

# 1The Standardization Debate in Islamic Finance: A Case Study

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*This paper discusses the standardization debate in Islamic finance. 'Islamic' structured products particularly Wa'd-based total return swaps are used as a case study to discuss the importance of standardization. The growth of the Islamic finance industry has been hampered by the lack of consensus (ijma`) among the Shari`ah scholars' who belong to diverse sects or schools of thought (madahib). This diversity has resulted in disagreements about the acceptability of specific features of Islamic financial products. Standardization means establishing universal Shari`ah standards which would eliminate the shortage and the divergence of Shari`ah interpretation. The call for standardization has had proponents as well as opponents. Proponents of standardization claim that standardization would make the product development process more efficient, they argue that without standardization the industry is left exposed to 'Shari`ah arbitrage' as institutions, bankers, and consumers 'shop around' for the fatwa that suits their objectives. Proponents also believe that standardization supports the integration of Islamic financial markets into mainstream global financial markets. Opponents believe that 'Shari`ah harmonization' would inhibit innovation, emphasizing that standardization is usually driven by 'cross-border, quasi-governmental organizations'. Michael McMillen proposes a 'sort of flexible "codification" of the Shari`ah principles and precepts', but believes that standardization will never be achieved in an absolute sense; he argues that 'sufficient standardization to allow effective interplay of Islamic markets seems a realistic and realizable goal'. The ongoing standardization efforts by AAOIFI, IFSB, and International Islamic Financial Market (IIFM), among others, are examined. The benefits to the Islamic finance industry are discussed, including stability, transparency, cost efficiencies, as well as lower Shari`ah risk and systemic risk, all of which are vital for making Shari`ah-compliant financial products more competitive globally. The role played by Shari`ah scholars is discussed.*

**Key Words:** Islamic Finance, Standardization, Structured Products, Total Return Swap, Shari`ah-Compliance

## Introduction

The Islamic finance industry has been growing at about 15 percent a year; Shari`ah-compliant assets currently valued at \$1 trillion are projected to rise to \$1.6 trillion by 2012, according to the Kuala Lumpur-based Islamic Financial Services Board (IFSB).

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In 2008, at a Euromoney roundtable, Islamic finance industry experts suggested that “*fuller development depends on clearer views on objectives, further development of regulation and **standardization** of products and approaches*”. At the same event Khalid Hamad who is Executive Director of Banking Supervision at Central Bank of Bahrain, was quoted “*Islamic finance is still a niche market. There are too many loopholes in terms of the practice, in terms of the laws and regulations*”.

The sustainable growth of the Islamic finance industry is currently impeded by the lack of standardized regulation, an unclear legal framework, different scholar interpretations of Shari’ah, and different levels of strictness (Khalaf and Tett 2007).

Shari’ah scholars’ lack of consensus has been hampering innovation on one hand (Ghoul 2008b) and creating loopholes that are exploited by product designers on the other hand. McKinsey’s Ozgur Tanrikulu, Global Head of Islamic Finance, states that “*innovation will take place, so long as the basic standards are set. But if you have an industry where even the basics are continually questioned, it will impede growth*”, (Wigglesworth 2009).

The lack of standardization across Islamic finance markets increases the risk of non-compliance with Shari’ah, which creates the hazard that a contract will not be recognized as valid under Islamic law by all Islamic scholars.

### **Definition of standardization**

Standardization means establishing universal Shari’ah standards possibly through a ‘*flexible “codification” of the Sharī’ah principles and precepts*’ as suggested by McMillen(2010), which would eliminate the need for individual decisions by Shari’ah scholars, thus reducing the problems of the shortage of Shari’ah scholars and the divergence of Shari’ah interpretation.

Oakley (2010) notes that the Islamic finance industry is not currently codified and individual transactions need approval by Shari’ah scholars. This means that a **globally recognized Islamic manuscript** is needed to help consolidate interpretations of Islamic law in order to speed up product development and reduce the risk of noncompliance with Shari’ah.

