

Reflections on Global Forum on Islamic Finance 2014

The Global Forum on Islamic Finance (GFIF) 2014, organised by COMSATS Institute of Information Technology with the support of the Islamic Research and Training Institute (IRTI) was held in Lahore, Pakistan on 10-12 April 2014, brought together an extensive range of representatives and their variety of experience and presented topics.

The second in an annual series, this event benefited not only from the breadth of the offering but also from the exchange of ideas from different segments of the sector, namely researchers, regulators, and those engaged in the business of Islamic finance itself.

Various concerted discussions viewing the subject through distinct prisms of observation of international delegates have indeed gathered diverse sources of knowledge and insights.

Collaboration indeed was a keyword to be digested by the gathering, inevitably considering the sheer scale of the possibilities among a range of audiences and customers, and the necessity of interconnectedness of the industry on a cross-border basis.

The 2nd International Forum for Islamic Banks and Financial Institutions, Luxembourg

General Council for Islamic Banks and Financial Institutions organised the 2nd International Forum for Islamic Banks and Financial Institutions jointly with Arab-Belgium-Luxembourg Chamber of Commerce. The forum entitled “Islamic finance in Europe: Lessons from Previous Experiences” took place in Double Tree Hilton Hotel, Luxembourg and was attended by around 150 participants. The participants were mostly bankers, lawyers, financial experts, representatives of various ministries, academics as well as students. The forum was spread across 7 main sessions consisting of both academic and professional sessions, during which IRTI representative made presentations on the following themes: 1) Success Story of

Islamic Financial Services Industry in Indonesia, and 2) The Role of Multilateral Development Bank in Islamic Financial Services Industry.

**“IIFM Industry Consultative Meeting on *Ṣukūk* Standardisation”
Dubai International Financial Centre, Dubai, UAE**

The International Islamic Financial Market (IIFM) organised “The IIFM Industry Consultative Meeting on *Ṣukūk* Standardization” hosted by Dubai International Financial Centre (DIFC) on Wednesday, 16th April 2014 at DIFC, Dubai, United Arab Emirates. The consultative meeting was a continuation of a workshop on “*Ṣukūk* Restructuring” jointly organised by IIFM and IRTI held in November 2013.

The meeting was attended by more than 60 participants comprising prominent Sharī‘ah scholars, regulators, Islamic financial institutions, law firms, infrastructure institutions, multilateral development institutions and other industry stakeholders.

The main objective of this consultative meeting is to establish the market needs of developing *Ṣukūk* documentation & product standardization and guidance notes. It was clear from the discussion throughout the meeting that the guidelines on *Ijārah Ṣukūk* will be developed due to its prominence.

The discussions of the meeting which spread across two main sessions revolved around the following points:

1. Develop Standard Terms & Conditions that would apply to all *Ṣukūk* irrespective of the structures.
2. Develop general guidance notes for market participants such as process flow on developments and performance of the underlying assets, build- in provisions to make an exchange program in the event of default i.e. convert a capital market issue into a debt (can it be mandatory for all *Ṣukūk*.)
3. Follow one *Ṣukūk* Structure at a time and establish priority.
4. Develop Guidance notes specific to the selected *Ṣukūk* structure.
5. Improve transparency, provide disclosure guidance notes on implication on Balance sheet, Capital, Sharī‘ah and risk disclosures.
6. Naming of *Ṣukūk* SPV correctly and clearly (in order to help identify the credit risk and the issuer. Names like Wings, Danga etc., does not provide any immediate indication of the actual credit risk). Standard or guidelines to be provided. (Should *Ṣukūk* name also identify the Sharī‘ah Structure?).

