Financial Sector Assessment of Islamic Finance As of 2015-16

By

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// Abstract

Islamic Finance is still considered a niche in the current Financial Market but the facts are not so. Still in infancy, but the market has started unfolding its positive impacts. However to make it a reality, role of every segment from country to country specifically Muslim Countries, its actual targets i.e. helping poverty alleviation, bringing social justice to the society and better service to the customers with equitable opportunities to all market players are very important.

The analysis has discussed all these areas even taking example of UK where no legislation on Islamic Finance exists but still UK is playing an important role in development of Islamic Finance. The oncoming challenges to Islamic Finance have also been highlighted in the analysis . Where needed data has been provided with some suggestions.

However this is an open debate and every researcher can participate in these endeavors. No doubt future of Islamic Finance is highly bright but as happening in conventional world role of governments and regulators are becoming more important that are mostly missing right now. To meet this, Research and market development with right kind of products can be the right answer.

Acknowledgement& Forwarding Note

The visit to Saudi Arabia during April 20 to May 17, 2015 proved turning point for me. The main supporting event took place during my visit to Islamic Development Bank Jeddah where I met its officials and held discussions on Islamic Finance. On return I decided to focus again on research activities now mainly on Islamic finance that I was doing for the last fifteen years. But as happensin our part of the world nobody listens to others, neither we care for any advice coming from any side. Only "me and me" with objective, how to mint money have become our main goal. This mindset needs to be changed if we have to move forward positively.

What is Finance? It is the Science of doing business with proper management of balance sheet basically going for profit. It is one step forward from Islamic Economics or Conventional Economics that deals with distribution of resources that are available in scarce. So Finance is one step ahead of Islamic Economics. Unfortunately in dealing Islamic Finance we have totally forgotten Islamic Economics. This is the flaw that needs to be corrected. So for going forward in Islamic Finance we have to attach it with Islamic Economics first as its basic.

Second flaw is that we mainly focus on that how speedily Islamic Finance is growing. We forget that Islamic Finance has still narrow base as compared to conventional Finance so obviously it would grow with more speed as compared to its counterpart i.e. conventional side.

So what needs to be done. Products and markets development should be the focus with an edge over conventional side covering profit and risk management elements. This is time taking and research oriented tasks that need to be brought forward.

On macro side it should bring dent to poverty existing in Muslim countries through various steps and active role of Islamic Finance and then to structure corporates, SMEs and house hold sectors accordingly. Whether we are doing this . No Sir No.

So let us than start it with clear vision based on honesty.

From our side and to break prevailing status quo Center of Advisory Services For Islamic Banking & Finance"(CAIF) has been launched/established for the support of its growth to find solutions for the challenges under which it is working . It has its own website as :islamicfinancecaif.com.

CAIF through its website and other modes would work to bring :-

1. Clarity on perception of Islamic Banking and Finance on the public front.

2. To work with Central Banks like SBP, other banks and financial institutions and multilateral agencies like World Bank, IMF, ADB, ISD for development of market of Islamic banking and Finance with Takaful and Microfinance.

3. To work on different models prevailing right now in the world working in the area of Islamic Banking and Finance.

4. To study Islamic products available in the market and to help in to refine them to enhance returns with minimum risk as per Basle 1,2 and 3.

5. To work for establishing research centers in educational institutions and devise fresh curriculum for the students.

6. To hold and organize workshops, refresher courses on the subject.

7. To work for developing macro and micro structure for Islamic Banking and Finance to play its due role in the national economy.

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1. Overview of the Islamic Finance world wide

The difference in between Islamic and Conventional Finance is thatcharging and paying interest is banned in Islamic Finance. Islamic finance institutions instead invest in infrastructure or other types of projects and share risk and earning with the clients. Islamic finance institutions are not allowed to deal in financial risk markets or participate in the sale or purchase of mortgage-backed securities, or any type of credit default swap, either. Investing in industries such as cigarettes and alcohol manufacturing, casinos and adult entertainment companies, all of which are not tolerated under Sharia law, is also forbidden.

The Islamic financial systems have long history but Islamic banking and finance industry came into existence with profit and loss sharing investment by Egypt's MitGhamr Saving Banks in 1963. After official existence Islamic banking has grown in the area of finance, banking, insurance, mortgage, and assets management business with annual growth rate of 10-15 % now approximately 20 % since 1990. Actual development in Islamic banking started after 1970 with new investment techniques, strategies and product development. Dubai Islamic Bank (DIB) is known as world first Islamic bank. It was formed in 1975.Currently it has lot of branches which provide great services. DIB provide auto, home and personal finance products

In some countries such as Iran and Sudan all banks were operating according to Islamic financial laws but in some other countries such as Pakistan, Bangladesh, Egypt, Indonesia, Jordan and Malaysia Islamic banking services are provided through Islamic Banks or windows provided by the conventional banks. But now situation have started changing and some space has been provided to conventional side in Iran and Sudan as well making them part of rest of the Islamic countries.

The main hypothesis presented in favor of Islamic Banking is that Muslim population wants to spend their lives according to their faith. According to Islamic teachings interest is strongly prohibited in Islam and they want to avail banking services such as saving accounts, current accounts, home finances, insurance and loan according to Islamic Sharia laws. Since in most of the countries their banking and financial rules are most in favor of conventional banking system hence due to this, Islamic banking is facing some difficulties in the way of its progress. In other word these problems are great challenges for Islamic banking. If they work hard based on ground realities and not on rhetoric than Islamic banking can be developed in short period of time.

Going forward since Islamic finance is basically rooted in Islamic Countries .The richest nation among the Muslim nations of the world continues to be the Qatar, followed by Brunei,United Arab Emirates, Kuwait and Bahrain. The poorest nation in the Muslim world is Somalia, followed by the Palestinian territory of the Gaza Strip.

Allianz's Global Wealth Report have found that people hold a total of 111 trillion euros ($150 trillion) of financial assets, which include bank deposits, investments and pensions. This has marked an 8.1 percent increase since 2011, and was driven by gains on global stock markets, despite a number of global concerns including the ongoing euro zone crisis, the U.S. fiscal cliff and fears of a China slowdown.

Asia witnessed the fastest rate of growth in total financial assets, they said, at almost 16 percent. The region was followed by Oceania (which includes Australia and the islands of the central and south Pacific), Latin America and eastern Europe, all of which also reported growth running into the double digits.

In comparison Islamic financial assets had come in the range of $ 1.8 trillion by 2015 with growth by 19.6%. In 2012 they were at $ 576 billion.

So in these terms Islamic finance stands less than 1% on global basis. This invites everyone to realize that lot have to be done in competing with conventional finance.

However the promising point is that a group of 25 Rapid Growth Market countries would constitute 50% of world GDP, 38% of global consumer spending and 55% of world fixed income investments in 2020. Out of these countries, 10 countries are with major Muslim population.

In the coming years Bahrain, Qatar, Saudi Arabia, Malaysia Turkey, Indonesia and UAE are going to be the focal areas. Pakistan stands at number nine.

Two factors are going to be in favor of Islamic finance in future i.e.atilt coming in support of Halal Economy and secondly it can narrow gap in between monetized part of economy and real sector. But this would also bring in front lot of questions that how prudent and well managed Islamic banks and other institutions in these economies are. The focus on this can be the game changer element in future.

Currently profitability of 20 top Islamic banks are at 12.6% (ROE) comparable to 15% of conventional banks. So this area needs to be looked in to.

Globally Islamic banks holds 38 million customers that is not enough.

Going forward Mix of Basel III and IFSB guidelines are going to be the main factors in raising no of customers and return on Islamic finance.

2. Role of Islamic Finance In The Current Financial World

The beliefs of Islam encompass all aspects of a Muslim's life, determining the articles oftheir faith and the relationships between man and God, and between human beings. They also determine their moral and behavioral code, as well as giving the framework for their daily activities. Islamic law or Sharia - as revealed in and derived from the Qur'an and Sunnah (the sayings and practices of the Prophet Muhammad (PBU)) - governs all economic and social activities and undertakings of Muslims.

The Islamic economic model has been developed over time, based on the rulings of Sharia on commercial and financial transactions. The Islamic financial framework, as seen today, stems from the principles developed within this model, some of which are outlined below:

1. The Islamic economic model emphasizes fairness. This is reflected in the requirement that everyone involved in a trans action makes informed decisions and is not misled or cheated.
2. Islam encourages and promotes the right of individuals to pursue personaleconomic wellbeing, but makes a clear distinction between what commercialactivities are allowed and what are forbidden. For example, transactions involvingalcohol, pork related products, armaments, gambling and other sociallydetrimental activities are forbidden.
3. One key Sharia ruling on economic activities of Muslims is the strict and explicit prohibition of Riba, most usually described as usury or interest. Sharia scholars consider exchanging interest payments within the conventional banking system as a type of Riba. Modern Islamic banking has developed mechanisms to allow interest income to be replaced with cash flows from productive sources, such asreturns from wealth generating investment activities and

operations. These includeprofits from trading in (real) assets and cash flows from the transfer of usufruct (the right to use an asset), for example, rental income.

4 The Islamic economic model is based on a risk and profit-sharing and loss-bearingphilosophy. So, in this respect, Islamic transactions are similar to, if not the same as,equity-based transactions in rewarding performance. However, Sharia requirements go further to ensure that in distributing profits more emphasis is placed on reward for effort rather than reward for merely owning capital.

5 The Islamic Law of Contracts plays pivotal role within the Islamic financial system. Islamic commercial jurisprudence consists of principles and rules that mustbe observed for transactions to be acceptable in Islam; and the Islamic Law of Contracts is at the heart of this. One important principle is contractual certainty.Under this body of law, uncertainties or ambiguities that can lead to disputes may render a contract void under Sharia.

6 While some of these principles and rules are based on clear and explicit rulings of Sharia, others are derived from Sharia scholars' interpretations and understanding of the law, known as Fiqah, as set out in the Qur'an. These interpretations can and do differ between Sharia scholars. Certain contractual terms deemed to be valid under Sharia by the scholars of one school of Fiqah may not be acceptable to scholars from another school. This has had significant implications for the development of Islamic finance.

No doubt during last three to ten years, Islamic finance has grown with immense pace. It may be due to narrow base or petro dollars controlled by the Muslim states or on account of renaissance of Islamic thoughts, but the fact is that re-emergence of Islamic finance is different from what was happening hundred or two hundred years back. This needs to be examined a fresh with new ideas based on principles laid down in Quran, Sunnah and thoughts provided on fiqah byImam A'zam Abu Hanifa, Imam Maalik, Imam Shaafi and Imam Ahmed bin Hambal and other scholars in combination with current financial norms and practices.

Like any system Islamic finance or Islamic banking has its supporters as well as critiques. Hence, for moving forward, strength needs to be drawn from its supporters and lessons from its critiques.

Starting from its base, the main charge leveled on current Islamic banking or finance is that Islamic banking cannot be implemented till an Islamic state come in to form. Ideally it looks fine but practically it is not possible. To reach upon to that target some transitory arrangements have to be made. Justice Wajihuddin of Pakistan in his observations in Shariat Bench ruling of 2000 has asked for these arrangements to be swift but not abrupt. Further it needs to be realized that these changes are already taking place, however, one can differ on pace that is very slow. In fact arbitrage of Islamic and conventional systems are now moving towards convergence in form of realization that social order and equity is the prime target to be in front of everyone.

The basic objective of Islam is against anything that oppresses people and in this way interest (Riba) comes in its way that has many ways of exploiting others, namely the depositors and borrowers. Also, profitability is not seen as the soul target for performing business in Islam. Rather Islamic banking is responsible for social objectives, such as equal distribution of wealth. Social goals are not to be ignored in any part of Islam and this should be the basis of Islamic banking.

As stated above Islam treat Riba as a tool of exploitation so its definition becomes important to design Islamic social system. For example, some time it is argued that current Islamic banking is based on a limited concept of Riba or interest that allows rent on assets providing a basis to Mudarbah contract, the very basis of current Islamic banking. According to these arguments rent tantamount to excess on principal in form of money or other assets. Since in Quranic verses, the excess is not permissible so as per these arguments, rent comes under the definition of interest and thus bringing in to structure of whole Islamic banking under question.

Riba has been discussed at 20 places in Quran. However there is a difference in approach in understanding Riba in its strict sense. These approaches have been elaborated in the Supreme Court of Pakistan (Shariat appellate Jurisdiction) judgment 2000. According to this:

One school of thought says that the verses of Quran which prohibit Riba were revealed in the last days of Holy Prophet(PBU) and he could not have time to interpret them properly, hence no hard and fast definition can be found in Quran and Sunnah. According to this approach the prohibition of Riba should be restricted to the limited transactions expressly mentioned in the Hadith and the principle cannot be extended to the modern banking system which was not imaginable at that time.

Second approach says that Riba only refers to the Usurious (personal) loans on which excessive rate of interest is used to be charged by the creditors which tends towards exploitation. As for modern banking interest, it cannot be termed as Riba if the rate of interest is not excessive or exploitative.

Third approach says that differentiation should be made between consumption loans and commercial loans. Since consumptions loans(mostly consumed by the poor people) tend towards exploitation so they come under the definition of Riba but commercial loans used for commercial or productive purposes do not come under the definition of Riba.

Fourth approach says that Quran has prohibited Riba al jahlia. This was a particular transaction of loan where no additional amount over and above the principal was stipulated in the agreement of the loan. According to this theory if an increased amount is stipulated in the initial agreement of loan it does not constitute Riba-ul-Quran; however it does fall in the definition of Riba al Fadl prohibited by Sunnah.

However, after listening these arguments Shariat Appellate court of Pakistan gave its verdict as "any additional amount over the principal in a contract of loan or debt is the Riba prohibited by the Holy Quran". Further to this following transactions were also termed as Riba as per Sunnah (1) a transaction of money of the same denominations where the quantity of both sides is not equal either in a spot transaction or in a transaction based on deferred payment (2) A barter transaction between two weighable or measurable commodities of the same kind where the quantity on both sides is not equal, or where the delivery from one side is deferred. (3) A barter transaction between two different weighable or measureable commodities where delivery from one side is deferred.

According to verse Al-Baqrah 2:278-79, any excess compensation over and above the principal without due consideration has been termed as Riba. However in the same verse it has been further said "Those who benefit from interest shall be raised like those who have been driven to madness by the touch of the devil: this is because they say; "trade is like interest" while God has permitted trade and forbidden interest". So it is very much clear that if transactions are backed by trading activities than excess earned through this mean is not Riba.

Four imams viz: Imam A'zam Abu-Hanifa, Imam Maalik, Imam Shaafi and Imam Ahmed-bin-Hambal are very close in defining Riba, however they technically vary. The Hanafi says that Riba is the extra or the increment of wealth without any return in the exchange of wealth according to Sharia legal measurement. The Hamblis says that Riba is a contract which is

the extra or the increment of something which is defined according to legal Sharia and legal measurement. The Shaafi and Malaki say that Riba is a contract which is without equal return or something defined according to sharia legal measurement during the contract or with lapse of time in exchange.

As explained above, Riba in Pakistan has been defined strictly as any excess which is predetermined over the principal sum in a loan transaction.

In Iran the Riba is defined as receipt of any extra amount in excess of principal amount of loan if and only if such receipt has been preconditioned. The preconditions are

- Existence of indebtedness i.e. if in any deal the factor of indebtedness is avoided than the receipt of any extra amount will not be considered as Riba.
- Existence of debtor independence from creditor i.e. in Iran it is presumed that if lender and borrowers are not independent and interdependent like son and father or central bank and government than receipt of any extra amount on principal will not bring it under Riba definition. Taking advantage of this, the problem of public debt and statuary reserves have been solved in Iran.
- Existence of a precondition i.e. if a condition for receipt of extra amount is not included in the lending agreement evidently, nothing is payable. However, if in the absence of that condition any amount in excess of principal is paid than it will not be treated as Riba.

In Malaysia they have factored in secondary market trading of debt and debt based securities by making it possible through Bai-ul-Dayn that is not permissible as per most of Sharia Scholars. Even in Malaysia most of the scholars do not agree with this permission though this transaction is supported by underlying asset. The traditional Muslim Jurists are unanimous on the point that Bai-ul-Dayn with discount or premium is not allowed in Sharia, however some Sharia scholars have allowed this kind of sale by referring ruling of Shaafi School but they also consider this fact that the Shaafi School of jurists allowed it in cases where debt is sold at its par value. All this situation transpires that three main groups exist on definition of Riba in Islamic world: Pakistan, GCC, Sudan follow one school of thought; Malaysia another; and finally Iran another based on their Fiqah where only Quranic definition of Riba is considered as important. These are technical deviations but matter a lot in case of their applications.

Now coming back to the argument of treating rent as un-Islamic only by saying that it is not supported by Quran or Hadith even on the basis of depreciation. This does not hold any merit. Islam and teachings of Quran are against exploitations and if this analogy is followed than it would be an exploitative act against lessor in case of renting contract. By definition rent means:-

1. Payment, usually of an amount fixed by contract, made by a tenant at specified intervals in return for the right to occupy or use the property of another.
2. A similar payment made for the use of a facility, equipment, or service provided by another.
3. The return derived from cultivated or improved land after deduction of all production costs.
4. The revenue yielded by a piece of land in excess of that yielded by the poorest or least favorably located land under equal market conditions. Also called economic rent.

Ricardo, the main architect of rent theory on the conventional side says that rent is "the difference between the produce obtained by the employment of two equal quantities of capital and labor." The model for this theory basically said that while only one grade of land is being used for cultivation, rent will not exist, but when multiple grades of land are being utilized, rent will be charged on the higher grades and will increase with the ascension of the grade. As such, Ricardo believed that the process of economic development, which increased land utilization and eventually led to the cultivation of poorer land, benefited first and foremost the landowners because they would receive the rent payments either in money or in product. Thus, in a way Ricardo has supported existence of some element of exploitation in rent process. How that can be checked requires land reforms or some other steps.

Commenting on Ricardo definition, SM Yusuf an Islamic Jurists, have said that in early Islam there was a definite tendency to ordain the future development of agriculture in such a way that there is no charge for the use of what Ricardo in his own definition of rent called original and indestructible power of land.

Parallel to these thoughts Islamic jurists have a consensus on illegitimacy of interest charged on money loans but on owners right to income from his property in form of rent and profit they have difference of opinion. Abu Suleiman (a scholar who wrote theses on the subject in 1960 and 1973) allows profit sharing but the share of the capital is only to compensate him from probable loss. He does not allow net pure profit in this case. Contrary to this, other jurists endorse the unanimous verdict of all the four principal schools of Islamic law that the two parties to the mudarbah contract are free to agree on any formula of sharing the profits provided these shares are fixed percentage wise and not in the form of given amounts. Abu Suleiman view point is also somewhat shaky as he failed to account for that an entrepreneur decision is involved in selecting the right party in the Mudarbah. Further he also did not provide support to his views by any precedents from the Sunnah and did not give any argument against the unanimous verdict of fiqah. Further there is a general consensus among sharia scholars that in Mudrabah, the basis of modern Islamic banking, there is no stipulated ceiling on the percentage share of capital in profit.