The absence of standardization has resulted in un-unified Islamic governance models, consequently ‘*demonstrating compliance with Shari’ah can be difficult as different institutions have different governance models by which they set, measure, and monitor their compliance*’ (KPMG 2006).

Three organizations have been spearheading the effort to set standards followed by Islamic financial institutions (IFI’s), namely the Islamic Financial Services Board (IFSB) and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), as well as the International Islamic Financial Market (IIFM).

IFSB was established in 2003 in Kuala Lumpur, Malaysia; it is an international organization which has been issuing standards for the effective supervision and regulation of IFI’s.

AAOIFI is an independent international organization based in Bahrain, which is supported by central banks, IFI's, and other participants from the global Islamic banking and finance industry. It has been working on a set of international standards on accounting, auditing, corporate governance, ethics, and Shari'ah-compliance; its principles are followed by the majority of IFI's.

IIFM is the leading Islamic finance standard-setting body based in Manama, Bahrain, it was formed by several central banks to resolve issues such as the divergence in opinion between Shari'ah scholars; it is considered to be a platform that aims to serve and benefit all industry stakeholders.

The role played by these organizations is discussed further below.

### **Benefits of standardization**

Most observers of the Islamic finance industry agree that the standardization of both regulation and Shari'ah interpretation would facilitate the industry's growth; **we focus on the latter in this paper.**

The benefits of standardizing Shari'ah interpretation include time and cost savings, financial stability, greater transparency and consistency in financial reporting, as well as improved public confidence.

Most importantly, standardization would take the compliance burden off of product developers' shoulders. Another benefit is increasing cross-border marketability; currently a product that is considered to be compliant in Malaysia, which is reputed to be rather liberal, may be rejected by GCC scholars and/or customers.

Oxford Analytica (2010) adds that greater harmonization of practices among Islamic financial institutions would help the consolidation and further expansion of the industry.

**Standardization could eventually eliminate the need for a Shari'ah board at every single Islamic financial institution.** Global Islamic Finance Magazine (2011) interviewed Ruggiero Lomonaco's the Executive Director of the Middle East sales of equity derivatives and Islamic structured products in the Royal Bank of Scotland (Dubai). Lomonaco states that the lack of standardization has been forcing Islamic banks to enter into derivatives transactions with international financial institutions, **in order to avoid the complexities of dealing with two Shari'ah boards if they were to deal with another Islamic bank.**

### **Challenges that face standardization**

Ilias(2010) reports that the challenges that face standardization include different interpretations of Shari'ah, diverse stages of maturity of Islamic financial markets; country-specific laws and regulatory practices , and the absence of consensus among scholars.

However, Oxford Analytica(2010) points out that different trajectories of Islamic banking and Islamic capital market development might slow down, if not hinder, the further standardization of Islamic financial products.

### **Opponents of standardization**

Some opponents have argued that forcing standardization is contrary to the essence of Islam (Esposito 2005). Others fear that a standardized application of Shari`ah principles would prohibit the development and growth of Islamic finance by killing innovation.

There are some opinions that standardization may result in independently developed Islamic products, which could be of higher Shari`ah quality, however concerns are expressed about **losing the brand recognition** associated with Islamic versions of conventional banking products. **We do not subscribe to this view**, because creating “Islamized” versions of conventional products has been taking the Islamic finance industry away from its real objectives, and causing a lot of skepticism.

Concerns have also been voiced that standardization of the product development process could reduce returns, thus rendering the industry less attractive to new entrants, which would hinder innovation and competition.

**The most important objection to standardization efforts** is the concern that the compliance of member institutions with the standards *“can neither be enforced nor fully monitored, unless they are mandated at country level and then enforced by domestic regulators”* (Bloomberg 2011).

