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Standardisation within the context of Islamic Finance

Standardization is a very commonly used term to describe a specific set of features or functions. However, when it comes to interpretation of something of the of Islamic finance, standardization becomes complicated. The principles and tenets of Islamic finance have their roots in Sharia, the Holy Quran and the Hadith. The main reason lack of standardization is not the ambiguity of the sources but rather their interpretation. There is already a considerable progress that has been made to make Islamic laws more global and universally acceptable. The Accounting and Auditing Organization for Islamic Financial Institutions or the AAOIFI has been working towards standardizing these principles. This article discusses the standardization in Islamic finance and the steps and techniques adopted across world to expedite the standardization process.

Key words: Islamic finance, principles and tenets of Islamic finance, standartization.

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Исламдық қаржыландыру тұрғысындағы стандарттау

Стандартизация ол – өзіне тән сипаттамалары мен қызметтерін суреттеу үшін жиі пайдаланылатын термин. Бірақ, мәселе қандай да бір құбылыстың маңыздылығы ислам қаржысы көзқарасы тұрғысынан пайымдалғанда, стандартизация онан да күрделі болып көрінуі мүмкін. Ислам қаржысының принциптері мен постулаттары Шәрияттан, Қасиетті Құраннан және Хадистен алынған. Стандартизацияның бұл аймақтағы кемшілігінің негізгі себебі олардың қайнарының белгісіздігінде емес, олардың интерпретациялауында. Бүгінгі таңда исламдық заңдарды жаһандау және әмбебапты қолайлы жасау жолында бірталай прогресс байқалады. Есеп және Аудит Ұйымы Исламдық Қаржы мекемелері үшін дәл осы принциптерді дайындаумен айналысып отыр. Бұл мақалада исламдық қаржыларындағы стандартизациялау процестерін жылдамдату үшін исламдық қаржылардың стандартизациялау мәселелері және оларды бүкіл әлемде қалыптастыру бастамалары мен тәсілдері талданады.

Түйін сөздер: исламдық қаржы, исламдық қаржының принциптері мен постулаттары, стандартизациялау.

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Стандартизация в контексте исламских финансов

Стандартизация – это наиболее часто применяемый термин для описания набора специфических характеристик или функций. Однако, когда дело касается интерпретации какого-либо явления с точки зрения важности исламских финансов, стандартизация представляется более сложной. Принципы и постулаты исламских финансов происходят из Шариата, Священного Корана и Хадиса. Основная причина недостатка стандартизации в этой области заключается не в неопределенности источников, а в их интерпретации. В настоящее время отмечается существенный прогресс в том, чтобы сделать исламские законы более глобально и универсально приемлемыми. Организация Учета и Аудита для Исламских Финансовых Учреждений (AAOIFI) как раз занимается разработкой таких принципов. В данной статье обсуждаются вопросы стандартизации в исламских финансах и шаги и способы их адаптации во всем мире для ускорения процесса стандартизации в исламских финансах.

Ключевые слова: исламские финансы, принципы и постулаты исламских финансов, стандартизация.

**STANDARDISATION
WITHIN THE CONTEXT
OF ISLAMIC FINANCE***Standardization and certification in Islamic Finance:
international view*

Islamic Finance is growing at a great pace and the developments in the Islamic financial instruments have been phenomenal. However, there is one shortfall that exists in Islamic Finance. It lacks standardisation. The principles and tenets of Islamic finance have their roots in Sharia, the Holy Quran and the Hadith.

Despite these sources, the disparity in the standard of Islamic Finance exists. The main reason for this disparity or a lack of standardisation is not the ambiguity of the sources but rather their interpretation.

When it comes to Islamic finance and its interpretations by the scholars, there is an existence of «Ijma», which means a lack of consensus [1]. The lack of standardisation in Islamic finance is because the scholars who interpret Islamic finance do not belong to the same «Madahib» or schools of thoughts.

These scholars belong to different regions, cultures and even the countries with the types of governments. Their understanding and interpretation of Sharia laws are according to the training they have received and has developed over time according to the local variations of Islam. Several of these scholars belong to Islamic nations with varying degrees of stringent following of Islam and many of them even belong to secular countries.