However on money rent on cultivable land a distinction has to be made between plain land in its natural form in which the owner has not invested any labor or capital to effect improvement and improved land. There is no dispute that money rent is valid in case of latter in lieu of depreciation. Tahafi, a jurist finds that there are authentic traditions from the Prophet (PBU) both allowing and prohibiting money rent on land. He is of the view that it depends on different conditions.

Basically depreciation is a shelter from tax that one has to pay when he sells it or during the period of his ownership or arises due to its wear and tear. So these obligations are quite measurable. However it is also argued that most of the time property tends towards appreciation on the basis of its demand and supply. In the current complex world, different factors play their role in mark to market valuation of any asset class. Moreover, if one may accept that rent is tantamount to excess on principal and is not permissible than in fact he is denying the valuation concept of any property which has never been desired by the Islamic system of economy.

It is now very much clear that rental contracts are allowed in Islam if designed in line with due consideration i.e. tending towards business, productive activities and increase in wealth with its improvement and does not have any exploitative posture. This should be the basis for Mudarbah contracts making base line for Islamic banking. The dogmatic position that rent should be prohibited as it is like interest is not tenable economically in this world. It would have been better if proponents of this view point have also provided some alternate in case they are refuting something.

However the perception of functioning of Islamic banks like a conventional bank culminates from some other aspects. Like they are managing their liabilities on P/L sharing basis whereas their assets built up are mostly debt based i.e. Murhabah,

Salam or Istisna. Further their P/L arrangements are being done by using benchmarks in the conventional market as they have constraints of competing with their conventional counterparts. These are the issues that should have been looked upon by the governments and regulators.

No doubt on emergence of US recession in 2007 and now in Europe in 2015 due to irresponsible banking practices taking blame for bringing about the global economic crisis, there has been a surge of interest in Islamic finance.

According to current ratings of Moody's, the global Islamic finance sector is worth $1,800 billion and has the potential to be worth $4 trillion.

What's more, the ethical principles underpinning Islamic finance are seen by some as offering a more sustainable alternative to profit-oriented conventional banking. The result is that academic institutions are lining up to offer formal training in the area.

Islamic finance has been growing by 15 to 20 percent per year for some time and there is a lot of interest at the moment. People are looking for alternatives after the economic crisis.

Islamic economists believe that if the principles of Islamic finance were followed the crisis wouldn't have happened. We are seeing a lot of non-Muslim countries, including the UK, France, Japan, Hong Kong and Singapore encouraging Islamic finance. There are many differences between Islamic and conventional banking practices. One fundamental difference is that Islamic banks do not charge interest. Rather than borrowers and lenders, the system is based on buyers and sellers.

"Conventional banking is biased to the seller. Islamic finance is trying to level the ethics between the two parties," AlyKhorshid, an Islamic finance scholar who writes for Islamic Banking and Finance magazine, told CNN.

"People think the Islamic system is based on faith, but it's based on justice. The system is based on justice for the two parties and how you get to the justice is extracted from Islamic faith," he said.

Khorshid says that there are similarities between "ethical investment" schemes and Islamic finance, in that the Islamic system does not allow investment that harms people or the environment. He credits the rapid growth of the Islamic finance sector on the success of "sukuk"-- Islamic bonds.

In the West, banks including Lloyds TSB, HSBC, Deutsche Bank and Citibank all offer Islamic finance products, catering to a niche market of Muslim borrowers.

But while Islamic banks allow Muslims to take advantage of financial services that are consistent with their religious beliefs, it is the ethics underpinning Islamic finance that are attracting the interest of conventional finance institutions keen to learn lessons from the banking crisis.

Although Islamic banks have suffered from the global repercussions of the economic downturn, they emerged largely unscathed from the initial banking meltdown that brought about that financial turmoil. Ahmed an economist have told CNN that it is because Islamic banks are not allowed to deal in mortgage-backed securities or credit-default swaps, two of the practices accused of helping bring about the banking crisis.

Khorshid says that although it's too early to say if Islamic finance has dealt with economic downturn better than conventional finance, the Islamic system has many more layers of risk assessment and management, which could help protect it from the problems afflicting conventional banks.

But the growth of Islamic finance has brought its own problems. Critics say some banks use Islamic finance to package what are essentially conventional products. "Islamic banks are also driven by the profit motive and sometimes that can dominate the ethics," Ahmed told CNN.

While Europe is catching up with the demand for these banking products, the U.S. is lagging behind. Ahmed says that regulatory and legal changes are needed for Islamic finance to grow in the U.S., but he adds there are signs that Canada may become a North American center for Islamic finance.

The lack of Islamic finance services in the U.S. is reflected in a relative lack of demand for Islamic finance courses, but in the UK there is the opposite problem. With students coming from Asia and the Middle East to get the qualifications that will help them take advantage of the Islamic finance boom, Ahmed says it is difficult for universities to find qualified teaching staff. "Most people with PhDs in Islamic finance are working in the industry, making a lot of money," he told CNN.

He added that Islamic finance products have the potential to appeal to the non-Muslims market, pointing out that in Malaysia the majority of customers for Islamic banks aren't Muslims.

"If people look at the principles they'll see something beneficial in terms of economics, rather than just religious reasons. It's a type of ethical finance that may be attractive to a lot of people." He says.

But still one has to go a lot in this area.

The promising point for the Islamic Finance in the world is that here, fund managers have to focus on the company's core business in compliance with Sharia rulings. If the company's business centers on prohibited activities, the company is out.; it doesn't even have the time,than to make the second financial round.

3. Countries Playing Role In Development Of Islamic Finance

The global Islamic finance sector is estimated around $1.8 trillion.

Islamic banking and sukuk sectors dominate the industry, with respective 80% (USD1.5tln) and 15% (USD286.4bln) shares in aggregate assets as at 1H2014. Sukuk issuances rose to USD114.7bln in 11M14 (Jan-Nov 2014), a sizeable 8.6% increase from the USD105.6bln volume recorded during 11M13. Sovereign issuances accounted for almost 80% of total issuances. The record for issuances was in 2012 when $137.1 billion was raised, while issuance dropped to $116.9 billion in 2013 and fell further in 2014.

The 2014 and onward has so far been broadly positive for the industry, and a number of traditional Islamic finance countries have launched initiatives aimed at reviving their Islamic financial sectors including Bahrain and Pakistan. Kenya and Nigeria in Africa and the United Kingdom and Luxembourg in Europe are revitalizing their efforts in developing their financial centers as regional hubs for Islamic finance.

Islamic finance assets in Malaysia rank the highest at USD369bln; Saudi Arabia follows closely with more than USD347bln in Sharia compliant assets. The UAE (USD122bln), Kuwait (USD86bln) and Qatar (USD73bln) also feature in the top five Islamic finance domiciles

By sector, Saudi Arabia is the largest domicile for Islamic banking, Islamic funds and Takaful, while Malaysia is the largest for sukuk outstanding. Indonesia features in the list for sukuk instead of Kuwait. Meanwhile, Jersey and Luxembourg are listed in the top five Islamic fund domiciles by assets under management.

The largest Islamic banking markets are in the Middle East and North Africa (MENA) region spearheaded by Iran: as at

end- 2013, MENA (excluding the Gulf Cooperation Council [GCC]) accounted for 45% of total Islamic banking assets world-wide The GCC on its own had a 37% share in the aggregate. Asian jurisdictions cumulatively made up the third largest domicile area for Sharia compliant banking assets with a 13% share.

The top ten countries in terms of Islamic banking assets - namely, Saudi Arabia, Malaysia, the United Arab Emirates, Kuwait, Qatar, Turkey, Bahrain, Indonesia, Bangladesh, and Pakistan - hold 89% of the global total Islamic banking assets (excluding Iran).

Islamic banking is set to gradually take the lead as the main banking sector in top Islamic finance jurisdictions such as Saudi Arabia (where it represents 52% of the domestic system's banking assets), Malaysia (26%) and Kuwait (45%).

The global Islamic finance industry could grow from its present $1.8 trillion to around $4 trillion within five years as untapped markets such as China open up and new products drive demand. Standard Chartered says in its Islamic finance industry outlook in June 2014 that banking assets of the Sharia-complaint segment, currently are growing twice as fast as conventional banking assets.(Noor Islamic Bank chief executive Hussain Al Qemzi). So everybody believe on growth but the expectation on growth is different.

International Turnkey Solutions have created comprehensive and scalable technology solutions to help banks stay sharia-compliant.

The modern Islamic finance sector has only quite recently come into being, and although its roots can be traced as far back as the Ottoman Empire, its ranking alongside the financial giants of the Western world is something it is only now beginning to expand.

Muslim Countries are thought to be the core area in this regard but non-Muslim countries notably UK, Singapore and Hong Kong are also playing pivotal role in this regard. The reason being is to attract petro dollar investment or to structure their infrastructure financing techniques on Islamicfinancing lines. China can emerge as the main player in this regard in the coming years.

The GCC is at the heart of the Islamic world, with the two holiest shrines under the guardianship of Saudi Arabia, a kingdom that prides itself on being governed under sharia law. It would therefore be expected that the GCC states would be at the Centre of the rapidly expanding Islamic finance industry, which encompasses retail and investment banking, insurance, fund management and the issuance and trading of sharia compliant securities known as sukuk.

Yet it is countries elsewhere, notably Malaysia and the United Kingdom, that have played a leading role in Islamic finance, with Kuala Lumpur the most active Centre for Islamic securities trading and London the Centre for Islamic investment banking and cross border treasury management. However it needs to be seen that why the GCC states have failed so far to provide leadership in Islamic finance and what can be done to rectify this situation.

Five out of the six GCC states host Islamic financial institutions, Oman, for political reasons, refused to award any Islamic banking licenses initially. However nowas the first Islamic finance institution in the country, Bank Nizwa is leading the way in opening up the promising Omani market for customers and investors alike.Islamic banking is in its infancy in Oman. The Islamic finance industry took off in the country with the opening of the first three branches of Bank Nizwa in January 2013.

The Islamic Republic of Iran passed legislation in 1983 abolishing interest based transactions and making it mandatory for all internal financial dealings to be sharia compliant, but similar legislation has not been adopted in any of the GCC states.

UAE Islamic banking assets would grow to 20 per cent of the total banking sector in 2012 -15 from an estimated 18 per cent in 2011.

Kuwait adopted legislation in 1976 to allow the establishment of Kuwait Finance House, for many years its only Islamic bank, but this legislation was superseded in 2004 by an amendment to the Central Bank Law 32 of 1968 allowing Islamic financial institutions to function alongside conventional banks, but with no special privileges for the former. The law does however provide a framework for Islamic financial governance, especially articles 86, 87, 93 and 96, including a stipulation that each institution should have a sharia board with at least three members.

There is no similar legislative provision in any other GCC state, where Islamic finance is dealt with at the regulatory level only, with Bahrain having the most detailed rule book. The extent to which statutory and regulatory provision is an obstacle to Islamic finance development in the GCC needs to be investigated.

Standards for sharia compliance are problematic in the GCC where each institution has its own sharia board but apart from in Bahrain, there are no national boards. Consequently there are conflicting fatwas reflecting different interpretations of sharia. In contrast in Malaysia and Pakistan both the Central Bank and the Securities Commission have sharia boards who alone have the power to issue fatwas. Banks in Malaysia and Pakistan have their own sharia boards, but there role is to ensure the agreed fatwas are implemented rather than making independent pronouncements. Furthermore all those appointed to the sharia boards of the banks have to apply to the Central Bank and obtain accreditation. There is no comparable system in the GCC, where the lack of standardization has caused confusion and uncertainty and hindered Islamic financial development.

Bahrain has functioned as a regional financial Centre since 1976, keeping its market open to foreign banks, while Saudi Arabia and Kuwait only licensed majority locally owned institutions. Bahrain has more than thirty Islamic financial institutions, including banks and takaful insurance companies, most of which serve the regional rather than the local market. It is very dependent on Saudi business however, and as the latter opens up its financial sector, there are competitive challenges to Bahrain, including in Islamic banking.

Qatar has also a financial Centre, with a detailed rulebook covering Islamic finance, including criteria for sharia supervision. A higher proportion of bank deposits are sharia compliant in Qatar than in any other GCC state.

The Dubai Financial Centre has the highest international profile in the region, but Islamic finance is somewhat marginal to its interests.

Competition can of course be helpful to financial development, but the emergence of rival centers in the Gulf have fragmented the Islamic finance industry and resulted in many very small institutions being licensed which cannot benefit from economies of scale or scope.

None of the Islamic banks in the Gulf is in the top 100 world banks in terms of assets, and as a consequence it is the major international banks such as HSBC, Deutsche Bank and Citibank that have moved into Islamic finance to fill the void, especially in investment banking, where capacity and capability are of critical importance. Although HSBC has based much of its Islamic banking operations in Dubai, the other investment banks conduct their Islamic finance business from London, where it is easier to recruit skilled professionals, rather than the GCC.

The popular preference for Islamic banking in the GCC indicates that it is more of a bottom-up than a top-down movement. Al Rajhi Bank in Saudi Arabia has more branches than any other bank in the kingdom, and despite the reluctance to grant it

a license in the 1980s, it has become the largest stock market listed Islamic bank in the world. Like the Dubai Islamic Bank, the oldest Islamic commercial bank, which dates from 1975, Al Rajhi has successfully developed a range of deposit and financing products that has attracted millions of clients. The aim of these institutions is to provide as wide a range of facilities as conventional banks, but through sharia compliant products.

Critics of these institutions argue they are simply imitating conventional banks, and focusing on more affluent clients rather than playing a social role and assisting the poor. They are also accused of encouraging consumer indebtedness through their highly popular vehicle and home finance, but most GCC citizens take cars for granted and want to own the homes they live in, and indeed acquire additional property to rent to expatriates to enhance their current income. The poorest in the GCC are mostly migrant laborers rather than local citizens, and laborers only use banks for remittances.

A major limitation of the GCC market is its small population size, even though admittedly the region has more than its share of high net worth bank clients. As GCC markets have become saturated with Islamic banks, the leading institutions have expanded by establishing networks abroad. The Kuwait Finance House opened a branch network in Turkey in the 1990s and has subsequently opened a Malaysian subsidiary, while Al Rajhi Bank has twenty five branches already established in Malaysia. Dubai Islamic Bank has a presence in Pakistan and has bought a Sudanese Islamic bank. Abu Dhabi Commercial Bank has bought a significant stake in RHB Bank of Malaysia in order to strengthen its Islamic banking presence in South East Asia.

Investors concerned with sharia compliance in the GCC are increasingly looking to Asian markets, with particular interest in real estate and equity funds. Singapore and even China are increasingly willing to accommodate sharia compliant finance from the GCC, and India has a sharia compliant infrastructure fund.

The GCC's top utilities providersare one of the Gulf's biggest ever infrastructural improvers. They in fact made a surge in demand for Islamic securities. Saudi Electricity Company has also come up as one of the main stakeholder in this regard.

World Bank report says, investment in innovation and education will transform Middle Eastern and African economies to provide greater financial growth. Across the Arab world there is no coherent strategy for developing economies, with some countries relying on natural resources, while others are trying to create tourism or financial services driven markets.

Many emerging industry players are now enticed to reap comprehensive rewards from sharia compliant companies - a relatively new sector in Europe compared to conventional banking. The concept of sharia compliant investment - having spanned the better part of 40 years - has always proven an attractive proposition to financial institutions and asset management firms alike.

For example founded in 1926, the Saudi Hollandi Bank was the first operating bank in Saudi Arabia. Since its inception the bank has adhered to an organized and direct approach, providing solid banking solutions nationally. Originally it was known as 'The Netherlands Trading Society', and operated out of one office in Jeddah. Its main business at the time was providing financial services to Haj pilgrims from Indonesia. As it was the only bank in the Kingdom at the time, but now it has turned in to a big organization.

Many are comparing the recent Arab Spring to the fall of the Berlin Wall, when Eastern Europe joined the rest of the world. Just as the collapse of communism recast Eastern Europe, both in political and business terms, so now the Arab Spring canalso serve as a wall to boost economies in this part of the world.

Sharia-compliant banks are providing investment opportunities to a market in much need of innovative and ethical modes of transaction.

In this regard, example is emergence of Aljazira Capital that is a Saudi Closed Joint Stock company operating under the regulatory supervision of the Capital Market Authority, specializing in the securities business and providing the services of dealing, underwriting, managing, arranging, advisory services on Islamic Finance.As another example,National Commercial Bank is Saudi Arabia's oldest bank, and one of the strongest proponents of Sharia-compliant finance in the region.

One should remember that global banking policy is not traditionally something closely linked with cultural attitudes; it has been allowed to roam free in the pursuit of growth and profit. Islamic banks, on the other hand, consider their cultural makeupaligned with performance of banking industry.

This internationalization of GCC Islamic finance is now a two way process. GCC based institutions are influencing public perceptions in ASEAN and elsewhere, they are also influencing their Malaysian and Indonesian counter-parties, not least by Malaysia, where there are a number of high profile female sharia scholars, in contrast to the GCC where it is an exclusively male preserve.

So it is clearly a tough challenge for the GCC to regain the initiative in Islamic finance that many are expecting. Greater financial integration would certainly help, as would cross border mergers of Islamic financial institutions, although these have not been successful in the past. Establishment of consistent sharia standards would also be helpful, although even this seems problematic given the differences of opinion amongst the sharia scholars in the GCC and the lack of any central authority.

Islamic finance activity is currently still very much concentrated in Southeast Asia and the Arab Gulf, so adding North Africa could broaden its geographical reach. North Africa's contribution to global Islamic banking assets currently stands at a meager 1% (Standards and Poor's).

In north Africa, Tunisia and Egypt implemented new laws allowing for the issuance of Islamic bonds in late 2013, while Morocco in 2015 put in place a legal framework for Islamic institutions (Standard & Poor's).

The ratings agencies and Islamic finance bankers cite two major factors, why North-African countries have been actively developing Islamic finance. The Arab Spring upheaval resulted into the ascendancy of more conservative leaders who are keen on establishing their Islamic credentials by developing sharia-type financing while they also increasingly rely on Gulf Arab countries for financial help where Islamic finance is at a much more advanced stage.

In addition, the twin burden of political instability in the past few years and a shaky global economic environment exacerbated the governments' financial headaches so that they have to search for other funding means.

Establishing a more sharia-friendly environment in new countries could spark interest in issuing Islamic bonds there, bankers say. For example, Tunisia is considering issuing a $500 million sukuk in 2015 (S&P and Reuters).