Reuters (2011) quotes Mohamad Nedal Alchaar, Secretary General of AAOIFI who laments the fact that his organization works on setting standards but *“we just don’t have the enforcement power.”*

Some experts do not see the lack of standardization as a problem, and view the ‘**variance**’ in Shari`ah interpretation as a driver of innovation; for instance Reuters (2011) quotes Iqbal Khan, chief executive at Fajr Capital, *“the Islamic finance industry has had about 6,500 fatwas and with 95 percent of them, there is consensus, the 5 percent where the difference lies gives us hope that there will be more innovation, that 5 percent is very important for change and evolution in the industry”*.

### **Proponents of standardization**

Proponents of standardization believe that it will enhance stability of the industry, as long as it does not contradict with Islamic values, however, some suggest that there are many tools, other than strict standardization, to promote cross-jurisdictional harmony (Esposito 2005).

## **Current standardization efforts**

In this section we present some of the recent efforts to develop common standards for Islamic financial institutions.

### **The Role played by IFSB in standardization**

Cpifinancial.net conducted an interview with Professor Datuk Rifaat Ahmed the Secretary General of the IFSB from its inception until April 2011. Ahmed points out the need to adapt accounting, auditing, or related international standards in a manner that fits the specificities of Islamic finance; this would shield institutions that offer Islamic financial services from being at a disadvantage. Ahmed adds that IFSB'S work "*basically complements that of the Basle committee on banking, the international organization of securities commissions (IOSCO) for capital markets and the international association of insurance supervisors (IAIS) for insurance*"

IFSB does not have any legal enforcement powers; however Ahmed hopes that the production of high quality standards will lead to their adoption.

**Steps followed by IFSB in creating standards, as reported by Professor Datuk Rifaat Ahmed**

**Step 1:** a draft of a new standard is prepared through a joint effort by a team of participants from regulatory authorities and market players

**Step 2:** the Islamic Development Bank mandates that IFSB should forward the draft to the IDB's Shari'ah committee for approval.

**Step 3:** an exposure draft is issued by IFSB's technical committee, giving the public a period of between three to six months to comment through public hearings and educational workshops held by IFSB,

**Step 4:** IFSB revises the exposure draft in light of what are usually constructive comments received both from regulatory authorities and the public.

**Step 5:** IFSB trains users of financial industry standards to make them comfortable to implement new standards through a program called "Facilitating the Implementation of IFSB Standards".

The adoption of IFSB's standards can help Jurisdictions to mitigate systemic risk which threatens their financial stability.

### **The role played by AAOIFI in standardization**

In February of 2010 AAOIFI announced that a committee of eight people (Islamic scholars, auditors, bankers and lawyers) will screen Islamic financial products, "product by product" to verify Shari'ah-compliance (Reuters 2010).

The AAOIFI's role will thus expand beyond that of being a mere standard setter to playing a more active role in ensuring the Shari'ah compliance of the products that Islamic financial institutions offer (Ilias2010).

Oxford Analytica(2010) reports that AAOIFI's standards have been made mandatory for Islamic financial institutions in Bahrain, Dubai International Financial Centre, Jordan, Sudan, Syria and Qatar. AAOIFI standards have been incorporated into national guidelines and are adhered to by AAOIFI member institutions in other countries, including Indonesia, Lebanon, Malaysia, Saudi Arabia and the United Arab Emirates. However, the compliance of member institutions can only be enforced or fully monitored if AAOIFI standards are mandated at country level and then enforced by domestic regulators.

### **The role played by IIFM in standardization**

Kamal (2008) points out that the divergence in opinion between Shari'ah scholars over Islamic financial products has caused concern in the market, hence the International Islamic Financial Market (IIFM) is stepping up its efforts to pave the way for standardization of rules and practices for the sector.

Bloomberg (2011) reports that IIFM is working on global rules for Shari'ah-compliant structured products to make them acceptable across borders as banks start selling more derivatives. IIFM's efforts reportedly include developing a common template for hedging instruments such as currency swaps.

Oakley (2010) reported on the first worldwide standardized documentation for privately negotiated Islamic derivatives which was launched in March 2010, as a major effort between IIFM and ISDA; it is expected to pave the way for much greater use of hedging in Islamic finance

### **Structured Islamic products: a case study of the current chaos in Islamic finance**

Standardization could put an end to cases where a product is technically Shari'ah-compliant, but whose objective is inconsistent with the spirit of Shari'ah.

