

A NEW ORDER



The Shariah hierarchy needs overhauling if Islamic banking and finance is to offer a genuine alternative to conventional finance, argues Dr Aly Khorshid

SHARIAH BANKING has been trying to market itself to investors, businesses and the general public as a credible alternative to conventional western banking. At first blush, the exponents of Islamic finance certainly have a bullet-proof argument—that the reckless risk-taking and bad decisions that tipped global banking into meltdown could not happen under the wise leadership of the Shariah sector.

If only it were that simple. While international finance suffered humiliating government bailouts, there is little evidence that Islamic banking has stepped in to fill the void. But Shariah banking's secular cousin, the ethical banking sector, has clearly benefited.

Are the men at the top of the Islamic finance tree engaging in self-criticism and calls for rejuvenation? Is there even much call from outside this elite group for a revolution that could bring success?

Simple maths

There are 1.7 billion Muslims. The rate of education in the Muslim world stands at 40%—that is, 680 million with a basic education. Of this number, 0.01%—680,000—are highly educated. There are 1500 BA graduates from Shariah and *fiqh* colleges per year, and 300 Masters and 30 PhDs in Al-Azhar University in Egypt alone. There are around 16 Islamic teaching universities in Islamic countries plus several universities in the Western counties that confer PhDs. Put simply, the number of candidates capable and competent of serving as Shariah board members exceeds 6800—far greater than what is needed.

When Islamic finance was taking shape in the West, it needed help from scholars able to advise on the principles and prohibitions under Shariah. These consultants provided advice and helped to set up a working practice, although they did not understand how the Western economic system was regulated, governed and run. In most cases they made a positive attempt to create a working Islamic system by Islamising the existing conventional system. It has worked fairly well but not enough to create a truly alternative financial system.

To make themselves valuable and for personal gain, Shariah scholars have managed to create a mysterious screen, one that has made the financial industry believe that, without them, our sector can't be Islamic. The origin of trading and dealings in Islam emphasises permissibility—prohibition is the exception. The scholars have reversed the principle and made the exceptional—which needs their advice and stamp—supersede the basic fact of Islam of the middle-ness between far right and far left. This is similar to the Catholic church which puts its priests as mediators between God and people, “the issue of confession”.

Huge increases in oil prices have led Western financial institutions to look at investing surplus cash into Shariah-compliant investments to satisfy their clients. Western financial institutions are not that concerned about which investment, but by having Shariah board members create a “glass barrier”—of that permissible and that not permissi-

ble—they will distance themselves from the whole Islamic system and the global economy misses out on a fair and just economic system.

Graduates of the Islamic studies may attain the qualifications necessary to sit on Shariah boards, but they have found it difficult to open the door because the Old Guard are protecting their own personal interests under the umbrella of experience and qualifications. But it is they who need the experience of the world economy; the new blood is the only hope for Islamic financial to become an alternative to the conventional system.

Change from within

With Shariah boards so insulated from accountability and scrutiny, they can go on in defiance—or in ignorance, if we're being charitable—of the real world. We must not forget that this young system is still run by the some of the very people who pioneered it, along with their loyal acolytes. Criticism and accountability, they would say, is not part of the model because the backbone of Shariah banking is the holy *Koran* itself. Who can argue with that?

Shariah scholars are allowed to sit on numerous boards and gain a kind of celebrity status in financial circles, acting as rubber stamps for new products—of which there are shockingly few. Imagine the media reaction if it were discovered that the chairman of Shell or Barclays was a member of 76 other boards, possibly with competing interests, was remunerated handsomely and was rarely, if ever, seen around the table. Surely there would be a shareholders' revolt, or possibly at least the threat of a government inquiry.

If we're hoping for a consistent approach to be imposed by the IFSB, we might have some time to wait. After much deliberation and consultation, the board issued two important drafts: “Guiding principles on the Shariah governance system” and “IFSB exposure draft on conduct of business”. Accountability is given supreme importance, but nowhere in the pages of these highly detailed documents does the issue of accountability or transparency get an airing. Competence, independence, confidentiality and consistency are certainly given the IFSB treatment, but the elephant must have been led into another room, if and when the subject of accountability came up.