A survey by Reuters estimates Islamic banking will constitute 40 percent of Tunisia's financial sector by 2018 in light of new reforms.Tunisia's burgeoning sharia-compliant finance industry is forecast to make up nearly 40 percent of its financial sector by 2018 - provided regulatory upheavals, consumer education and private investment plans materialize as anticipated."Developing and issuing such [legal] frameworks will definitely be seen positively by the market and we expect to see issuances and an increase in investor participation in the years to come," (Salah Jaidah, head of Islamic finance at Deutsche Bank).

Islamic finance could especially come in handy to serve the countries' infrastructure and project finance needs in the coming years as the capacity of conventional financiers appears limited.

"Several projects in renewable energy, transport infrastructure, and communication are ongoing or expected to be launched in the future in North African countries. Using sukuk to finance some of these projects could help diversify investors' base and tap an additional pool of resources," (S&P).

Still, investors may need to adopt a long-term view as progress is likely to take time in North Africa, where people will need to be convinced of the possible advantages sharia finance can deliver.

"We expect the process to be very gradual, however, because local banks and corporates are slowly familiarizing themselves with Islamic finance and the Sukuk markets as a credible financing alternative," (S&P).

Now coming to Central Africa, Nigeria has a Muslim population of close to 80 million, but the Islamic finance industry is extremely under developed. Over the past few months in 2014, however, Nigerian authorities have started studying and announcing new regulations that will allow the Islamic finance to grow and develop in the country. Nigeria's banking sector has been the fasted growing in Africa, both in consumer and corporate sectors; it is also home to the largest Muslim population in Sub-Saharan Africa.

Over the past few months Nigerian authorities have announced a number of regulatory initiatives that will prepare the landscape for the development of a strong Islamic finance hub. Though there are only two institutions that currently provide Islamic finance services in Nigeria and only a limited number of products are available.

"The potential is there but the market is negligible in Nigeria because we have only one Islamic bank and one window - but it has potential to grow," (Bashir Aliyu Umar special adviser on non-interest banking to the Nigerian Central Bank Governor). At the moment only Stanbic IBTC, a subsidiary to South Africa's Standard Bank, and Jaiz Bank, a local Islamic finance founded in 2012 operate in the market in Nigeria.

Since its inception in 2012, Jaiz Bank has already increased its branches from three to ten, and has announced plan to open 100 branches before 2017. However, the market is lagging behind in competition. Sterling Bank, another local institution, has recently been granted approval in principal to launch an Islamic finance arm, and a further two institutions have expressed interest in the market, according to the central bank. However, for the time being Jaiz and Stanic are the only Islamic finance providers.

Kazakhstan another Muslim Country in the Central Asia have started serving as the gateway to Islamic securities in the CIS region with underlining the strong regulatory measures being adopted by the Government to promote Islamic finance.

Turkey has recently enlisted itself as one of the country that is aiming to lead the market. Just recently, the World Bank launched its first representation office on Islamic finance which is the Global Islamic Finance Development Center, in Istanbul. With the support of the government to develop Islamic finance in Turkey, Turkish and foreign investors are becoming more and more aware of Islamic financing methods and products in Turkey; but still there are some of the legal and practical issues that investors have to face and the level in terms of legislative progress?

One of the glaring example of Islamic Finance is of Malaysia. Malaysia's Islamic finance industry has been in existence for over 30 years. The enactment of the Islamic Banking Act 1983 enabled the country's first Islamic Bank to be established and thereafter, with the liberalizationof the Islamic financial system, more Islamic financial institutions have been established.

Malaysia's long track record of building a successful domestic Islamic financial industry of over 30 years gives the country a solid foundation - financial bedrock of stability that adds to the richness, diversity and maturity of the financial system. Presently, Malaysia's Islamic banking assets reached USD65.6 billion with an average growth rate of 18-20% annually.

Today, Malaysia's Islamic finance continues to grow rapidly, supported by a conducive environment that is renowned for continuous product innovation, a diversity of financial institutions from across the world, a broad range of innovative Islamic investment instruments, a comprehensive financial infrastructure and adopting global regulatory and legal best practices. Malaysia has also placed a strong emphasis on human capital development alongside the development of the Islamic financial industry to ensure the availability of Islamic finance talent. All of these value propositions have transformed Malaysia into one of the most developed Islamic banking markets in the world. Rapid liberalization in the Islamic finance industry, coupled with facilitative business environment has encouraged foreign financial institutions to make Malaysia their destination of choice to conduct Islamic banking business. This has created a diverse and growing community of local and international financial institutions.

Currently, Malaysia has a significant number of full-fledged Islamic banks including several foreign owned entities; conventional institutions who have established Islamic subsidiaries and also entities who are conducting foreign currency business. All financial institutions are given permission to conduct both ringgit and non-ringgit businesses.

Malaysia continues to progress and to build on the industry by inviting foreign financial institutions to establish international Islamic banking business in Malaysia to conduct foreign currency business.

The steps for Islamization of banking and financial system of Pakistan were initiated in 1977. Pakistan was among the first three countries of the world that had been trying to implement interest-free banking at national level. In early 1980s numerous measures were taken to introduce interest-free banking in Pakistan. Banking and other relevant laws viz. SBP Act 1956, BCO 1962, Companies Ordinance 1984, Recovery Laws, Negotiable Instruments Act 1881, etc. were amended to facilitate interest free banking system in Pakistan whereas the industry was given a specific timeline to convert to the Islamic banking system. However, these efforts could not produce desired results due to absence of sharia compliance mechanism in place, lacking proper homework at the level of central bank as well as that of the financial institutions to enable such a sudden shift.

Considering the lessons learnt from the earlier efforts, Islamic Banking in Pakistan was re-launched in 2001 when the Government decided to promote Islamic Banking in a gradual manner and as a parallel and compatible system in line with the best international practices. Accordingly, Islamic Banking Department was established at SBP on 15th September 2003 with the mandate of developing and strengthening regulatory and Sharia compliance framework for Islamic banking industry and taking initiatives for the promotion of Islamic Banking as a parallel and compatible banking system in line with the best international practices.

Since its re-launch in 2001, the progress of Islamic Banking industry in Pakistan has been tremendous yielding the growth of more than 30% on yearly basis in terms of assets. Currently there are six licensed full-fledged Islamic banks and fifteen conventional banks with standalone Islamic Banking Branches operating in the country. Various steps are under consideration to make Islamic banking industry in Pakistan a viable alternative to conventional banking.

The Indonesian Islamic banking industry have grown promisingly after the establishment ofthe first Islamic bank namely Bank Muamalat Indonesia (BMI), in 1992. There are now eleven Islamic Commercial Banks (BUS) followed by twenty threeIslamic Banking Windows/Unit (UUS) and one hundred fifty one Islamic Rural Banks (BPRS)integrating 1796 offices

around the country). In the last five years, the industrygrew 46% per year which is well above the world growth of Islamic banking industry of 10%-20% per year (Eedle, 2009). The last growth of the Islamic banking industry recorded 47%.

In addition, Indonesia does not apply the controversial Sharia contracts such as Bay alInnah, Bay al Wafa, Tawarruq, Bay al Dayn, which dominate the Islamic banking contracts inMalaysia and Middle Eastern countries. It means that by applying only classical contracts (non-controversial contracts) the results are coming in.

After two decades of its operations, Islamic banking still stands on a single digit marketshare. Some underlying reasons explain this problem such as: (i) the limited involvement of thegovernment funds in the Islamic banking industry, (ii) the non-comprehensive understanding of

depositors, business partners and public with respect to the operations of Islamic banking and theSharia principles (Bank Indonesia, 2000-2005) and, (iii) the limited number of Islamic banks andwindows compared with the conventional ones and (iv) non-controversial contracts likeBay alInnah, Bay al Wafa, Tawarruq, Bay al Dayn,). In spite of this the Indonesian Islamic banking industry have still performed well despitehaving small market share.

The main element of advancement and expansion of this industryin Indonesia depends on the performance of the Islamic banks and economic conditions andnot on the application of controversial contracts.

In fact, the direction of development of the Indonesian Islamic banking industry is notreally similar with its neighboring countries. While Malaysia adopts top down approach in developing theIslamic banking industry, Indonesia occupies a bottom up approach. The banking funds in theIndonesian Islamic banking industry mostly come from the public funds while the governmentfunds are very limited. If the government can commit to realize all or some of the its funds, itcould boost the Indonesian Islamic banking industry even faster and bigger than the ones in existence.

Another flashing area in the region isBrunei Darussalam. The first bank in Brunei Darussalam, prior to British colonialism, was established in 1935and was called the Post Office Savings Bank. Japanese occupation destroyedmost of the records of the bank. The first bank during British rule was theHong Kong & Shanghai Bank (established in the mid-1940s and currently called Hong Kong Bank) followed by the Standard Chartered Bank. These banks were supported by the British administrators and followed conventional banking practices under British Law. Subsequent banks in Brunei include Malayan Banking (1960) followed by the United Malayan Banking Corporation (1963), the National Bank of Brunei (1964), Citibank (1971), the Island Development Bank (1980), Baiduri Bank (1992), TabungAmanah Islam Brunei (1992) and the latest, the Development Bank of Brunei (1995). In the mid-1980s, the National Bank of Brunei folded and the Island Development Bank (IDB) became the only local bank in Brunei. IDB was subsequently renamed the International Bank of Brunei and largely enjoyed the support of the BruneiGovernment. In 1993, the International Bank of Brunei was renamed as the Islamic Bank of Brunei to administer the financial affairs of the community according to the ideals of Islam.

Banks in Brunei are regulated under the Banking Act and Finance Companies Act through the Ministry of Finance. There is no Central Bank in Brunei but the functions of monitoring are under the jurisdiction of the Ministry of Finance through the Brunei Currency Board, the Department of Financial Services and the Brunei Investment Agency. The Brunei Currency Board is in charge of controlling the money in circulation and maintaining currency interchangeability (fixed at par) with Singapore.

Of the total banks in Brunei Darussalam, the Islamic Bank of Brunei (IBB) and TabungAmanah Islam Brunei (TAIB) are the only banks that offer Islamic banking services. The others offer financial services based on conventional banking practices. It is only in the early 1990s that Islamic banking facilities were available. The first Islamic bank came into being with the inauguration of TAIB in 1992, since it was regarded as a FarduKifayah (religious obligation) on the Muslim community. TAIB's initial formation was as a trust fund whose prime function was to provide facilities for Muslims to make the pilgrimage to Mecca. The second Islamic Bank, IBB, was established in 1993 to provide Muslims with Islamic banking facilities mainly in trade and commercial finance. Between 1992 and 1997, IBB's customer deposit base has grown tremendously from about BND386 million to about BND782 million. The core clientele base of IBB comprises the affluent and the middle class segment of the population. TAIB is similar to a savings and loan institution and is owned by the government. Its main objectives are to operate/promote Islamic financial services and to raise the socio-economic standards of the population. Between 1992 and 1996, the customer deposit base of TAIB rapidly grew two and a half times from BND118 million to about BND295 million. TAIB mainly focuses on the underprivileged segment of the population.

As the prevailing banking act does not require foreign controlled banks to publish local financial results for the public, very little information is available about the performance of such banks. However the total Islamic banking deposits aggregated to about 11.5 per cent of the market share. Ithas been stagnant between these years.

Worldwide Islamic banking has experienced growth rate of 10-15 percent per annum globally over the last few decades and now above 20% pa has been getting popularity in conventional banking system at such a rapid pace that Islamic financial institutions represent today in over 51 countries. Despite this consistent growth, many supervisory authorities and finance practitioners remain unfamiliar with the process by which Islamic banks are introduced into a conventional system.

Although the growth rate of Islamic banking is very high but the main issue is of its understanding because many of Muslims still have not enough information about the fundamentals of these institutions.

In UK the main center of Islamic Finance outside Muslim Countries,all major banks have opened Islamic banking windows, e.g.; Saudi American bank and Saudi British bank as well as international players in financial sector such as HSBC and Citibankhave launched Islamic banking units. Lloyd TSB extended Islamic banking services to fulfill the requirements of increasing number of customers in UK. Islamic current account and home finance products which are fully designed according to Islamic Sharia law are available in different branches of banks throughout the country. On current account the banks do not pay interest to customer who is in credit and these customers have no any facilities of overdraft on this account. For home finance the bank uses diminishingMusharaka and Ijarah scheme to complete property purchase agreement.

London is a big financial market in the world and its regulatory environment is well established and respected all over the world. In London there is high rate of skilled people in financial sector especially in conventional banking side. Islamic banking is getting advantages of these skills through hiring these staff member from conventional banking to Islamic banking (Teran, 2007).

Due to world financial crisis there is a big opportunity to develop Islamic banking on modern basis because in modern world financial distortion is created by interest based system. Nowadays many Muslim and other qualified and skilled worker are interested in the field of Islamic banking in UK. It would help to develop and boost Islamic financial system in this shacked economy.

According to (Percy, chief executive of the bank of London and Middle East (BLME)), Islamicfinance in the United Kingdom has passed the primary development phase and has entered in stage of its growth. There are 21 conventional insti-

tutes in the UK which provide Islamic financial services according to Sharia law to 1.8 million Muslim people.

A London-based Islamic financial advisory company, Edbiz Consulting, has formulated the Islamic Finance Country Index (IFCI), which ranks about 50 countries of the world in terms of their role in developing, promoting and advocating Islamic banking and finance. Pakistan comes after eight countries, namely Iran, Malaysia, Saudi Arabia, Bahrain, Kuwait, United Arab Emirates (UAE), Indonesia and Sudan.

Among these HSBC has a great contribution in Islamic banking sector its goal is to provide Islamic financial services throughout the world where the Muslim community is living in Islamic aswell as non-Islamic countries. According to manager of HSBC Amanah(Amjid Ali) HSBC has a plan about Future developments in Islamic section such as Sharia insurance, pensions and savings accounts.

HSBC provides services of Islamic mortgages and current accounts as well as they have great participation such as HSBC Amanah which consists of following feature:

- Investment account through Murabaha contract
- Amanah cards which are based on fixed services fee
- Home finance and vehicle finance through Ijarah concept
- Personal loan based on the theory of Tawrraq

It is concluded from the above that in the UK Islamic banking reached as a prominent financial player in the market. It is really good condition and improvement in Islamic finance in just four years. If the organizers of Islamic finance work hard in all sector such as relation to FSA and regulations authorities, products development, market development, awareness program, institutional and legal framework areas then Islamic finance will hold a respectable position in financial sector of the UK.

Finally Islamic Banking and Finance, though in development is sketchy at the moment. ISDB and other world bodies can play their role to bring clarity by picking best examples from the activities going over in various countries.

Chart 2 Major Islamic Countries showing Islamic Finance in their respective country

Country	Islamic financial assets (US $ billion)	Last five years growth rate in %	Market share in %
Qatar	54	31	24
Indonesia	20	42	4.6
Saudi Arabia	245	11	53
Malaysia	125	20	20
UAE	83	14	17
Turkey	39	29	5.6
Pakistan	12.59	21.40	10.4
Egypt	16.38	10	7
Source Central Banks of respective countries			

Chart 3 Best Islamic Banks					
Country	**Banks**	**Branches**	**Assets US $ billion**	**CAR in %**	**Profit $ in million**
Brunei	Bank Islam Brunei Darussalam	14	4.8	26	87
Indonesia	Bank SyariahMandiri	712	4.04		56.76
Malaysia	CIMB	800 in 16 countries	90.52	14.10	995.6
Pakistan	Meezan Bank	551	5.06	10.20	47.80
Saudi Arabia	Al Rajhi	500	82.056	13.808	1822
Bahrain	Al Barkah	400 branches in 15 countries	23.3	16	275
Kuwait	Kuwait Finance House	355 worldwide	56.93	14	139.02
Qatar	Qatar Islamic Bank	15	10.16	16.5	58.24
UAE	Abu Dhabi Islamic Bank	55 local branches	23.41	21.4	124.26
Source Financial statements of respective banks as of Dec 2014					

Some indicators of Islamic Banking in some Muslim Countries in 2015 as compared to 2013									
	Saudi Arabia	Iran	Pakistan	UAE	Malaysia	Indonesia	Bangladesh	Sudan	Kuwait
Capital Adequacy Ratio 2013	20.3%	8.9%	13.4%	17.6%	14.3%	14.4%	12.1%	16.6%	19.2%
2015	19.7%	7.4%	16.9%	15.8%	15%	15.1%	11.4%	18.2%	16.4%
ROA 2013	2.0%	0.6%	0.8%	1.1%	1.2%	1.6%	1.7%	3.7%	1.0%
2015	1.9%	0.7%	0.8%	1.6%	1.0%	0.5%	1.5%	3.0%	0.9%
ROE 2013	13.5%	8.1%	10.7%	9.1%	1.2%	20.0%	22.8%	29.6%	8.0%
2015	13.0%	10.0%	12.4%	14.4%	1.0%	5.7%	22.7%	29.3%	7.6%
Net Profit Margin 2013	42.1%	5.2%	18.15%	35.3%	38.4%	12.2%	33.3%	52.6%	N.A
2015	49.3%	15,2%	16.7%	35%	38.1%	2.4%	30.9%	48.7%	N.A
Growth Financing to Private sector 2013	10.7%	23.6%	24.3%	-9.6%	20.7%	22.1%	11.2%	35.1%	N.A
2015	6.8%	16.0%	59.1%	19.5%	19.9%	2.3%	15.2%	9.8%	N.A
Islamic Banks Nos 2013	4	31	5	8	16	11	8	37	6
2015	4	34	6	8	16	12	8	37	6
Branches 2013	698	21299	862	290	2177	407	823	685	N.A
2015	765	21453	2146	306	2192	448	962	776	N.A
Financing Diminishing Musahrkah	0*	60% of total financing	Rs in million 71,912	0*	0 **	0**	0*	0*	0*
2015	0	63% of total financing	Rs in million 115,281	0	0	0	0	0	0.8% million in local curency
QardeHasnaRs	0	7% of total financing	Rs in million 25.9	0	0	953 million in local currency	78759 million in local currency		
2015	0	8% of total financing	Rs in million 35.5%	0	0	263 million in local currency	120547 million in local currency		

*Murhabah/commodity Murhabah/Ijarah are mostly used
**Ijarah and Musharkah are mostly used

4. Macro And Micro Format Of Islamic Finance

Chart 4	
% of population below poverty line (countries) i.e. earning $ 1.25 per day with six member family	
Ten major Muslim countries	**% of population below poverty line i.e. earning $ 1.25 per day with six member family (Source- World Bank & World Charitable giving organization)**
Pakistan	**32**
Iran	**40**
Turkey	**20**
Malaysia	**8**
Saudi Arabia	**12.7**
Indonesia	**15.2**
Egypt	**16.7**
Nigeria	**60**
Bangladesh	**45**
Kazakhstan	**19**
Six Countries at the top of poverty level	
Moldova (Non-Muslim Country)	**80**
Gaza Strip (Muslim Country)	**81**
Chad (Muslim Country)	**80**
Angola(Non-Muslim Country)	**70**
Guatemala(Non-Muslim Country)	**75**
Liberia(Non-Muslim Country)	**80**

On a macro-economic level, the Islamic model aims at social justice and the economic prosperity of the whole community; for example, specific Sharia rulings seek to reduce concentration of wealth in a few hands, which may be detrimental to society.