**The lack of standardization of Shari'ah interpretation and the absence of a globally recognized and centralized Shari'ah certification body has been causing chaos in this budding industry.**

To demonstrate, we discuss several 'Islamic' structured products, with a special focus on the total return swap (TRS).

Structured products are used to construct portfolios with very specific risk-return objectives. They replace the payment features from a conventional security with payoffs derived from the performance of one or several underlying assets.

HSBC's website states that structured products help clients to minimize investment risks, optimize returns within risk-reward parameters, minimize capital raising costs, hedge or diversify market exposures, customize investment returns; access international markets, and manage credit exposure, ([www.hsbcnet.com/treasury/capital-markets](http://www.hsbcnet.com/treasury/capital-markets)).

Islamic structured products have recently been developed in order to widen the spectrum of Islamic investment choices; unfortunately their compliance with Shari'ah is questionable.

These products are said to be more conservative than their conventional counterparts, thus they have suffered less in the recent crisis and have become quite popular due to special features such as the yield enhancement, capital protection, as well as risk control features. Wright (2007) points out that even a basic Shari'ah-compliant product necessarily involves some degree of structuring, which means finding methods to replicate the economic paybacks of conventional financial products, while trying to abide by Shari'ah law.

The combination of contracts is a common mechanism of structured product development in Islamic finance; however, this concept raises legal concerns due to *ahadith* (Arabic for Prophet's sayings, peace be upon him) that forbid two contracts in one deal (Arbouna 2007). Some Islamic structured products have been successful, causing little controversy thus far; for example, Wietske (2011) quotes Ahmad Shahrman Mohd Shariff, head of regional Islamic structuring for Asia-Pacific markets at Citi in Kuala Lumpur, who reports introducing **risk control features** into Citi's Islamic investment structures, and that this is "*becoming somewhat of a trend among product providers.*" In such Islamic investment structures the portfolio manager constructs a portfolio to match the client's risk tolerance level, by deciding on a target beta or standard deviation, and adjusting the asset allocation i.e. rebalancing the allocation between 'risky assets' and 'risk-free assets' when the risk measures deviate from the target level; the risk-free asset is usually cash.

Other Islamic structured products use a **dynamic investment strategy**, for example CIMB's 'MaxInvest Save' product was launched in October 2008, it has been well received, and it references the CIMB Evergreen Index. The dynamic investment strategy allocates funds to different asset classes depending on market scenarios (bearish versus bullish), and based on the efficient frontier theory. If the product is held to maturity (15, 20, 25 or 30 years), the investor is guaranteed the receipt of the principal, as well as a rate of return "*based on the highest market price achieved during the chosen tenure*" (Wietske 2011).

### **The controversial 'Islamic' Total Return Swaps (TRS)**

A conventional Total Return Swap (**TRS**) replaces the payment features from one basket of securities with payoffs derived the performance of another basket of securities, which could be a hedge fund or an equity index. TRS enables exposure to an underlying reference asset without being its legal owner.

TRS involves conventional option contracts (puts and calls), these are haram because Shari'ah prohibits the sale of a promise, *riba*, speculation, and leverage, besides the fact that options do not generally lead to real economic activities (Ghoul 2008a). Similar reasons prohibit conventional hedge funds.

Wa'd (unilateral promise) is currently being used to replicate "Shari'ah-compliant" options; it is the basis for many recently issued Islamic structured products. Wa'd is more flexible than a contract because many scholars have agreed that Wa'd is not subject to the restrictions that Shari'ah imposes on a contract. Contract restrictions include a defined/predetermined delivery date, advance knowledge of the price and the terms of payment, a specific description of goods, and the transfer of ownership.

