



HARVARD LAW SCHOOL
Islamic Legal Studies Program

and

LONDON SCHOOL OF ECONOMICS

Workshop on

*Reappraising the
Islamic Financial
Sector*

Thursday, February 24, 2011

London School of Economics
Tower #3, 5th Floor (BOX)
London, United Kingdom

HARVARD LAW SCHOOL
ISLAMIC LEGAL STUDIES PROGRAM

S. NAZIM ALI
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February 24, 2011

Dear Participant:

Once again, on behalf of Harvard Law School's Islamic Legal Studies Program (ILSP) and the London School of Economics (LSE), I would like to welcome you to our 5th workshop in the series. This year's workshop will address the topic "Reappraising the Islamic Financial Sector".

As with the previous events, this workshop brings together leading scholars, economists and practitioners so that they may exchange their views on some of the most pressing issues facing the sector today. We hope that this workshop will continue to encourage open dialogue and develop further insight, rather than prescribe a particular course of action or conclusion.

The aforementioned topic was chosen in response to recent claims that the Islamic financial sector may have veered off-track. Many accuse the sector of not being substantively different from conventional finance products or of failing to realize the original economic and social ideals espoused in earlier thought and literature. In lieu of these remarks, our workshop seeks to address questions such as: What are the institutional objectives of Islamic Finance and are there appropriate standards for assessing the performance of the sector? How can we make IF and Islamic financial products more transparent, coherent and convincingly distinct from conventional finance?

We have already started this conversation by seeking your comments on the topic. These have helped inform the structure of our workshop and ensure that our time is used even more productively, in line with our goal of advancing an engaged and insightful dialogue. We thank you for your valuable participation and hope to see you at future events, including the 10th Harvard University Forum on Islamic Finance to be held in 2012.

I would also like to thank the LSE for partnering with the ILSP in this event and look forward to our continued collaboration. The ILSP is also grateful to have the generous support of the sponsors of Harvard Law School's Islamic Finance Project: HSBC Amanah, Kuwait Finance House and Islamic Research Training Institute of the Islamic Development Bank.

We hope this workshop will fulfill its goal -with your help- and welcome any suggestions for the future.

Sincerely,

S. Nazim Ali, Ph.D.

Director, Islamic Finance Project &

Acting Executive Director, Islamic Legal Studies Program

Harvard Law School
Islamic Legal Studies Program
&
London School of Economics

Workshop on

Reappraising the Islamic Financial Sector after the Downturn: Introspective Reflections

Thursday, February 24, 2011
8:30a.m--5:30p.m.

London School of Economics
Box Room, 5th Floor, Tower #3
London, United Kingdom WC2A 2AE

Directions: <http://www.lse.ac.uk/resources/mapsAndDirections/findingYourWayAroundLSE.htm>
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Overview of the Topic

Participants overwhelmingly chose to focus this year's annual Harvard-LSE Islamic Finance Workshop on re-appraising the Islamic finance sector.

Though it is still debatable as to whether or not the downturn has ended, participants have voiced their concern that there is a general sense or "feeling" that there is a fundamental problem or flaw with the current sector and its practice. But there does not seem to be any agreement as to what that "problem" is.

Some feel that the sector has:

1. Generally lost its sense of direction;
2. Veered off course;
3. Reached a cross-roads; and/or
4. Fallen into disillusionment with its own products and achievements.

While on the other hand, others believe the sector is actually on track, but needs some minor adjustments and/or simply better marketing. A general summary of participants' views can be found in **Appendix D** (Participants' Perspectives) to this document.

Participants have highlighted in their comments their various thoughts and reasons for such sentiments. Furthermore, both in the comments as well as in past workshops, participants spent a considerable amount of time identifying, analysing and developing lists, concepts, ideas and issues requiring the attention of the Islamic finance practitioners to that effect. Some of these issues are specific in nature, while others are more general or conceptual.

What is evident from these discussions is the lack of any clear basis on which to measure or contextualize these concepts. How do we appraise the value or importance of an idea or a concept? Is it worth this industry's full attention or not? How do we measure whether or not the sector's ideals are being met? Who decides? On what bases do we measure the pulse of this sector and how it is doing? How do we know whether the sector, an Islamic financial project or a financial institution is 'on track' or whether it is 'off-course'? Also, how do we measure whether a project or financing is meeting the *maqasid* of Islamic finance?