It makes it impossible to have a similar interpretation of the Quran or Sharia or Hadith and even Islam itself. Apart from these facts, the extent to which the conventional financial system has a hold over the economy of their respective countries also determines how these scholars will interpret the tenets of Islam.

These differentiating factors make it inherently impossible for the Islamic scholars to give a standardised interpretation of Islamic financial laws. Every scholar interprets Sharia differently and there are numerous factors affecting and influencing its interpretation. Thus, it leads to lack of standardisation.

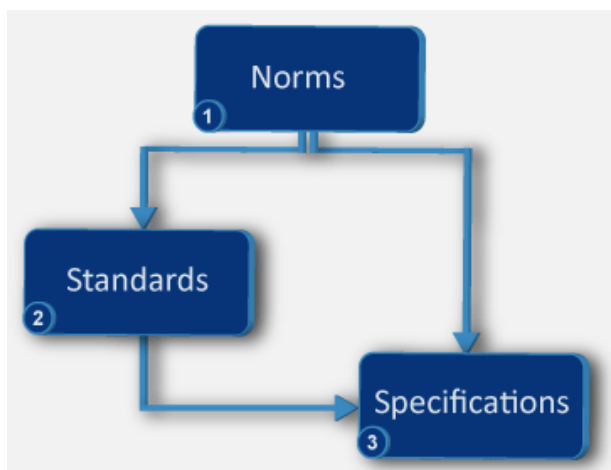
What is Standardisation within the context of Islamic Finance?

Standardisation is a very commonly used term to describe a specific set of features or functions. However, when it comes to interpretation of something of the magnitude of Islamic finance, standardisation becomes complicated.

Islamic laws or Sharia form the base of the life of Muslims around the world. Muslims constitute one of the largest population groups in terms of religion. However, when it comes to culture, geography and demography, there are huge variations. These variations have their root in the local geographical and historical factors.

The interpretation of Sharia and subsequently the Islamic finance has been done since ages on the basis of the local varieties and sensibilities of people. Islamic is a dynamic and great religion that symbolises unity in diversity and mandates respect for everyone, irrespective of their colour, race, class or financial background.

This diversity is honoured in the manner in which Sharia and Islamic financial laws are understood and interpreted. The interpretation of the financial laws is in conformity with the several local and international factors. These interpretations suit the requirement of the local populace to which the scholars interpreting belong.



(Standardisation and its elements. Source: Cartes-Bancaires.com)

Diagram 1: Standardisation

All these factors make standardisation a complicated process. Hence, the very definition of what standardisation could mean in terms of Islamic finance requires a deeper understanding. Standardisation in this context means converging together the divergent interpretations of the Islamic financial laws and building a common standard for all the Muslims around the globe. It involves bringing a parity among the Norms, Standards and Specifications.

And, in the process, due care must be taken to eradicate any flaws or shortcomings of the

various interpretation while also ensuring that the sensibilities of all the stakeholders – the Muslims from around the world – are protected.

In this process, all the common features are identified and any gaps in their interpretation and disputes are resolved amicably. It entails revising each of the principles and interpreting them in the purest of the forms. Thus, standardisation requires a common minimum factor on which all the scholars have a consensus. This common minimum factor should encompass all the main and critical rules and regulations to offer a universal guideline.

Benefits of Standardisation

Standardisation helps in identifying the common principles that are applicable to Islamic finance in every part of the world. It allows framing standards that are universal and can be interpreted in a similar way in every part of the globe irrespective of the country, its financial system or the system of the government.

Such universal principles and standards help eliminate any anomalies that exist in the regional interpretations of Sharia and Islamic finance. A standardised law or legal framework would also mean that the Islamic financial scholars can check for similar principles in another country and accordingly form their guidelines.

It means that the precedents from one country can be used in another country which will make forming laws and implementing them easier. It will also mean that the universal principles are in conformity with the original tenets of Sharia.

A standardised process and the laws that are universally acceptable means that the regional Islamic institutions cannot misuse Sharia and Islamic finance through their misinterpretation. Hence, they cannot selectively use laws for their vested interests such as issuing fatwas based on the interpretation of some of the laws (which can also include manipulated or misinterpretation) of laws and avoiding those that are against their personal interests.

Disadvantages of standardisation

While there is a strong need that has been felt for standardisation, there is also an opposite view to it. Several scholars oppose standardisation. They believe standardisation will negate any possible innovations in the field of Islamic finance and the financial instruments.

