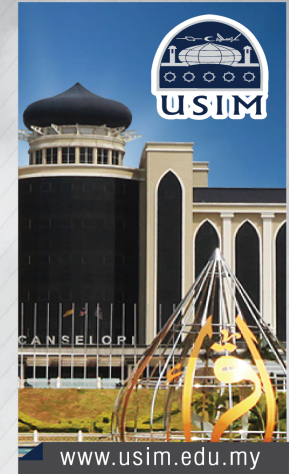


مقدمة



# ISLAMIC FINANCIAL PRODUCTS AND SERVICES: PERSONAL REFLECTION

Zulkifli Hasan

**MEMPELOPORI SAINS ISLAM • MEMIMPIN KEILMUAN**  
**PIONEERING ISLAMIC SCIENCE • SPEARHEADING KNOWLEDGE**



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- Islamic Financial Products Between Aspiration and Reality
- Challenges
- The Way Forward
- Concluding Remarks

# Introduction

- **Global Islamic banking assets reach USD2 trillion (17% average annual growth and Islamic finance will be able to tip USD6.5 trillion by the year 2020).**
- **Islamic banking growth: 1.9 times higher than conventional 2009-2013.**
- **Shari'ah compliant fund suffered difficulties in 4 years due to lack of innovation (USD584 bn in 2015/USD2.4 bn in 2014). (Sukuk issuance \$50 billion in 2016 (\$63.5 billion in 2015).**
- **Despite the growth and transformation, there are numerous criticisms on the current practice of Islamic finance, which have led to series of questions as to the distinctiveness of Islamic finance with its conventional counterparts and the growing frustration on the ethical issues beyond the legal realm of Shari'ah-compliance.**

# Islamic Finance Updates

**“Everything that lapses out from justice into injustice, and from mercy into its opposite, and from *maslahah* to *mafsadah*, and from wisdom into the frivolous, does not belong to *Shari’ah*, even if it is inducted into it by interpretation” (Ibn al-Qayyim).**

**2015**

Market Share

Customers

Total Assets

4 Markets with  
30% Market Share

Less than 100  
million customers  
(2.5 bn no bank's  
account, 1 bn  
youth across OIC)

2 trillion (Global  
financial asset  
USD300 trillion)

**2021**

20 markets with  
40-50% Market  
Share

250 million  
customers

9 trillion

## Islamic Bank Share of Total Assets & Deposits

Country	Assets %	Deposits %
Saudi Arabia	48.9	N/A
Kuwait	44.6	47.3
Bahrain	27.7	47.8
Qatar	23.6	35.7
UAE	21.4	32.8
Pakistan	9.5	11.4
Turkey	5.9	7.1
Indonesia	5.5	11.4



# Malaysia

Sectors	Achievement
Islamic Banking	<b>28% (Target 40% 2020)</b> 7 out of the 8 major banks have yet to reach 40%. The decline in annual growth rate from a double-digit in 2011 (24.2%) to 8.2% in 2016
Takaful	<b>14.6% (7.5 bn)</b>
Sukuk	<b>Market share of 52.6% (USD183.8 bn) of total Global issuances</b>

**Table 5 - Key Performance Indicators For S&P Global Ratings' Sample Of GCC Islamic Banks, Dec. 31, 2015**

	<b>Country</b>	<b>Islamic bank ranking*</b>	<b>Overall ranking*</b>	<b>Assets (bil. US\$)</b>
Al Rajhi Bank	Saudi Arabia	1	5	84.1
Kuwait Finance House	Kuwait	2	11	54.5
Dubai Islamic Bank	United Arab Emirates	3	16	40.8
Qatar Islamic Bank (S.A.Q)	Qatar	4	17	34.9
Abu Dhabi Islamic Bank PJSC	United Arab Emirates	5	21	32.2
Al Baraka Banking Group B.S.C.	Bahrain	6	26	24.6
Bank Al-inma	Saudi Arabia	7	28	23.6
Masraf Al Rayan	Qatar	8	30	22.8
Bank Aljazira	Saudi Arabia	9	33	16.9
Emirates Islamic Bank PJSC	United Arab Emirates	10	34	14.5
Ahli United Bank B.S.C.	Kuwait	11	37	12.9
BARWA BANK P.Q.S.C	Qatar	12	38	12.4
Al Hilal Bank PJSC	United Arab Emirates	13	39	11.7
Qatar International Islamic Bank	Qatar	14	40	11.1
BOUBAYAN BANK K.S.C.P.	Kuwait	15	42	10.3
Sharjah Islamic Bank	United Arab Emirates	16	45	8.1

\*Ranking by total assets. GCC--Gulf Cooperation Council. Source: Company financial statements.



