faiths in Allah, the Angels, the Holy Quran, the prophets, the Judgment Day and the Destiny. *Akhlaq* is the Islamic ethical code on individual conduct relating to his behavior, attitude and work ethics by which he performs his practical actions. *Shariah* entails the laws governing the compliance to the beliefs of Islam and laws pertaining to activity in political, economic and social activities.

3.0 The Fault Lines in Risk Transfer for Conventional Finance

The barrage of definitions on risk transfer, tend to converge on one central issue of moving potential losses likely to be suffered by the financier in its totality, away to the

other party of the deal. Many operational problems and designs in the financial system that anchored on risk transfer doctrine tend to provide a recipe for chaos. Since risk is assumed to have been transferred to the recipient of funds, who in the eyes of the fund's owner has no observed alternative, there exists predilection for free credit extension by conventional banks and the financial system as a whole. The economic system, more often than not, pays only lip service to strict credit proposal evaluation because of the false belief that no losses expected, for the deficit unit is hamstrung.

Allied to the above is the existence of inflationary pressures created by unrestrained credit expansion that is sometimes bereft of responsibility and prudence, which later becomes the subject matter for monetary policies formulation and implementation. The resultant effect on the system is seen in policy somersaults that frustrate financial inclusion right from micro finance level and extends to other wider levels. As such, the vulnerable poor are not better anyway as they are further pauperized by more financial exclusion and not financial inclusion.

Furthermore, the likelihood for the accumulation of debt occasioned by a penchant for giving risk transfer-laden loan packages, which normally end up in fresh capital injections to sustain comatose entities, and usage of debt-equity swaps, exacerbate low financial inclusion that leaves the vulnerable low-income class to bear the brunt of economic malfunction. Thus, potentials for entrepreneurship anchored on shared prosperity inherent in Islamic risk-sharing finance are not promoted, a move that could have brought higher economic growth.

Another point of reference as a fault line in the risk transfer based financial system is the proliferation of fictitious assets that have the tag of derivatives, with their accompanying trading volume worth \$600 trillion. In fact, 92% of the world's 500 largest companies use them to lower risk. (Source: NYT, Banks Face New Checks on Derivative Trading, January 3, 2013)

4.0 Why Risk Sharing in Islamic Finance?

According to Greuning & Iqbal (2008), higher interest in risk analysis and risk management of Islamic banking in the past decade is motivated by three main reasons. First, frequent incidences of financial crises lead to more significant awareness in risk mitigation. Second economic diversification and product innovation create a new dimension of risk and third, the inception of Basel II necessitate more comprehensive approach on the transaction with a higher level of risk in addition to counterparty risk for Islamic banking (Akhtar, 2007). Although bearing higher risks than conventional banks, like financial institutions, Islamic banks are equally responsible for generating profit for their depositors and shareholders. Hence, sound risk management practices and corporate governance ought to be executed to ensure proper risk control and mitigation.

Some arguments drive home the nobility in risk sharing as an accompanying component of Islamic finance. To start with, one could raise suspicion on the nexus between the conventional financial system operations and equity. A case in point here is that with debt dominated structures for financing, asymmetric exposure to risk cases abound and thus, equity fashioned financing styles compromised. Where this arrangement becomes the order, in which dual risk assessment from both parties is not

practiced, equity and profit and loss arrangements with their robustness, regarding shared prosperity and duality for evaluation of risk jettisoned. Where this happened, an uncaredful extension of credit thrives and thus misapplication of funds is almost guaranteed.

As earlier noted also, financial derivatives role in risk management represents a sharp obliteration of realities. In its essence, derivatives trading are no more than nonsense short of any economic value addition. It unequivocally represents a down payment for Islamic finance with its risk-sharing attribute to step in.

Another argument which this paper advances to validate risk sharing posture of Islamic finance is the fact that returns on capital are devoid of upfront determination. Here, it should be noted however that this does not by any means suggest that its return on equity is put at zero. What it means is that let us wait for the transaction to consummated in real terms before celebrating the returns.

A fundamental flaw in the workings of the conventional financial system is the deployment of the powerful money creation mechanism in banks. This practice as contained in the United States Federal Reserve's produced document (modern money mechanics) ushered a fraudulent technique for creation of money from thin air and gives rise to debt creation that is valueless and therefore, a recipe for inflation. For example, it is documented that this fraudulent money creation mechanism drew the attention of a former President of the United States of America who reacted by scrapping the Federal Reserve during his tenure and was only brought back after his exit. The synergistic effect of this sharp practice is that in a real sense, no value backed money is created in the first place and so any subsequent claim of credit extension from that method, whether within or outside limits is a sham. With this defective structure, a fertile ground for risk sharing as canvassed for in Islamic finance is available.

Furthermore, it is relevant to appreciate here that financial resources are known only for their role in the provision of lubrication services to the engine of economic activities. Other resources have to be matched along to come up with results in the form of goods and services. In doing this, rational thinking dictates that risks set in the process and therefore losses cannot be left to be borne by one party alone. Hence, risk sharing attribute of Islamic finance is rightly recognized.

Although there are varieties of players in the overall system, risk sharing in Islamic finance derived its substance mainly because Islamic community knows the fact that there exist different states of nature in transactions. The rules of life are indeed not always favorable that could bring about a pre-defined positive rate of return. However, at this level, we are genuinely interested in obtaining a better or full realization of the potentials in Islamic finance found in its risk-sharing attribute, and thus see the need for an injection of more equity in the financing structure of contracts than that of debt. By so doing, it promotes more sense of ownership to both parties and thus more commitment and stakeholding that tends to give more impetus for honest dealings from both sides of the deal.

Also, the issue of efficiency and effective positioning of institutions in the Islamic and the conventional financial system for service delivery is essential. A malfunction of any player in the overall scheme could have a multiplier effect on the quality of service

delivery as well as the stability of the system. Along with this line, all apparatus for monitoring and evaluation of proposals such as staff competence and compliment, adequate remuneration of staff, appropriate and zero tolerance for improper conducts and periodic reviews of changing environment situations are among another measure to pursue.

It is noteworthy here to take into cognizance the fact that there is the likelihood that many of the risk managers in Islamic banks may have necessary risk management background from conventional banking operation. Some of them could have their risk management experience mainly on credit risk and not much exposure to more sophisticated threats such as those derived from Islamic finance products. Where this scenario arises, it becomes incumbent on Islamic finance institutions to design training and retraining programmes aimed at reorienting them to focus on the needful risk mitigation techniques in Islamic financial system.