The fundamental question extrapolated from these ongoing discussions is not necessarily whether something is or is not *shari'ah* compliant, but whether the results of actions and decisions taken by its stakeholders and practitioners are or are not meeting the ideal objectives the industry had set out for itself.

This workshop is therefore an attempt to take these on-going discussions one step further.

Purpose of the Workshop

The purpose of this workshop is to set out and possibly develop a framework for better measuring success and/or failure in this industry.

To do so, two items are required:

1. **A common set of core *Shari'ah* objectives;** and
2. **A common set of benchmarks against which to assess those objectives.**

In other words, by creating a common yardstick, participants can all better gauge and systematically assess whether something is or is not meeting those standards set out for the industry.

To keep the discussion focused and manageable, this workshop will only focus on the objectives pertaining to Islamic financial institutions and to their financial transactions (in a general sense). Therefore, objectives outside of these two areas, such as of a global systemic/macro nature or a micro-level, should only be discussed within this framework.

Participants will be asked to review a pre-populated list of core *shari'ah* objectives and their benchmarks for each of the listed most relevant factors affecting Islamic financial institutions and their financial transactions. These lists can be found in **Appendix A** and **Appendix B** of this document.

By discussing and agreeing upon these core *shari'ah* objectives and their benchmarks, participants can begin to formulate a yardstick in which to measure the successes and failures of this industry.

Furthermore, through use of this common set of objectives and benchmarks, participants can better understand how they compare to those in conventional finance. Such a comparison may allow participants to more systematically assess those aspects in which Islamic finance has been accused of 'mimicking' conventional finance.

Lastly, participants will discuss those who should be responsible for monitoring and enforcing such objectives and benchmarks.

Workshop Structure

In order to create a framework in which to assess the successes and failures of the industry, participants are encouraged to review a pre-populated common set of core *Shari'ah* objectives and their benchmarks, as set out in the tables as found in **Appendix A and Appendix B**.

To keep the discussion focused and meaningful, general systemic/macro objectives as well as individual/microfinance objectives will not be examined in this workshop. The workshop will focus just on two parts, Islamic financial institutions and Islamic financial transactions.

Islamic Financial Institutions

- I. **Part I of the Workshop:** The participants are to assess and to discuss the core *Shari'ah* objectives and benchmarks specific to Islamic financial institutions, as listed in Appendix A. Participants are also asked how these differ from conventional finance standards, if at all.
- II. **Part II of the Workshop:** The participants are then to discuss the implementation of each of the agreed objectives specific to Islamic financial institutions, as listed in Appendix A. Participants are to confirm: (a) whether or not a new benchmark needs to be created, separate from that used in conventional finance; (b) who should create it; and (c) who should monitor and enforce it.

Islamic Financial Transactions

- III. **Part III of the Workshop:** The participants are to assess the listed core *Shari'ah* objectives and benchmarks specific to Islamic financial transactions, as listed in Appendix B. Participants are also asked how these differ from conventional finance, if at all.
- IV. **Part IV of the Workshop:** The participants are then to discuss the implementation of each of the agreed objectives specific to Islamic financial transactions, as listed in Appendix B. Participants are to confirm: (a) whether or not a new benchmark needs to be created, separate from that used in conventional finance; (b) who should create it; and (c) who should monitor and enforce it.

Recommendations

- V. **Part V of the Workshop:** Participants make general recommendations as to how to move the industry forward given the workshop discussions on objectives and benchmarks and given their current perceptions of the industry (see Appendix D of this agenda).

Workshop Agenda

8:30 a.m.

Reception and Coffee

9:00 a.m. Opening Remarks by Professor Stuart Corbridge, Pro Director
London School of Economics

9:10 a.m. Introduction by Workshop Moderator, Professor Frank E. Vogel

Summary of participants' perspectives and comments creating the backdrop to this workshop discussion.

PART 1: ISLAMIC FINANCE OBJECTIVES AND BENCHMARKS – ISLAMIC FINANCIAL INSTITUTIONS

9:20 a.m. Participants' Views – Open Floor Discussion

Discussion: Islamic Financial Institutions – Columns A & B of Appendix A page 10

In order to create a framework with which to systematically assess the successes and failures of the industry, participants are encouraged to assess and discuss the **core *Shari'ah* objectives and benchmarks specific to Islamic financial institutions**, as listed in **Columns A and B only of Appendix A on page 10** of this document.