## Present Number of Scholars

- The total number of Shari'ah scholars reached 952 covering 652 IFIs in more than 46 countries.
- 75% within the top 10 countries (Malaysia Bangladesh Indonesia Kuwait Saudi Arabia Bahrain Sudan UAE Pakistan Oman)
- 41% in the GCC region.
- 26% South East Asia
- 16% in South Asia
- 11% in MENA nations
- 2% Europe

# Shari'ah Scholars Around the World

Countries	Number
Malaysia	203
Bangladesh	173
Indonesia	131
Kuwait	70
Saudi Arabia	68
Sudan	60
Bahrain	60
UAE	57
Pakistan	43
Oman	32
Qatar	30

## *High Concentration on Few Scholars*

- 10 Shari'ah scholars serve in approximately 497 IFIs representing 76% the total IFIs with Shari'ah boards.
- 3 scholars with the highest number of board memberships serve about 40% of IFIs globally.
- The number of institutions increases and the amount of work increases.
- There is deficiency of about 1700 Shari'ah board members, whereby it is expected that the requirement for Shari'ah scholars will rise to 3000 in next 5 years if 5% growth is assumed in the number of IFIs.
- Succession Plan – Serious action required
- Performance Assessment (Collective & Individually) <sup>11</sup>

## **Islamic Financial Products and Servives: Between Aspiration and Reality**

A study by Beloufi et al (2015) on 40 researches between 1983-2013 found a significant divergence between the theory and practice of Islamic finance.

## Sheikh Saleh Kamel

- “I would like to tell you, in all frankness, that if I were to start all over again, I would not choose the bank as a framework for the application of Islamic teachings in the field of economy and investment. I would look for another framework, which is fully in line with the Shari’ah principles regulating investment. This is due to the fact that we have not been satisfied with taking only the name of the bank but also its basic concept, namely, that it is a financial intermediary. So, we have not been able to find for our financial institutions a concept and a pattern, which goes beyond the issue of financial intermediary. **This has led to the fact that the preferred investment patterns of Islamic banks have become a mix of a loan and an investment. It is a mix, which has most of the characteristics of a *riba*-based loan and the flaws of the Western capitalist system.** It fails to highlight the features of Islamic investment based on risk-sharing and real investment. It does not recognize the guarantee of the capital or its return.”

# Stages of Islamic Finance

- **STAGE 1:** Focus on how to migrate Muslim from practicing *riba*. The focus was to find halal solution by replicating certain features of conventional product with some *hiyal* to quickly migrate the practice from *riba*.
- **STAGE 2:** Focus on to be genuinely based on *Shari'ah* by removing excessive *hiyal* in their practice.
- **STAGE 3:** Concern with the TAYYIB dimension of having a “good and responsible finance”. The permissibility of a transaction will not only depend on the pillars of a valid contract but also on the values, ethics, outcome or consequences of the transactions.



# Islamic Finance is More than Financial Contract

**Tenet-Bound**  
Fundamentals tenets  
derived from Shari'ah

**Principles-Bound**  
Concept is grounded on  
ethics and values  
Prohibition of riba, gharar  
and maysir  
Greater transparency

Real-economy Linked  
Asset-backed transactions  
with investments in real,  
durable assets  
Money is not a commodity  
Prohibition of excessive  
leverage

**Society-Service**  
Serving communities, not  
markets  
Safety net mechanisms for  
the poor

<b>Key Differences</b>	<b>Iran</b>	<b>Sudan and KSA</b>	<b>South Asia</b>	<b>GCC and Europe</b>	<b>South East Asia</b>
<b>Mazhab</b>	<b>Syiah</b>	<b>Sunni Maliki (Sudan) Hanbali (KSA)</b>	<b>Sunni Hanafi</b>	<b>Sunni Hanbali</b>	<b>Sunni Shafii</b>
<b>Shariah Governance</b>	<b>Centralised</b>	<b>Centralised (Sudan) Self-governed (KSA)</b>	<b>Centralised and self-governed</b>	<b>Self-governed except UAE</b>	<b>Centralised</b>
<b>Shariah contracts</b>	<b>Equity and lease based</b>	<b>Tawarruq restricted for liquidity Equity and Salam and no credit card and cashline (Sudan)</b>	<b>Tawarruq restricted for liquidity MM and Ijarah Running Musharakah</b>	<b>Tawarruq widely applied Large Ijarah Property financing</b>	<b>Bay al Inah and Bay al Dayn and Tawarruq widely applied Small Equity</b>
<b>Derivatives</b>	<b>-</b>	<b>Not acceptable</b>	<b>For hedging only based on wa'd only</b>	<b>For hedging only but based on wa'd, wakalah, CM. eg IPRS and Ijarah Rental Swap</b>	

