

REQUIREMENTS TO BE FULFILLED WHEN CONVENTIONAL BANKS SET UP ISLAMIC BANKS, 'WINDOWS' OR 'ISLAMIC FUNDS'

Praise be to the Almighty Allah, the Lord of the worlds, and peace and blessings be upon the most honorable amongst prophets and messengers, our Prophet Mohammed, and upon all his scion and companions and those who follow their footsteps until the Day of Judgment.

This is a modest contributory note that sets out the most important conditions to be fulfilled when setting up any Islamic bank, or “window” or “fund” by conventional banks and financial institutions the Articles of Associations of which do not comply with the tenets of Islamic Sharia.

The importance of this issue cannot be overstated, particularly in view of the wide spread of this trend, over the past few years, and the oft-repeated claims by many parties that their transactions and dealings are in full compliance with the provisions of Islamic Sharia, but when subjected to scrutiny and examination, the truth is otherwise.

For my part, I have not found any research conducted on this matter, and therefore this note is a beginning towards this end, hoping that it will be followed by specialist research and studies by our eminent honorable scholars and academicians, for I'm no more than a parasite eating at their banquets.

Before delving into the details of these requirements, we have to note that co-operation and overlapping between Islamic and conventional financial institutions in managing investments has taken a number of forms, some of which are listed below:

- (i) An Islamic financial institution would offer an investment portfolio, backed by Sharia expertise provided by it, but vests management of the investment of this portfolio unto an external investment manager who undertakes to comply with its conditions and applies the criteria and standards laid down in it in managing investment.

This is permissible in Sharia, if the investment manager complies with the conditions, and its success has been proven in more than one experiment.

- (ii) A conventional financial institution or bank would sell and market an Islamic product, introduced and planned by an Islamic financial institution through its Sharia expertise.

This is also sanctioned in Sharia, and it has been proved to be successful in more than one practical example.

- (iii) Alternatively, a conventional financial institution or bank would open an “Islamic window” in its premises or introduce an investment product marketed as “Islamic,” such as funds, for example, or set up a private Islamic bank or company. This is the subject of our discussion.

Some scholars believe that this is not permissible, because these conventional financial institutions do not comply, in the first place, in terms of their incorporation and statutes, with the teachings of Islamic Sharia, so how can they claim to be complying with them in ‘funds’, ‘branches’ or ‘windows’?

In addition, the funds of these conventional institutions are drawn from prohibited earnings, so how can they invest unlawful funds in Islamic investment products? The rationale cited by these scholars is that these financial institutions or banks are only intent on exploiting practicing Muslim investors and on unfairly competing with Islamic financial institutions.

On the other hand, there is a group of contemporary scholars who permit this type of investment products, if Sharia conditions laid down for them are satisfied. They argue that dealing in compliance with the teachings of Sharia in transactions and their Islamically sound contracts is not confined to a certain group of people, and that it is permissible - indeed it is incumbent upon whoever can conduct dealings in accordance with the provisions of Sharia to do so. If it is impossible for him to do so in all his contracts, at least he should start with those which are possible. As to what is said that the source of these funds is from unlawful earnings, the reply is as follows: ‘there is nothing to prevent such funds from being purified and cleansed, and subsequently directed to lawful and permissible channels’. Jurists say that it is permissible to deal with commingled (mixed) funds¹, as stated by Shaikh OI-Eslam Ibn Taymiyah, may the Almighty Allah have mercy upon him, in his ‘Collection of Fatwas’, and as stated by other eminent scholars.

As to the claim that these traditional financial institutions want to unfairly compete with Islamic financial institutions, it can be refuted by saying that competition is always in favor of the most suitable, efficient and fittest. Perhaps this kind of competition will prompt Islamic financial institutions to exercise more diligence and care to introduce better quality products and to be more efficient in their activities. This is in fact evident in many

¹ The commingled (mixed funds) are those which are not purely lawful funds, but are mixed, containing both lawful and unlawful money.

countries in which there is competition. On the other hand, conventional financial institutions may gradually convert into full-fledged Islamic financial institutions if they find this to be a viable proposition and they have acquired adequate practical experience and Sharia practices in this field. There are practical examples to substantiate this argument.