If there is standardisation, the financial institutions in the various countries will avoid issuance of any new product with the fear that it might not be in line with the universally accepted principles of Sharia and Islamic finance. Although

these innovative products would comply with Sharia per se, they may not be acceptable under the universal laws.

In a nutshell, the opponents believe that standardisation will stifle the scope of Islamic finance and will make it narrower as it will not be able to introduce new and innovative products that are capable of competing with the products of the traditional financial frameworks. Hence, Islamic finance may not be able to compete against the traditional financial systems.

Therefore, it is also recommended that the universal laws should be flexible and must allow some scope to the regional differences to the interpretation of Sharia. The broader guidelines could be global or universal, but their details can differ from country to country and region to region.

Current Progress in Standardisation of Islamic Financial Laws

There is already a considerable progress that has been made to make Islamic laws more global and universally acceptable. The Accounting and Auditing Organisation for Islamic Financial Institutions or the AAOIFI has been working towards standardising these principles [2].

The AAOIFI has been working towards creating a harmony among the different Sharia interpretations and is working on identifying a common ground. It wants to introduce transparency and more efficient enforcement of the Sharia laws.

So far, the organisation has issued 83 common standards that span across Sharia, governance, audit, accounting and ethics. These standards are being followed by several financial institutions and regulatory authorities. It has helped increase harmonisation of Islamic financial laws to a great extent. However, there are still several challenges. There are lots of financial organisations and nations that are yet to accept these standards and ensuring their adherence is a major issue.

Analysis

Based on the advantages and disadvantages, it can be stated that although there are some valid assumptions against standardisation, it is critical to ensure that there are universal principles so that the financial organisations as well as their customers get access to only Sharia compliant products and services.

Lack of standardised certificates

Just like the standards of Islamic finance, there is a lack of certification in Islamic finance. There are no specific and standardised qualifications that are currently available for those who want to professionally contribute to Islamic finance.

Despite such qualifications and certifications, there is a clear lack of a standardised approach to qualifications in Islamic finance. The differences are in terms of their content, course outlines and the principles of Sharia taught by them [3].

Therefore, it is important to have a common standard for the certifications and qualifications in Sharia financial laws for those who want to pursue a career in this field. It will encourage more and more scholars with excellent knowledge of the tenets of Islam to enter the field of Islamic finance and contribute towards its growth and development.

Accounting and Audit Organisation for Islamic Financial Institutions (AAOIFI)

The Accounting and Audit Organisation for Islamic Financial Institutions is an independent non-profit organisation that audits Islamic financial institutions to evaluate their accounting standards and practices, ethical practices and compliance with the Sharia laws [4].

The organisation also offers certifications in the field of Islamic finance and imparts training to the professionals who want to work in the industry. Some of the qualifications offered by AAOIFI include CIPA Sharia Advisor and Auditor or the CSAA.

AAOIFI seeks to implement standardised processes and practices in the domain of Islamic finance. It aims at bringing harmony among the different facets of Islamic finance and the various parties that are involved. It was established in 1991 in Bahrain and since then has grown to become a global organisation.

Among the primary objectives of the organisation is to ensure that the Islamic financial institutes follow ethical practices by appropriately interpreting the principles of Sharia. Islamic finance lacks standardisation and the presence of any global regulatory body. It results in a huge disparity among the various Islamic institutions as each one of them interpret Sharia and Islamic financial laws differently.

AAOIFI seeks to remove this disparity and bring harmony among the various institutions by establishing specific universal standards, auditing the accounting documents, monitoring the ethical practices of these organisations and suggesting the right structure of products and financial institutions.

Recently, on 26th April 2016, the organisation conducted the first meeting of its Ethical Board after it was constituted. On the same day its subcommittee at Jeddah discussed on standards that can be implemented for the conversion of conventional banking system to Islamic banking. Its

subcommittee in Kuwait also issued new standards on the same day.

The standards defined by AAOIFI are developed by several Islamic Sharia scholars. These scholars have in-depth knowledge of the Sharia and Islamic financial principles. The standards issued by the organisation are not mandatory and the financial institutions and countries may voluntarily implement them. However, more and more countries have begun to implement these standards in the recent years.