On macro perspective, it can be seen from the impact to the overall performance of economy, as being pointed out by Shidiqi (2006) that debt-based financing under conventional system is really terrible since it would prompt speculation which would leads into the instability to the overall economy. Instability itself harms to the real sector in the economy such as unemployment, poverty, inflation although there is no contribution from financial sector into real sector at the first phase. It is interesting to note that under conventional system there is separation between real sector and financial sector in the economy in which the debt-based financing is merely backed by financial assets and the flow of money just runs within the financial sector. Buttragically, adverse effects of financial sector are felt by real sector in the economy. Actually, it can be referred to the current financial crisis in which just because of the greediness as well as misconduct of Wall Street peoples, all peoples in the U.S economy are affected badly such as high unemployment, housing foreclosure, etc. Thus, it is clearly injustice for those peoples who do not have access of financing in the financial sector feel the bad impact from the people who have access of financing in the financial sector.

However, under the Islamic financial system desired by Islamic economists and shariascholars, through the equity financing or profit-loss sharing agreement, there will be clearly no distinction at all between the financial sector and real sector in the economy since whatever the financial sector does will contribute to real sector since the equity financing is backed by real assets rather than financial asset prevalence in the financial sector. Due to that reason, it will stimulate the employment in the economy which would lead to eradication poverty as well as hinder speculation in the economy which is bad evil in the conventional system. Hence, the Islamic financial system which is based on equity financing promotes the expansion of the economyand also stability in the economy. Besides, it creates socio-economic justice among the peoples

Four examples are often quoted in growth of Islamic Banking viz: Sudan, Iran, Malaysia and Pakistan. All are trying to have complete Islamic Banking but they are still standing at the brink of parallel Banking. So in all these countries and others a transitional phase exist with more to come. But primary question remains that how far introduction of Islamic Banking in these countries have succeeded in getting success in macro indicators effecting the lives of their people. In Sudan inflation has remained at 32.1% with unemployment at 10%, GDP growth rate at 3.2% Public Debt above 100% of GDP. In Iran inflation has remained at 18.2% with unemployment at 10.4%, GDP growth rate at -2.2 %, Public Debt above 18.7 % of GDP. In Malaysia inflation has remained at 3.1 % with unemployment at 3.1 %, GDP growth rate at 6.4 % Public Debt at 53 % of GDP. In Pakistan inflation has remained at 5.2 % with unemployment at 6.4 %, GDP growth rate at 4.2 %, Public Debt above 67 % of GDP (the weakest point in case of Pakistan is that its 30% of population lives below poverty line i.e. Rs 200 per day.

Unofficially this figure is above 60% since 50% of Pakistan economy is undocumented). Except Malaysia we see that Islamic Banking has played almost no role in correcting macro indicators.

After independence Sudan, established the Sudan Currency Board to replace Egyptian and British money. It was not a central bank because it did not accept deposits, lend money, or provide commercial banks with cash and liquidity. In 1959 the Bank of Sudan was established to succeed the Sudan Currency Board and to take over the Sudanese assets of the National Bank of Egypt. In February 1960, the Bank of Sudan began acting as the central bank of Sudan, issuing currency, assisting the development of banks, providing loans, maintaining financial equilibrium, and advising the government. Since the Nimeiri government decreed the 1970 Nationalization of Banks Act, all domestic banks have been controlled by the Bank of Sudan.

The Faisal Islamic Bank, whose principal patron was the Saudi prince, Muhammad ibn Faisal Al Saud, was officially established in Sudan in 1977 by the Faisal Islamic Bank Act. The "open door" policy enabled Saudi Arabia, which had a huge surplus after the 1973 Organization of Petroleum Exporting Countries (OPEC) increases in the price of petroleum, to invest in Sudan. Members of the Muslim Brotherhood and its political arm, the National Islamic Front, played a prominent role on the board of directors of the Faisal Islamic Bank, thus strengthening the bank's position in Sudan. Other Islamic banks followed. As a consequence, both the Ansar and Khatmiyyah religious groups and their political parties, the Umma and the Democratic Unionist Party, formed their own Islamic banks.

The Faisal Islamic Bank enjoyed privileges denied to other commercial banks (full tax exemption on assets, profits, wages, and pensions), as well as guarantees against confiscation or nationalization.

The appeal of the Islamic banks, as well as government support and patronage, enabled these institutions to acquire an estimated 20 percent of Sudanese deposits. Politically, the popularity and wealth of Islamic banks have provided a financial basis for funding and promoting Islamic policies in government. In 1999, Sudan began exporting crude oil and in the last quarter of 1999, recorded its first trade surplus but now after separation of South Sudan as an independent country it is again standing with nowhere to go.

This is reflected in the Corruptions Perception Index that indicates Sudan as one of the most corrupt nations in the world. Sudan still has one of the lowest human development in the world. Almost one-fifth of Sudan's population lives below the international poverty line which means living on less than US$1.25 per day.

Iran's economy is a mixture of central planning, state ownership of oil and other large enterprises, village agriculture, and small-scale private trading and service ventures. Iran is ranked as an upper-middle income economy by the World Bank. The government doesn't recognize trade unions other than the Islamic Labor Councils, which are subject to the approval of employers and the security services. The minimum wage is 487 million rials a month ($134). Unemployment has remained above 10% since 1997, and the unemployment rate for women is almost double that of the men.

Economic sanctions against Iran, such as the embargo against Iranian crude oil, have affected the economy. Sanctions have led to a steep fall in the value of the rial, and one US dollar is worth 27,347 Rial in 2015 compared with 16,000 in early 2012.

Malaysia is a relatively open state-oriented and newly industrializedmarket economy. The State plays a significant but declining role in guiding economic activity through macroeconomic plans. Malaysia has had one of the best economic records in Asia, with GDP growing an average 6.5 per cent annually from 1957 to 2005. In 2014, the GDP (PPP) was about $746.821 billion, the third largest economy in ASEAN and the 28th largest in the world. In 1991, former Prime Minister of Malaysia, Mahathir bin Mohammad outlined his ideal in Vision 2020, in which Malaysia would become a self-sufficient industrialized nation by 2020. In the 1970s, the predominantly mining and agricultural-based economy began a transition towards a more multi-sector economy. Since the 1980s, the industrial sector, with a high level of investment, has led the country's growth. The economy recovered from the 1997 Asian financial crisis earlier than neighboring countries did, and has since recovered to the levels of the pre-crisis era with a GDP per capita of $14,800. Economic inequalities exist between different ethnic groups. The Chinese make up about one-third of the population, but accounts for 70 per cent of the country's market capitalization. Chinese businesses in Malaysia are part of the larger bamboo network, a network of overseas Chinese businesses in the Southeast Asian market sharing common family and cultural ties.

Islamic banking in Malaysia began in September 1963 when Perbadanan Wang SimpananBakal-Bakal Haji (PWSBH) was established. PWSBH was set up as an institution for Muslims to save for their Hajj (pilgrimage to Mecca) expenses. In 1969, PWSBH merged with PejabatUrusan Haji to form LembagaUrusandanTabung Haji (now known as LembagaTabung Haji).

The first Islamic bank in Malaysia was established in 1983. In 1993, commercial banks, merchant banks and finance companies were allowed to offer Islamic banking products and services under the Islamic Banking Scheme (IBS). These institutions however, are required to separate the funds and activities of Islamic banking transactions from that of the conventional banking business to ensure that there would not be any co-mingling of funds.

In Malaysia, the National Sharia Advisory Council additionally set up at Bank Negara Malaysia (BNM) advises BNM on the Sharia aspects of the operations of these institutions, as well as on their products and services. In 2006, Bank Negara Malaysia setup International Centre for Education in Islamic Finance (INCEIF) a dedicated University to provide skilled and certified personnel for Islamic Finance in Malaysia. The university was established as part of the Malaysian Government's initiative to further strengthen the country's position as an international Islamic finance center. It is the only university in the world that is wholly dedicated to postgraduate study in Islamic Finance.

Astonishingly Global Islamic Finance Report 2014 reveals that Pakistan ranks number nine in the world in terms of development of the Islamic financial services industry in the country whereas we claim our position at number 2. A London-based Islamic financial advisory company, Edbiz Consulting, has formulated the Islamic Finance Country Index (IFCI), which ranks about 50 countries of the world in terms of their role in developing, promoting and advocating Islamic banking and finance. Pakistan comes after eight countries, namely Iran, Malaysia, Saudi Arabia, Bahrain, Kuwait, United Arab Emirates (UAE), Indonesia and Sudan.

The Global Islamic Finance Report 2014 estimates the size of the global Islamic financial services industry at $1.813 trillion. This represents 12.3% annual growth, an increase of $182 billion in absolute terms.

Many Islamic financial institutions appear among top five banks in their respective countries. In Pakistan, the largest Islamic bank is Meezan Bank, which is fast assuming mainstream prominence.

In Pakistan the newly unveiled Islamic banking strategy by the State Bank of Pakistan attempts to double the number of Islamic banking branches from 1,300 in the next four years, and to increase its market share from 12% to 20%. Given the huge potential the country has in terms of Islamic banking, increasing the share to 20 % is a modest aim. Indeed, if Islamic banking fails to achieve 20% share in the market by 2018, by all indicators, it fails to reach its potential.

Given that a number of banks showing renewed interest in Islamic banking, the industry targets an increase of 2% in market share every year through Brownfield growth, i.e. cannibalization of conventional banking and through conversion of con-

ventional into Islamic banks.

As an example Summit Bank of Pakistan converted into a full-fledged Islamic bank, is anticipated to become the second largest Islamic bank in the country, taking the number two position from Bank Islami (assuming that Bank Islami does not grow further). Only this will give 8% additional market share to Islamic banking over the next four years.

If Islamic banks exhibit Greenfield growth, more than the growth in conventional banking, it should be able to double its market share. Greenfield growth is not only possible but is in fact needed in Pakistan where there is widespread financial exclusion. If that happens, the country will stand next to a number of Gulf countries and Malaysia where Islamic banking represents between 20% and 30% of the market share. Pakistan, however, will become the most important player in Islamic banking and finance, if it attains 20% market share. This is so because the country is the second largest Islamic market (population-wise) after Indonesia.

On Micro level it can be seenin many instances hat debt based financing is unjustespecially to the poor. According to SoumikMajumdar (2008), under the present bankingscenario in order for the transaction to occur there needs to be trust between the borrower and lender which is mostly dependent on the availability of collateral, something which the poor don't have! Therefore the poor cannot borrow. This lack of access to funds sometimes leads the poor to borrow from unscrupulous lenders. This can be seen in Malaysia i.e. Ah Longs. This is not just or fair as these people take advantage of the poor and charge them exorbitant rates of interest, this goes against many Islamic principles especially as Islam condemns exploitation. This is the same reason why Muhammad Yunus opened theGrameen Bank in Bangladesh, as poor had no access to financing due to their lack of collateral. In other words the poor wereUn-bankable (Yunus, 2007). This is blatantly unjust as in Islam everyone should have equal opportunities no matter their background.

The famous Muslim scholar Nizam Al Mulkis of the opinion that for society to be stable it is a requirement that even the poor should have access to the same economic opportunities. This is not the case with debt based financing as the majority of the time the poor have no access to this type of financing due to the absence of collateral hence the injustice occurs. The Maqasidsharia (Maqasid is an Arabic word for goals or purposes. In an Islamic context, the term can refer to the purposes of Islamic faith, zakat (charity tax), pilgrimage, or of the Qur'an's and Sunnah'stext. In terms of Sharia, there are five foundational goals (maqasid al-Sharia). These are the preservation of: Religion/Faith, Life(nafs),Lineage/Progeny (nasl),Intellect ('aql),Property / Wealth (mal))aims to protect life, every year millions of poor people die due to the limited opportunities presented to them to climb out of poverty. As we see from our definition of Maqasid some scholars have included in their definition that man's dignity should be protected. Hence we can see that man's dignity depends on his ability to survive and his ability to put bread on the table for his family. In order for man to achieve this dignity especially the poor, it is essential that they have access to financing on a fair basis so that they have the opportunity to attain dignity in the society by becoming successful entrepreneurs. If they are given this opportunity they will not have to rely on Handouts and charity and thus this is better for the society at all levels. There is a famous Chinese proverb in which it is stated "give a man a fish you will feed him for a day, teach a man how to fish and you will feed him for a lifetime' we can relate this to our present scenario, if we give a poor man financing on Mudharabah or Musharakah he becomes independent rather than depending on charity. As Muslims we have to critically analyze the effects of an action before undertaking it. One may ask what is the actual effect of debt financing on society and is it in conflict with the basic principles of the Maqasid. According to NazrolKamil (2005) debt has many negative implications on our society and therefore should not be encouraged. If we look at the Maqasidwe see that one of the main aims is protection of the family unit and societal wellbeing. With debt financing man is encouraged to live beyond his means (credit cards) and thus this has detrimental effects on the society. A man is forced to work extra in order to pay of his debts and thus has no time for his family. Clearly this is against the objectives of the sharia. In contrast to this when Equity is used as the basis of financing this does not happen as both partners are madeto look out for one another and thus not one individual will bear the responsibility. Another effect on the society is that due to lack of access of funds sometimes the poor can stay poor while the rich become a lot richer. This can lead to the breeding of hatred and enmity in a society. When the inequality worsens there can be loss of life and destruction of property such as the race riots in Malaysia (1969). This goes against the Maqasid of sharia, as the protection of property and life are some of the core principles of the sharia.

So to change Macro and Micro formats of Islamic Finance very cautious moves are required. To make the whole system equity based as per its basic requirement, is bit difficult. Hence to move forward we have to find some correlation between debt based and non-based products. Further we have to link Islamic Banking with country's macro and Micro indicators. Islamic Banking from A to Z should be based on social justice and to eliminate poverty all over the world in general and in Muslim Countries in specific not thorough rhetoric but with practical steps and product development. Still Islamic Banking stands as a specialized area. Hence all Muslim countries have to act independently in this specialized area to come on some converging point and that is the crux of all answers to move forward.

5. Capital And Money Markets In Islamic Finance

Chart 5

All figures given are in Billions of US$ and are sourced to the IMF. There is no universally recognized standard for measuring all of these figures, so other estimates may vary. A GDP column is included as a comparison.

Year	Stocks	Bonds	Bank assets	Total of stocks, bonds and bank assets.	World GDP
2013	62,552.00	99,788.80	120,421.60	282,762.40	74,699.30
2012	52,494.90	99,134.20	116,956.10	268,585.20	72,216.40
2011	47,089.23	98,388.10	110,378.24	255,855.57	69,899.22

Capital markets are financial markets for the buying and selling of long-term debt or equity-backed securities. These markets channel the wealth of savers to those who can put it to long-term productive use, such as companies or governments making long-term investments. Capital markets are defined as markets in which money is provided for periods longer than a year. Financial regulators, such as the UK's Bank of England (BoE) or the U.S. Securities and Exchange Commission (SEC) or SECP in Pakistan, oversee the capital markets in their jurisdictions to protect investors against fraud, among other duties.

A key division within the capital markets is between the primary markets and secondary markets. In primary markets, new stock or bond issues are sold to investors, often via a mechanism known as underwriting. The main entities seeking to raise long-term funds on the primary capital markets are governments (which may be municipal, local or national) and business enterprises (companies). Governments tend to issue only bonds, whereas companies often issue either equity or bonds. The main entities purchasing the bonds or stock include pension funds, hedge funds, sovereign wealth funds, and less commonly wealthy individuals and investment banks trading on their own behalf. In the secondary markets, existing securities are sold and bought among investors or traders, usually on an exchange, over-the-counter, or elsewhere. The existence of secondary markets increases the willingness of investors in primary markets, as they know they are likely to be able to swiftly cash out their investments if the need arises.

A second important division falls between the stock markets (for equity securities, also known as shares, where investors acquire ownership of companies) and the bond markets (where investors become creditors).

The money markets are used for the raising of short term finance, sometimes for loans that are expected to be paid back as early as overnight. Together, money markets and capital markets form the financial markets as the term is narrowly understood.

Islamic Finance is part of overall Market depending on its own modalities.

Since price dissemination is the prerequisite for both the markets so first innovation came on the side of Islamic Finance in the Stock Markets was the introduction of Dow Jones Islamic Market Index' (DJIM). That was launched in 1999 in Bahrain and was the first index created for investors seeking investments in compliance with MuslimSharia law.

The DJIM has an independent Sharia's (Islamic Law) Supervisory Board. The DJIM screens have been adopted by the Accounting and Auditing Organization for Islamic Financial Institutions ("AAOIFI")-Standard 21. ' The DJIM measure the performance of a global universe of investable equities that have been screened for sharia compliance consistent with Dow Jones Indexes' methodology. The selection universe for the DJIM family of indexes is the same as the universe for the Dow Jones World Index, a broad-market index that seeks to provide approximately 95% market coverage of 44 countries.

The first level of DJIM screening removes companies involved in such products alcohol, pork-related products, conventional financial services (e.g. banks and insurance companies), entertainment (e.g. hotels, casinos, gambling etc.), tobacco, and weapons and defense. A second level of DJIM screening based on financial ratios, is intended to remove companies based on debt and interest income levels in their balance sheets. The ratios of debt size are different in Muslim Countries and elsewhere, like in Pakistan equities of a corporate carrying more than 30% of debt does not qualify for such index.

Stocks of companies that pass both sets of screens are included in the DJIM. All other indexes in the DJIM family are created as subsets of this benchmark.

Different Stock Markets are passing through different phases in this respect. One of the biggest i.e. Saudi Arabia's stock market "Tadawul" has been opened for foreign investors as of June 15, 2015. With a market cap of $535 billion, Saudi Arabia's market size is individually bigger than South Africa, Russia, Mexico and Turkey. It makes up 6.4% of the global Emerging Market's capitalization, which stands at $8.3 Trillion. Furthermore, the Saudi market trades more than $2.4 billion in daily value compared to the $18.2 billion traded in all emerging markets on a daily basis, representing 13% of emerging markets

liquidity.

Global investors for the past 15 years or so have endorsed emerging markets as a core weight within their global portfolio, to augment their strategies for growth. This strategy has been hedged with emerging markets' currency volatility and/or political and governance risks. Saudi Arabia's market provides growth without the associated common currency and political risks.

