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Islamic Social Responsibility and
Corporate Governance:
*Transforming Islamic Finance into a
value proposition*

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Transforming Islamic Finance into a value proposition

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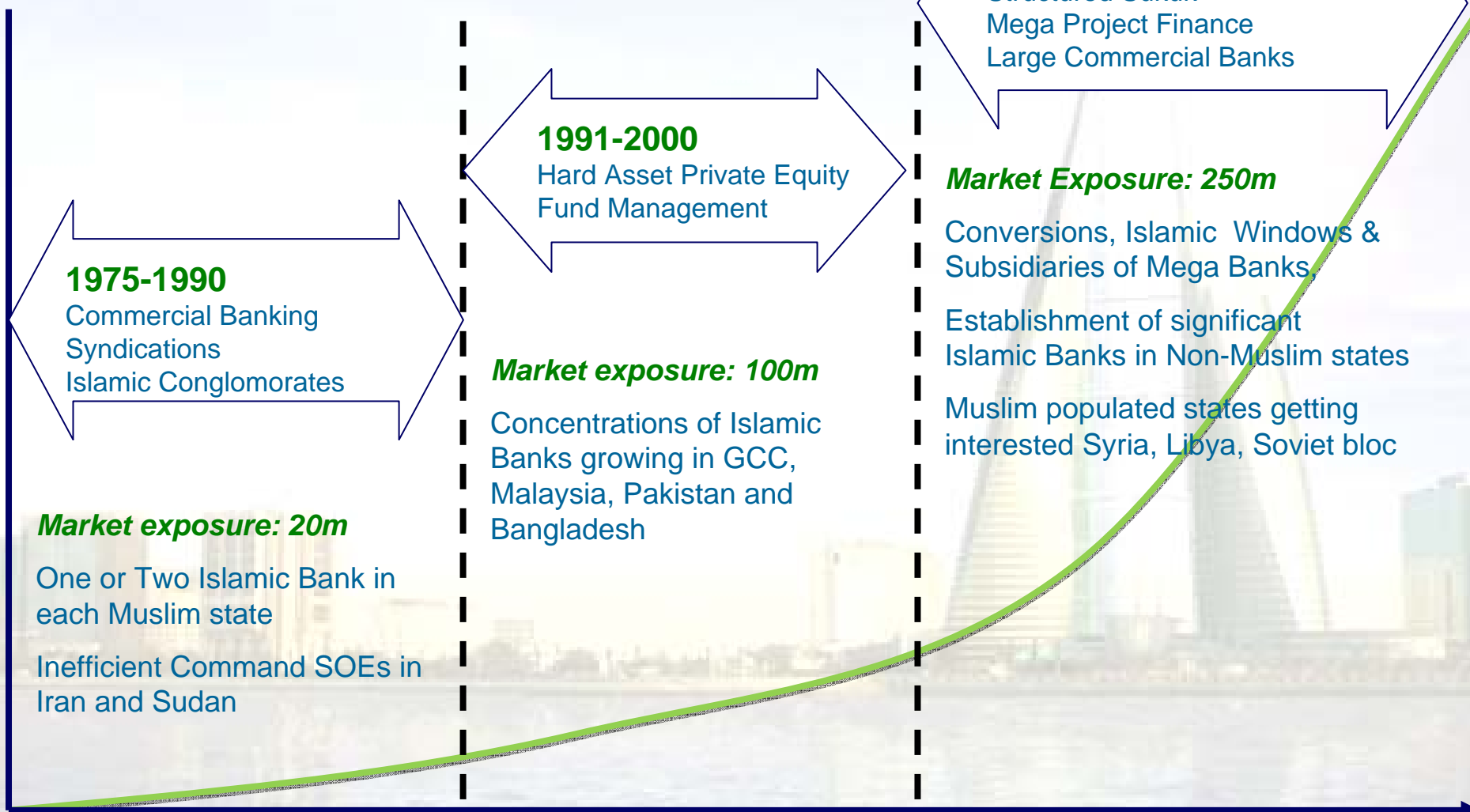
Shaping Tomorrow's financial leaders today

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Focus of this presentation

- The role and rationale of Social Responsibility in Islamic Financial Institutions
- How it can be harnessed to provide a leading edge to Islamic Financial Institutions and to the Islamic Finance Industry in general
- This will be done by:
 - Reviewing the factors related to our achievements and growth to date
 - Anecdotally forecasting the future growth trends in Islamic Finance
 - How Social Responsibility can play a role in providing a sustainable Islamic Finance industry
 - What kind of Social Responsibility applies to Islamic Financial Institutions

Where are we coming from?



Market exposure: 20m

One or Two Islamic Bank in each Muslim state

Inefficient Command SOEs in Iran and Sudan

1991-2000

Hard Asset Private Equity
Fund Management

Market exposure: 100m

Concentrations of Islamic Banks growing in GCC, Malaysia, Pakistan and Bangladesh

2001-2010

Structured Sukuk
Mega Project Finance
Large Commercial Banks

Market Exposure: 250m

Conversions, Islamic Windows & Subsidiaries of Mega Banks.