# IMF Report 2017

- **Islamic banking (IB) continues to grow rapidly, in size and complexity, posing a challenge to supervisory authorities and central banks.**
- **Progress has been slow in developing IB's liquidity management and money markets.**
- **hybrid financial products in IB have emerged that replicate aspects of conventional finance in an IB context, raising financial stability concerns.**

# Partnership Based Contracts

- Mudharabah
- Musharakah
- The total aggregate financing of Islamic banking system in Malaysia through musharakah and mudharabah contributed only 6% of the total aggregate financing.
- High risk of investment; difficulty in selecting appropriate partners; demand comes from low credit worthiness customers; and lack of capital security

# Exchange based Contracts

- Murabahah, Bay al Istisna', Bay al Salam, Bay al Dayn, Bay al Sarf, Ijarah, Bay al Istijrar, Bay al Inah and Bay al Tawarruq
- Heavy reliance on Bay al Tawarruq after migrating from Bay al Inah.

# Other Contracts

- 1. Security Contracts: Kafalah (guarantee) and Al rahn (mortgage)
- 2. Charitable Contracts: Hibah and Wadiah (Deposit)
- 3. Supporting Contracts: Muqasah, Ibra and Wa'd
- Excessive usage of wa'd in transaction.



# Critique on Islamic Finance (1)

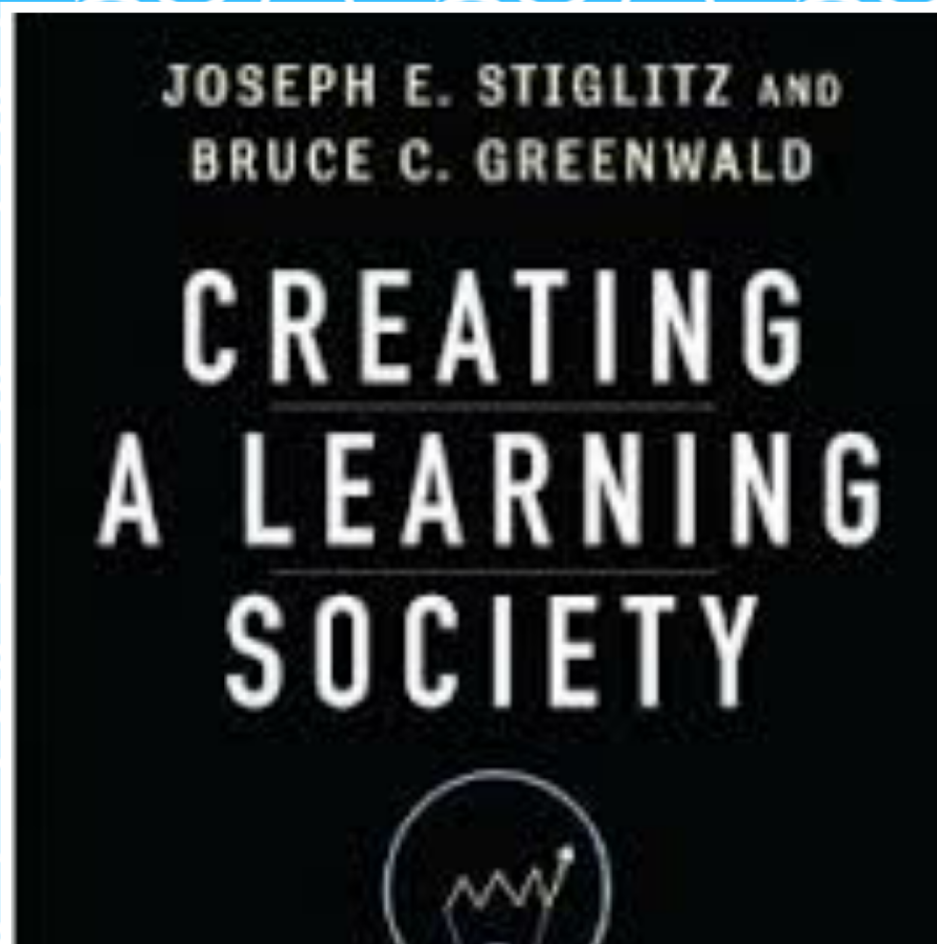
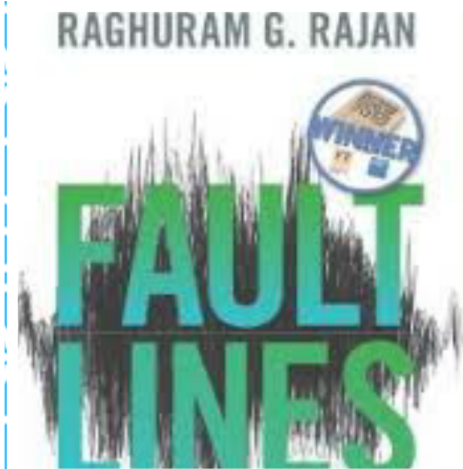
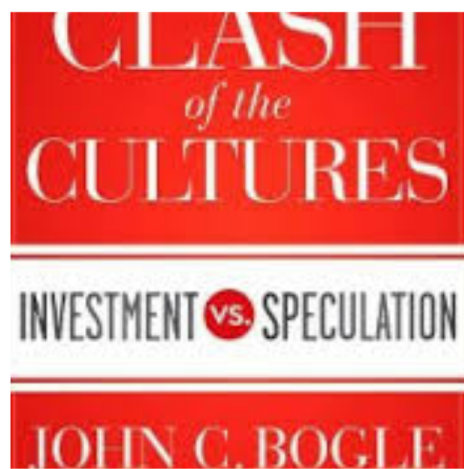
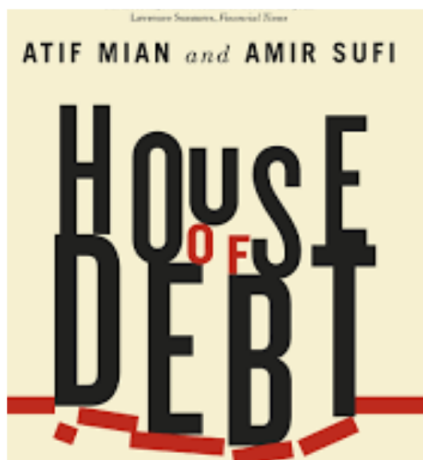
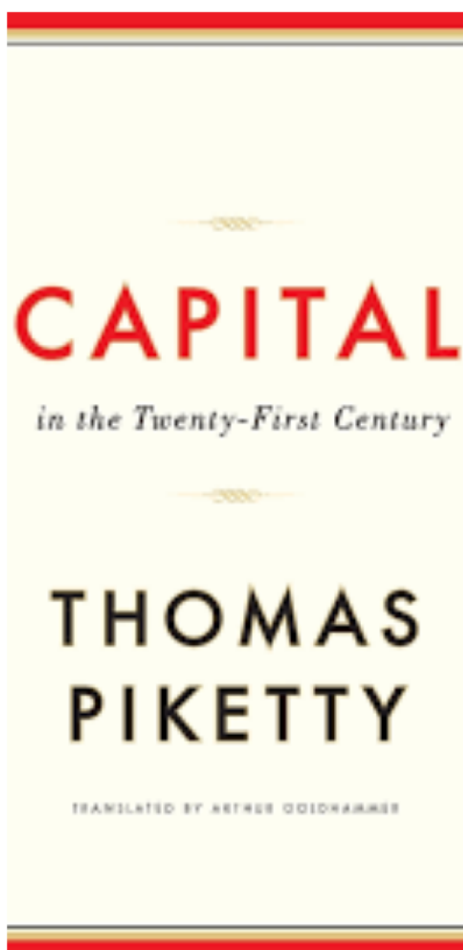
## **Objectives of Islamic law.**

- **Islamic in Islamic finance should relate to the social and economic ends of financial transactions rather than the contract mechanics through which ends are achieved.**
- **Theoretically, it is expected that the Islamic banks, relying on interest-free banking, shall not be affected by the interest rates; however, the Islamic banks are visibly influenced by interest rates and in fact are more sensitive with the interest rates movement.**