Moreover, a conscious programme of action is needed to ensure that much financing requests are applied to the real sector of economies only. When this has become the standard theme in the financial system, more employment opportunities would include creating entrepreneurship and skills development could be enhanced, and talents promoted. This is more urgent in the Muslim world that is poverty stricken with high rates of joblessness and unemployment for the teeming youths.

There is also a compelling need to ensure that the initial step in risk management practice should provide that Standard Operational Procedure (SOP) is strictly followed in the financial institutions. For Islamic banks, observance of disclosure requirement is a must. These disclosures of information requirement in Islamic finance based on the Quran and Sunnah of Prophet Muhammad (SAW) *"The Prophet said, 'Both the buyer and the seller have the option of canceling or confirming the bargain unless they separate.'"*

The sub-narrator, Hammam said, "I found this in my book: 'Both the buyer and the seller give the option of either confirming or cancelling the bargain three times, and if they speak the truth and mention the defects, then their bargain will be blessed, and if they tell lies and conceal the defects, they might gain some financial gain, but they will deprive their sale of (Allah's) blessings.'" (Sahih al-Bukhari)

If this concept is embedded in the risk management process, all parties comprising the customers, bank officers and support staff should be consciously executing all tasks and responsibilities entrusted to them. Back office staff in particular play a vital role in managing and the monitoring stages of risk management process.

5.0 Conclusions

The preceding discussion on the vitality of Islamic risk sharing mode, as against conventional risk transfer in engendering shared prosperity and financial inclusion, remains incomplete when little recognition is given to the role of government as a tonic provider in the quest for higher and essential financial stability of the system. Governments have roles to play with their arrays of interventions and instruments, to complement and fill in the gap that remains available (not captured by financial institutions activities) for vulnerable poor people in the society. Such need for governments' interventions and facilitation are borne out of a genuine need to forestall

the consequences of financial exclusion to any economy. Such consequences include but are not limited to weakening firms' product and services output when patronage levels drop as a consequence, stifling of economic development increases, the rise in unemployment levels as well as general macroeconomic fragility.

Economic growth and stability remain a mirage unless rooted in the equitable arrangement. By this, it means the promotion of equity financing over debt financing is desirable to provide a sense of belonging to all parties in transactions and contracts. The paper further argues for the need to institutionalize financial discipline in the entire system, which should be everybody's' business irrespective of whether the system is an Islamic or a conventional one.

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The Halal and Haram Aspect of Cryptocurrencies in Islam

By
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Abstract

This paper takes into view the conditions that render an investment or transaction haram in Islam and relates them to cryptocurrencies through a literature research methodology. Furthermore, elements that exist in the cryptocurrency ecosystem such as tokens, initial coin offerings (ICOs) and cryptocurrency derivatives are assessed to check as to whether they are compatible with Islam. The difference between Bitcoin and its alternatives is also recognized by analyzing their underlying technology and how they could be a major tool in defining whether or not a cryptocurrency falls in the Islamic permissibility criteria. It concludes that although the technology of cryptocurrencies in itself is Halal; different aspects contribute in deciding whether the specific digital currency in question is Halal or Haram. Future research is needed on a couple of key issues related to Proof of Stake protocol which has been discussed.

Keywords: Cryptocurrency, Protocol, Halal, Haram, Derivatives

1. Introduction

With the rise of Bitcoin threatening the traditional fiat currencies, the world saw governments responding to it in different ways. Some like Dubai legalized it and went on to make use of its underlying technology, ‘the Blockchain’ to establish plans for a smart city whereas some even introduced their own cryptocurrencies like Venezuela. But for Muslims, another dilemma of the “Halal or Haram” aspect is present which must be dealt with for progress in the Muslim world. In existing cases, some scholars have deemed Bitcoin as Haram on the accounts of ambiguity and excessive risk involved, others have stated it as Halal declaring it be even cleaner than the debt-based fiat currencies we use today. (Evans C. W, 2015). But moving beyond Bitcoin, not much literature is present to

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guide Muslim investors in terms of the other cryptocurrencies and tokens that exist like Ethereum, Litecoin, and Golem.

The author believes it is essential to understand the basic difference between a cryptocurrency and a token in order to have a sense of what one is investing in. Cryptocurrencies are coins that are specifically created to be used as digital currencies, as a medium of exchange. On the contrary, tokens serve as a fundraising tool used by startups related to the crypto sphere as opposed to traditional finance raising methods such as venture capital. Tokens are released to the public through an Initial Coin Offering (ICO) just as shares are issued by a public limited company(plc) through an Initial Public Offering (IPO). The latter is strictly regulated whereas ICOs have been exploited to pull off scams in the past. Although this is changing with countries such as America placing regulations on how these are conducted, the fraud can easily be avoided by due diligence, hence it does not go against Islam's principles. The value of a token depends on how the company who issued it in the first place is retaining demand and performing. This can be seen as owning a share in a company but with less right such as no equity, no say in the startup's decisions and no say in the direction the startup takes. This also conforms to the Islamic principles of an investor knowing as to what they are buying with no deception involved. So cryptocurrencies are digital currencies whereas a token is an asset much like a share.

The author believes that cryptocurrencies and tokens in themselves are Halal and further delves into separating the Shariah-compliant and non-Shariah compliant types. Realistically, it is not possible to evaluate every single cryptocurrency or token but by analyzing the protocols that govern each currency, the intended use cases of each currency and seeing whether the cryptocurrency or token in question falls into certain areas such as Riba, this paper delves into the aspects that would make a cryptocurrency or token haram along with its derivatives such as options and futures contracts.

2. Literature Review

Bitcoin has been subject to debate for long on its compliance with the Islamic world of finance. Evans (2015) analyses the blockchain technology along with Bitcoin concluding that both conform to the requirements laid out by Islamic law. Furthermore, a comparison is drawn which establishes that Bitcoin being free of Riba, inflation, and debt plus using fair circulation renders it more Halal as compared to the fiat money that exists at large today. On the other hand, Adam M (2017a) argued that although Bitcoin possesses the traits of wealth and legal value, it fails to stand as a currency but still any return attained would be lawful according to Islam. This view was revisited with his stand of Bitcoin qualifying as a currency with Zakat being compulsory in regards to it due to its monetary value. (Adam M, 2017b). Alzubaidi& Abdullah (2017) use Bitcoin as a primary example to propose changes that would make the development of a digital currency from an Islamic perspective possible. It is argued that although Bitcoin and the blockchain are easily claimed to be Shariah compliant, this is only true to a certain extent as issues still exist in relation to compliance with the Islamic law. Solutions are proposed to cater to the problems of digital currencies not having a physical intrinsic value, and not being under any supervisory control through attaching physical commodities to digital currencies and introducing an alternate system of mining for the latter.

