Standardisation, a long-standing issue in Islamic finance, should be addressed properly to avoid damage to consumer confidence in the retail sector and confusion in the corporate sector.

According to Islamic finance analysts, while Islamic business is growing by the day, its growth is hurdles by the lack of standardisation and homogeneity.

As there is no single interpretation of Islamic law, each financial institution has a board of religious scholars who determine which products are Islamic. So what one bank considers Shariah-compliant may be unacceptable to another.

Industry players, speaking to Emirates Business, said some standards already exist, but due to the nature of Islamic finance, establishing a body to set global standards is not only difficult to attain, but also almost impossible to achieve.

They said an Islamic accounting standard has already been established and is recognised by the world's multinational institutions such as World Bank and International Monetary Fund. It is called Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI).

Rather, what is needed today is a more consistent application of the standards promulgated by AAOIFI, said Omar Shaikh, Executive Board Member at Islamic Financial Council UK. "We do have a degree of consistency on Shariah standards. I think we need more consistency on the application of the AAOIFI standards," he said.

Dr Mohamad Akram Laldin, CEO and Executive Director of International Shariah Research Academy for Islamic Finance, said there is still a "long way to go" as far as implementation is concerned. "We have a Shariah parameter and that's the AAOIFI, but not many jurisdictions are subscribing to it. Only certain countries are subscribing, but in other jurisdictions. The case is they may adopt or they may not adopt."

Shaikh said standardisation has not been much of an issue in the corporate world, which has been endowed with more sophisticated investors. The problem is that conflicting views of scholars have at times affected retail investors and individuals.
"Quite frankly the Muslim world today is not governed by a structure – like the Vatican where you have a Pope structure – so you will always have conflicting views," he said.

"Some scholars say it is healthy as it gives you more options. But retail investors get confused when one scholar says this is Islamic and the other say this is not Islamic. That is a challenge that needs to be addressed because consumer confidence gets hit significantly with different opinions," he said.

Although Islamic instruments have in the past gained rapid popularity thanks to abundant sukuk issuance, corporate players are also facing the challenge of distinguishing the Islamic from the non-Islamic transaction.

"It has to be made clear what constitutes a sukuk and what a non-sukuk," said Jan Willem Plantagie, Managing Director of S&P Middle East, adding lack of clarity has caused confusion in the business community.

Regulators are also in need of more guidance and clarity.

Paul M Koster, Chief Executive of Dubai Financial Services Authority, told the Sixth IFSB Summit that standards setting, including regulatory, accounting and market standards, constitutes a "challenge" in the Islamic finance realm.

"As non-Islamic regulators around the world come to deal with Islamic finance, they will not simply tear up their rulebooks, based on the standards of Basel, or Iosco or Iasb; they will seek to adapt them, and they look for standards that are as well thought out as those they are used to. If they cannot find them, they will either ignore Islamic finance or press the conventional standards setters to address the issues," he said.

With regards to Shariah infrastructure, Koster said while Shariah advice is critical to the proper conduct of Islamic finance, there are also many areas in which there is not full consensus, and that Shariah governance imposes material costs.

"There is much discussion of how greater consensus can be achieved in important areas, and how the number of Shariah scholars can be increased," he said. "But there is also scope to discuss how the need can be reduced, in areas where transaction forms can be standardised, and also the infrastructure of what is now becoming a profession."

Abdulla Al Awar, CEO of Dubai International Financial Centre, said standardisation is needed in contracts to better facilitate transactions. "We have worked with many initiatives in terms of standardising, for example the commodity Mudaraba transaction – we have already achieved that. From a tools and contracts perspective, there is a call for standardisation," he said.

"But there is a misconception in the market. When they talk of standardisation they also talk of standardisation of scholars' opinions, which I don't think you will ever have."

He stressed variety is also good for business because it gives the institution the opportunity to target a specific group or niche.

"However, let's not forget that Islamic finance globally constitutes one percent of the entire financial services industry. Ratio-wise it is still small and the priority is to increase that ratio," he said.

The so-called "differences" and "divergence" are in fact only minimal, but people tend to zero in on them, said Laldin.

"Sometimes we tend to focus too much on certain differences between Malaysia and the GCC, but that is not the case," he said. "There is more convergence in the views of scholars rather than divergence, but the problem is we always think about the..."
differences.

"If you look at Malaysia, we are very much open in a sense that we do have products subscribing by the GCC standards. Some of the instruments in Malaysia are also using interpretation that comes from the Middle East. It is a question of business strategy or targets."

Laldin said the industry is now moving away from controversial interpretation of Shariah to lesser controversial interpretation.

"The most known controversial contract, which is contractable in Malaysia and Brunei, is the Bay' Inah, a buy-back arrangement," he said. "That is allowed in Malaysia, but not in the Middle East. Another is the selling of debt. Malaysia's commission of Shariah board and the Central Bank allow selling of debt in certain conditions, which is not acceptable in the GCC."

Under Islamic principles, the sale of debt is not allowed. A loan or debt to be repaid in cash is considered as "money" hence this system does not allow it to be sold for anything other than its par value. Secondly, the concept of risk management is different. In the current system, risk is transferred – split and sold. In the alternative system, risk is shared, almost like a collective insurance scheme.

This means that instead of a sub-prime loan risk being sold until it reaches a bank in the Middle East or Asia, it will be managed by the institutions that can assess and react to any changes in circumstances.

But is standardisation indeed needed?

"Not really," said Laldin. "The issue in Shariah is that the law is not given ready-made. It does not work like this is right and this is not. If you look at the Quran and Sunnah, you'll find broad principles, which are to be applied in different areas of Islamic commercial transaction."

"In the retail product, there are different concepts such as Wadiah and Mudaraba."

Asked whether it is possible to create a global body that will decide what is acceptable and what is not, Laldin said: "You just can't have it because it is not practical."

**Bay' Inah contract**

Bay' Inah, meaning sale with immediate repurchase, is a contract that involves the sale and buy-back transaction of an asset by a seller.

A seller will sell the asset to a buyer on a cash basis. The seller will immediately buy back the same asset on a deferred payment basis at a price that is higher than the cash price.

It can also be applied when a seller sells the asset to a buyer on a deferred basis. The seller will later buy back the same asset on a cash basis at a price that is lower than the deferred price.

Under Islamic principles, the sale of debt is not allowed. This is because money is not considered to be a commodity, which has a price of its own. Instead it is only a medium of exchange and a measure of value.

A loan or debt to be repaid in cash is considered as "money" hence this system does not allow it to be sold for anything other than its par value.

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