Primary Questions:

1. Do you agree with the core *Shari'ah* objectives & benchmarks listed for each of the various factors?
2. What would you amend or add?
3. Do you agree with how the benchmarks differ from conventional finance, if at all?

Participants are also encouraged to refer to and compare the general 'core' objectives of the Islamic finance sector, as identified by participants, on Appendix C of page 12 of this document.

10:45 a.m.

Tea/Coffee Break

11:00 a.m. Summary – Frank E. Vogel to provide a summary of all the points of views for Part 1

PART 2: IMPLEMENTATION AND ENFORCEMENT OF OBJECTIVES – ISLAMIC FINANCIAL INSTITUTIONS

11:10 a.m. Participants' Views – Open Floor Discussion

Discussion: Islamic Financial Institutions – Columns C & D of Appendix A page 10

Based on the results of the earlier sessions, participants are encouraged to assess and discuss the actors responsible for **monitoring and enforcing the core objectives and benchmarks specific to Islamic financial institutions**, as listed in **Columns C and D of Appendix A on page 10** of this document.

Primary Questions:

1. Do you agree that a new benchmark standard should be created different from conventional finance, and if so, by whom?
2. Do you agree with the list of those suggested to monitor and enforce such Islamic objectives for each of the various factors?
3. What would you amend or add?

Participants are encouraged to consider the general perspectives on reappraising the industry, as compiled from the submitted comments, in Appendix D on page 14 of this agenda.

12:35 p.m.

Lunch

1:10 p.m.

Summary –

Frank Vogel to provide a summary of all the points of views for Part 2

PART 3: ISLAMIC FINANCE OBJECTIVES AND BENCHMARKS – ISLAMIC FINANCIAL TRANSACTIONS

1:20 p.m. Participants' Views – Open Floor Discussion

Discussion: Islamic Financial Transactions – Columns A & B of Appendix B, page 11

In order to create a framework with which to systematically assess the successes and failures of the industry, participants are encouraged to assess and discuss the **core *Shari'ah* objectives and benchmarks specific to Islamic financial transactions**, as listed in **Columns A and B only of Appendix B on page 11 of this document**.

Primary Questions:

1. Do you agree with the core *Shari'ah* objectives & benchmarks listed for each of the various factors?
2. What would you amend or add?
3. Do you agree with how the benchmarks differ from conventional finance, if at all?

Participants are also encouraged to refer to and compare the general core objectives of the Islamic finance sector, as identified by participants, in Appendix C on page 12 of this document.

2:45 p.m. Tea/Coffee Break

3:00 p.m. Summary –
Frank Vogel to provide a summary of all the points of views for Part 3.

PART 4: IMPLEMENTATION AND ENFORCMENT OF OBJECTIVES – ISLAMIC FINANCIAL TRANSACTIONS

3:10 p.m. Participants' Views – Open Floor Discussion

Discussion: Islamic Financial Transactions – Columns C & D of Appendix B page 11

Based on the results of the earlier sessions, participants are encouraged to assess and discuss the actors responsible for monitoring and enforcing the core objectives and benchmarks specific to Islamic financial transactions, as listed in Columns C and D of Appendix B on page 11 of this document.

Primary Questions:

1. Do you agree with the list of those suggested to monitor and enforce such Islamic objectives for each of the various factors?
2. What would you amend or add?

Participants are encouraged to consider the general perspectives on the industry, as compiled from the submitted comments, in Appendix D on page 14 of this agenda.

PART 5: RECOMMENDATIONS FOR THE FUTURE

4:30 p.m. Conclusions and Recommendations

Draft Summary and Action Plan – Participants to assist Frank Vogel in framing any conclusions from the workshop, suggesting solutions and remedies and any action to be taken on them, and identifying areas for further research or discussion, especially given the participants' current perceptions of the industry (see Appendix D). These points will be included in a draft summary of the workshop to be prepared after the workshop and distributed to all parties.

Next Workshop – Participants propose topics for the next workshop, for a later vote.

5:30 p.m. End of Workshop

APPENDIX A

INSTITUTIONAL OBJECTIVES

Core Objectives for Islamic Financial Institutions

	A	B	C	D
Financial Institutions only	<i>Shari'ah</i> Objective	Benchmark/ Standard – Same or different from conventional finance standards?	Should a new benchmark be created & by whom?	Who Should Monitor & Enforce (Implementation of objectives)
1.				
2.				
3.				
4.				
5.				
6.				
7.				
8.				
9.				
10.				