Establishment of significant Islamic Banks in Non-Muslim states

Muslim populated states getting interested Syria, Libya, Soviet bloc

Timeline 1975-2010

Where are we going to?

2011-2040

Sophisticated Private Equity, Mega Islamic Commercial, Full Service Investment Banks

Market exposure: 6000m

Competition with Mega Banks, Concentrations in Muslim states, Conversions in Muslim states, Growth in Non-Muslim states ?

Market exposure: 1500-2000m

No further growth beyond core Muslim constituency?

Market exposure: 500m-1500m

Reputation Risk ?

Timeline 2011-2040

Historical Growth Factors

- **1975-1990**

- Resource Boom
- Academic and scholarly encouragement and experiments
- Arab Entrepreneurs

- **1991-2000**

- Regulatory Recognition and Encouragement
- Growth of tiger economies
- Efficient interbank markets
- Development of infrastructure

- **2001-2010**

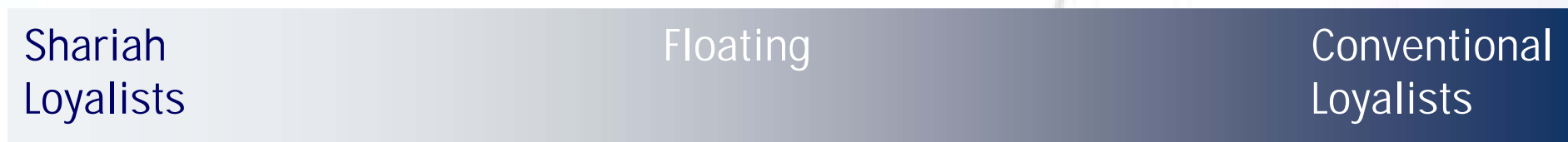
- Resource wealth and surplus liquidity
- Sukuk
- Islamicisation and Religiosity
- Real Estate Asset classes
- Further infrastructural developments

Future Growth?

- **Stellar?**
 - Value proposition for both Islamic and conventional populace
 - Limited competition presented by conventional financial institutions
- **Steady?**
 - No value proposition beyond Muslim states and populations
 - High competition between Islamic and conventional megaliths
 - Efficiencies and economies achieved in Islamic
- **Negative?**
 - Reputation risk associated with terrorism
 - Failure to achieve economies and efficiencies

Market Dynamics of Islamic Retail

Significant driver of commercial banking and capital market activities when emerging markets become wealthier



- **Shariah Loyalists:**
 - Becoming price sensitive due to sustained competition
 - Growing in mass and wealth ?
- **Floating:**
 - Price and feature sensitive
 - Largest population but unconvinced ?
 - High growth in emerging economies ?
- **Conventional: Lured by features/price?**
 - Purely price and feature sensitive?

Continuing stellar growth?

- Three factors will determine competitive edge for Islamic Finance:
 - Pricing
 - Shari'ah Compliance
 - Features
- **Pricing**
 - Islamic Banks are becoming more efficient and achieving economies already
- **Shari'ah Compliance**
 - Remains a major challenge since many floaters are of the opinion that Shari'a compliance is a wider definition than Shari'a arbitrage
- **Features**
 - Product features must differentiate the value proposition for conventional and floaters

Stellar growth beyond Shari'ah Loyalists can only be achieved if a differentiated strategy is adopted for the industry

Islamic Social Responsibility and Corporate Governance

The differentiated strategy

- **The only real value propositions of Islamic Finance:**
 - Shari'ah Compliance (for Shari'ah Loyalists and Floaters)
 - Social Responsibility (for Floaters and both loyalists)
- **Shari'ah Compliance:**
 - complying with the Shari'ah rules associated with each instrument or transaction
- **Social Responsibility:**
 - the broader manifestation of Islamic principles of equity and social justice evident in the micro rules of the Shari'ah
- **How can these be implemented?**
 - Islamic Corporate Governance

Accountability Framework of an IFI

The need for additional governance and policies

Overarching Accountability to Allah (SWT)

Investors

Shareholders

Investment Account
Holders

Contractual parties

Employees and
contractors

Clients
(Current A/C holders, Lessees,
Partners, Vendors and Buyers)

Other contractual
parties

Society

(Poor, youth, elders, marginalised,
discriminated against, environment)