Firoozye(2009) reports that the ability to exchange Wa'ds was a major breakthrough because *“there were no Shari’ah requirements on the actual conditions in the Wa’d, as well as the promised action as long as it did not compel the Muslim investor to do anything haram (forbidden)”*. **Later on in this paper we report Firoozye’s criticism of the use of Wa’d in “Islamic” TRS.**

Wa’d is being used to design an ‘Islamic’ TRS, which consists of two unilateral promises, it enables a Muslim investor to profit from the performance of non-halal assets without having to own these assets. The bank and the Muslim investor agree to swap the returns derived from the investor’s halal basket and the bank’s non-halal basket of assets which could be a **conventional hedge fund**; the two baskets are kept completely separate. Two Wa’d agreements are signed to ensure that both sides carry out their obligations on the due date.

Deutsche Bank (DB) was a pioneer in promoting the use of Wa’d to develop ‘Islamic’ TRS products (DBWP 2007). Wright (2007) quotes Geert Bossuyt, managing director for global markets and regional head of Middle East structuring for Deutsche Bank in Dubai in reference to DB’s TRS *“Just as, for example, you have sukuk with periodic payments linked to Libor where it is very clear the cash is not used to invest in Libor deposits, similarly you can make a product linked to hedge fund returns where the money is not directly invested in hedge funds.”*

Attalah and Ghoul (2011) argue that *“TRs may be Shari’ah-compliant in form but not in substance, and it may be consistent with the letter but not the spirit of Shari’ah”*.

The same source argues **against** ‘Islamic’ TRS products whose return is derived from non-halal assets, adding that TRS can increase Shari’ah risk and reputation risk; it might involve indirect riba, gharar, exposure to leverage, a high probability of a loss, risk amplification, speculation, and is not usually linked to real economic activities

The authors opine that innovation is needed and encouraged in Islamic finance as long as Shari’ah’s spirit is preserved.

### **DeLorenzo versus Hassan: the debate about Wa’d-based Total Return Swaps**

Sheikh DeLorenzo, is Chief Shari’ah Officer and board member, Shari’ah Capital, he is a stern opponent of ‘Islamic’ TRS products, he argues that the returns are not compliant with Shari’ah, and that the assets in both baskets should be halal (Delorenzo 2007).

DeLorenzo does not accept Bossuyt’s argument that the haram basket is playing the role of a benchmark, in the same way the return on Sukuk products is benchmarked with LIBOR.

**Dr Hussein Hassan**, is Director Of Islamic Finance Structuring at Deutsche Bank, UAE, he is a zealous proponent of ‘Islamic’ TRS products; he argues that the *“TRs is a Shari’ah-compliant product that gives Islamic investors exposure to non-Shari’ah returns”* (Stanton 2007). Hassan reports that Islamic investors' assets at Deutsche Bank are isolated from haram assets, and this is proven by *“regular Shari’ah audits carried out on the bank”*. He adds that TRS is entirely compliant with Shari’ah regardless of what assets make up the haram side of the swap.

Deutsche Bank's White Paper (2007) which launched TRS, argues that *"there are no reasons, in the Shari'ah, why an asset may not be sold at a price linked to the performance of a separate asset or index or other benchmark which may itself be Shari'ah compliant or not. This is of course subject to the requirement that the exchange respects the rules on riba, gharar, etc"*.

Next we present other criticisms of the highly controversial "Islamic" TRS.

### **Kilian Bälz's criticism of Deutsche Bank's "Islamic" Total Return Swap**

Bälz (2008) critiques Deutsche Bank's TRS, objecting to its development history among other things. He points out that a consultancy, Dar Al-Istithmar, which is a subsidiary of Deutsche Bank that specializes in structuring Islamic transactions, developed DB'S "Islamic" TRS, it was largely behind issuing the fatwa for its permissibility, and the product was later approved by the consultancy's Shari'ah Board.

Bälz is critical of the fact that *"the Shari'ah process was taken out of the hands of the Shari'ah scholars"* and he is not convinced that TRS is Shari'ah-compliant.

Bälz disapproves of the fact that the TRS's fatwa of permissibility was published in the form of a research paper and published on the Internet, *"with the aim of generating authority through transparency"*, and he questions the success of this strategy.