Different Fatwas have been put forward by Islamic scholars with conflicting views on the permissibility of cryptocurrencies. The Grand Mufti of Egypt, the Turkish government, the Fatwa Center of Palestine and Shaykh Haitam from the UK among others have regarded them as Haram whereas others such as the Darul Uloom Zakariya – a Fatwa center in South Africa – has qualified Bitcoin as an asset being permissible for trade but subject to government approval for its qualification as a currency. (Abu Bakr, 2017). However, Mufti Abu Bakr goes on to debunk the points held against Bitcoin and its counterparts establishing that Bitcoin is permissible in Islam.

Reviewing the research that has been published on cryptocurrencies from an Islamic perspective, the majority of them have been targeted at Bitcoin and the blockchain. While this does serve as a useful guide in assessing the Shariah compliance of the king of cryptocurrencies, it does not adequately provide guidance regarding the other cryptocurrencies and tokens that exist. Mufti Muhammad Abu Bakr (2017) states “The principles and arguments to determine any type of cryptocurrency are same. Therefore, the existing literature pertaining to Bitcoin specifically has benefits broadly with regard to cryptocurrency.” Unfortunately, this is simply not true. As discussed later in this paper, alternatives exist that differ from Bitcoin in terms of the underlying technology they use which opens them up to further research. This paper aims to move beyond Bitcoin and deconstruct other parts of the cryptocurrency ecosystem including alternate digital currencies, tokens and financial derivatives that have emerged recently in the cryptocurrency world, assessing as to how they relate to the Shariah in different conditions paving a new path for Muslim investors and traders.

3. Methods

To investigate beyond the scope of the current literature that exists on Bitcoin and focus on other aspects of the cryptocurrency ecosystem, a literature research approach is being used. Different sources of information are employed consisting of journal publications, books and articles. In order to work towards maintaining the authenticity of the information sought, credible sources are targeted. The credibility of these sources can be judged by the fact that they were produced by reputable scholars and experts in existing fields.

Since the existing literature on Islamic banking is vast but limited about cryptocurrencies, this paper aims to collect together the information that exists, identify the gaps that exist and pave the way towards future research on the Shariah compliance of other cryptocurrencies and tokens beyond Bitcoin. Furthermore, in addition to analyzing Islamic financial rules, the very technology that governs cryptocurrencies is also deconstructed to provide an argument that can be applied in different cases. Real world examples are also provided to make it easier for Muslims to understand the context of these regulations instead of being bound theoretically.

4. What makes an Investment and Transaction Haram in Islam?

Islamic law provides a set of certain conditions which must qualify for an asset to be Halal. Although cryptocurrencies are in the literal sense to be used as a medium of exchange, they also qualify as assets along with Tokens since they serve as a store of

value as the traditional fiat currencies may while the latter resembles a share of a company as mentioned earlier in Section 1.

4.1 Riba – Interest.

One of the thumb rules of Islamic finance is that Riba (Interest) is strictly forbidden. Similarly as covered in section 3.2, there are digital currencies and tokens that make use of any of the two types of Riba - Riba Al Fazl and Riba Al Nasee'ah.- to facilitate the running of the coin's network on a daily basis falls into the impermissible. Hence, all cryptocurrencies or tokens involved in activities that are related to Riba are Haram. This is further clarified by the Prophet Muhammad PBUH's Hadith: "Allah has cursed the one who consumes riba, the one who gives it, the one who witnesses over it, and the one who writes down the transaction." (Sahih Muslim) And a verse of the Holy Quran, "Allah has permitted trade and has forbidden Riba." (Quran 2:275)

4.2 Unlawful Industry.

Judging from over hundreds of cryptocurrencies and tokens that exist in the market today, many of them are targeted to serve industries that are regarded impermissible in Islam. An example is of the Funfair token – explained in section 3 - which aims to deliver casino gaming to the public. As gambling is Haram, this automatically makes this token Haram regardless of other properties that may be permissible in themselves. Tron is another token aimed at serving the entertainment industry which directly correlates to music, movies, dancing and other acts which fall out of the permissibility criteria in Islam rendering it Haram. Other industries Muslims should beware of include Pornography, Non-Islamic Banking, Alcohol, Pork and Tobacco.

This concept can be understood with an analogy to the widely understood stock market. If someone invests in a company like Microsoft which is developing software products, this is Halal and hence the investment is Shariah Compliant whereas if one invests in a Company like Diageo which is involved in the production of alcoholic beverages, this investment would be haram.

4.3 Gharar– Uncertainty.

Gharar is the Islamic term for transactions or investments that involve uncertainty consisting of two types: Gharar-e-Fahish(excessive) and Gharar-e-Yasir(minor), the latter one being permissible as a trivial amount of uncertainty is present in every kind of contract and transaction, hence it is considered tolerable.(Uddin, M. 2015, October 13). On the other hand, Gharar-e-Fahish is strictly forbidden.

To demonstrate this, here's an example: A retailer promised to buy the rice harvest of a farmer next year for a fixed price of \$20,000 regardless of the number of rice crops grown. This means that even if all the crops are burned or even if the product is worth \$40,000, the retailer will still pay the fixed amount of \$20,000. This introduces the concept of uncertainty(Gharar) in 3 ways.

- a. The commodity that is being sold does not exist yet.
- b. The quantity and quality of the crops are unknown.

- c. The farmer is selling something that he does not own which imposes upon him a debt. The buyer also now owes an amount of money to the seller resulting in debt in both cases, hence the transaction being a debt to debt one becomes prohibited according to the Shariah.

These facts are evident from the Hadith of the Prophet Muhammad PBUH in which a man asked him, “People ask me to sell them things I don’t have. Should I say yes, and go buy them?” and the Messenger of Allah PBUH said, “No, go buy them first, and then sell them.”

However, as Mufti Taqi Usmani states, with 2 exceptions namely Salam and Istisna such deals are allowed.

i. Salam.