"We have understood this positioning and kept Saudi Arabia within our global asset allocation as an alpha optimizer).The macroeconomics strengths of the Saudi market are not fully realized and reflected in the exchange's capitalization."(Bernard Caralp, CIO of SEDCO Capital)

Islamic Finance postulate four pillars in this respect; a fundamentally-driven, socially-responsible and financially prudent philosophy, a disciplined, research-based, scientific process and approach that is stock-selection focused, run by a solid team with international asset management experience with the longest top quartile track-record in the region.

Now coming to trading side, mostly Stock Markets are driven on the basis that how much they contain free float equities i.e. customers other than owners and sponsors. The ratios stand different in different countries. In Pakistan it is almost 25% of total equities. The narrowness of free float gives birth to monopolistic trends and inside trading, detrimental to the society as a whole. So Governments and regulators including IDB, World Bank should look in to the ways to expand free float numbers in the stock markets.

The Islamic money market on the other hand is integral to the functioning of the Islamic banking and financial system, firstly, in providing the Islamic financial institutions with the facility for funding and adjusting portfolios over the short-term, and secondly, serving as a channel for the transmission of monetary policy. Financial instruments and interbank investments allow surplus banks to channel funds to deficit banks, thereby maintaining the funding and liquidity mechanism necessary to promote stability in the system. MM is limited to 12 month period so basically it reflect liquidity management from one day to 365 days.

The Islamic Money market is still in infancy. But some Central Banks have moved towards its making like Bank Negara Malaysia , Central Bank of Indonesia and to some extent State Bank of Pakistan. However on monetary management side they go with different approaches even on conventional side like Pakistan targets O/N interest rate, Malaysia do it but with clean lending and borrowing with the banks targetingconventional interest rate , whereas whole GCC except Kuwait is pegged with dollar so they move with LIBOR in this respect. However this trouble would remain depending on different economies but for Islamic Finance each country has to come up with its solutions for procuring balance in monetary management.

In this respect IFSB based in Malaysia guidelines allow national financial regulators to have the final say on how they apply standards, but its prescriptive approach is gradually helping to harmonize practices across the industry's core centers in the Middle East and southeast Asia.

Islamic banks face uncertainty over how regulators will treat their deposits, compounded by a lack of well-developed Islamic securities markets.

The IFSB's guidance note on liquidity management aims to clarify the accounting treatment of Islamic deposits and defines the types of high quality liquid assets (HQLA) that Islamic banks can hold to meet regulatory requirements under the Basel III banking standards now being implemented around the world.

HQLA can range from cash and central bank reserves to sukuk (Islamic bonds) issued by both sovereigns and corporates, subject to various haircuts, the IFSB says.

Given the shortage of such instruments, the IFSB outlines three other actions which regulators can take to facilitate the industry: liquidity facilities from central banks, allowing banks to hold HQLA in international currencies, and widening HQLA criteria.

This would help Islamic banks to meet Basel III liquidity coverage ratios that are being phased in from 2015 to 2019; a net stable funding requirement will be implemented in 2018.

Regulators will have to determine the rights of bank customers to withdraw their Islamic deposits to define the weights, or run-off rates, that apply to these, the IFSB says. It adds that developing sharia-compliant deposit insurance schemes is required if deposits were to be considered "stable" under Basel rules.

Regulators must also decide on the treatment of Islamic deposit holders, who must be classified as investors, as a liability to the bank, or as a mix that is partly risk- absorbent, the IFSB says.

It would be prudent if deposit holders in Islamic banks may be treated as investors or equity holders under current arrangement of Islamic Banking based on Mudarbah to mitigate financial risks. Governments can come forward by providing legislation in this respect.

The IFSB has also published a draft standard on core principles for regulation and supervision of the industry, which was supposed to come into effect in January 2016.

These broadly mirror the Basel core principles, while addressing other issues such as the treatment of Islamic window operations, which are sections of conventional banks that operate according to Islamic religious principles.

The draft standard requires windows to have a minimum amount of funding from the conventional parent, and makes sharia supervision comparable to that of full-fledged Islamic banks.

IFSB is stepping up its efforts to bolster money markets after Lehman Brothers Holdings Inc. went bankrupt in September 2008, causing a global credit crunch. Dubai World roiled markets in November 2007 sought to delay payments on $24.9 billion of debt. The Sharia-compliant products thus came to fill in the hole in the $1 trillion industry as an example.

"These are breakthrough," says Zeti at Bank Negara Malaysia, who is an IFSB council member. "They are short term, and they will be, we expect, highly rated instruments and therefore, there would be strong demand for them. This would enhance the competitiveness of Islamic finance," she says.

The Islamic finance industry is growing 20 percent annually since 2000, bringing it into direct competition with non-Sharia-compliant global banking, without offering a comparable level of liquidity and returns, according to an IFSB report. It estimated rise in its assets to cross $1.6 trillion by 2014 compared with $660 billion in 2007 and Revenues to rise by $200 billion from $53 billion.

However there's a lack of creation in Islamic money-market instruments and the market needs a lot of them, "Malaysia, the world's biggest market for Islamic bonds, Bahrain and Indonesia sell bills to help soak up cash in the financial system and set benchmarks for short-term bond sales.

The primary Sukuk market, basic of Islamic Money Market rose to USD114.7bln in Jan-Nov 2014, an 8.6% gain from the USD105.6bln volume recorded during Nov 2013. Sukuk issuances included a number of first time sovereign obligors such

as the United Kingdom, Senegal, the Emirate of Sharjah, Hong Kong, South Africa, Luxembourg and Pakistan.

Bank of Tokyo- Mitsubishi UFJ and Goldman Sachs debuted in the global Sukuk market in September 2014.

The global sukuk outstanding reached USD300bln as of Nov 2014, an 11.4% rise from USD269.4bln at end- 2013.

Malaysia's secondary sukuk market is fairly sizeable at approximately USD173.4bln, a 9.6% increase year-on-year (y-o-y).

Meanwhile, the total GCC Sukuk outstanding portfolio grew by 6.4% to USD90.8bln, as compared to USD85.3bln outstanding at end-2013

By country, Malaysia continued to dominate the sukuk market, accounting for a 64.6% share of total issuances; with Saudi Arabia (10.3%), Indonesia (5.4%), the UAE (5%) and Turkey (3.6%) rounding up the top five markets

Notably, the sukuk market is more geographically dispersed now, which is a healthy sign of expansion into new markets - in Nov 2014, the top five countries accounted for around 89% of total issuances, down from 95% last year.

Pakistan while entering in to Sukuk market has now Euro Sukuk$ 4,550 million,Rs 326.4 billion Domestic Sukuk of 3 years maturity in its stock as of June 2015.

Further Pakistan has also decided to facilitate Islamic Banking industry in their liquidity management and more effective transmission of monetary policy. For that SBP has decided to outright purchase or sale Government of Pakistan IjaraSukuk (GIS) either on deferred payment basis (Bai-Muajjal).Technically it is a financing technique adopted by Islamic banks that takes the form of MurabahaMuajjal. It is a contract in which the seller earns a profit margin on his purchase price and allows the buyer to pay the price of the commodity at a future date in a lump sum or in installments. He has to expressly mention cost of the commodity and the margin of profit is mutually agreed. The price fixed for the commodity in such a transaction can be the same as the spot price or higher or lower than the spot price or on ready payment basis through Open Market Operations (OMOs) based on multiple price competitive bidding auction process. For a county like Pakistan these steps are not enough and lot is needed to be done to bring some solution to trickle down its effects to the Islamic Banks, its Customers and Economy as a whole.

The United Arab Emirates is also looking at issuing short-term bills that comply with religious principles once regulations are passed says the central bank Governor . "If you are going to fund your long-term investment with short-term liabilities like customer deposits, you run an asset- liability mismatch,". MalekTemsah, a treasury and investment manager at AL Barka Banking, says "This, as the global credit crisis showed, is dangerous. You could end up in a liquidity freeze."

However Banks Negara Malaysia has taken some initiatives in this regard by allowing following Instruments in Islamic Interbank Money Market

a) Mudharabah Interbank Investment (MII):-MII refers to a mechanism whereby a deficit Islamic banking institution (investee bank) can obtain investment from a surplus Islamic banking institution (investor bank) based on Mudharabah (profit sharing).

b) Wadiah Acceptance-Wadiah Acceptance, is a transaction between BNM and the Islamic banking institutions. It refers to a mechanism whereby the Islamic banking institutions placed their surplus fund with BNM based on the concept of Al-Wadiah. Under this concept, the acceptor of funds is viewed as the custodian for the funds and there is no obligation on the part of the custodian to pay any return on the account. However, if there is any dividend paid by the custodian, is perceived as 'hibah' (gift). The Wadiah Acceptance facilitates BNM's liquidity management operation as it gives flexibility for BNM to declare dividend without having to invest the funds received. Under the liquidity management operation, BNM uses the Wadiah Acceptance to absorb excess liquidity from the IIMM by accepting overnight money or fixed tenure wadiah. Indonesia also follows this concept for liquidity management. Pakistan can also follow this concept by making slight adjustments in accordance with its Sharia standards.

c) Government Investment Issue - When the first Islamic bank in Malaysia began operations in 1983, the bank cannot among other things, purchase or trade in Malaysian Government Securities (MGS), Malaysian Treasury Bills (MTB) or other interest-bearing instruments. However, there was a serious need for the Islamic bank to hold such liquid papers to meet the statutory liquidity requirements as well as to park its idle fund. To satisfy both requirements, the Malaysian Parliament passed the Government Investment Act in 1983 to enable the Government of Malaysia to issue non-interest bearing certificate known as Government Investment Certificates (GIC) {now replaced with Government Investment Issues (GII)}. The GII was introduced in July 1983 under the concept of Qard al- Hasana.

The concept of Qard al- Hasana does not satisfy the GII as tradable instruments in the secondary market. To address this shortfall, BNM opened a window to facilitate the players to sell and purchase the papers with the central bank. On 15 June 2001, the Government of Malaysia with the advice of Bank Negara Malaysia, issued a 3 -year GII of RM2.0 billion under a new concept of ofBai Al-Inah. The move therefore had added depth to the IIMM as the GII is now tradable in the secondary market via the concept of Bay ad- Dayn (debt trading) (not allowed in Pakistan and other Muslim Countries on Fiqah basis)

d) Bank Negara Monetary Notes-i (BNMN-i) BNMN-i are Islamic securities issued by Bank Negara Malaysia replacing the existing Bank Negara Negotiable Notes (BNNN) for purposes of managing liquidity in the Islamic financial market. The instruments will be issued using Islamic principles which are deemed acceptable to Sharia requirement. The maturity of these issuances has also been lengthened from one year to three years. New issuances of BNMN-i may be issued either on a discounted or a coupon-bearing basis depending on investors' demand.

e) Sell and Buy Back Agreement (SBBA) Sell and Buy Back Agreement (SBBA) is an Islamic money market transaction entered by two parties in which an SBBA seller (seller) sells assets to an SBBA buyer (Buyer) at an agreed price, and subsequently, both parties entered into a separate agreement in which the buyer promises to sell back the said asset to the seller at an agreed price.

f) CagamasMudharabah Bonds CagamasMudharabah Bond was introduced on 1 March 1994 by CagamasBerhad to finance the purchase of Islamic housing debts from financial institutions that provides Islamic house financing to the public. The SMC Mudharabah Bond is structured using the concept of Mudharabah where the bondholders and Cagamas share the profits according to the agreed profit-sharing ratios.

g) When Issue (WI)- When Issue is a transaction of sale and purchase of debt securities before the securities is being issued. The National Sharia Advisory Council viewed that the WI transaction is allowed based on the permissibility to promise for sale and purchase transactions.

Here it must be remembered that activities in Islamic Finance are prohibited under following activities so lot of innovations and research is required to compete with the counterpart markets in developing IMM:

- Conventional financial services that feature transactions based on interest, speculation, and/or gambling:
- Companies whose core businesses involve alcohol, pork products, or other meat that's not slaughtered according to sharia law aren't considered compliant.

- The tobacco industry and activity related to illegal drugs:
- The production of weapons of mass destruction (WMDs):
- Sharia prohibitions apply to adult entertainment products, including magazines, videos, audio recordings, websites, and all methods of distributing pornography. The same prohibition applies to erotic arts. In addition, certain types of non-Islamic music and cinema are prohibited.
- Cloning: This example demonstrates a crucial point: Islamic scholars must continually make decisions about the compliance status of new technologies and industries. Obviously, the prohibition against cloning activity is a fairly recent decision, and the prohibition of cloning could possibly change depending on future circumstances.
- Groups of companies with subsidiaries that engage in activities prohibited by sharia also are excluded from Islamic investment funds. For example, consider a hotel (owned by a large corporation) that derives a substantial amount of its income from a nightclub or casino that is prohibited per sharia. Because the profits from this nightclub or casino impact the overall profit of the corporate group, an Islamic fund can't invest in the group as a whole.

It must also be remembered that Islamic Banks get their funding through Mudarbah contracts. A mudarabah contract is based on a partnership in which one partner is the financier (the investor, or silent partner) and the other partner (the fund manager, or working partner) manages the financier's investment in an economic activity.

In this contract, the basic factors of production (from the Islamic economics viewpoint) - capital, labor, and entrepreneurship - are combined to make an economic activity. The rab al mal provides the capital, and the mudarib provides entrepreneurship and labor. The mudarib gets a portion of the profit for his effort, and the rab al mal gets the remaining profits.

A rab al mal can choose to invest in two types of mudaraba contracts:

- Restricted mudaraba(mudaraba al muqayyadah): The investor specifies a particular business or project where the investment funds are to be used; the working partner should not use the funds for any other business or project (not in practice in Pakistan and some other countries).
- Unrestricted mudarabah(mudaraba al mutlaqh): In this mudaraba contract, the investor gives the working partner permission to funnel the funds into any type of business or project that best suits the financial goals of both partners. Here is a visual of how the mudarabah contract works as a financial instrument signifying that the loss is to be borne by the investor that puts an onus on Islamic Banks to be more vigilant in managing their business particularly liquidity management. By treating depositors as investors this pitfall can be avoided.

Finally taking Pakistan as case example, there is no other opinion that Islamic Banking is still standing on perception and not on innovations and new techniques in the world. The main responsibility in this regard lies on SBP in case of Pakistan. For Islamic Money Market development the main emphasis should be on Research and Sharia Compliant side. It has been seen that most of the Treasurers in Islamic Banks world overand in Pakistanuse conventional methods for their liquidity management. This is absolutely wrong. Secondly SBP should focus on bringing complete legislation for Islamic banking through sitting government. Moreover Hybrid instruments (mix of debt and non-debt based instruments) with short term period be brought in. Pakistan do have an experience of Short term Federal Bonds for 3, 6 and 12 months floated in some period of 1990-2000 where markup was allowed on par value. The same model can be adopted. For liquidity injection Musharkah model can be adopted being used in Export Refinance Schemes. One must remember that in Indonesia and Malaysia they work with Islamic and conventional Banks on clean basis i.e. without collateral, but in Pakistan SBP work on collateral basis. So Pakistan and other countries not working on clean lending/borrowingshave to change their techniques a lot in this respect.

Contrary to this GCC countries except Kuwait are pegged with US dollar. Since in reserve money that is targeted in the monetary policy to keep inflation and unemployment at some level, the component of Net foreign Assets plus Net domestic assets play pivotal role. So their stands little scope for the central Banks in GCC to come up with some independent monetary policies in the interest of their own economies. However now in compliance to Basle III they are coming up with some steps but they would remain cosmetic till they bring basic changes in accordance with their macro objectives.

Recently The Central Bank of the UAE has announced a set of new regulations on liquidity risk management for the banking sector as part of compliance requirements for the Basel III rules on capital and liquidity requirements for UAE banks. According to circular No. 33/2015, issued on May 27, 2015, all banks must abide by the provisions of these regulations and the guidance manual.

The objective of these regulations is to ensure that liquidity risks are well managed at banks operating in the UAE and are in line with the Basel Committee for Banking Supervision (BCBS) recommendations.

In three articles, the new regulations define the qualitative and quantitative liquidity management frame work for the banks operating in the country. In quantitative requirements banks are mandated to keep a minimum level of liquid assets to meet sort term liquidity stress. Banks should also structure their funding profile to limit the impact of long term market disruptions.

To achieve these two objectives, the Central Bank requires banks to comply with the prescribed the Eligible Liquid Assets Ratio (ELAR); or move to the Liquidity Coverage Ratio (LCR) as and when approved by the central bank. Banks approved to move onto the LCR will also be required to comply with the Net Stable Funding Ratio (NSFR) when this ratio comes into effect by 1 January 2018.

ELAR is defined as the percentage set by the Central Bank of the banks' total liabilities in eligible liquid assets, consisting of items such as account balances at the Central Bank, Physical cash at the bank, Central Bank Certificates of Deposit (CDs)., UAE Federal Government bonds and Sukuk. Eligible securities include the UAE local governments and public sector entities publicly traded debt securities up to 20 per cent of total eligible liquid assets. Foreign, Sovereign debt instruments are limited to 15 per cent.

This ratio was supposed to become effective on 1 July 2015. The initial compliance level for this ratio is set at 10 per cent of the total liabilities. The Central Bank will periodically review this ratio.

Banks allowed to move to LCR from 1 January 2016 will follow a 30-day stress based liquidity coverage that will require the bank to be able to survive the stress using a stock of high quality liquid assets. The LCR requires that banks should always be able to cover the net cash outflow with high quality liquid assets. The Basel III accord requires that the minimum LCR is 100 per cent, starting on 1 January 2015 with 60 per cent minimum coverage and increasing by 10 per cent each year to reach 100 per cent by 1 January 2019. Net Stable Funding Ratio (NSFR) is a structural ratio that aims to ensure that long term assets

on the banks' balance sheets are funded using a sufficient amount of stable liabilities. It also requires an amount of stable funding to cover a portion of the contingent liabilities.

A dearth of money-market instruments is an issue all over the world. This has forced Islamic lenders in Indonesia to keep as much as 20 percent of their excess cash with the central bank, compared with 2.1 percent at non-Islamic banks, according to a study by IFSB. In Pakistan, the figure was 3.8 percent against 0.3 percent. In Bangladesh, the ratio was 57.3 percent versus 24 percent. Such deposits earn little or no interest.

The Islamic finance industry has been growing 20 percent annually since 2000, bringing it into direct competition with non-Sharia-compliant global banking, without offering a comparable level of liquidity and returns, according to an IFSB report.

"There's a lack of creation in Islamic money-market instruments and the market needs a lot of them," said Khalid Abu Khadra, assistant treasury manager at Saudi Investment Bank. "There's also a problem with the mismatch of maturity, so if this could work in harmony across all jurisdictions, then we have one less barrier to growth."

To avoid 'Liability Mismatch'- Malaysia, the world's biggest market for Islamic bonds, Bahrain and Indonesia sell bills to help soak up cash in the financial system and set benchmarks for short-term bond sales.