7. SPV ownership - Independence of SPV- (Should the issuing Corporate control the SPV or it must have independence? Should the purpose of establishing SPV be logistical purpose only or it should have a greater role
8. Condition on Use of Funds and type of Asset or Business that would comply for *Şukūk*.
9. Purchase Undertaking (need to address, clarify, define Purchase undertaking by the issuer of a *Şukūk*, especially in terms of buying back at Initial price, market price, or by a formula agreed at inception.
10. Role of purchase undertaking for convertible *Şukūk*
11. What exceptions if any can be considered when Sovereign is issuing a *Şukūk*.
12. Continuous Sharī'ah monitoring of *Şukūk* terms for Non compliance. Should each *Şukūk* have a Sharī'ah monitoring till maturity, either by a Sharī'ah scholar, a panel of Sharī'ah Scholars or by the Lead Managers Sharī'ah team.
13. Role of trustee – In *Şukūk*, Should Trustee be involved in *Şukūk* offering documentation, its role with ongoing processes / Redemption and Event of Default.
14. The role of trust and does the trustee need to be empowered to protect the certificate holders on certain issues such as indemnities required by the lead bank third party guarantee – Should there be fee payment. What about Guarantee by Parent or by another sister Company?
15. Secondary market trading of *Şukūk* at discount or at par when tangible assets are either not there or has fallen below an agreed threshold.
16. Late payment of Periodic payment or late payment at maturity.
17. Methodology for dealing with minority creditors
18. Information flow between the lead manager and paying agent in special circumstances
19. Asset Based *Şukūk* versus Asset Backed *Şukūk* (obstacles and ways to promote issuance of Asset Backed *Şukūk*)
20. Assist due diligence process particularly for private deals the transaction document to be more informative
21. In case of restructured *Şukūk* perhaps requirement of new assets as a replacement could be explored
22. Framework that support securitization and risk transfer mechanism

23. The restructuring of *Shukūk* and how differences, if any, in the case of restructured/renegeotiated *Shukūk* are to be treated. Question will be when renegeotiated amounts are lower than the original *Shukūk* issue amount then how should the difference be treated in the books of the issuer? Would the difference be income or an item of equity? What level of disclosure should be provided by the issuer in these circumstances?

Notes on the Mid-Term Review of the Islamic Financial Services Industry

The Islamic Research and Training Institute (IRTI) of Islamic Development Bank in collaboration with the Islamic Financial Services Board (IFSB) published The Islamic Financial Services Industry (IFSI) Development: Ten-Year Framework and Strategies (Framework) report in March 2007.

Recently, the respective entities, in collaboration with prominent institutions such as Fajr Capital, Durham University, Afkar Consulting, and INCEIF have completed a project to review the Framework to ensure that it remains relevant as a platform for various Islamic finance jurisdictions to assist them in orchestrating the future direction of the industry. A draft report (the Mid-Term Review, MTR) has been circulated, taking into consideration feedback from a roundtable and forum in 2013, and other review committee meetings and soundings.

The MTR document, which has recently been approved by IFSB Council has generated the following key findings:

- (i) The industry has shown growth and resilience, with growing market share and profitability, an expanding number of institutions, and numerous industry-level initiatives under way, reflecting customer confidence in the sector, whose concept is proven in many markets.
- (ii) Macroeconomic events or external factors have brought both challenges and opportunities for the sector, which has not been immune to the effects of the global financial crisis, by way of the economic impact, the approach to financial regulation, the strength of partners and counterparties, and the value of assets and investments. Nevertheless, member countries have acted as important centres of growth as the global economy has stumbled. Political developments in recent years have also made several member countries more open to Islamic financial services. Technological innovations such as branchless financial services are now available, and can allow the industry to broaden its future reach.

(iii) The development of the industry has varied by sector, while estimates of its total asset size and growth rate vary significantly (either near or well above USD 1 trillion). As a key example, Islamic microfinance has transitioned from a concept with isolated case studies to a fledgling sector across multiple markets. Moreover, although the market values of certain Shari'ah-compliant instruments have shown mixed performance due to overall capital market challenges, and Shari'ah-related challenges remain, the breadth and sophistication of such instruments has improved.