## Critique on Islamic Finance (2)

### **Excessive debt.**

- **The disproportionate percentage of debt-based instruments as compared to equity-based.**
- **A comparative study on 34 IFIs and 34 conventional banks in 16 countries affirms the finding that no significant difference in terms of the effect of the financial crisis on the soundness of Islamic finance and Conventional banking system.**
- **Islamic banking industry is not entirely crisis-proof and financial crisis does have an impact on the Islamic banking performance.**



# Critique on Islamic Finance (3)

## Mere Replication and Identical to Conventional

- “The ‘applied business model’ of IBs is almost identical to the conventional interest-bearing one. It is neither a ‘two-tier mudharabah’ nor a wakalah (agency) but rather a specially ‘engineered’ debt model.
- The framework adopted and products are almost equivalent in economic and risk characteristics to conventional debt instruments.
- Although the Islamic banks have successfully replaced the practice of interest with other modes like *BBA and Tawarruq*, doubts regarding their permissibility still persist. This is because Islamic banks in those contracts are not actually interested in real sale, but just to facilitate cash;
- In developing a *fiqh muamalat* caution must therefore be exercised for it is all too easy, when creating and then relying on legal fiction.

## Critique on Islamic Finance (4)

### **Social Dimension**

- **Lack of commitment of Islamic finance industry to support developmental agenda and corporate social responsibility.**
- **‘The doctrine of shareholders’ value, which is the bedrock of capitalistic market, has been shown to be the basis of Islamic finance practices’.**

## Critique on Islamic Finance (5)

### **Lack of authenticity**

- **Operates within Neo-classical economics.**
- **Rather than being part of the Islamic political economy, Islamic finance has been pursuing policies away from the theoretical underpinnings and systemic understanding of Islamic economics and has located a surrogate financial framework in neo-classical economics”.**



# Critique on Islamic Finance (6)

## Over legalistic..

- From the legalistic perspective, it is argued that interest is haram for being unjust and exploitative. However these concerns are merely rhetorical, as the new institutions in question have become too cozy with their own exploitative environment about which they are mute. Islamic finance is delinked from the broader goals of development and poverty alleviation.
- Islamic finance is experiencing a “formalist deadlock” where the industry is more concerned with formal adherence to Islamic law instead of promoting Islamic ethical values. “The current trend reduces Islam and its *Shari’ah* to their legal dimension rather than seeing them within a greater civilizational framework”

## Critique on Islamic Finance (7)

**Negative perception by the general public.**

- **Muslim Consumer Association of Malaysia (PPIM) reported that they have received more than 4000 reports from consumers between 2003-2012 of their dissatisfaction with IFIs. The PPIM claimed that the IFIs have abused the word 'Islam' for the purpose of profit maximization without taking into consideration the ethical aspects of doing business.**
- **There are many cases where the customers need to pay the whole amount of selling price to IFIs even the construction project was clearly abandoned.**

# Shari'ah Non-Compliance Income

<b>Islamic Banks</b>	<b>2015</b>
<b>BIMB</b>	<b>RM7,768.02</b>
<b>AIBB</b>	<b>RM363,945.67</b>
<b>HSBC Amanah</b>	<b>RM135,000.00</b>
<b>Maybank Islamic</b>	<b>RM65,000.00</b>
<b>OCBC Al Amin</b>	<b>RM2,631.00</b>
<b>HLIB</b>	<b>437,833.89</b>
<b>Alliance Islamic</b>	<b>RM245,593.30</b>
<b>CIMB Islamic</b>	<b>0</b>
<b>AmIslamic</b>	<b>RM113,600</b>

# Challenges and Realities

<b>Competitiveness</b>	Equal the conventional product in benefits.
<b>Price</b>	Islamic funding may cost more. Benchmark against conventional.
<b>Process</b>	Process and operation slightly longer and require additional document.
<b>Flexibility</b>	Interchangeability of Shari'ah concepts to be at par with the conventional products .
<b>Non-Compliance</b>	To simplify operation, some process may be omitted. E.g execution of blank Letter offer

<b>Profitability</b>	Some charges may not be avail to Islamic products e.g commitment fees, lower compensation fee.
<b>Market Differences</b>	Differences in Shari'ah concepts in various markets. E.g Bai Al Dayn not acceptable by many market or even banks in M' sia.
<b>Product Awareness</b>	Public awareness on Islamic finance is still lacking. Indifference attitude
<b>Positive Values</b>	Islamic principles advocates fairness and just. Ideally, genuine defaulters to be given concessions, but not being done in some IFIs.