Pakistan plans to sell sukuk maturing in a year or less in the domestic market as it seeks to double Sharia banking and attract investors from the Persian Gulf, The United Arab Emirates is looking at issuing short-term bills that comply with religious principles once regulations are passed,(central bank Governor Sultan bin Nasser al-Suwaidi).

Hence lot of steps are in line to create competitive Islamic Money and Capital Markets. If done than automatically it would provide support to long term market of the Islamic Financial instruments that are very much required for the infrastructure financing for the uplift of the economies.

Advantages of Sukuk can be-

- Diversification of investor base away from banks (fund managers, private banks, insurers, corporates and central banks)
- Attractive maturity terms are available
- Provides rating agencies and creditors with proof of ability to diversify funding, having access to capital markets on a regular basis
- Ability to fund in large size given deep investor base
- Easy to replicate for subsequent transactions

However Limitations of Sukuk canbe

- Expensive to prepay in early years (no free call option)
- Issuance is subject to market conditions
- Execution risk could be higher in volatile market conditions vs. loan (targeting core relationship banks)
- Higher upfront costs (ratings, legal fees, etc..), although can be mitigated by establishing a Sukuk/ Trust Certificate Programme
- Work required to acquire credit ratings
- Modification process is more difficult (but far less frequently required) than a bank debt A shift from Loans to Debt Capital Markets (Sukuk& Bonds) can be-
- Liquidity in the bank loan market has reduced post the credit crisis, which has prompted global borrowers to shift financing from loans to Sukuk& bonds
- Sukuk& Bonds markets have allowed corporates to extend tenors beyond the traditional 5-year sweet spot of the syndicated loan market
- Aggressive pricing levels have been achieved in the Sukuk& Bonds markets on the back of large investor demand, providing corporates with the opportunity to invest and fund their capital expenditure/acquisitions by raising cheap senior funding or capital without having to raise dilutive equity

Benefits of a Sukuk/ Trust Certificate Programme vs. a Standalone Issuance

Funding flexibility can be

- Allows issuer to issue multiple tranches at the same time (based on the same programme documentation)
- Also provides issuer with the flexibility to issue different kinds of notes (fixed rate, floating rate, callable, putable, full flexibility over currencies of denomination - USD, SAR, G8 and non-core currencies etc - and tenors etc.)

Speed of execution

- All documents (trust deed, programme agreement, form of subscription agreement) are negotiated at the time of the establishment of the programme, so negotiation at the time of each issuance is minimized
- An up-to-date programme can allow issuance in as little as 1 week
- Avoids the requirement for new issuance approvals at the time of each issue
- Reduces execution risk, and provides access to "reverse enquiry" and private placement market

Significant cost efficiencies

- Once established, the programme helps reduce the costs of subsequent drawdowns
- Cost saving benefits are typically better realised if multiple tranches per annum are issued, compared to a standalone issue
- If execution is delayed, documentation of a Programme does not go stale for purposes of Reg S or domestic issuance

International profile

- Demonstrates funding flexibility and ability to raise attractive funding in the international capital markets
- Enhances issuer's profile in the international investor community and enhances transaction visibility

Commercial Considerations

Size of Issuance

- The size of a Programme or a Standalone issuance is generally a function of a message to the market , setting the amount of financing the issuer is targeting to raise in upcoming 2-3 years or at once
- The size of the programme or issuance will also be driven by the size of suitable identified assets to be tied to the Sukuk structure
- Issuer will have the flexibility to increase the Programme size at any point, in accordance with the terms of the Programme Agreement, should it wish to raise further debt out of the debt capital markets upon raising the maximum indicated size, particularly for M&A driven activities

Tenor Considerations

- Majority of large sized Rule 144A/Reg S offerings were issued via dual- or triple-tranches since 2012, combining a 10-year tranche with a 5- and/or a 30-year offering
- 10-year is an existing investor sweet spot for a Rule 144A / Reg S USD benchmark transaction, as evidenced by both MENA- and CEEMEA-based issues during 2012-2013
- A 5-year tranche will allow Issuer to take advantage of strong Middle Eastern and Asian demand, particularly Islamic investors, and accordingly achieve the most aggressive pricing

Coupon Format

- The majority of international USD issuances, both from the GCC and the broader Emerging Markets, have comprised of fixed rate notes
- On the back of the uncertainty witnessed around the US Tapering event, a significant amount of international investors have shown interest in floating rate note instruments, particularly on short-to-medium term durations
- In 2013, two financial institutions out of the GCC have issued in floating rate notes (QNB and ADCB - both 3-years)

Pricing Considerations

- For a new USD issue, investors' pricing methodology will be expected to use recent comparable, SWAP rates for comparable tenor and other USD alternate investment opportunities
- Pricing of existing financing arrangements, banking relationship, shareholders, credit rating of the issuer and of the sovereign and market appetite/ liquidity are the factors that dictate issue pricing

Syndicate Structure

- Typically, issuers in the international markets would appoint 2-3 reputable international banks to act as joint lead managers and book runners
- This allows issuers to maximize investor reach, have joint views on key decisions and have maximum support in terms of secondary market liquidity
- The two to three banks will lead the different work streams jointly with each taking the lead on one work stream to ensure efficient execution (documentation, Sukuk structuring, investor presentation / marketing and logistics)

U.K. has recently Sold Islamic Bonds in First Non-Muslim Sovereign Issue.

The U.K. raised 200 million pounds ($339 million) from Islamic bonds, with investors bidding for more than 10 times the amount offered as the nation became the first non-Muslim sovereign issuer of the debt.

The notes maturing on July 22, 2019, were sold at a profit rate of 2.036 percent, offering zero spread to the 1.75 percent gilt due in 2019, according to data on the U.K. Debt Management Office page on Bloomberg. Investors bid for about 2.3 billion pounds of the debt, the Treasury said in a statement.

The sukuk will help London establish itself as a global capital for Islamic finance alongside Dubai and Kuala Lumpur, The industry is growing 17 percent a year and may be valued at $2.67 trillion by 2017, according to PricewaterhouseCoopers LLP.

"We have seen very strong demand," George Osborne, Chancellor of the Exchequer, said in a Treasury statement. "I hope that the success of this government issuance will encourage further private sector issuances of sukuk in the U.K."

While a solid Islamic banking base is necessary to become a true universal Islamic finance hub, there's no doubt that supporting the industry and its service providers will enable London to maintain a share of the global sukuk market," New York-based Howladar said in an e-mailed statement today.

6. Legal Infrastructure Of Islamic Finance

Chart 6

Comparison of Enactments in Major Muslim Countries regarding Islamic Finance

Country	Central Bank Act	Banking and F/I Act	Islamic Banking Act	Insurance Act	Takaful Act	Islamic Micro Finance
Malaysia	Central Bank of Malaysia Act 1958 (Revised 1994)	Banking and Financial Institutions Act 1989 (BAFIA)	Islamic Banking Act 1983	Insurance Act 1996	Takaful Act 1984	Nil
Bahrain	Central Bank of Bahrain and Financial Institutions law	Central Bank of Bahrain and Financial Institutions law/Bahrain Stock Exchange law	Nil	Nil	Nil	Nil
Saudi Arabia	Banking Control law/ Currency law	Kingdom of Saudi Arabia Capital Market Law	Nil	Cooperative Insurance Companies Control law	Nil	Nil
Pakistan	State Bank Act	SECP Act 1997/ Stock Exchanges Act 2008	Nil	Nil	Nil	Nil
UAE	Union law of 1980 concerning Central Bank, the monetary system andorganization of banking	Federal Law of 2000 concerning the Emirates Securities and Commodities Authority and Market	DIFC law 2004 regulating Islamic financial business/ Federal Law of 1985 Islamic Banks	Nil	Nil	Nil
Qatar	Law No 15 of 1993 establishing Qatar Central Bank/law No 33 of 2006 Qatar Central Bank	Law No 33 of 2005 and law No 14 of 2007 regarding Qatar Financial Markets Authority and Qatar Securities Market	Nil	Nil	Nil	Nil
Turkey	1970-1211 Law on Central Bank/Law 2005 Banking Law	Law 1981-2499 Capital Market Law	Nil	Nil	Nil	Nil
Indonesia	Act 23 of 1999 on Bank Indonesia	Nil	Nil	Nil	NIL	Enactment of Bank Indonesia regulations for Islamic Micro Finance. Asset Management and rating of

						Islamic Banks in 2004,2005,2006 and 2007
Iran	Monetaryand Banking Law of Iran	Nil	Law of Usury (Interest fee banking) Iran	Iran Insurance Act	Nil	Nil
Sudan	Bank of Sudan Act	Public Corporations Act 1976	Nil	Nil	Nil	Nil
Nigeria	Central Bank of Nigeria Act 1991	Nil	Nil	Insurance Act 2003	Nil	Nil
Bangladesh	Financial Institutions Act	Securities and Exchange ordinance 1969	Islamic Development Act 1975	Nil	Nil	Micro Credit Authority Act
Source The world Law Guide (Lexadin)						

Unfortunately currently only one country i.e. Malaysia exists with clarity on the legal infrastructure for Islamic Finance. Rest of the Muslim countries have to bring such clarityin the coming days.

In legal infrastructure for Islamic banks three areas are important. One is protection to the depositors and investors, second one is equitable tax treatment as compared to conventional side and third one is empowerment and clarity on Sharia boards and power to the regulators for development of new products and carrying out awareness and education to the staff of the Islamic banks.

It is seen that different tailor-made products and procedures for financing in particular areas are made by commercial conventional banks. For healthy developments, Islamic Banking Institutions should be asked to develop more diminishing Musharaka products, in line with market prices and rentals. Islamic banking industry has been trying for the last over twenty years to extend its outpace to bring it at least to the level of conventional banking. But the absence of Sharia-compliant legal framework which is needed to make interest-free banking acceptable and create sound financial institutions is the major hurdle behind its low infiltration in the financial market. Attempts should be made to modify the existing structure to provide better products and quality service within the ambit of Islamic laws.

Islamic banking contracts are treated as buying and selling properties and hence are taxed twice. No doubt the commercial, banking and company laws contain provisions that are narrowly defined and prohibit the scope of Islamic banking activities within conventional limits. It is necessary that special laws for the introduction and practice of Islamic banking be put in place. For supporting Islamic legal system Islamic banking courts must be established within Banking Mohtasib area. The courts would require extra efforts and costs. In such a case banking and companies' laws in several countries require suitable modifications to provide a level-playing field for Islamic banks.

Deposits in Islamic banks are usually based on principle of profit and loss (Musharaka or Murabaha). If something happens and the bank suffers loss it has to be transferred to the depositor directly. This fear of loss is the biggest barrier to deposit mobilization in Islamic banks. The depositors should be provided with some kind of protection.

The main legislation regulating Islamic banking in Turkey is the Banking Law No. 5411 (the "Banking Law"). The financial institutions whose activities are in compliance with the Islamic rules are called participation banks (kat?l?mbankas?). Today there are four participation banks in Turkey: Bank Asya, Albaraka Turk, Kuveyt Turk and TurkiyeFinans. The conventional banks and the participation banks are both governed by the Banking Law and monitored by the same authorities (Banking Regulation and Supervision Agency and the Savings Deposit Insurance Fund). Regulated under the same legal framework, participation banks must establish their own financing models approved by the sharia Islamic finance is growing at a considerable pace throughout the world. Turkey is one of the countries that is aiming to lead the market. Just recently, the World Bank launched its first representation office on Islamic finance which is the Global Islamic Finance Development Center, in Istanbul. With the support of the government to develop Islamic finance in Turkey, Turkish and foreign investors are becoming more and more aware of Islamic financing methods and products in Turkey; but there are some of the legal and practical issues that investors have to face affecting level in terms of legislative progress?

Legally, participation banks cannot form sharia boards in Turkey, but they usually take advice from consultancy boards or outside scholars.

The Islamization of the economy of Pakistan, started with General Muhammad Zia-ul-Haq's"Islamisation" programme. Under this programme, Pakistan was to begin Pakistani society-including economic regulation, taxation, etc. -- in line with the principles of Sharia law General Zia-ul-Haq signed and issued executive decrees on Zak?t (poor-due), Ushr (Tithe), elimination of mudarabah (profit-sharing), and perhaps most importantly, termination of riba (defined by activists as interest charged on loans and securities).

However, in spite of the public support allegedly demonstrated for it (and other Islamisation policies) by the 1984 Islamisation referendum and the programme's initial gains and success, it failed to achieved international targets and to meet commercial interactions with other major international banks.

Article 28 of Pakistan's 1956 Constitution called for the elimination of riba "as early as possible". The 1962 Constitution provided in the principles of policy that "usury" should be abolished. Similar provisions were found in the 1973 Constitution. In 1969 the state-sponsored advisory body known as the Council of Islamic Ideology (CII), declared that Pakistan's banking system was "fundamentally based upon riba", and unanimously called for its elimination.

In Pakistan's financial sector, as of 2006, a system of Islamic banking has been adopted that operates in parallel with the conventional banking system. Pakistanis can choose between the two modes of financing. Most informed Pakistanis, however, insist that there is "no concerted move" to do away altogether with the conventional banking system, or to replace existing linkages and relationships with international financial markets.

Islamic activists (such as M. Akram Khan), maintained that Islamic banking and economics had "effectively failed" because of lack of "political will", ignorance of Islamic banking's "potential", the "inexperience" of the banking sector, failure to interest the public,etc.

Other economists had different and more critical explanations and observations. In 2000, the than Governor of the State Bank of Pakistan, IshratHussain contended that "Pakistan is far removed from the day when it will be ready to adopt a full-fledged Islamic economic system. ... Most of the assumptions and premises on which the (scientific) hypotheses about the Islamic economic system have been constructed are serious flawed... "A report by the IMF noted that the government has been unable to formulate non-interest based instruments for financing budget deficits, "thus the government, which is the major exponent of the implementation of the Islamic system, is forced to raise funds through borrowing on the basis of a fixed rate of return".

The most practical consideration in the Islamic Banking and Finance is their potential tax liabilities. Participation banks are subject to the same tax regime as conventional banks. In principle, if the financing is deemed one of the types of loans under the Banking Law, the tax regime for loans should be applicable. However, for an Islamic financing model, the financing is always based on a real transaction. The taxation problem occurs if the authorities apply separate taxes on the underlying transactions. Do taxes arise on a musharakah partnership formed between a participation bank and the customer? How will the income and profit of the partnership be taxed? Do taxes arise on the acquisition or sale of an asset under a murabaha agreement? The tax authorities cannot provide clear opinion on these questions.

The tax treatment of a transaction is a fundamental part of any evaluation of its economics. Tax law however differs from country to country.

Accordingly, two specific Islamic finance structures to assess how they might be treated for tax purposes in different countries. After a brief review of the tax position, it then considers what general conclusions can be drawn.

For simplicity, one can considers:

- commodity murabaha, also known as tawarruq, and
- diminishing musharaka

In Commodity Murhabahtransaction is used when Party A wishes to advance money to Party B.

Party A (usually a bank) will buy something that can be sold very easily afterwards and with little difference between the bid/offer (buy/sell) prices. A typical example would be a quantity of copper bought in a commodity market. Party A buys the copper,, immediately paying $100 for it, and transfers ownership to Party B at a price of $110 payable in, say, two years' time.

Party B can then immediately sell the copper for a price of about $100. This gives Party B cash equal to what Party A has laid out, $100, and an obligation to pay Party A $110 in two years' time. The extra $10 is the cost of the finance, and corresponds to a simple interest rate of 5% pa.

Diminishing Musharkah on the other handis often used by people buying houses for owner occupation instead of a conventional mortgage, but can also be used for the purchase of investment property.

Diminishing musharaka is used when one party, here called the 'eventual owner', wants to buy an asset but cannot afford to pay for all of it. In the diagram, on day one the bank buys 75% of the asset, for example a building, while the eventual owner buys 25%. Under the contract the eventual owner has immediate rights to sole occupation of the entire building.

The eventual owner pays rent to the bank on the 75% of the property that he doesn't own. Then, over the life of the arrangement, as well as paying the rent, the eventual owner will make additional payments to the bank to purchase additional slices of the asset. These purchases may be at the option of the eventual owner, although usually the bank will also have a 'put' option to require the property to be purchased at some stage.

The key question in the tax treatment of the tawarruq transaction is whether the finance cost which is implicit in Party B's deferred purchase price of $110 and immediate sale price of $100 is recognized as such for tax purposes.

Many Muslim majority countries where Islamic finance is practiced do not have a corporate income tax, as it is not needed due to the level of government revenues from natural resources. However, others that do such as Egypt treat the $10 difference as a finance cost without considering specific legislation to be needed. As the legal systems of Muslim majority countries have been heavily influenced by, or are expressly based on, Sharia, one would expect a Sharia compliant financial transaction to have its implicit finance cost recognized as such for tax purposes.

Malaysia however has put the matter beyond doubt. Section 2(7) of the Malaysian Income Tax Act 1967 provides that:

"Any reference in this Act to interest shall apply, mutatis mutandis, to gains or profits received and expenses incurred, in lieu of interest, in transactions conducted in accordance with the principles of Sharia."

This means that the Malaysian income tax legislation treats 'profits' to be similar to interest making the taxability or deductibility of 'profits' similar to the treatment of interest in a conventional financing agreement. All of the other requirements of Malaysian tax law governing when interest is taxable or deductible are then applicable.

In the case of Western countries where Sharia compliant transactions are still relatively new, there is no reason to assume that any particular tax treatment will apply.

One of the factors that distinguish tax systems from one another is the relative emphasis they place on "form" and "substance." In this context, "form" is used to describe putting significant emphasis upon the legal form of a transaction, in other words how is the transaction implemented from a legal perspective? In contrast, "substance" is used to denote an approach of basing the tax treatment primarily upon the economic reality of a transaction. Tax systems based entirely on "form" or entirely on "substance" do not exist. Instead, there is a spectrum, with countries combining the two elements in varying degrees. Furthermore, different parts of a country's tax system may have distinct positions on the spectrum.

To illustrate the distinction between form and substance, it is helpful to review a UK tax case, Commissioners of Inland Revenue (CIR) V. Plummer, citation 54 Tax Cases 1. While the case was heard several decades ago, and its specific facts have been superseded by subsequent changes in UK tax law, it illustrates the form and substance distinction very clearly.

The facts of the case are relatively simple. On 15 March 1971 a charity called HOVAS paid £2,480 to Mr. Plummer. In exchange, he undertook to make five annual payments to HOVAS under a deed of covenant, with the first payment due on 29 March 1971. The amount of each annual payment was whatever sum, after deduction of all taxes, amounted to £500.

The substance of the transaction was that Mr Plummer was borrowing £2,480 from HOVAS and repaying this in five annual installments of £500; effectively borrowing at a relatively small rate of interest.

