

Doctors of law needed to take Islamic finance forward



(SASAN SAÏDI)

By Eman Al Baik

Published Sunday, June 21, 2009

With the global financial crisis exposing the limitations of traditional banking systems, there is now a big push in the banking sector worldwide to incorporate Islamic banking, the total assets of which are expected to reach \$2 trillion (Dh7.34trn) in 2015, according to experts.

However, Islamic banking is not without its challenges, the most

prominent of which is to find adequately qualified Islamic scholars for the Shariah governance boards of Islamic banks and financial institutions.

Two experts that **Emirates Business** spoke to said a PhD in Shariah law should be a mandatory requirement for any member of a governing board of an Islamic bank. They also proposed a system of issuing operating licences for the scholars after testing them to ensure they met all the required criteria.

Dr Mabid Al Jarhi, President of the International Association for Islamic Economics, Financial Expert and Head of Training at Emirates Islamic Bank, said Islamic banking faces a number of challenges that need to be closely considered to help increase reliability and authenticity. One of the most serious challenges is represented in the need for set standards and criteria for the governance of Shariah boards at Islamic banks, said Dr Al Jarhi.

The market demands the development of new innovative Shariah-compliant financial products. However, currently there seems to be a lack of adequate qualified practitioners to do so. "The market requires professionals who not only have excellent financial knowledge, but also a good understanding of Islamic law," Dr Al Jarhi said.

"Many members of governing Shariah boards are not qualified enough to study and generate Shariah-compliant products and this reduces the reliability of Islamic banking and finance," he said.

Central banks should intervene to issue a set of eligibility criteria for joining governance boards to help produce genuine Shariah-compliant products that have positive impacts, Dr Al Jarhi said. At the same time, there should be control over products that are listed as Shariah compliant but are not – such as "Tawarroq" – and

products based on debt and risk trading. There is an urgent need for the members of Shariah governing boards to be holders of PhDs from recognised universities, such as Al Azhar of Egypt, University of Islamic Shariah in Syria and Umm Al Qura University in Saudi Arabia.

"Unfortunately, some Islamic banks appoint Muslim scholars who are not even holders of high degrees in Islamic Shariah," Dr Al Jarhi said. "The market is unable at this point to meet the demand for innovative financial products to meet all types of investment requirements." Economic advisors of these boards, too, should be holders of PhDs from recognised universities and the Shariah board should comprise an odd number to ensure a majority in voting.

The economic expert would explain the economic side of a proposed product and its short- and long-term consequences, while the scholars should study them from a Shariah perspective, Dr Al Jarhi said. There should also be a central authority that controls Islamic Shariah financing and banking.

Another challenge is represented in the sudden and vast expansion that resulted in a shortage – scarcity even – of specialised and trained human resources, he said. To meet expansion demands, it is vital that more executives have adequate understanding and knowledge of Shariah-compliant products.

The situation has pushed Islamic banks to recruit people who have experience in conventional banking. However, these staff should be offered adequate training in Islamic banking to help avoid bad management and consequent failures. "There is an urgent need to set up training institutions specialised in this field," Dr Al Jarhi said.

Islamic banking and finance is relatively new to the global financial

system and most consumers are not aware of procedures and products, he said.

There are some banks that offer various Shariah-compliant products, while others are limited to just a few. Clients should educate themselves about the types of Shariah-compliant product and which suits their objectives.

Banking procedures are not standardised, Dr Al Jarhi said. Client clarity becomes critical, especially for non-Muslim customers who need extra motivation apart from it just being an ethical product to be attracted to Islamic financial services. Also, clients should check the reliability of the board of governance prior to making any transactions, said Dr Al Jarhi.

Agreeing with him was Dr Abdulazeem Jalal Abozaid, Professor of Islamic Law of Transactions at Damascus University's Faculty of Shariah, who also said members of Shariah boards should be holders of PhDs in Islamic law, or "fiqh", of transactions. This is because there are different divisions of Islamic law and a "fatwa" in the field of transactions cannot be made by just any scholar.

"Not all members of a Shariah board are specialised in this field and this has resulted in products that can be described as un-Islamic," he said.

Analysing the current situation, Dr Abozaid said a few Shariah scholars were monopolising Shariah boards. This is due to various reasons, but primarily because newly-opened institutions usually ask existing ones to recommend scholars for their Shariah governance boards – a practice that ends up with the same scholars working for a number of institutions.

Another reason is that many banks have become interested in

offering products that have been somehow labelled Islamic, regardless of whether they are genuinely in compliance with Islamic Shariah.

"In the end banks are institutions that are out to make profits. So they appoint scholars who are known for their 'lenient' approach towards Islamic principles. Scholars who have a reputation for not being too rigid, and who promote themselves as such, have become controllers of governance at most Shariah boards," he said.

Dr Abozaid, who has been a Shariah consultant and trainer for some Islamic financial institutions since 2004, said in the early days of Islamic banking there was a shortage of qualified scholars, but now there are highly qualified graduates of recognised Shariah universities. However, as governance boards were already monopolised by "lenient" scholars, there was no way for the induction of these new graduates.

Apart from those who are qualified to issue fatwas and check for complicity with Islamic principles and teachings, Dr Abozaid, listed three other types of Shariah board members: the academically unqualified; those that are qualified but use their qualifications only as a calling card to secure their places and sources of earning; and those who believe they serve Islam and Islamic banking best by approving as many products as possible without checking their Shariah compliancy.