In Salam, a future contract is permissible under certain conditions. This was allowed at the time of the Holy Prophet Muhammad PBUH because after the prohibition of Riba, it was difficult for traders and small farmers to finance themselves. In order to solve this, Salam was allowed which is a transaction in which the seller agrees to sell goods to the buyer on a future date but the buyer must make the full payment at the time of the contract in order for the deal to be beneficial to the seller. The buyer benefits from this due to getting a lower price than the market price. However, there are certain strict conditions under which this contract is valid:

- The payment must be made at the time the contract is made.
- The buyer must give the seller at least one month for the time of delivery of goods. This is because the seller might not be able to deliver before which will undermine the basic reason of granting relief to the seller in terms of finance.

ii. Istisna.

Istisna also allows future contracts but is distinguished from Salam by a few conditions:

1. In an Istisna contract, the seller must be a manufacturer whereas, in Salam, this is not a requirement – the seller could be a retailer or of any other profession.
2. Payment in advance is not a requirement.
3. It is possible to cancel the contract before the seller starts the work of manufacturing.
4. The time of delivery does not have to be fixed.

4.4 Maysir (Gambling).

Maysir is the gaining of wealth through very easy means without any effort and purely depends on speculation without the person having any control of the outcome. It is strictly forbidden in Islam, in any form.

Allah says, “O you who have believed, indeed, intoxicants, gambling, [sacrificing on] stone alters [to other than Allah], and divining arrows are but defilement from the work of Satan, so avoid it that you may be successful.” (Quran - 5:90)

5. Blockchain Consensus Protocols

For the purposes of efficiency and security, consensus protocols are used to ensure the network operates smoothly with every user having a common version of the blockchain avoiding conflicts and attacks from adversaries.

5.1 Proof of Work.

The very first cryptocurrency, Bitcoin made use of the Proof of Work(PoW) protocol, hence it does not come as a surprise that it's the most popular and frequently used protocol today. In PoW each coin is generated by solving tough cryptographic puzzles through the use of computational power. In this way, money isn't created from thin air and is backed by an asset, in this case, electricity. This also serves as a mechanism to regulate the supply of currencies as the difficulty factor in solving the cryptographic puzzles are directly proportional to the number of computational power being invested into the network. In 2009, Bitcoins were mined using personal computers due to the low amount of computational power required whereas now in 2018, specialized hardware exists to cater to the miners market.

In Islam, one of the requirements for something to be legal tender is it to have an intrinsic value. Bitcoin has been criticized in the Islamic world on the basis of having no intrinsic value but this fact is easily debunked in the case of the PoW protocol as electricity serves as the asset backing the currency in question without any debt being used. (Maierbrugger, 2017). However, there is a limitation to this argument which is put forward by Alzubaidi & Abdullah (2017) in which it is argued that electricity does not qualify as the physical existence of an asset which holds its value in the real world. Nevertheless, the author believes that this does not render the PoW protocol impermissible; further research still needs to be undertaken regarding this specific issue.

5.2 Proof of Stake (PoS).

While Bitcoin is regarded as one of the greatest achievements of our time due to the technological advancements it has brought forward, there has been much criticism on the amount of electricity that is wasted to generate new coins through the process of mining. In Bitcoin's infancy, coins could be mined using the graphical processing unit(GPU) of a normal computer machine but with the passage of time, the difficulty of the network has increased. Now miners need to purchase specialized equipment which can compete with the rest of the participants on the Bitcoin network for solving tough cryptographic puzzles. The miner to solve the puzzle in the fastest time gets to validate the transaction block and is rewarded a certain sum of Bitcoins which decreases over time.

Table 1. Estimated Bitcoin Energy Consumption Statistics.

Description	Value
Bitcoin's current estimated annual electricity consumption* (TWh)	62.06
Annualized global mining revenues	\$7,082,886,904
Annualized estimated global mining costs	\$3,102,851,896
Current cost percentage	43.81%
Country closest to Bitcoin in terms of electricity consumption	Switzerland
Estimated electricity used over the previous day (KWh)	170,019,282
Implied Watts per GH/s	0.222
Total Network Hashrate in PH/s (1,000,000 GH/s)	31,880.00
Electricity consumed per transaction (KWh)	939
Number of U.S. households that could be powered by Bitcoin	5,746,022
Number of U.S. households powered for 1 day by the electricity consumed for a single transaction	31.75
Bitcoin's electricity consumption as a percentage of the world's electricity consumption	0.28%
Annual carbon footprint (kt of CO ₂)	30,408
Carbon footprint per transaction (kg of CO ₂)	460.27

Note: Reprinted from Bitcoin Energy Consumption Index, by Digiconomist. Retrieved from <https://digiconomist.net/bitcoin-energy-consumption> Copyright 2018 by Digiconomist. Reprinted with Permission.

As seen in Table 1, the amount of electricity dedicated to Bitcoin mining operations leads to immense wastage and increased costs. In response to this, in 2012 Scott Nadal and Sunny King introduced the Proof of Stake (PoS) protocol incorporating it first in a new cryptocurrency called Peercoin. PoS aims to minimize on electricity usage with the transactions in the network being validated through another way as opposed to the use of computational power in PoW. This involves the method in which a person can validate the percentage of transactions according to the amount of stake they hold in the coin. Along with this, investors can earn interest based on the amount they have put on stake for the purpose of validation in the network. As a thumb rule of Islamic finance, interest (Riba) is strictly forbidden. On the other hand, so is the creation of legal tender without an intrinsic value. In the case of Proof of Stake, both of these become true hence ruling that any digital currency following the Proof of Stake (PoS) protocol is Haram. Other variations of the PoS also exist, one being the Delegated Proof of Stake (DPoS). In DPoS, a representative democratic process is applied in which the users of the currency vote for delegates to serve on a panel that may contain a different number of witnesses. These panel members are responsible for confirming transactions, setting transaction fees and transaction sizes. Just like in PoS, the influence or power each delegate holds is directly proportional to the stake they contain in the coin.

The benefits of PoS can be seen in the non-Islamic world which has urged several cryptocurrency projects to make the transition from PoW to PoS in order to save the high electricity consumption. One of these is Ethereum, the second largest network by market capitalization after Bitcoin. To make this change, the lead developers of the network have decided to apply a gradual change in which every-one transaction block out of 100 that are processed will be secured via the PoS protocol whereas the rest will continue to use the PoW protocol (Heritage, A). This results in a hybrid system different from the pure PoW or PoS cryptocurrencies we have mentioned above which pose a problem from a Shariah compliance perspective.