Under the legal form adopted, each of the £500 payments was treated as a larger gross payment from which Mr Plummer

was entitled to withhold and retain income tax at the standard rate. For example, at the tax rate then prevailing, the first payment was legally a gross payment of £851.06. As a charity, HOVAS was entitled to a refund from the Inland Revenue of the tax withheld of £351.06, making the transaction very attractive to HOVAS; an internal rate of return of 27% was mentioned during the litigation.

Under the tax law then prevailing, Mr Plummer was entitled to offset the gross payment of £851.06 when computing his liability to higher rate tax, but not standard rate tax. (The standard rate tax relief was already achieved by him deducting and retaining the £351.06.) Accordingly, the transaction was also extremely attractive to Mr Plummer as a way of reducing his higher rate tax liability.

The tax authorities litigated and the case went through every level of the UK court system. Mr Plummer was successful before the Special Commissioners, before the High Court in 1977, before the Court of Appeal in 1978 (where the judges decided 3-0 in his favour) and before the House of Lords in 1979 (where the judges decided 3-2 in his favour).

The case is instructive to read as the legal arguments were directed almost entirely to the legal form of the transactions and whether the detailed stipulations of UK tax law had been complied with. The Inland Revenue did not attempt to argue that the transaction should simply be taxed on its economic substance as such an argument would find no support in UK tax law. (The courts might well take a different approach today, given the way case law has subsequently evolved in the UK.)

Against this background, tax systems which seek to identify the "substance" (i.e. the underlying economics) of the transaction have no difficulty deciding that Party B has suffered a £10 finance cost. Quite clearly the only reason Party B is paying £110 for copper that it can only resell for an immediate payment of £100 is that Party B is granted a two year deferral before it needs to pay the £110. This treatment applies in the Netherlands and in the USA, both tax systems which look very much to the substance of a transaction.

Conversely, the UK approach is that the tax treatment is heavily influenced by the legal form of the transaction. The legal form is that Party B has actually purchased an amount of copper at a price of £110 and then sold that copper, for immediate payment, at a price of £100. Accordingly, its loss has arisen on the purchase and resale of copper.

Such a loss on the purchase and resale of a commodity may not be tax deductible. In the UK, for example, unless Party B can show that it is trading (as understood by tax law) in copper, it will not be entitled to deduct the £10 loss against its other income. Furthermore, even if Party B regularly trades in copper, this transaction does not look like a legitimate trading transaction since Party B knew that it would suffer a £10 loss when it commenced the transaction. (Trading is normally done with a view to profit.) Accordingly, under UK tax law (before the recent changes to facilitate Islamic finance discussed below), Party B would not be expected to obtain tax relief for its £10 cost.

Now The UK is a pioneer amongst Western countries in adapting its tax system to facilitate Islamic finance. Accordingly, the strategic considerations that underlie the UK approach merit analysis, as the UK's example may be followed by other Western countries that seek to encourage Islamic finance.

The tax law changes governing the computation of taxable income were introduced by the Finance Act (FA) 2005, with subsequent expansion of the range of transactions covered in FA 2006 and FA 2007. A review of the legislation enables one to 'reverse engineer' the design considerations that underlie it. Four key principles emerge:

- Tax law must apply equally to all taxpayers;
- Tax law changes should not impact upon transactions not intended to be covered;
- Legislation should not be longer than is necessary;
- Addressing specific obstacles to Islamic finance.

Strictly speaking, the UK has not enacted any Islamic finance legislation. A search of FA 2005 will fail to find words such as Islamic, Sharia, tawarruq or any other term used specifically in Islamic finance. The reason is that the tax treatment of a transaction cannot be allowed to depend upon whether it is Sharia compliant. As well as introducing significant uncertainty into the UK tax system, introducing Sharia considerations would create a situation where all taxpayers were not receiving identical tax treatment.

Instead, the UK identified certain types of transaction widely used in Islamic finance, and ensured that those types of transaction received appropriate tax treatment. This is illustrated by FA 2005 section 47 "Alternative finance arrangements", reproduced here in full as originally legislated:

(1) Subject to subsection (3) and section 52, arrangements fall within this section if they are arrangements entered into between two persons under which-

(a) a person ("X") purchases an asset and sells it, either immediately or in circumstances in which the conditions in subsection (2) are met, to the other person ("Y"),

(b) the amount payable by Y in respect of the sale ("the sale price") is greater than the amount paid by X in respect of the purchase ("the purchase price"),

(c) all or part of the sale price is not required to be paid until a date later than that of the sale, and

(d) the difference between the sale price and the purchase price equates, in substance, to the return on an investment of money at interest.

(2) The conditions referred to in subsection (1)(a) are-

(a) that X is a financial institution, and

(b) that the asset referred to in that provision was purchased by X for the purpose of entering into arrangements falling within this section.

(3) Arrangements do not fall within this section unless at least one of the parties is a financial institution.

(4) For the purposes of this section "the effective return" is so much of the sale price as exceeds the purchase price.

(5) In this Chapter references to "alternative finance return" are to be read in accordance with subsections (6) and (7).

(6) If under arrangements falling within this section the whole of the sale price is paid on one day, that sale price is to be taken to include alternative finance return equal to the effective return.

(7) If under arrangements falling within this section the sale price is paid by installments, each installment is to be taken to include alternative finance return equal to the appropriate amount.

(8) The appropriate amount, in relation to any installment, is an amount equal to the interest that would have been included in the installment if-

(a) the effective return were the total interest payable on a loan by X to Y of an amount equal to the purchase price,

(b) the installment were a part repayment of the principal with interest, and

(c) the loan were made on arm's length terms and accounted for under generally accepted accounting practice.

Reading section 47, it is clear that it was designed to facilitate murabaha and tawarruq transactions. However it nowhere

uses those terms and nothing in section 47 limits its application to Islamic finance. If a transaction falls within section 47, the tax treatment follows automatically, regardless of whether the transaction is (or was intended to be) Sharia compliant.

Commercial sales of goods often involve a credit period for the customer. It would unduly complicate UK tax law if every sale of goods with deferred payment required identification of the price that would have prevailed if no credit were given, and then giving separate tax treatment for the implied cost of the credit. Consider for example a food manufacturer selling hundreds of thousands of tins of food to retailers with 30 days credit allowed for the payment of each sales invoice.

Section 47 limits its impact by requiring the involvement of a financial institution in subsection (3). This ensures that only transactions where finance is provided by or to a financial institution fall within the new rules. Accordingly, the food manufacturer and its customers should not be impacted by these new rules. (One drawback of this approach is that it is currently impossible for two non-financial companies to transact Islamic finance with each other and receive the tax treatment given by the new legislation.)

Financial institution is defined in section 46(2) as:

(2) In this Chapter "financial institution" means-

(a) a bank as defined by section 840A of ICTA [1988],

(b) a building society within the meaning of the Building Societies Act 1986 (c. 53),

(c) a wholly-owned subsidiary of a bank within paragraph (a) or a building society within paragraph (b),

(d) a person authorized by a license under Part 3 of the Consumer Credit Act 1974 (c. 39) to carry on a consumer credit business or consumer hire business within the meaning of that Act, or

(e) a person authorized in a jurisdiction outside the United Kingdom to receive deposits or other repayable funds from the public and to grant credits for its own account.

Tracing through the definitions establishes that they cover all banks licensed in the European Economic Area and also persons licensed to take deposits in other countries, which is the key practical definition of a bank. However many other bodies engaged in financial activities, such as hedge funds, fall outside these definitions.

Section 47 reproduced above demonstrates how complex it can be to legislate for an apparently straightforward transaction. Drafting the new legislation would have been very arduous if it was then necessary to legislate specifically for all the tax consequences flowing from murabaha or tawarruq transactions.

The legislation avoids this burden by assimilating the tax consequences of Islamic finance transactions into the existing tax legislation. For example, where a company undertakes a murabaha or tawarruq transaction, the tax consequences are governed by FA 2005 section 50 (1) Where a company is a party to arrangements falling within section 47, Chapter 2 of Part 4 of FA 1996 (loan relationships) has effect in relation to the arrangements as if-

(a) the arrangements were a loan relationship to which the company is a party,

(b) any amount which is the purchase price for the purposes of section 47(1)(b) were the amount of a loan made (as the case requires) to the company by, or by the company to, the other party to the arrangements, and (c) alternative finance return payable to or by the company under the arrangements were interest payable under that loan relationship.

FA 1996 which governs loan relationships contains a very extensive and complex set of provisions which apply to companies engaging in the lending or borrowing of money and paying interest or other finance costs. Section 50 (1) is not saying that section 47 involves the making of a loan; instead it taxes the company as if a loan had been made and as if the alternative finance return (the profit or loss under the murabaha or tawarruq transaction) were interest.

The UK's approach here is similar to that in Malaysia, where the tax treatment of "profit" on Islamic financing transactions is assimilated to the tax treatment of "interest."

Tax legislation in the UK has grown steadily since income tax became a permanent feature of the tax system in 1842, and was of course developed long before Islamic finance was contemplated in the UK. Not surprisingly, it happened to contain specific provisions which would impact upon Islamic transactions, even though the equivalent conventional transaction was not affected. These were addressed by specific legislation.

For example, the UK has long had a provision to counter companies disguising equity finance in the form of debt, in order to obtain tax relief for payments that are economically equivalent to dividends to risk bearing shareholders. This can be found in ICTA 1988 s.209 (2) (e) (iii):

(2) In the Corporation Tax Acts "distribution", in relation to any company, means …(e) any interest or other distribution out of assets of the company in respect of securities of the company (except so much, if any, of any such distribution as represents the principal thereby secured and except so much of any distribution as falls within paragraph (d) above), where the securities are …(iii) securities under which the consideration given by the company for the use of the principal secured is to any extent dependent on the results of the company's business or any part of it.

This provision would preclude Islamic banks offering investment accounts to their customers, since the profit share paid to the customer would be treated as a distribution. This means that the payment would not be tax deductible for the bank.

This problem is addressed specifically by FA 2005 s.54 which effectively disapplies ICTA 1988 s.209 (2) (e) (iii):

Profit share return [defined in FA 2005 section 49 in a form that corresponds to profit share return on investment account deposits of Islamic banks] is not to be treated by virtue of section 209(2)(e)(iii) of ICTA as being a distribution for the purposes of the Corporation Tax Acts.

The diminishing musharaka transaction outlined above presents relatively few difficulties from the perspective of corporate or personal income tax. The Eventual Owner is paying rent to the bank, and the deductibility or otherwise of this rent in most countries will depend on whether the property is occupied for business purposes or for personal use.

The UK has however legislated specifically for such transactions, by setting out precise requirements in FA 2005 s47A for a transaction called "diminishing shared ownership." If a transaction falls within these rules, the rent being paid is treated for tax purposes as if it were interest, both for the payer and for the receiving financial institution. This is particularly important if the financial institution is not UK resident, since the UK always charges withholding tax on rent paid to foreign persons, whereas interest paid to foreign persons often has a reduced or zero withholding rate due to the operation of double taxation treaties.

The legislation in FA s47A is very precise. The financial institution can share in any losses on the asset. If the bank couldn't share in any losses on the asset, then this contract would probably fail to be Sharia compliant and nobody would ever use it. However, FA s47A states that the bank cannot participate in increases in the value of the asset. This could become a problem. While many diminishing musharaka contracts are based upon the original purchase price, there is also a move by some organizations to have a contract which allows the financial institution to participate in the growth of the asset. This may be regarded by them as being slightly better from a Sharia perspective. Unfortunately such a contract does not satisfy the UK

tax rules as they currently stand.

The most important question with diminishing musharaka however is the taxation of the property ownership changes, as many countries have some form of real estate transfer tax. In the case of a conventional bank mortgage, there is normally only a single taxable real estate transfer, from the vendor to the purchaser buying with the aid of a mortgage. However, in diminishing musharaka, the vendor sells to the bank, and the bank then sells to the eventual purchaser. Are there two incidences of real estate transfer tax?

The distinction between substance and form discussed above is not relevant, and a double real estate transfer tax charge will apply, in the absence of specific relief, even if the country adopts a substance based approach to taxation. That is the case in the Netherlands for example. In most countries, the double real estate transfer tax charge can only be eliminated if there is specific legislation to that effect.

Malaysia has enacted specific legislation. Section 2(8) of the ITA seeks to ignore the underlying transaction so that tax neutrality can be achieved in Islamic funding transactions, by providing that:

"… any reference in this Act to the disposal of an asset or a lease shall exclude any disposal of an asset or lease by or to a person pursuant to a scheme of financing approved by the Central Bank or the Securities Commission or LOFSA [Labuan Offshore Financial Services Authority], as a scheme which is in accordance with the principles of Syariah where such disposal is strictly required for the purpose of complying with those principles but which will not be required in any other schemes of financing."

The requirement for advance approval negates any uncertainty in the application of the provision.

Similarly, the UK legislated relief from multiple charges to its real estate transfer tax called Stamp Duty Land Tax (SDLT) in FA 2003 s71A. This relief from SDLT was originally only available where the person renting or buying the property was an individual. In Finance Act 2006, the relief was widened because it was recognized that Muslims not only wanted to use this approach for the acquisition of personal residential property but also to acquire property for their businesses in a Sharia-compliant way and such a business might well be conducted by a company.

The treatment of Islamic finance transactions in computing business income may or may not need specific legislation. Muslim majority countries may not need legislation, illustrated by Egypt, or may choose to legislate to put the tax treatment beyond doubt as in the case of Malaysia. In the case of Western countries, if the tax system looks primarily to the substance of a transaction as with the Netherlands or the USA, specific legislation may not be needed. Conversely, if the tax system looks primarily to the legal form as with the UK, then specific tax legislation will be needed to ensure that Islamic finance transactions receive the expected tax treatment.

With regard to transaction taxes such as real estate transfer taxes, Islamic finance transactions risk incurring multiple charges to such taxes, compared to conventional transactions which bear only a single charge, unless the country concerned enacts specific legislation to prevent such multiple charges.

Bank Negara Malaysia has published the second edition of the Sharia Resolutions in Islamic Finance Book in October 2010. This second edition of the SAC resolutions, which is a compilation of all Sharia resolutions made between 1997 and 2009, is a continuation of the earlier efforts of Bank Negara Malaysia to deepen the understanding on the Sharia interpretations and the juristic reasoning for the rulings. It aims to increase the level of transparency on juristic reasoning in Islamic finance and thus, an increased appreciation and acceptance of Sharia decisions. It would also allow for more efficient Sharia governance at institutional level, whilst catalyzing greater cross-border harmonization in the interpretation and application of Sharia.

This edition supersedes the Sharia Resolutions in Islamic Finance (First Edition) published in 2007 and the Summary of National Sharia Advisory Council Decisions for Islamic Banking and Takaful (Summary of NSAC Decisions) issued in 2002. Accordingly, all new Islamic financial products that are going to be offered by Islamic financial institutions or any existing products to be offered to new customers must comply with the rulings of this Sharia Resolutions in Islamic Finance (Second Edition). However, for Islamic financial products which have been contracted between the customers and Islamic financial institutions based on the Sharia rulings published in the First Edition and the Summary of NSAC Decisions, the contracts remain in force until maturity.

Regarding empowerment and clarity on Sharia boards and power to the regulators for development of new products and carrying out awareness and education to the staff of the Islamic banks thae matter has been dealt in the later part of the paper.

7. Supervisory environment

Supervision of Islamic banks is equally important. At present, lack of effective prudential regulation is one of the weaknesses of the Islamic banking industry. For instance, leasing prudential regulations are applied to Ijara where the nature of both is different, such as taking advances. The bank is the owner in Ijara; so taking advances will render the contract of Ijara for conversion into Musharakah whereas the rules of Ijara are applied to it, which is illegal.

"The thing about the Islamic economy is that all of the Halal activities need to be focused and there needs to be an established link between Islamic finance and the Halal activities, and make sure they are served by Islamic finance. Financing for Halal business could come from conventional financing. But in general now, the focus for Islamic finance is to link it to the Islamic economy. This in general is something that will carry the industry further in the future. The more links, the more demand there will be for Islamic finance, so these forces will work together to make both bigger. There are weak links as well. One known issue in the Islamic finance industry, since we do business cross border, is the lack of unified regulation for Islamic finance. That makes it difficult and sometimes costly to conduct Sharia-compliant finance in countries that do not have regulation for that. Regulation is a very important part, but it's also getting discussed more and more."(Islamic Corporation for the Development of the Private Sector (ICD) CEO Khaled Al-Aboodi).

All Islamic financial institutions offer the same basic products, (90 per cent Murabaha and Ijarah) but the problem is that each institution has its own group of Islamic scholars on the Sharia board to approve the product. Consequently, the very same product may have different features and will be subject to different kind of rules in these institutions.

Every country is required to supervise its financial sector onsite and offsite. However for this they have to follow country's legislation, rules and regulations in the best interest of all the players of the financial market and finally in the betterment of economy. Since now in 21st century we have become a global village so international standards also paly their role in evolving supervisory environment.

On Islamic Finance notable international bodies include, The Islamic Financial Services Board (IFSB) ,The Accounting and Auditing Organization for Islamic Financial Institutions(AAOIFI), IIFM and Islamic Development Bank (ISDP). Further for

mitigating financial risks Basle standards are also very important.

The Islamic Financial Services Board (IFSB) is an international standard-setting organization that promotes and enhances the soundness and stability of the Islamic financial services industry by issuing global prudential standards and guiding principles for the industry, broadly defined to include banking, capital markets and insurance sectors. The IFSB also conducts research and coordinates initiatives on industry related issues, as well as organizes roundtables, seminars and conferences for regulators and industry stakeholders.

The Accounting and Auditing Organization for Islamic Financial Institutions(AAOIFI) is an Islamic international autonomous non-for-profit corporate body that prepares accounting, auditing, governance, ethics and Sharia standards for Islamic financial institutions and the industry. Professional qualification programs (notably CIPA, the Sharia Adviser and Auditor "CSAA", and the corporate compliance program) are presented now by AAOIFI in its efforts to enhance the industry's human resources base and governance structures.

As an independent international organization, AAOIFI is supported by institutional members (200 members from 40 countries, so far) including central banks, Islamic financial institutions, and other participants from the international Islamic banking and finance industry, worldwide.

Total of 88 standards have been issued: (a) 48 on Sharia, (b) 26 accounting, (c) 5 auditing standards, (d) 7 governance, (e) 2 codes of ethics. In addition, new standards are being developed and existing standards reviewed.

IIFM is the international Islamic financial market's organization focused on the Islamic Capital & Money Market (ICMM) segment of the Islamic Financial Services Industry (IFSI). It was founded in 2002 by the collective efforts of the Islamic Development Bank, Authority Monetary Brunei Darussalam, Bank Indonesia, Central Bank of Bahrain, Central Bank of Sudan and the Bank Negara Malaysia (delegated to Labuan Financial Services Authority) as a neutral and non-profit organization.