<b>Product Risk</b>	<p>Risk in some concepts are higher than the conventional product.</p> <p>E.g Murabahah (risk of non acceptance of goods by customer) Istisna' (non-completion of projects).</p> <p>All possible risk to be identified and properly mitigated.</p>
<b>Legal documentation</b>	<p>An extended version of conventional document. Too much influence on the previous practice. Market wants simple documentation</p>
<b>Modified Concepts</b>	<p>Investment products e.g pure Musharakah cannot be done without modification.</p>

<b>Shari'ah Risk</b>	<p>Product development and operation requires Shari'ah Committee's endorsement and requires in depth study. Conventional banking can transact on anything.</p> <p>Non-Shari'ah compliant may lead to "haram" income which requires the bank to forgo the profit earned.</p>
<b>Balancing of Business and Shari'ah</b>	Some business areas are out of bound in Islamic finance.
<b>People</b>	Changes in inception of Islamic finance knowledge and values amongst staff.
<b>Technological Advancement</b>	Efficient digital banking system that comply with the <i>Shari'ah</i> principles

# Different Requirement of Standard-Setting Agencies

Areas of Standards	Key Agency(s) in the International Financial Architecture	Corresponding Agency(s) in Islamic Finance
1. Accounting	International Accounting Standards Board (IASB), International Federation of Accountants (IFAC), Committee on Banking Supervision (BCBS)	AAOIFI
2. Anti-Money Laundering / Combating the Financing of Terrorism	Financial Action Task Force (FATF)	Common
Auditing	International Federation of Accountants (IFAC)	AAOIFI
3. Banking	Committee	IFSB
4. Corporate Governance	OECD, Basel Committee, World Bank	AAOIFI and IFSB
5. Data Dissemination	IMF	Common
6. Fiscal Transparency	IMF	Common
7. Insolvency and Creditor Rights Systems	World Bank, United Nations Commission on International Trade Law (UNCITRAL), International Bar Association (IBA)	Not yet addressed but especially critical for Islamic financing as it is based on risk sharing
8. Insurance Regulation	International Association of Insurance Supervisors (IAIS)	Not yet addressed but within the mandate of IFSB
9. Monetary & Financial Transparency Policies	IMF	Common
10. Payments Systems	Committee on Payment and Settlements Systems (CPSS)	Common
11. Securities Market Regulation	International Organization of Securities Commissions (IOSCO)	Not yet addressed but within the mandate of IFSB

# The Way Forward

# Towards Value-Based Intermediation

- **Paradigm Shift**
- **From Financial Intermediaries towards Investment Intermediaries**
- **UN Sustainable Development Goals**

## Islamic Finance Principles

Prohibition of  
Riba

Prohibition of  
Speculation

Prohibition of  
Financing Illicit  
Sectors

Profit and loss  
sharing principle

Asset backing  
principle

## Sustainable Development Goals



# Innovation in Islamic Finance

- **Crowdfunding and Equity Crowd Funding’, ‘Equity Finance’, ‘Business Angel Investment’, ‘Investors New Paradigm’, ‘Risk Sharing Finance Facility’, “Risk Sharing Securities’, dan ‘Customer-Owned Banking’.**
- **Eg. *Al-Waqf Home Financing-i*** by Bank Islam resulted in the construction of 76 residential and 9 commercial lots on a 9-acre plot in Penang. This project (RM24 mil) was in partnership with Jabatan Agama Islam Pulau Pinang and a property development company.

# Standardisation and Harmonisation

- For the purpose of harmonisation and consistency, the standard setting agencies and regulators have issued several *Shari'ah* parameters and guidelines to IFIs as guidance and reference to promote harmonization and standardization of Islamic finance practices.
- These standards put certain requirements to ensure each financial transaction is genuine and valid.



# Concluding Remarks

# Ask our Heart

- There are some valid and legitimate concerns on the current practices and trends of Islamic finance. In simple words, '**ask our heart**', whether the recent Islamic finance practices have fulfilled the real higher objectives of *Shari'ah*.
- It is important to critically evaluate the performance of IFIs against their foundational base and at the same time to maintain its positive development.
- More importantly, with the current practices, Islamic finance is surely not immune from the crisis. As the crisis is not the outcome of sudden practices, Islamic finance must learn from the history and take lesson from previous financial crisis.
- **We do not want to hear that the only lesson that Islamic finance has learned is that it never learns.**