5.3 Other Protocols.

Apart from the 2 widely used above mentioned protocols, a variety of others such as Proof of Funds, Proof of Activity and Proof of Capacity exist and before investing in any such coin that makes use of these, a Muslim should be well informed on their status in respect to the financial rules in Islam. One way to ensure this is to check that every protocol is in agreement with the requirements laid down by Islam which have been mentioned above in section 2.

6. Cryptocurrency Derivatives

Just like any asset, cryptocurrencies have also started to attract the integration of derivative instruments to cater to the risk reduction need of investors who are particularly concerned with the high volatility cryptocurrencies bring along.

6.1 Futures Contracts.

Recently with the surge in the popularity of Bitcoin, finance professionals have started offering Bitcoin Futures which are contracts that allow people to buy bitcoins for a fixed price in the future no matter what the price will be at the time. Currently, established corporations such as the Chicago Board of Exchange (CBOE) and Chicago Mercantile Exchange (CME) Group are offering these contracts.

The CBOE introduced their first set of offerings on 11, December 2017 for its January 2018 contracts at a selling price of over \$20,000 per Bitcoin whereas the current price of Bitcoin was hovering between \$16,500 and \$17,500. However, as the month of January began, Bitcoin's price plunged down to under \$15,000 with being \$10,900 on January 17 when the contract ended (Zuckerman, M. J. 2018, January 18). This highlights the uncertainty involved in the deal. The buyers made a loss on the specific contract whereas the sellers – CBOE – made a profit.

In the near future, we can expect this trend move away from the king of cryptocurrencies to others such as Ethereum and Litecoin but what does this mean for Muslim investors in the crypto space? As mentioned in section 2.3, there are certain conditions which make future contracts impermissible.

1. The commodity being sold does not exist. We can be sure that the Bitcoins are already in existence that can cater for the contract's customers so this condition does not apply here.

2. The commodity being sold is not owned by the Seller. We do not know for sure but it is possible that the company offering them already owns the Bitcoins so this would vary from case to case.
3. The buyer does not pay the amount of the contract beforehand. In this case, it is indeed possible that the buyer pays the amount at the time the contract is finalized, however, this may also vary from case to case.
4. The quantity and quality of the goods or services being sold are unknown, in this case, both are known as the quality is consistent while the quantity is always known in such deals.
5. The contract includes elements of Gambling (Maysir) such as future contracts which employ the Contract for Differences (CFD) or Cash Settlements method in which instead of the buyers of the contracts owning the underlying asset, they instead gamble on the direction the price would take and make a profit or loss on the price difference between the opening and closing price of the asset between the set dates. This also takes into account the prohibition of a sale without a subject.

In the case that for example, the company is not in possession of the Bitcoins and neither the buyer has paid for the amount in advance, this will make these contracts impermissible as in this case, neither the conditions of Salam nor of Istana will apply. However, in the case of CBOE, they are making use of “cash settlements” which makes these contracts Haram. From this, the author concludes that these conditions can always vary and Muslim investors need to assess these factors from case to case using the specific criteria mentioned above.

6.2 Options.

Options refer to contracts that facilitate the buying and selling of an underlying asset at a fixed date with a fixed price in the future. Although more commonly used in the Stock Market, options have also made their way to the cryptocurrency world serving as another addition to the variety of derivatives available and also another important issue for investors to investigate in order to keep their investments Shariah Compliant.

There is a fundamental difference that sets them apart from future contracts which is that the buyer has the right to but no compulsion to buy the asset in the future and may cancel the deal at anytime although the seller is obligated. This places the seller in debt but not the buyer hence making it differ from the debt to debt transactions in futures contracts in which both parties are bound. Usually, the buyer also pays a down payment ahead of the deal which is known as the ‘premium’ and in the case, the transaction does not go through due to the option expiring or the buyer not exercising his option, the seller gets to keep the amount. This is known as the Arbun call option in Islam. The permissibility of down payments is not agreed upon by consensus among the different schools of Islamic law. The Hanafi, Maliki and Shafi’i schools declare them to be Haram whereas the Hanbali school declares them to be permissible.

However, there are a number of other aspects that contribute to Options as a whole which must be assessed for their compliance with the Shariah and only then can it be

decided if they are permissible or not. The Islamic Fiqh Academy in its seventh session in Jeddah, Saudi Arabia on 9-14 May 1992, declared the following in its 63rd Resolution regarding Options,

Option contracts as currently applied in the world financial markets are a new type of contract which do not come under any one of the Shariah nominate contracts. Since the object of the contract is neither a sum of money nor a utility or a financial right which may be waived, then the contract is not permissible in Shariah. As these contracts are primarily prohibited, their handling is also prohibited. (Islamic Fiqh Academy & Islamic Research and Training Institute, 2000, p.131).

This makes it evident that options trading in cryptocurrencies is prohibited.

7. Recommendations for Future Research

Although the technical aspects of the cryptocurrency ecosystem were deconstructed along with assessing the permissibility criteria according to Islamic teachings, further research is required to tackle more complex issues which are of significance in making cryptocurrency adaption possible in the Islamic world. A couple of specific questions are as follow:

1. A currency using the PoS system is Haram due to the dividend it offers its holders in the form of interest but does the same approach apply if a currency only uses a small part of this approach as in the case of the Ethereum Casper protocol mentioned above?
2. Is it Halal to trade cryptocurrencies or tokens using the Proof of Stake protocol if one does not participate in activities such as validation which result in the accumulation of interest money? In banking, Islamic scholars have suggested a number of ways to tackle the interest money given by a bank using ways such as opening a checking account and doing timely payments, disposing of the interest in the form of charity or, rejecting it altogether from the bank. But what approach will apply in this aforementioned case of cryptocurrencies and tokens?

Producing solutions to these key questions and further complex issues that can arise will help Muslim investors proceed with a more comfortable approach towards cryptocurrencies and in such have a positive impact on the Islamic financial system.

8. Conclusion

In light of the above discussion, it can be concluded that the cryptocurrency ecosystem consists of both Halal and Haram elements. In analyzing any digital currency or token, one must look at different aspects both from a technological and a religious point of view. Technologically, the consensus protocols must be deconstructed logically to assess whether they are in line with Islamic conjunctions. Currently, the author believes the Proof of Work (PoW) protocol as Halal whereas the Proof of Stake (PoS) protocol as Haram. Religiously, the prohibitions of Riba, Gharar and Maysir must be checked against in every transaction or investment. With the increase in financial instruments such as futures contracts and options, it is imperative that one should assess

their compliance with a Shariah perspective as well in the context of cryptocurrencies although existing ones were found to be Haram. Even though they don't affect a digital asset directly, the earnings resulting from an impermissible source themselves are deemed Haram which is why due diligence is needed in this field.