APPENDIX B

TRANSACTION OBJECTIVES

Core Objectives for Islamic Financial Transactions

	A	B	C	D
Financial Transactions only	<i>Shari'ah</i> Objective	Benchmark/ Standard – Same or different from conventional finance standards?	Should a new benchmark be created & by whom?	Who Should Monitor & Enforce (Implementation of objectives)
1.				
2.				
3.				
4.				
5.				
6.				
7.				
8.				
9.				
10.				

APPENDIX C

GENERAL CORE OBJECTIVES

Extracted from Participants' Submissions

GENERAL CORE OBJECTIVES OF ISLAMIC FINANCE

PROMOTIONAL OBJECTIVES

I. Systemic Economics

- Linking to real economy
- Replacing conventional finance
- Financing future investments & consumption
- Price stability commensurate with growth
- Promoting community banking not markets

II. Wealth Creation

- Creating real wealth and real prosperity
- Employing wealth creation & resources equitably
- Increase financing for development

III. Social Welfare & Equality

- Preserving and managing wealth for the poor
- Socially desirable projects
- Equal distribution of wealth
- Circulating wealth to the poor
- Promoting microfinance and PLS
- Increase role of SMEs in the economy
- Empowering individuals to meet their needs
- Bring about equitable distribution of income and services to the poor

IV. Risk sharing

- Financing aligned with the risks
- Risk sharing activities and PLS

PREVENTION OBJECTIVES

I. Systemic Economics

- Avoiding injustices and economic inefficiencies
- Avoiding exploitation and exploiting ignorance
- Preventing monopolies
- Minimizing frequency and severity of financial crises
- Avoiding excessive leverage and debt
- Reduce mimicking of conventional products
- Reduce dependence on debt financing

II. Social Welfare

- Eradicate poverty
- Reduce concentrations of wealth
- Reduce unemployment

III. Risk

- Avoid risk Transfer
- Reduce speculation

IV. Ethics

- Not hiding the truth
- Oppose hoarding
- Avoid falsifying and poor disclosure
- Avoid use of tricks to change form/substance

V. Ethics

- Ethical behaviours
- Transparency
- Honesty
- Equality
- Giving full measure
- Mutual consent
- Dignity

VI. Contractual

- Participation in ownership
- Fulfilling form, substance and spirit of IF
- Abiding with commitments (*wa'd*, *'ahd*, *'aqd*)

VII. Ideal Projects

- Promoting good environment
- Good labor conditions
- Conservation of resources
- Minimizing environmental effects
- Productive projects rather than just credit-worthy

VIII. Perceptions

- Better image of Islam and Islamic finance

V. Contractual

- Avoid *gharar*
- Avoid *Riba*
- Avoid *haram* activities, goods

APPENDIX D

PARTICIPANTS' PERSPECTIVES

Extracted from Participants' Comments
By Husam El-Khatib

The following are generalized factors, issues or concepts identified in participants' comments reflecting current self-perception of the sector.

A. Economic Perspectives:

Macro Factors:

1. Divergence from *maqasid al-Shari'ah*;
2. Failures linked to the global financial crisis;
3. Imitation of conventional interest based products;
4. Debt v equity;
5. Lack of proper standardization;
6. Lack of focus on retail/social/poor financing, as per ideals; and/or
7. No control of monetary policy factors.

Micro Factors:

1. Lack of new "ideal" products;
2. Constrained by interest based pricing mechanisms;
3. Poor ethical standards;
4. Lack of efficiencies; and/or
5. Lack of good corporate governance standards.

B. *Shari'ah* & Legal Perspectives:

1. *Shari'ah* governance, conflicts of interest and supervision issues;
2. Form versus substance;
3. Lack of proper regulation; and/or
4. Reconciling *Shari'ah* requirements with unwavering national laws.

C. Practitioners Perspectives:

1. Imitation of conventional products;
2. Standardization;
3. Image and marketing of the industry;
4. Unclear impact and roles of rating agencies; and/or
5. Lack of proper liquidity products and services.

D. No Disillusionment:

1. A number of minor issues, but not quantitatively different from conventional finance;
2. Some have suggested that conventional finance has more pressing, complicated issues, comparatively; and/or
3. If there are any problems, they are simply an image problem, due to lack of self-confidence, poor communication or poor marketing.

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