Among those who hold this view are our honorable scholars: Dr. Yousuf Al Qardawi, Dr. Abdul Sattar Abu Ghuddah, Shaikh Mohammed Taqi Usmani, Dr. Nazih Hammad, Dr. Abdulla Al Muslih, Shaikh Abdulla Bin Sulaiman Al Manea, etc. Among the economic researchers who also espouse this view are: Dr. Mohammed Ali Al Qari and Dr. Munzer Quhf who all concur that the required conditions should be strictly complied with.

The most important conditions to be complied with are:

1. Complete Segregation of Funds:

The funds of the Islamic investment product and of the financial institution, in which Sharia provisions are not observed, must be completely segregated. The funds of investors who are very diligent and anxious to earn lawful earnings should not be commingled with those of conventional investors who are not observant of Sharia provisions and are not anxious to earn lawful income. Therefore, there should be separate accounts, books and computer programs evidencing this complete segregation of funds. This matter is no more of a difficulty or problem in view of the availability of modern electronic systems, if there are sincere intentions and the required expertise is available. This compliance should be enshrined and expressly stated in the statutes or the prospectus.

2. Sharia Supervisory Board:

There should be a Sharia Supervisory Board for any institutional Islamic investment body, and that such Sharia Supervisory Board should consist of trustworthy scholars who are highly qualified to issue fatwas on financial transactions, and who have vast experience and knowledge in modern dealings and transactions. The Articles of Association or the prospectus, or statutes, depending on the type of activities, should provide for the existence of the Sharia Supervisory Board. The Board's fatwas and resolutions should be binding upon the financial institutions management, and also for its independence and freedom to give opinions on proposed contracts and transactions. The role of the Sharia Supervisory Board should be concurrent with that of the financial institution itself in the sense that it should be formed from the moment the financial institution is incorporated, and that it should provide continued supervision and permanent checking of contracts, transactions and procedures. This should be expressly provided for in the Articles of Association or the prospectus.

3. Management Fully Convinced of Islamic Concepts:

The financial institution's management undertaking such type of business activities should be fully convinced of the concept and also fully committed and dedicated to it, and anxious to implement it and comply with the teachings governing it. Unless the entire management is committed and convinced, the business activities and the enterprise will not be foul-free or will escape irregularities and deviation. Regardless of how strict and stringent fatwas and contracts are, this will not ensure sound practices if there are no persons to carry out and implement the principle who are sincere enough and who are fully committed to it. However, there is no harm in starting first with the executive senior management which implements resolutions and subsequently trains the other members of the administrative team. The general manager himself should act as a springing point and set a good example for all in this respect.

4. Safeguarding Muslim Investors' Funds Against Negligence, Trespass and Fraud:

It is an established principle in Sharia that the Mudarib does not guarantee the Mudarabah capital for the capital provider. Hence, investment accounts in Islamic financial institutions are not guaranteed by the Mudarib. However, this does not prevent that a stipulation should be laid down **requiring the parent conventional financial institution (the original company)** to guarantee Muslim investor's funds against trespass, negligence and fraud. Some major financial institutions may sometimes shirk their responsibility in this connection by claiming that the 'Islamic window', 'Islamic branch' or 'Islamic section' is privately incorporated, and they may cite other reasons and excuses. This is totally rejected, and should be guarded against and precautions should be taken to avoid. It should also be expressly stated in the Articles of Association or the prospect of the financial institution.

5. Compliance with the Standards of the Accounting and Auditing Organization for Islamic Financial Institutions:

The Accounting and Auditing Organization for Islamic Financial Institutions has issued and published a number of accounting standards as well as auditing standards which should be complied with and implemented by all Islamic financial institutions. The reason is that the Organization's activities are considered a fundamental groundwork that underpins Islamic banking activities by keeping them away from individualism and personal reasoning, and are considered collective personal reasoning (Ijtihad) that is highly important in this vital aspect of Islamic economic life. Therefore, these standards should be strictly complied with. A number of government authorities and central banks in certain countries have circulated these standards and obliged other financial institutions to comply with them. That is why any party wishing to incorporate or set up

an Islamic financial institution should be required to comply with these standards, in order to avoid confusion, misunderstanding and ambiguity, and to seek clarity and sound business activities.

In conclusion, I would like to add one more thing. Islamic investment, with its governing Sharia rulings and provisions, is an open area for all those wishing to give it a try, provided that they should approach it from its door and comply with its provisions, and at the same time honestly deal with people in their message and transactions. And for those who are intent on fraud, cheating and misleading, all we can say to them is 'He who cheats us is not one from us'.

Allah's peace and blessings be upon our master, Mohammed, and upon his family and companions.