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Country Model

Afghanistan *

Having 99 percent Muslim population and prevalence of huge financial exclusion presents Afghanistan as a natural market for Islamic finance to flourish. However, political instability and security concerns have adversely affected Islamic finance along with the overall economic and financial system of the country.

Regulatory Environment

In the rubbles of war, banking sector was re-established from scratch in 2003 in Afghanistan. Realising huge financial exclusion, the central bank of Afghanistan, Da Afghanistan Bank (DAB), launched five years plan in 2009 with the major objective to attract large customer base. Subsequently, an Islamic Finance Division and Shariah Board were established at DAB.

DAB, in the latter half of 2015 issued much-awaited Islamic finance regulations, which cover licensing of Shariah banks and windows, Islamic liquidity management, capital adequacy, asset classification, profit distribution and Shariah governance among others. These came into effect in February 2016. The year 2016 can be termed as an important period where major Islamic finance regulatory developments took place in Afghanistan. The year saw 46 manuals of regulations and guidelines released by the central bank, which can be termed as a positive step toward the further implementation of Shariah banking.

While Da Afghanistan Bank has the authority to provide regulations on specific services and products, as well as to issue licenses to commercial banks in order to perform Islamic banking services, commercial banks must establish a council of religious scholars to ensure their compliance with Islamic principles.

Islamic Banking & Finance

Banking and finance players have been positioning themselves in Afghanistan's nascent Islamic finance market, attracted by the high demand from the Muslim-majority population. There are 18 licensed banks in Afghanistan, according to the Ministry of Finance, with at least seven offering Shariah banking services on a window basis, including Afghanistan International Bank. Conventional lender Bakhtar Bank is in the process of transforming its operations to comply with Shariah principles, becoming the Republic's first full-fledged Islamic bank.

Islamic microfinance is also present in the country: the Foundation for International Community Assistance was the first institution to extend Shariah compliant (Murabahah) microcredit in 2006 and has led the way for others to follow suit, including non-governmental organization, Islamic Relief. Another prominent Islamic microfinance

* Source: State Bank of Pakistan, Quarterly Islamic Banking Bulletin Oct-Dec 2017

initiative was the Rural Finance and Cooperative Development program by the US Agency for International Development which ran from 2009-12 and which developed Islamic investment and finance cooperatives to enhance financial accessibility in southern and eastern Afghanistan. To boost microfinance activities in the country, the government in 2003 established the Microfinance Investment Support Facility for Afghanistan.

Capital Markets

The Ministry of Finance is working with an Islamic finance consultancy to introduce Sukuk; work is underway to set up a regulatory framework for the issuance of Sukuk. If this is done, it may return investor confidence in the Afghan market, which has been talking about establishing an Afghanistan Stock Exchange for years.

Takaful

There are four insurance operators in Afghanistan: Afghan National Insurance Company, Insurance Corporation of Afghanistan, Insurance Group of Afghanistan and Afghan Global Insurance, which fall under the purview of the Afghanistan Insurance Authority (AIA); however, none of them are offering Shariah compliant products. The regulator is working on drafting a new insurance law and regulations to replace the law passed in July 2008; however, no specific takaful provisions are included, according to the AIA.

Future Outlook

With Muslim majority population, it appears that Islamic finance will stay and grow in Afghanistan. However, political uncertainties are likely to continue weighing on the Afghan economy which may dampen banking and finance activities. Yet there are pockets of opportunities for Islamic banking. The political will demonstrated by the government, through new regulatory measures, bodes well for the sector.

Given the peculiar situation of Afghanistan, the role of international investors is also significant. Moreover, capacity building of Islamic finance industry and awareness raising among masses can catalyse growth of Islamic finance in Afghanistan.

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Book Review

مالیاتی ادارے اور شریعہ ایڈوائزری بورڈ: ضرورت، ذمہ داریاں، ضابطے (تحقیقی جائزہ)

Financial Institutions and Shari'ah Advisory Board Importance, Responsibilities and Criterions: A Critical Review

Authors: Mufti Muhammad Iqbal & Prof. Dr. Lutfullah Saqib
Publisher: Center for Excellence in Islamic Finance, IM-Sciences, Peshawar.
Year: 2016 Pages: xiii + 148
Price: Not mentioned
Reviewed by: Muhammad Ismail*

One of the core differences between IFIs and conventional ones is that IFIs certifying its products, services and operations with *Shariah* advisory board but conventional financial institutions don't require any such certifications and review for its products, services and operations. Globally people are continuously switching to IFIs and in order to cater the needs of such people *shariah* advisory board of IFIs are engaged in product development activities. Therefore *shariah* advisory is considering the backbone for IFIs. The book under review, written in Urdu and is about the meaning, need, criteria, functions, responsibilities, contemporary practices etc. of a *shariah* advisory board within in Islamic financial institution. The authors of the book are prominent scholars in the field. Mufti Muhammad Iqbal is a lecturer and researcher of Islamic banking & finance at AshabeAlsuffah Islamic Education System, Islamabad, while Dr. Lutfullah Saqib is an assistant professor at Swat University, KP and also holds the position of *shariah* advisor and consultant at many government and private financial institutions. Moreover the book is first publication of Center for Excellence in Islamic Finance, Institute of Management Sciences Peshawar.

The book comprises eight chapters and a beautiful preface. In preface the authors detailed about the Islamic teaching of economics and finance and then wrote about steps taken toward Islamization of economy globally and especially in Pakistan while in the end of preface, authors threw light on importance and scope of *shariah* advisory in Islamic financial institutions.

The first chapter deals with history and importance of *shariah* advisory. Importance supported with many relevant verses from holly Quran and practices of Prophet Muhammad PBUH as grand *shariah* advisor/ *mufti* of the first Islamic state. On

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the other hand strong evidences were given regarding the presence of *shariah* advisory institution/ committee at the era of *Sahaba, Tabieen, TabaTabieen, Mughal* dynasty and *Othman* dynasty. *Shariah* advisory board play a leading in the development of Islamic financial system of a country because they make their *shariah* policies, analyses their existing products, guiding them toward the right and wrong, present parallel Islamic alternative to the conventional products through *shariah* compliance and structuring their new *shariah* based products by considering the current financial practices and *urf*.