The situation begs for central banks to intervene and stipulate a set of rules and regulations for joining Shariah boards to help maintain the public's confidence in Islamic banking and ensure global growth, he said.

Malaysia's central bank is one that has adopted such rules and is

regulating Islamic banking and finance in the country. However, there are still highly controversial products offered in the country, such as "Einah" which is even worse than "Tawarroq". Both are similar to interest-based lending in conventional banking, Dr Abozaid said.

"These two products are wrongly given an 'Islamic compliancy' clearance. Under them loans are offered against bogus operations of selling and buying back a specific commodity, ensuring that a specified amount of profit accrues to the bank," he said, adding that "Einah" is widely offered in Indonesia, Brunei and Singapore, as well.

"Central banks should have a special division for the governance of Shariah boards and should examine the qualifications of board members in banks that offer, or are planning to offer, Islamic banking and finance. The proposed products should also be subject to the approval of the central bank," he said, and added that such centralisation would not prevent competition but rather encourage innovation in generating new products and increase public confidence in Islamic banking.

Licencing Shariah personnel

Dr Abozaid also called for issuing licences to Shariah scholars engaged in Islamic banking, similar to the ones given to engineers or doctors before they are allowed to start their practice. An independent body should be set up to licence scholars for the membership of Shariah boards, he said. It should be made mandatory for scholars to clear a test in the Islamic law of transactions and the basics of Islamic finance in order to obtain the licence. A possible licencing body could be the Bahrain-based General Council for Islamic Banks & Financial Institutions, he suggested.

"This is the core necessity for correcting the current anomalies in the Islamic banking and finance sphere," said Dr Abozaid.

In addition, scholars would also be required to have sufficient knowledge of the English language, as all contracts were in English, he said, and added that a non-profitable institution for training scholars should be set up to help increase their expertise.

It is also unprecedented in Islam that a scholar is paid by the party that seeks his opinion on Shariah laws, Dr Abozaid said.

"Currently, the scholar who is assigned to give an Islamic Shariah opinion, or 'fatwa', is paid by the bank – the party that seeks this legal opinion. This opens the door for violating and manipulating Islamic principles to favour the bank," he said.

In addition, it falls under the duties and responsibilities of the Shariah boards to arbitrate any dispute between the Islamic bank and its clients. It is unprecedented in the Shariah that an arbitrator or a judge takes his fees from one of the parties involved in a dispute. Such a practice is prohibited under Shariah, as it may open the door to malpractices that favour the party paying the fees.

To ensure that Islamic principles and teachings are implemented in banking transactions with honesty and integrity, scholars should not be paid by a party that needs a "fatwa" but rather by a third party, which could be the central banks, Dr Abozaid said. Central banks, in turn, may collect an amount from the allowances payable by Islamic banks to the Shariah boards members.

Speaking about the current state of the Shariah finance market, Dr Al Jarhi said GCC countries are expected to lead a future charge

into Islamic finance and banking with about \$900 billion in assets by 2015.

He told Emirates Business that Shariah-compliant assets in the GCC had already reached about \$250bn by the end of 2008 and this region constitutes about 50 per cent of Islamic banking worldwide. The growth of the Islamic finance industry so far has been more concentrated in the Middle East. The growth rate in the GCC regions between years 2000-2008 was reported at 30 per cent.

The current financial crisis, however, has also impacted the growth of Islamic banking – albeit less – and now the sector is not expected to repeat the growth it enjoyed in previous years. But it is projected to recover with the global economy and continue growing to reach beyond its previous levels, Dr Al Jarhi said.

Even before the current crisis started, a number of non-Muslim countries adopted principles of Islamic finance and banking systems, he added. The UK was the first among the non-Muslim countries that thought of adopting this system, followed by Singapore.

Dr Al Jarhi said the UK started considering offering Islamic finance as a business tool back in the year 2000, following a global boom in the practice. It wanted to compete with Bahrain and Malaysia and become a hub for Islamic finance but the first worry was providing Shariah-compliant mechanisms for the settlement of disputes arising out of Islamic banking transactions. Currently, however, the UK applies Shariah principles in financial and commercial contractual relations in Islamic banking.

Singapore has followed the UK and carried out serious Shariah consultations. Kazakhstan has also adopted the necessary laws

and regulations, including civil, commercial, banking and financial market laws.

The irony is, with regard to commercial contractual disputes, countries such as the UK and Kazakhstan recognise Islamic Shariah principles whereas many Muslim countries do not. The situation urges the need for adopting commercial laws that recognise Islamic Shariah principles to maintain the rights and obligations of parties involved in Shariah contractual relationships, Al Jarhi urged.

He said the economic crisis has exposed conventional banking and finance for two reasons: involvement in loans and risk trading. Trading with loans was the cause behind the spread of the crisis. And risk trading is bluntly a sort of gamble, especially with the prices of bonds reaching unrealistic levels.

"The value of bond deals worldwide reached up to \$1trn a day and banks' derivatives trading reached \$600trn at a time when the global GDP was not more than \$33trn. This situation obviously led to a crunch. All this capital did not support economies but were used only in speculation," said Dr Al Jarhi.

Due to recent demand, Syria, which has a Muslim majority population, is currently building institutions to offer Islamic banking products. Earlier, it did not have Shariah complaint banking – which prompted the public who wanted to invest in Islamic products to seek individual businessmen, he said