### **Nikan Firoozye's criticism of 'Islamic' Total Return Swaps**

Firoozye (2009) is critical of 'Islamic' TRS products; he opines that *"with no prohibition on the non-Muslim counterparty, almost anything was allowed"*.

Shari'ah prohibits the sale of a promise, however Firoozye points out that TRS gets around this prohibition through avoiding discussing the actual sale of a promise and resorting to the use of "the 'fee' language", adding that *"the fact that a fee was allowed meant that other than minor variations of nomenclature, one could effectively buy a promise"*.

We report Firoozye's literal criticism of the use of Wa'd to avoid losing the effectiveness of his words *"the Shari'ah-compliant option was altogether worse than its conventional counterpart. For one thing, the fee was likely to be larger than an option premium, including portions to reimburse bankers, structurers, Shari'ah scholars, salesmen and shareholders for their time and capital. All this for merely repackaging a forex call or put option and calling it a Wa'd or promissory note"*.

### **Islamic structured products and 'unusual' development strategies**

Osama (2008) criticizes what product developers are doing to get around Shari'ah's prohibitions. He points out that some developers are *"breaking down the overall questionable transaction into two segments - each of which, individually, being Shari'ah compliant - whose combination ends up recreating the overall effect of the forbidden transaction"*.

The same thing is happening in TRS, Muslim investors may not invest in conventional total return swap contracts due to their involvement in riba, gharar, leverage, and speculation,

usually through hedge funds. However Wa'd-based TRS claims to enable the Muslim investor to earn higher "halal" returns through a double-Wa'd transaction.

By forbidding investing in conventional TRS and hedge funds, Shari'ah has intended to discourage the negative elements they involve, namely *riba*, *gharar*, leverage, speculation and options. We borrow the words of Osama (2008) "*creating a complex instrument by breaking down the component transactions defeats the whole purpose*" of Shari'ah's prohibitions and objectives.

### **'Islamic' structured products' opacity and actual 'niyya'**

We are living in interesting times when non-Muslim experts preach to us about the importance of having an honest *niyya* (Arabic for intention) that *'comes from the heart'*, in reference to developing Islamic structured products. Newhorizon (2011) quotes Warren Edwards, who criticizes the bad "niyyat" of some "Islamic" structured product developers, who usually create a structured Special Purpose Vehicle (SPV), and "*whatever is inside would be invisible to the investor and could be related to gambling, alcohol stocks, money market funds, interest bearing bonds or other activities which are haram*". Edwards warns Muslim investors against "*entering into a synthetic riba transaction*", as well as checking whether funds from Islamic transactions have been commingled with the proceeds of conventional banking. Edwards also points out the need for transparency to enable potential investors to fully assess the structured products which they are considering.

### **"Islamic" structured products that lack links to the real economy**

Wietske (2011) reports the success of a new structured product launched in June 2010, it is CIMB's callable Islamic range accrual, whose sales volume was at least 31% of CIMB's 2010 volumes. The product's performance is linked to the level of Kuala Lumpur interbank offered rate (**Klibor**). The maturity is 5 or 7 years, it offers principal protection if held to maturity, plus a "*profit rate of between 4.8% to 7.2% a year (depending on tenure and ranges) for every day the six months Klibor stays within a range. Ranges are typically between 0% to 4.70% with an increasing upper limit*"

We believe that investing in such a product represents pure speculation, since it is not linked to any real economic activity; hence it is in clear violation of Shari'ah principles.

### **'Islamic' structured products increase risk**

Goud (2011) criticized Abu Dhabi Islamic Bank's soft commodity note, he reminds us that Islamic structured products generate high fees for the issuing bank. In ADIB's soft commodity note, the investor's money is invested by the bank in a Murabaha (to provide the capital protection), the profit is determined by "the price performance of cotton, corn and sugar". The bank promises a "*maximum upside return of up to 18 per cent over 2 years with an annual payout*". The product involves a Wa'd-based total return swap with an external counterparty, whereby the returns on the Murabaha are swapped with the returns on an index of the commodity price. The investor receives the return on the index, or their invested capital, minus the bank's fee.