The second chapter is on 'the essential qualities and qualification for a *shariah* advisor'. In contemporary world a *shariah* advisor is a person who is specialized in jurisprudence of finance, controls the financial activities of an IFI and passes *shariah* ruling/ *fatwa*. As this is a very tricky job and everyone is not able to execute it because of lack of *shariah* qualification, expertise and brainpower to get reasoning, analysis and pass ruling. Therefore the holly Prophet Muhammad PBUH, companions and many prominent jurists prescribed some essential qualifications and qualities required for a *shariah* advisor. These necessary qualifications are: enough understanding of Quran and Sunnah as they are the primary sources of *shariah*, knowledge about *nasikh wa mansukh*, acceptable hold on Arabic language and grammar(*sarfwanahw*), knowledge regarding principles of Islamic Jurisprudence, adequate understanding about *qiyas, ijihad, ijma, urf, istehsan, istidlal, istislah, sad al dhariah*, etc. and sufficient knowledge about the explanatory juristic schools and their correspondence differences in opinions. There are some other competencies that a *shariah* advisor must have, these are: work for Allah will rather than material gain (no material or worldly greediness against *fatwa* issuing), first follow his own ruling/ *fatwa*, quality of scholarship (*taqlid*), ignore earnest in passing *shariah* ruling, an ideal character in society, must know the mentality and cleverness of the society and should wait for suitable time to passing any *shariah* ruling (must not give any *shariah* ruling in the conditions of anger, happiness, hunger, thirst, slumber, sickness, critical relieve, warmth, etc.).

In third chapter the authors described about the manners and boundaries vital for *shariah* advisor before giving or passing any *shariah* ruling/ *fatwa*. The very first in these manners is 'turning to God' which mean that before giving any *fatwa* a *shariah* advisor must demand help from Allah and solely concentrated toward Allah throughout the entire *fatwa* process. The second manner is that a *shariah* advisor of an IFI must need to know about the contemporary financial practices (*urf*). The third manner which is necessary for *shariah* advisor before giving any *fatwa* is, if he don't know about the correct answer of the assign issue so he must express his ignorance and stop giving *fatwa* regarding the said issue, because *la'adri*(I don't know) is itself a knowledge and also is an excellence of mufti. The fourth manner is that a *shariah* advisor should have the quality 'to retract his previous *fatwa*/ decision after his approach to a correct decision. The fifth and last manner is that the *fatwa* of a *shariah* advisor should be 'unbiased'.

Chapter four deals with the critical analysis of the State Bank of Pakistan 'fit and proper criteria (FAPC)' for appointment of *shariah* advisor and the adopted curriculum of Pakistan's prominent Islamic education institutions/ *madaris-e-deniyah* and HEC approved degree issuing institutions/ universities regarding their respective *shariah* qualification. As per the curriculum of *madaris-e-deniyah* is concern, so it is more

compatible with the required qualification of a *shariah* advisor but the graduates of such institutions are hardly adjusted in modern institutions especially business and corporate sector because of unfamiliarity with contemporary knowledge and *urf*, moreover their fatwa giving competencies are limited to few famous classical and up to extent modern booked issues. As the system of these *madaris-e-deniyah* are almost scholarship base, therefore there is no trend of research, case studies etc. in such institutions. While on the other side curriculum of modern universities that offering higher study degree in *Usuluddin/* Islamic study, LLM Islamic jurisprudence/ LLM Islamic commercial law, Ph.D. Islamic banking & finance, etc. are much exposed to the contemporary economic and financial knowledge, practices and also aware with *urf* but in reality such graduates have little knowledge of *shariah*, therefore candidates having such sort of qualification can't fulfill the requirements of a *mufti/ shariah* advisor. The fit and proper criteria of SBP screened candidates for *shariah* advisory board on the basis of their respective certificates and degree, but this criterion can't provide us a candidate having the required qualities and competencies that explain in chapter two.

In chapter five the authors overviewed the current poor performance of *shariah* advisory board (SAB) and proposed vital steps toward its improvement. A notable hurdle that affects the performance of SAB is the lack of understanding of the contemporary conventional financial system and also its related disciplines like Economics, Accounting, and Auditing etc., to fulfill such knowledge deficiency it is recommended to SBP to arrange at least one year training for the selected *shariah* advisory board members. Secondly conflict of interest is also one the burning issue that faces by *shariah* advisor to give fatwa, as the senior management are interested in profit maximizing by approving their demanded profitable products while *shariah* advisors are focuses on the *shariah* legitimacy of financial activities, also *shariah* advisor is the employee of its financial institution and also get employment benefits, therefore he is always conscious about the continuity of his job and not go in such fatwa that leads to harm his occupation, to eliminate such obstacle, it is need to create such SABs that are completely independent from its respective financial institutions management and their salaries should be paid by SBP directly or indirectly. Thirdly if an entity put an issue in front of two or more different *shariah* advisors and demanded fatwa against its *shariah* legitimacy, so more probably it is possible that one may approve such an issue while make different opinions and make it disallowed, therefore due to such practices the position of *shariah* advisor is controversial in the eyes of layman, so it is need to create awareness and importance among *shariah* advisors about sanctity of *shariah* ruling. The last but not least hurdle is that, as *shariah* advisor hold its correspondence in financial institution for a very limited time throughout a month, thus it is impossible to overview, analyses and then passes rulings of the entire month activities in such a short session, therefore it is requested to the monitoring authorities to established such rules which restrict *shariah* advisors to hold his office for full time just like other employees.

Chapter six deal with the hurdles that directly affect the efficiency and objectives of *shariah* advisory board. Lack of cooperation from concern IFIs senior management is considering the biggest hindrance in this regard; the second hurdle that a *shariah* advisory board bearing is limited authority in their decisions making; holding office by *shariah* advisory board members for a very limited time also effect the task of the said

board and the last but not least snag is consistency of *shariah* advisory board members in appearing *shariah* advisory board's meetings. In order to achieve the goals and objectives of the said board, it is obligatory to remove will these hurdles.

In chapter seven the authors communicated about solutions to challenges of the *sharpi* advisor and *sharpi* advisory board. The authors recommended almost eight solutions, by adopting which a *shariah* advisory board should become challenges free, these are: i) making rulings and decisions in the light of *shariah* doctrines; ii) not compromising in the *shariah* legitimacy of any financial transaction and dealing; iii) Islamizing the entire internal environment of IFIs; iv) ensuring quality of *Istighn'a* without any expectation of reward; v) adequate understanding to the contemporary economics and finance theory and practice; vi) creating *shariah* awareness in public; vii) understanding the main philosophy of Islamic economics system and struggling for its achievements, and viii) highlighting the importance and sanctity of the status of mufti and *fatwa*.