The AAQIF produced a complementary document whose four aims are to:

- 1 complement other prudential standards issued by the IFSB by highlighting in more detail, to the supervisory authorities in particular and the industry's other stakeholders in general, the components of a sound Shariah governance system, especially with regard to the competence, independence, confidentiality and consistency of Shariah boards;
- 2 facilitate a better understanding of Shariah governance issues and outline how stakeholders should satisfy themselves once an appropriate and effective Shariah governance system is in place;
- 3 provide an enhanced degree of transparency in terms

of issuance, and the audit/review process for compliance with Shariah rulings; and

④ provide greater harmonisation of the Shariah governance structures and procedures across jurisdictions, especially as numbers of IFIs with cross-border operations are increasing.

It appears that an urgent review of corporate governance or accountability is not needed. So where are the calls for accountability from outside the inner circles? They are surprisingly numerous, but uncoordinated and dispersed enough to be described as being from individual cranks, bitter dissenters or heretics.

Perhaps the case for reform and accountability has not been put strongly enough. Even some relatively astute members of the Shariah banking community express surprise at the mere existence of an opposing view from the status quo. Opening minds to the inertia and nepotism at the top of the sector is the first step on the path to reform. But for the sake of Islamic finance, it is vital that Shariah board members become more accountable.

Credibility

The most important reason is credibility. Investors—be they fund managers or families—need to feel that the people looking after their money are trustworthy. As things stand, they have to take a guess or a leap of faith, and the post-recession figures breathtakingly suggest that the discredited mainstream sector is still a more attractive option to many Muslims.

Next up is confidence. The markets are confidence. Fortunes are made and lost on good and bad feeling, and strong businesses are better able to reinvest and become stronger still. Investors simply don't know enough about the running and decision-making of Islamic banks to place their money confidently in them.

If a transparent model can be adopted successfully in combination with the inherently risk-averse and conscientious of Shariah banking, the sector could act as an example to conventional banking. Shariah financial experts' opinions would be sought and valued, and the kudos of this model would blossom. Per-

haps, then, Western banking would take notice and avoid another catastrophe.

The credibility that comes with board membership counts only if the board served on is itself credible, just as a footballer's credibility is enhanced when he plays for a top club. It is in board members' interests to improve credibility, but this ostensibly chicken-and-egg situation can be resolved only by the members themselves.

The Islamic financial system can be viewed as oil to the global system's water—that is, the two simply don't mix. If the doors are opened, people will see that the two systems have more similarities than differences, and that the two are compatible.

The tools that form the basis of Islamic finance—its risk management mechanisms—are pretty solid, perhaps more so in theory than in their applied practice. But they would, if more widely understood, be of great value to world banking.

All religions and philosophies have an alien feel to them outside their heartlands, and Islam is no exception. By introducing a modern and successful Shariah banking sector, the principles of ethics, fairness and honesty that underpin Islam would be better understood globally.

Not all Muslims are Shariah experts, which is why we have scholars and jurists. Managers and shareholders will get better quality advice under an open-door, transparency-based system.

Sometimes it feels like the same old products are being tinkered with and peddled without regard to the goings on in the rest of the financial world. A new, credible system of board administration will allow research into and development of brand new products designed from scratch that will be open to examination and approval the world over.

Respect

First, *fatwas* issued with the full consideration of transparent boards will be granted more respect globally. Second, the open demonstration of the strict auditing standards that have helped to keep Islamic finance on an even keel throughout the crisis would serve as a demonstration of all that is stable about Shariah finance. Third, corporate governance of Islamic financial institutions—always a matter for concern for those on the outside (and many inside)—would be strengthened immeasurably if all dealings and decisions were transparent.

With the existing and potential advances Islamic finance has made in recent years, it is worth reminding ourselves that it is adherence to Islam that lies at the heart of all we do. By promoting the benefits of transparent governance and the resulting success of the Islamic banking sector, the ethical principles underpinning Shariah banking will be preserved.

If Islamic principles are followed, there would be no fraud or abuse in banking. Openness would simply guarantee this. The money-laundering and capital adequacy issues of Basel II and Pillar II would be upheld.

At present, anyone on a board can hide behind the layers of secrecy to perform illicit transactions. The solution is not as difficult as it seems—consistency with our religious principles must ultimately prevail if Islamic finance is to succeed.

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