Goud is suspicious of this product that offers an upside in prices (up to 18%) with no downside (due to the capital protection feature). He opines that this Wa'd-Murabaha structure amplifies **the risks borne** by the investor and he wonders if such structures are designed “*to work within the framework of Shari’ah-compliance or to avoid the restrictions of Shari’ah-compliance*”.

### **Challenges that face Islamic structured products**

#### **a. Unacceptability by the end investor**

An Islamic structured product may be technically Shari’ah-compliant, but still “*unaccepted by the end investor, who might naturally approach it with mistrust*” says Deutsche Bank’s Bossuyt (Wright 2007).

#### **b. Complexity and gharar**

Shari’ah prohibits gharar which is defined by Kamali (1999) as fraud, adding that gharar in transactions has often been used in the sense of risk, uncertainty and hazard. Kamali points out that in a contract of sale, gharar often refers to “*uncertainty and ignorance of one or both of the parties over the substance or attributes of the object of sale, or of doubt over its existence at the time of contract*”.

Thus over-complex structuring is controversial, for example in “Islamic” total return swaps the average investor does not know what is involved, because the product is too complex, which is viewed as gharar.

#### **c. Credibility of Fatwas issued to permit some products**

Wright (2007) points out that fatwas are issued under a certain program to approve certain generic types of pay-offs. This sometimes frees developers’ hands and gives them a “*carte-blanc*”, as they develop various products which would not individually have passed the Shari’ah-compliance test.

#### **d. Periodic monitoring for continuing Shari’ah compliance**

Wright (2007) points out that underlying investments must themselves be compliant, “*not just in terms of the industry they are invested in being halal, but also in their level of gearing and investments in interest-bearing deposits*”, which brings up the issue of periodic monitoring for Shari’ah compliance in the ‘halal’ basket of assets, and whether it is being taken care of by the bank that issues ‘Islamic’ structured products.

**We have demonstrated by examining several ‘Islamic’ structured products, that the Islamic finance industry currently offers the average “naïve” and/or trusting investor products which may be technically Shari’ah-compliant, but whose objective is inconsistent with the spirit of Shari’ah.**

**To conclude this section we reiterate that some experts hope that standardization of Shari’ah interpretation, when implemented in Islamic financial product development, would put an end to the current chaos that plagues the development of Islamic structured products we have just described.**

## Recommendations

Hakimah (2010) suggests establishing an **'International Shari'ah Board'** that will have members from the various schools of Islamic thought and *"whose decisions will be mandatory for all jurisdictions"*.

Other suggestions include the **expansion of the territory of the oversight of the AAOIFI Shari'ah Board.**

Others are calling for the creation of a financially independent, globally recognized and **centralized Shari'ah certification organization** that certifies Islamic financial products.

Most importantly this organization would be responsible for the **supervision of Shari'ah scholars** who operate within this industry, in the same way that the Securities and Exchange Commission (SEC) oversees and regulates auditing firms and rating agencies in the USA.

## Conclusion

Islamic finance currently faces a dilemma, which is sustaining its impressive growth rate while staying aligned with Shari'ah's objectives.

According to IFSB-IDB-IRTI (2010), financial innovation in Islamic finance must be carried out within Shari'ah parameters and tested against Shari'ah's objectives, namely *"the realization of benefits to the people"*.

Michael McMillen(2010) proposes a 'sort of flexible "codification" of the Shari'ah principles and precepts', but believes that standardization will never be achieved in an absolute sense; he argues that *'sufficient standardization to allow effective interplay of Islamic markets seems a realistic and realizable goal'*.

**We believe that the leaders of this young industry are in the driver's seat; they can either lead it to a safe harbor, possibly through standardization, or allow the hodge-podge of mostly greedy opportunistic 'amateur' players to push it over the cliff.**

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