Until now, banks and financial institutions had their own Sharia Supervisory Boards (SSB). Similarly, they also followed the regulations of the International Accounting Standards (IAS) which are followed by the conventional financial institutions and banks. It required that there needs to be a Sharia compliant organisation for regulating the Islamic financial institutions. Hence, AAOIFI has emerged as a viable option [5].

RAM Holdings

RAM Holdings Berhad is a Kuala Lumpur based organisation that offers advisory and credit rating services to the financial organisations [6]. RAM Holdings operates through its various subsidiaries such as RAM Ratings [7]. RAM Holdings and RAM Ratings provide rating services to Islamic financial institutions and was rated as the best Islamic Ratings Agency for the year 2011 [8].

The company was established in 1990 and since then has emerged as one of the most reputed and efficient Islamic financial institutions' rating agency in the world. The primary market of the company is Malaysia where it is based but it also offer rating services to Islamic financial institutions around the world.

The Islamic Financial Services Board (IFSB)

The Islamic Financial Services Board or the IFSB is an international body or organisation that defines the standards and practices to be followed by the Sharia abiding financial institutions. The board specifies the guiding principles and prudent objectives and standards to be followed by the banks, financial institutions, capital market companies and companies involved in Islamic finance compliant insurance industry [9].

IFSB supports researches in Islamic finance and provide the necessary support to the researchers. It presides over meetings and conducts conferences to support the development of Islamic finance and the financial instruments needed for its growth and development.

It is important to have efficient financial instruments as only then Islamic finance can

compete with the conventional financial system and attract investors.

IFSB began operations in Kuala Lumpur in 2003. It primarily constitutes a general assembly that comprises of all the members of IFSB. The next level in the hierarchy is the council that includes all the senior level executives and other full time members. There is also a technical committee that performs the role of an advisor to the council. It consists around 15 [10].

Further up in the hierarchy of the organisation is the working group that is responsible for drafting guidelines and standards for the perusal of the technical committee. At the top most level is the secretariat that is headed by the secretary general. The council appoints the secretary general and the secretariat acts as the permanent administrative body.

This is the hierarchical structure of IFSB. The primary responsibilities of IFSB include defining standards and principles for the Islamic Capital Markets, defining the concepts related to Islamic Finance and collecting and analysing the related statistics [11].

IFSB hosts summits that discuss the concepts of Islamic financial system and its products and services. The 12th summit of IFSB was conducted at Almaty on 20th and 21st May 2015. The summit was called «Core Principles for Islamic Finance: Integration with the Global Regulatory Framework» [12].

As the title of the summit itself specifies, it pertained to developing core principles that would integrate the tenets of Islamic finance and help with the development of a global regulatory framework.

International Islamic Rating Agency (IIRA)

The IIRA or the International Islamic Rating Agency is the only rating agency for the Islamic financial instruments. The agency rates the banks and capital market companies that sell Islamic financial instruments. It analyses the quality of the products and services of the various banks and financial companies globally and assign them specific ratings [13].

The agency rates the financial products to evaluate their efficacy which further helps with improving their quality and efficiency. It conducts qualitative analysis of the financial institutions and financial products to ensure that they adhere to the Islamic laws for financial products.

IIRA has been recognised by several international Islamic financial institutions, regulators and bodies. The Central Bank of Bahrain has appointed IIRA as its ECAI or the External Credit Assessment Institution.

IIRA was established in the month of July 2005. Its objective is to facilitate the development of the regional as well as international standards and assessment method that can be used to rate products and organisations and to ensure that the Islamic financial products achieve the required level of effectiveness and meet the desired quality standards where they are completely Sharia compliant.

Conclusion

There has been multiple efforts to standardised Islamic finance. Various organisations have been set up to measure and rate services of Islamic financial institutions. These institutions have so far done a commendable job of standardisation of

Islamic finance, however, given the complexity and magnitude of Islamic finance lot of work still remains to be done. Standards, developed by these organizations, are the basis for the law issuers in different countries to make decisions for Islamic financial institutions. For example, the mission of IFSB is to promote the development of a prudent and transparent Islamic financial services industry through introducing new, or adapting existing international standards consistent with Sharia principles, and recommend them for adoption. Such standards are the reference point for the states, as Kazakhstan, approaching to develop Islamic finance most widely.

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