Chapter eight is the last chapter of this book, in which the authors concluded the book and proposed structure for *shariah* advisory board in the light of explained discussion. The authors concluded that an acceptable *shariah* advisory board should be the one, which is more compatible with *shariah* and also meet the contemporary financial industry needs. Therefore adequate *shariah* knowledge (as explained in chapter two), plentiful understanding about interest and contemporary economic and financial systems with its correspondence consequences, awareness with *urf*, sufficient experience in making *shariah* rulings in financial sector, complete approach to required data, full authority in making *shariah* rulings/ *fatwa* issuing, *shariah* complaining of existing and new products and implementation of *shariah* advisory board's decisions are the key components of an acceptable *shariah* advisory board.

The book is a valuable contribution to the literature of Islamic banking and finance. In Urdu it is the first and unique publication of its kind. Too many references are quoted from Quran, Hadith and other relevant Islamic literature, which advanced the value and authenticity of the book, therefore the authors should be appreciated for their great research. The details communicated here, are much compatible with *shariah* doctrines regarding *mufti* and *fatwa* but it is hard to employ it in contemporary financial system, simply stated, it is more theoretical but less practical. Also the main theme of the entire components explained in last four chapters is almost same, which actually don't require explaining in separate chapters, while these are explained in separate chapters under different headings, as a result confusion arises during the reading of these chapters. Moreover in order to benefit maximum Islamic banking and finance academics' and industry's stakeholders, the book should be translated into English. It is too important to mention here that the publisher i.e. Center for Excellence in Islamic Finance, Institute of Management Sciences, Peshawar should also be appreciated for such a great addition.

Governance in OIC Countries

Country	WGI	World Rank	Country	WGI	World
Qatar	0.62	64	Djibouti	-0.67	160
Brunei Darussalam	0.60	66	Egypt	-0.68	162
United Arab Emirates	0.55	68	Lebanon	-0.71	163
Malaysia	0.34	75	Sierra Leone	-0.72	164
Oman	0.21	79	Azerbaijan	-0.77	167
Kuwait	0.08	90	Mauritania	-0.80	169
Bahrain	0.03	95	West bank and	-0.82	171
Jordan	-0.05	98	Kyrgyz Republic	-0.86	175
Turkey	-0.07	99	Bangladesh	-0.88	177
Suriname	-0.12	104	Cameroon	-0.91	180
Tunisia	-0.18	111	Comoros	-0.94	182
Albania	-0.20	112	Côte D'ivoire	-1.05	183
Senegal	-0.27	115	Pakistan	-1.07	186
Maldives	-0.29	118	Iran	-1.08	187
Benin	-0.29	119	Guinea-Bissau	-1.09	188
Morocco	-0.32	124	Tajikistan	-1.10	189
Saudi Arabia	-0.33	125	Nigeria	-1.13	191
Bosnia and Herzegovina	-0.33	126	Libya	-1.24	193
Burkina Faso	-0.37	132	Guinea	-1.24	194
Mozambique	-0.38	134	Syrian Arab	-1.27	196
Guyana	-0.39	135	Yemen	-1.27	197
Kosovo	-0.40	137	Uzbekistan	-1.27	198
Indonesia	-0.43	139	Chad	-1.36	200
Mali	-0.52	144	Turkmenistan	-1.36	201
Kazakhstan	-0.54	145	Iraq	-1.50	205
Gambia, the	-0.54	146	Sudan	-1.58	208
Uganda	-0.58	151	Afghanistan	-1.65	211
Niger	-0.65	157	Somalia	-2.30	212

Source: World Governance Indicators 2015, World Bank

Note to Contributors

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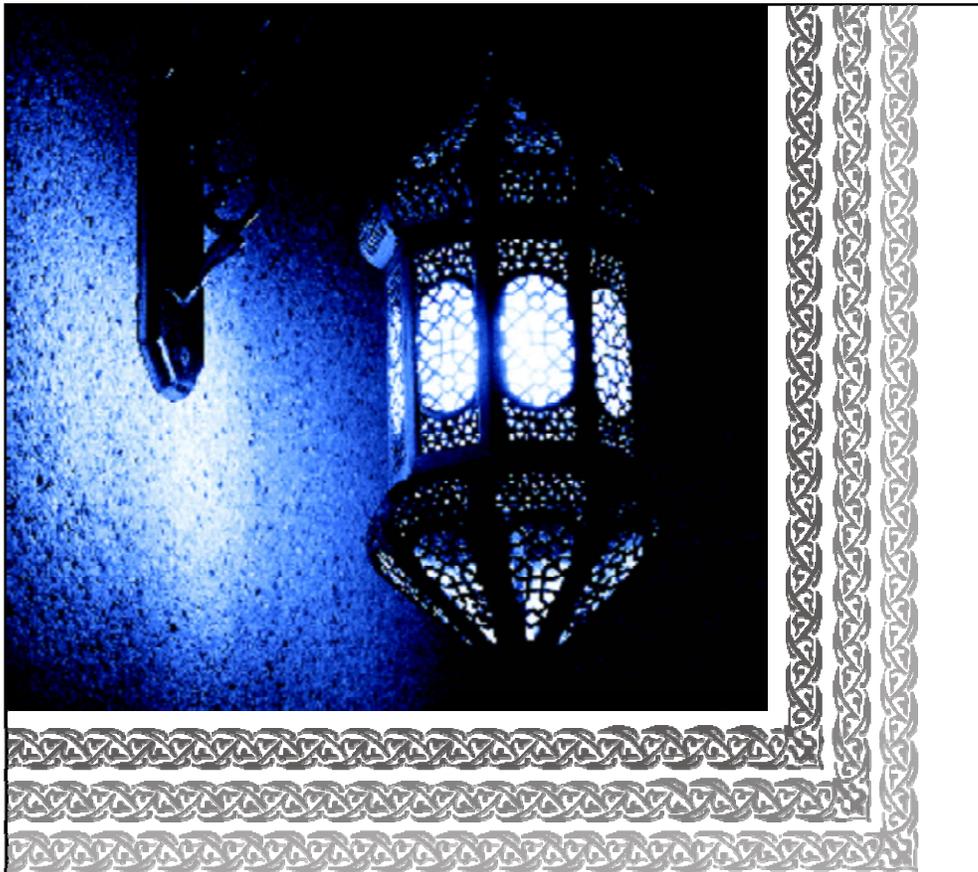
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