The 13 Framework Recommendations proposed in the Ten-Year Framework and Strategies Report remain pertinent, though now grouped under three themes: (a) Enablement -- fostering conditions for the industry to thrive; (b) Performance -- enhancing the effectiveness of institutions active in the industry; and (c) Reach -- expanding the set of potential beneficiaries of the industry.

Progress made on the original Recommendations has been mixed. For instance, many countries have adopted international standards specific to Islamic financial services; however, many have not yet fully done so. At this mid-term juncture, most Recommendations require greater focus from member countries in order to reach the aspirations envisioned. Metrics for tracking progress were generally not originally articulated, but are crucial for assessing progress.

Consequently, the MTR proposes a set of Key Performance Indicators (KPIs), for which member countries are urged to set national targets. A stronger implementation plan has also been proposed. Even so, member countries are a diverse group of nations, spanning a range of regions, cultures and stages of economic development. They adopt a range of Islamic law, common law, and civil law jurisdictions. The report's sponsors and the Review Committee appreciate that expectations must vary from country to country.

While diversity is appreciated, however, a key underlying theme is that a supportive public policy stance is essential for enabling the industry to reach its full potential. The report does urge that well considered strategies be formed, so that the Islamic financial services that offer benefits to the people and economies of member countries may best be utilised.

Seminar/Workshop “Towards a *Maqāṣid* al-Sharī‘ah based Index of Socio-Economic Development”

The Seminar/Workshop “Towards a *Maqāṣid* al-Sharī‘ah based Index of Socio-Economic Development” (from 30 April to 01 May 2014 at the IDB HQ) concluded with important recommendations to carry the work forward. Fifteen papers presented over the two days focused on clarifying the dimensions to be measured and the methodology of their measurement. The researchers and policy makers shared their work in which they have used various data sets and techniques to come up with multidimensional indices. The full set of papers and seminar highlights are available for your reading and download at www.irti.org under the events listing.

Key findings and recommendations of the seminar/workshop are:

- Multidimensional indices with some desirable characteristics are possible. It is desirable for these measures to be:
 - Disaggregated enough to facilitate policy making and at the same time aggregation friendly and collapsible.
 - A good summary of progress towards the objectives of Sharī‘ah.
- Measures that are constructed based on axiomatic foundations stand out as promising lead direction for development of *Maqāṣid* al-Sharī‘ah based index.
- The techniques of fuzzy logic and multi-dimensional graphical representation of data would simplify measurement and its representation, hence useful.
- The seminar papers have explored various databases and used variables from these databases to create experimental indices. There is a need to systematically explore and survey what databases are available, variables covered in them, and analysis of actual survey questions to determine feasibility of their use for *Maqāṣid* al-Sharī‘ah based index.
- There is a need to explain and convince data collecting agencies and policy making bodies in the OIC countries about the importance of *Maqāṣid* al-Sharī‘ah based multi-dimensional development index so that ‘direct measure data’ is collected by data collecting agencies.
- There is a need to initiate active policy dialogues with the social and economic policy making bodies in the OIC countries to let them know the usefulness of *Maqāṣid* al-Sharī‘ah based development index as a tool in policy making that is

geared towards a comprehensive socio-economic development. This dialogue will also bring to attention the needs of policy makers which would help refine the index itself and further develop it.

- Each participant was asked to think what they can contribute towards the development, refinement and promotion of *Maqāṣid* al-Sharī'ah based development index. In this regard the participants stated their short-term and long-term targets that they intend to pursue. This is very promising and encouraging in engaging academic institutions, policy making bodies, individual researchers and IRTI-IDB to collaborate and synchronize their efforts for the development (and use) of *Maqāṣid* based and policy relevant index.
- A network of researchers and policy makers was also initiated at the event that will work for refinement of a prototype index that IRTI is already working to produce.

The seminar/workshop was very fruitful. The outcome and further progress on a prototype index will be presented at the IDB Annual Meetings in Shabaan 1435H (June 2014). The second seminar of this effort is going to take place insha Allah in June 2014 in Yogyakarta, Indonesia.

