Country versus Bank Shariah Boards

“There are growing calls from within the industry to establish country-specific Shariah boards that complement bank-specific Shariah boards. Is this just another layer of costs (for investors to bear)? How is the role of Shariah advisors and advisory companies evolving in this context? How can the industry simultaneously encourage plain vanilla solutions (i.e. standardized and/or cost effective) as well as innovative structures (i.e. intellectual capital and/or black-box)? Is there a middle-ground?”

It depends on the size and nature of the business. In countries like Mauritius (which has a very small Muslim market) the Bank of Mauritius guidelines allow for a Central Shariah Board under the auspices of the Bankers Association. The banks that need the SSB will pay for the service and employ them on an ad hoc basis or on a retainer basis. This helps mitigate costs. This is a model that can be emulated by other countries, provided there is confidentiality and that Shariah governance from the SSB prevails.

In the case of large IFI’s, it is preferable to have their own SSB, because quite often a prompt strategic decision and approval is needed. This is more appropriate for private banks where they often develop products for individual clients, so a bank-specific SSB may help in this instance. The main point to consider is that there are two markets: the local and the international markets. If we talk of the local market then there is no problem having local scholars on the SSB, but when dealing on the international level the whole scenario changes. The Shariah Board will need to have greater product knowledge and recognition at the international level (not just country-wise).

Usually large banks will opt for their own SSB. There are some companies mushrooming to provide such services which are successful, but others are finding it difficult to break through the market. The number of clients who would need such a service is limited and also it is very difficult to have a company having all the expertise needed to cover the full spectrum of clients/products. Another issue is who is approving the products for clients and issuing the fatwas? The number of Shariah scholars having world reputation is limited and it is unlikely that such a small group will sit on the Shariah boards of all these advisory companies.

Yes it is possible to have plain vanilla solutions. In fact the prophetic tradition is clear “religion is easy/simple”. It is the modern financiers who want to complicate Islamic products with SPV’s, Swaps etc to avert risks (which they ought to take in a pure Islamic legal context). For example, we have instances in Bahrain where there is undergoing work regarding standardized contracts, with similar work available thru the State Bank of Pakistan. These can be used and adapted to one’s needs. Also there are the AAOIFI Standards which can be a good platform to develop plain and straight-forward products as everybody in the industry can acquaint themselves to these standards if they wish. However, this will apply mostly for retail products or takaful where there are one-off products that don’t require redesigning every now and then. In the case of private banking or highly engineered products for specific clients this approach would not work. Presently it is difficult to synchronize the industry due to lack of regulation and proper legal framework. It will take some time to reach the level of uniformity to satisfy the industry as a whole.

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National Shariah Board: It must be established and maintained under the aegis of the Banking Regulator. Thus, those regulators are excluded which are designed to be insulated against Shariah e.g. UK, Singapore, Hong Kong, some countries in the GCC, or France. Even where a form of National Shariah Council exists e.g. Malaysia, Pakistan, Sudan, some units of GCC; its role could vary on a wide spectrum: It may be restricted to oversight of ‘fit & proper’ personnel & Processes of Shariah approvals in the individual IFIs, or it could extend its authority - & accountability - to approving products of, or issue binding guidelines to, individual IFIs under the banking regulator.

Costs: An IFI does need a Shariah Committee/Board to approve its specific transactions. A National Body may facilitate domestic & possibly regional harmonization. The problem with National, in addition to IFI-specific, Boards is not so much costs as adding bureaucracy, and considering impact of various views i.e. AAOIFI, Fiqh Academy or ISRA, or IFSB before finalizing the National View.

Shariah Advisory Companies: Those which have reputable professionals in Fiqh & Western Laws do add efficiency and assist in innovation, because they can simultaneously interact with Shariah Scholars and Lawyers. Shariah approval gives comfort on sanctity, and Counsel’s opinion gives comfort on enforceability, of the specific transaction. However, if the Company is an entrepreneur competing on Costs and perhaps Shariah arbitrage, then its business aspirations may outweigh other considerations.

‘Plain Vanilla’ or ‘black box’ products: Both. The bread & butter plain vanilla products provide volume and territorial coverage. It also subsidizes research & development. What was exotic in 2002 is plain vanilla today, not just in Shariah compliance but e.g. computer software!

The Shari’a Boards at national level will not only complement the bank-specific Shari’a boards, but will also provide a forum for properly regulating the industry at the national level and ensuring compliance by all the players. The National Shari’a Board would have a policy making and general oversight role to ensure Shari’a compliance of the products and practices of Islamic financial institutions; and will not be involved in their day-to-day activities as the bank-specific Shari’a advisors or boards are; so the roles are complementary and not overlapping. Further, it would be a dispute resolution body between the IFIs managements and their Shari’a advisors/boards.

Since the cost of the national Shari’a Boards will be borne by the State/Central Banks, it will not add another layer of cost on the part of the investors.

While the plain vanilla products have been accepted and are being practised by all, there is no ban on innovation and new structures. However, new structures have to pass the scrutiny tests of other stakeholders and be fine-tuned to serve the interests of the industry.

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The basis of the success of Islamic finance is the suppleness of the Shariah law, as it accommodates the glitch by providing an alternative solution that provides the desired objective without compromising on Shariah limitations. And I suppose this is the magnificence where no man-made law can have such an immense adaptability.

There has been a constant debate regarding the standardization of agreements, standards and regulations. I personally think that the people who talk about standardization are misguided about the versatility of Shariah law. They want to condense the clouds in a droplet and that is not possible at all. Yes the thing required is to harmonize and regulate the industry by a strong, vigilant and expert group of people supporting and assisting the regulators. Once the supervision is effective, it will consequently bring harmony that will lead to standardization of the system. There will be less of irregularities, and gradually over a period of time it will develop a data that will create precedence for the industry.

There has been an overwhelming demand in the industry throughout the globe that such verdicts, deliverables that are said to be Shariah Compliant, must be recognized and regulated unless those turn to be a constraint and a challenge. Introducing a regional or country level Shariah Board is a step ahead towards the debate discussed above. Yes this will at times incur a cost that will be borne by the investors, but think in the broader perspective that an opportunity availed in the short term may not be an opportunity in the long term rather that might be a stigma for the future transactions and investments. So a minute financial burden at this stage will secure a financial arena for the lucrative future to come.

There has been a very strong view that advocated the complete standardization of Islamic transactions. There are many examples of standardization of contracts in various industries, and in financial trading. There has been standardized master agreement, such as agreements developed by the International Swaps Dealer Association (ISDA).in the past there has been efforts by the International Swaps and Derivatives Association (ISDA) and the International Islamic Financial Market (IIFM) to initiate development of master agreement for documenting privately negotiated Shariah compliant derivatives transactions. The fundamental idea behind this standardization is that the investors are able to incorporate reference definitions contained in the standards, saving costly, time-consuming and peculiar Shariah opinions, resulting in lowered transaction costs and increased transactional efficiency. But I will just add to the last conclusion that when structuring any conventional financial transaction, its documentation does not diminish the legal advisors role despite the fact that the conventional financial system has been prevailing for centuries, then how can we ignore the necessity of the Shariah experts while structuring Shariah Compliant transactions?

This step, I assume, will broaden the framework of vanilla structures, thus more products will fall into a vanilla structure category. However this will not lessen the importance of innovation through hybrid structuring and bundling and unbundling of products and services.

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