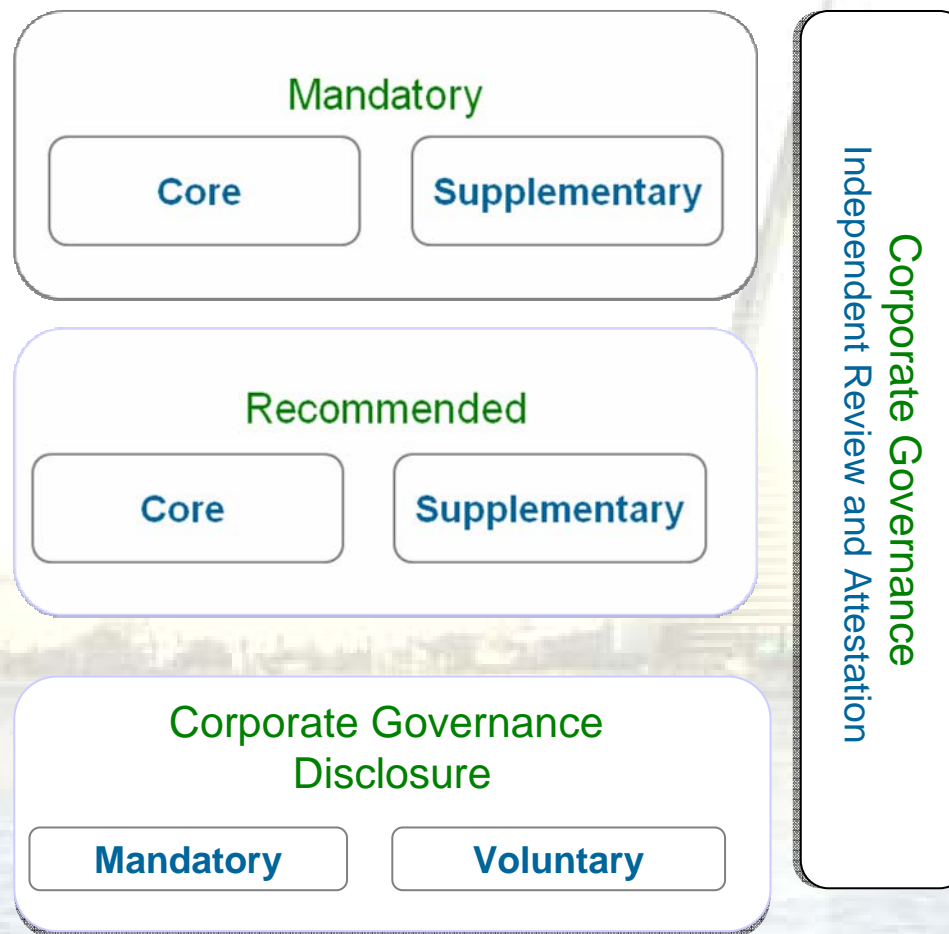
Islamic Corporate Governance

Application of governance rules and framework to ensure compliance with the letter and spirit of the Islamic Shari'ah

- **Why do we need such governance?**
 - Accountability to God
 - Shari'ah based instruments
 - More responsibilities owed to broader set of stakeholders (i.e. IAH)
- **Mechanisms available**
 - Independent Shari'a Board
 - Disclosure
 - Social Responsibility Standards for Internal Policies

Social Responsibility Standards for Internal Policies and Disclosure

Social Responsibility for Islamic Financial Institutions



Social Responsibility- Mandatory

Core

Screening clients
Responsible dealing with clients
Earnings and expenditure prohibited by Shari'a
Employee Welfare

Supplementary

Zakah policy

Social Responsibility- Recommended

Core

Qard Hassan
Reduction of impact on environment
Screening Clients (extension)
Screening Contractors
Industry Wise Investment Quotas
Social Impact Based Investment Quotas
Micro, Small Business and Social Savings and Investment Schemes
Employee Welfare

Supplementary

Charitable Activities
Waqf Fund Management

Corporate Governance- Disclosure

Rationale for Disclosure Requirements

Corporate Governance:

Disclosure is a means by which IFIs can discharge their obligation to their stakeholders

Non-price Competition:

It is also potentially a marketing tool for IFIs and the industry which can differentiate IFIs from conventional financial institutions perpetually

Disclosure Requirements

- Disclosure of key policies applied by Islamic Bank
- Mandatory disclosures cover mandatory conduct
- Recommended disclosures cover recommended conduct
- Required to be in a format acceptable to lay men

Corporate Governance- Internal Review and Attestation

Responsibility for Social Responsibility Conduct and Disclosure

- Bank management

Responsibility for Stakeholder Governance Review

- Placed on Shari'a Supervisory Board (SSB) as independent representative of stakeholders
- Can be outsourced to auditors and internal Shari'a review team, so long as SSB performs proper due diligence on the reports.

Responsibility for Stakeholder Governance Attestation

- Placed on SSB as independent representatives of stakeholders
- Must attest that management has pro-actively engaged in the mandatory and recommended provisions (if any)
- Must also attest that management's representations in the annual report regarding social responsibility fairly represent management's actual conduct

Conclusion

- Implementation of these best practice guidelines will mean that IFIs can differentiate themselves and also differentiate the Islamic Finance industry in a sustained manner.
- However, will require collective effort by IFIs and also implementation of a strong governance culture that proactively strives to achieve Islamic ideals.

Thank you for your time and attention!