Islamic Development Bank (IDB) based in Jeddah is mandated to foster socioeconomic development of its member countries and Muslim communities in non-member countries, in accordance with the principles of Sharia (Islamic Law). Since its establishment in (1975), membership in the institution has grown considerably and there has been several increases in its capital side by side with the demand for more resources from member countries to finance operations. For over a decade now, IDB is rated AAA by the three major Rating Agencies (Standard & Poor's, Moody's, and Fitch), facilitating mobilization of resources from the market to meet the rising financing requirements of member countries. It is this rising demand from stakeholders combined with the strategic challenges facing the Muslim world that led the IDB to realign its priorities and shape a new mission and vision for the institution in accordance with new world realities.

For instance as already elaborated the Kuala Lumpur-based Islamic Financial Services Board (IFSB) has released draft guidance on liquidity risk management for Islamic banks and a new standard for regulatory supervision, as the industry body tightens oversight of banking practices. IFSB guidelines allow national financial regulators to have the final say on how they apply standards, but its prescriptive approach is gradually helping to harmonize practices across the industry's core centers in the Middle East and southeast Asia.Islamic banks face uncertainty over how regulators will treat their deposits, compounded by a lack of well-developed Islamic securities markets.

The IFSB's guidance note on liquidity management aims to clarify the accounting treatment of Islamic deposits and defines the types of high quality liquid assets (HQLA) that Islamic banks can hold to meet regulatory requirements under the Basel III banking standards now being phased in around the world.HQLA can range from cash and central bank reserves to sukuk (Islamic bonds) issued by both sovereigns and corporates, subject to various haircuts, the IFSB said.Given the shortage of such instruments, the IFSB outlined three other actions which regulators could take to facilitate the industry: liquidity facilities from central banks, allowing banks to hold HQLA in international currencies, and widening HQLA criteria.This would help Islamic banks meet Basel III liquidity coverage ratios that are being phased in from 2015 to 2019; a net stable funding requirement will be implemented in 2018.Regulators will have to determine the rights of bank customers to withdraw their Islamic deposits to define the weights, or run-off rates, that apply to these, the IFSB says. It adds that developing sharia-compliant deposit insurance schemes would be required if deposits were to be considered "stable" under Basel rules.

Regulators must also decide on the treatment of Islamic deposit holders, who must be classified as investors, as a liability to the bank, or as a mix that is partly risk- absorbent, the IFSB says.The IFSB also published a draft standard on core principles for regulation and supervision of the industry, which will come into effect in January 2016.These broadly mirror the Basel core principles, while addressing other issues such as the treatment of Islamic window operations, which are sections of conventional banks that operate according to Islamic religious principles.

The draft standard requires windows to have a minimum amount of funding from the conventional parent, and makes sharia supervision comparable to that of full-fledged Islamic banks.

Basel III (or the Third Basel Accord) on the other hand is a global, voluntary regulatory framework on bank capital adequacy, stress testing and market liquidityrisk. They are equally applicable on conventional and Islamic Banks. It was agreed upon by the members of the Basel Committee on Banking Supervision in 2010-11, and was scheduled to be introduced from 2013 until 2015; however, changes from 1 April 2013 extended implementation until 31 March 2018 and again extended to 31 March 2019.The third installment of the Basel Accords was developed in response to the deficiencies in financial regulation revealed by the financial crisis of 2007-08. Basel III was supposed to strengthen bank capital requirements by increasing bank liquidity and decreasing bank leverage.

Unlike Basel I and Basel II, which focus primarily on the level of bank loss reserves that banks are required to hold, Basel III focuses primarily on the risk of a run on the bank by requiring differing levels of reserves for different forms of bank deposits and other borrowings. Therefore Basel III does not, for the most part, supersede the guidelines known as Basel I and Basel II; rather, it will work alongside them.

The original Basel III rule from 2010 required banks to hold 4.5% of common equity (up from 2% in Basel II) of risk-weighted assets (RWAs). Since 2015, a minimum Common Equity Tier 1 (CET1) ratio of 4.5% must be maintained at all times by the bank.

Furthermore, Basel III introduced two additional capital buffers:

A mandatory "capital conservation buffer", equivalent to 2.5% of risk-weighted assets. Considering the 4.5% CET1 capital ratio required, banks have to hold a total of 7% CET1 capital, from 2019 onwards.A "discretionary counter-cyclical buffer", allowing national regulators to require up to an additional 2.5% of capital during periods of high credit growth. The level of this buffer ranges between 0% and 2.5% of RWA and must be met by CET1 capital.

The Standards and steps coming from these institutions in fact give birth to supervisory environment in the world for Islamic Finance. With growth coming in they would have to be adopted more stringently to help Islamic Finance to play its actual role.

8.Islamic Finance In The UK AsCase Example Of A Country i.e. Not Muslim.

Most of the growth of Islamic finance in the UK has taken place in the last five years, but the existence of Sharia-compliant transactions in the London financial markets goes back to the 1980s. Commodity Murabaha type transactions through the London Metal Exchange were used, in significant volumes, to give liquidity to Middle Eastern institutions and other investors that fostered the development of a wholesale market in the UK. This did not, however, cater for retail Muslim consumers, as the products developed at the time were aimed exclusively at wholesale and high-net-worth investors. These products were relatively uncomplicated in structure and fell outside the scope of the regulators.

Retail Islamic products first appeared in the UK in 1990s but only on a very limited scale. A few banks from the Middle East and South East Asia began to offer simple products such as home finance. However, these compared unfavorably with their conventional equivalents in several respects, including their generally uncompetitive pricing. Most of these products did not fall within the regulatory framework, so consumers did not have the same protection as other consumers, for example, the availability of the Financial Ombudsman Service and the possibility of redress from the Financial Services Compensation Scheme. The growth of the retail market remained slow throughout the 1990s and early 2000s.

Much has changed since then. Both on the wholesale and the retail side, the quality of products has improved; a wider range of products has become available; and more players have entered in the market.

Today, London is seen by many firms, including Islamic as well as non-Islamic, as an increasingly important global center for Islamic finance. Some of the reasons are outlined below.

There are, perhaps, six main reasons for this growth:

1. Global expansion of Islamic finance
2. Markets and skills base-London is well placed to take advantage of these trends.
3. Islamic windows:-Several major international institutions such as Citi, Deutsche, and HSBC have had apresence in the Middle East and South East Asia for several years. As a result, they havedeveloped considerable knowledge and experience of local markets, including Islamicones. To accommodate the new and growing demand for Islamic products, they haveestablished business lines known as 'Islamic windows', some of which are based in the UKand others in the Middle East and South East Asia. These windows have contributedsignificantly to the development of Islamic finance because of the institutions' globalexperience in product development and their access to far greater resources than thoseavailable to local institutions in the Middle East and South East Asia.
4. Excess liquidity in the Middle East.
5. Public policy and taxation:-Since the early 2000s the government, for reasons of wider public policy, hasintroduced a series of tax and legislative changes specifically designed to removeobstacles to the development of Islamic finance. The first significant change came inthe Finance Act 2003 which introduced relief to prevent multiple payment of StampDuty Land Tax on Islamic mortgages. The Finance Acts 2005 and 2006contained further measures aimed at putting other Islamic products on the same taxfooting as their conventional counterparts.
6. Single financial regulator:-Another contributory factor is institutional. The establishment of the FSA in 1997combined 11 different regulators into a single body under a single piece of legislation.This has done much to resolve several of complications and conflicting views stemming from the previous regulatory regime where functions were divided. In particular, the FSA is able to look across the system as a whole, to assess Islamic financial institutions and products. To date, the FSA has authorized three wholly Islamic banks, initiated by Middle Eastern investors and institutions. The Islamic Bank of Britain began operations as an authorized firm in 2004, than came European Islamic Investment Bank, which was authorized in 2006. The Bank of London and the Middle East was authorized in July 2007, with a startup capital of £175m. The first of these is retail and the last two wholesale. Other applications are in the pipeline. The FSA has also authorized one Islamic hedge fund manager and is considering an application from the first wholly Islamic Takaful provider.

The FSA also has to consider the role of the Sharia Supervisory Board (SSB). The industry defines the key objective of SSB scholars as ensuring Sharia compliance in all an entity's products and transactions. In practice, Sharia scholars examine a new product or transaction and, if satisfied it is Sharia compliant, issue an approval. The FSA is, however, a secular and not a religious regulator. It would not be appropriate, even if it were possible, for the FSA to judge between different interpretations of Sharia law. However, the FSA does need to know, from a financial and operational perspective, exactly what the role of the SSB is in each authorized firm. It needs, in particular, to know whether and if so how the SSB affects the running of the firm. The FSA has to be clear as to whether the Sharia scholars have an executive role or one that is simply advisory.

This matters for two reasons. First, in the UK, any person acting as a Director of an authorized firm must be registered under the FSA Approved Persons rules. To assess the suitability of a person, the FSA has a standard known as the 'Fit and Proper test for Approved Persons'. One of the factors looked at is 'competence and capability'. So, for an individual to become a Director of an authorized firm, we would expect them to have relevant experience. If, therefore, Sharia scholars are seen to have a directorship role, it is possible that some of them may not meet the competency and capability requirements. Second, and assuming that Sharia scholars are Directors, their role is more likely to resemble that of an Executive Director than a Non-Executive Director as it might involve active participation in the firm's business. In such cases, it would be very difficult to justify multiple memberships of SSBs of different firms because of significant conflicts of interests. This would put further constraints on an industry already facing a shortage of Sharia scholars with suitable skills. The key point from the FSA's perspective is that firms can successfully show that the role and responsibilities of their SSB are advisory and it does not interfere in the management of the firm. The firms already authorized have been able to show this. The factors that the FSA typically looks at with regards to SSBs include the governance structure, reporting lines, fee structure and the terms and conditions of the SSB's contracts.

The FSA expects all authorized firms to identify, monitor and mitigate the risks they face. Islamic firms are no exception. Although there are many risks which are common to Islamic and conventional firms, the FSA's experience shows there are several risks which are specific to Islamic firms. The list is not exhaustive and not all of the risks apply to all Islamic firms. There are differences too in the risk management practices of wholly Islamic firms and conventional firms operating Islamic windows, some of which we also discuss here.

Risks specific to Islamic finance in UK have been identified as follows-

1. Sharia 'arbitrage'- There is a diversity of opinion as to whether particular practices or products are Shariacompliant. This means that some products and services may be approved as being Sharia compliantby some Sharia scholars but not by others. On a global level, the approval of Islamic firms' products and services may also depend on the jurisdiction they are to be offered in. This can add another layer of complication for regulators.The FSA is in no position to assess the suitability of the scholars consulted by Islamic firms. It does, however, want to see the basis on which an Islamic firm claims to be Sharia -compliant is communicated appropriately to the consumer. More generally, it supports moves to develop common Sharia standards by organizations such as the Islamic Financial Services Board (IFSB) and the Accounting and Auditing Organizationfor Islamic Financial Institutions (AAOIFI).The IFSB, for example, has recently called for a dialogue within the industry to adapt current insurance regulations to meet the specifics of Islamic finance. Greater standardization could reduce the potential for Sharia 'arbitrage' as well as making it easier for bankers and investors to understand the market.

2. Sharia compliance throughout the product life cycle- For Islamic finance providers, gaining approval from the SSB on Sharia compliance of aproduct before its launch is vital. Equally important for firms is recognizing that Shariacompliance is a continuous process that means their products and services areadequately monitored. Unlike conventional finance, this has implications for an Islamicfirm's prudential requirements as well as conduct of business: some products, if theybreach Sharia compliance rules, can adversely affect a firm's solvency by converting anasset into a liability on the balance sheet. Effective monitoring of Sharia compliance byan Islamic firm may involve reinforcing more remote SSB oversight through the InternalSharia Audit process and by developing more knowledge and expertise within the firm.

3. Issues for Sharia scholars:-Several of the potential issues for Sharia scholars were outlined as above. It is worthhigh-lighting two more. The shortage of appropriately-qualified Sharia scholars in theIslamic financial industry means it is common for individual scholars to hold positionson the SSBs of a number of Islamic firms. This raises concerns over the ability of SSBs toprovide enough rigorous challenge and oversight of firms' products and services. Anotherissue is where the SSB of a firm is responsible for the yearly Sharia audit as well asapproving products for Sharia compliance. As with conventional firms, the FSA wouldlike to see these conflicts recognized and carefully managed.

4.Human resources-It is widely acknowledged that there is a global shortage of experienced professionals inthe Islamic finance sector. There is clearly scope for more education and training in theUK and some positive steps are now being taken. These include university degrees andprofessional training courses.As explained, the shortage of resources also extends to Sharia scholars who haverelevant banking experience. To address this, some firms have placed less-experiencedscholars alongside experienced ones on their SSB, thus helping to develop moreknowledgeable scholars.

5. Contract and documentation risk- In contracts for Islamic transactions, the enforceability of terms and conditions dependson the governing law. In the case of a dispute, it is unlikely that a UK court will give averdict based on Sharia law. The precedent here is the case of Shamil Bank of BahrainEC v Beximco Pharmaceuticals Ltd et al, in 2004, when the Court of Appeal ruled that

it was not possible for the case to be considered based on principles of Sharia law. There were two main reasons. First, there is no provision for the choice or application of a non-national system of law, such as Sharia. Second, because the application of Sharia principles was a matter of debate, even in Muslim countries. To mitigate this risk, contracts have to be written very carefully to minimize potential disputes and state the governing law. This is well understood by the industry. At present, most Islamic contracts are governed by English law, and a few under New York law. There are also advantages in standardization of documentation and a number of

initiatives are under way in this field.

6.Risk of contagion-In the UK, the risk of contagion to the wider economy and financial markets through afailure of an Islamic financial institution is limited as the market is currently relativelysmall. In countries where Islamic institutions have a larger share of the market theimpact would be wider.The industry is still very young and it is still building its reputation and credibility.Additionally, in some countries, Islamic finance and its various business models (whichhave so far tended to be conservative) have not yet been tested in a severe economic ormarket downturn. Given these factors, a significant failure now in the Islamic marketmight have a damaging impact on the future development of this sector.

7. Risk management framework:-Sharia scholars of a wholly Islamic firm require all transactions within the firm to be incompliance with Sharia, including risk management. Many of the commonly used tools(for example, certain types of derivatives which are used for hedging against currency,interest rates and other risks), are not acceptable to almost all Sharia scholars. In thepast, this has made risk management more difficult for wholly Islamic firms as Shariacompliant substitutes have been slow to develop. However, new products andtechniques are gradually emerging - for example, Sharia-compliant, derivative-likeproducts for managing foreign exchange and interest rate risk.Liquidity management has also been a challenge because of the lack, or limitedavailability, of Sharia-compliant instruments. Two of the instruments widely used byconventional banks, namely inter-bank deposits and government and corporate bondsor notes, are interest bearing, so are viewed as non-Sharia compliant by scholars.

No doubt Islamic firms have to develop other methods as well. In the UK, as elsewhere, Commodity Murabaha transactions, which have a long history, are being structured so as to have almost exactly the same effect in terms of liquidity as the inter-bank deposits of conventional banks. Other products have been developed but their use is very limited. Some methods such as Tawarruq are controversial and no consensus has been reached on whether they are Sharia compliant. Islamic securities markets are still relatively small in volume and quite illiquid.

Nevertheless, volumes are now expanding and markets arebeginning to develop around the world. For banks with 'Islamic windows', the industry practice is that the risks arising from Islamic business and products are often pooled with risks from conventional business. Conventional tools are used to manage risks, at business unit or group level, but with certain limitations. For example, a firm that runs both Islamic and conventional mortgage books may have to keep the books separate at the start; but it may still pool the risks from the two books together and use a conventional tool to manage them. This practice has been accepted by the scholars of these firms. In short, the constraints in risk management for Islamic firms are due mainly to lack of availability of suitable products and the relatively small size of the markets. However, if Islamic finance continues to develop as it has done over the past five years or so, many of these constraints should reduce as more institutions enter the market and new tools evolve.

Basel 3 and risk management:-The new Basel 3 capital risk framework has been recently introduced in the UK, in theform of the EU Capital Requirements Directive. Basel 3 is a revision of the existingBasel accord, which aims to make the framework more risk sensitive and representativeof modern banks' risk management practices. The broad framework consists of threepillars. Pillar 1 sets out the minimum capital requirements firms will be required to meetfor credit, market and operational risk. Under Pillar 2, firms and regulators have todecide whether a firm should hold additional capital against risks not

covered in Pillar1, and must take action accordingly. Examples of Pillar 2 risks include concentration,liquidity and reputational risk. The aim of Pillar 3 is to improve market discipline byrequiring firms to publish certain details of their risks, capital and risk management.If, in practice, certain risks affected Islamic institutions more than conventional firms,the FSA would expect these to be identified and quantified under Pillar 2. Where this isnot possible or capital is not an appropriate mitigating tool, then other ways ofmanaging these risks would need to be identified. Similar to conventional firms, thesewill include sound corporate governance and appropriate systems and controls. TheFSA is in the process of putting this approach into practice across the firms it regulatesbut this is still work in progress. The FSA's approach to both Islamic and conventionalfinancial institutions will develop over time.

Islamic finance in retail markets:-After a slow start in the 1990s and early 2000s, the retail market has witnessed growthand some significant milestones in the last fifteen years. Even so, establishing the markethas not been as fast as some commentators predicted. Although reliable estimates of theoverall size of the Islamic retail market are hard to come by, volumes appear to berelatively small. The size of the Islamic mortgage market in the UK, for example, isestimated at only £500m compared with the stock of mortgage lending of over £1.1trillion in the UK as a whole and nearly 12 million borrowers. As far as we are aware,there are around nine or ten regulated financial institutions, including major high streetbanks, active in the Islamic retail markets. There are perhaps two main reasons for this modest growth. First, that demand may originally have been overestimated. Research by some commentators shows thatfinancial decisions in the Muslim community, as in the population as a whole, are influenced by a variety of factors. Similarly, the Muslim community is not a uniform group in terms of relative affluence. In the past, there have been tax and regulatory hurdles and it is tooearly to judge whether recent reforms will result in an increased market share for Islamic products.

Islamic mortgages:-In the UK, Islamic mortgages have been structured under two different Sharia-compliantcontracts, namely, Murabaha and Ijara.This method of financing falls within the definition of a regulated mortgage contract and has been regulated by the FSA alongside conventional mortgages since October 2004. It has rarely been used in the UK. Ijara based contracts - Ijara and Diminishing Musharaka - are the commonly used methods in the UK. the regulatory requirements that were introduced took account of the relatively small size of the market and the FSA's commitment to a more principles-based approach. It was recognized that imposing an expensive regime could have led some firms to cease offering the products altogether and to other distortions in the market. The FSA's requirements were generally kept at a high level and proportionate to the expected benefits for consumers.There is now a single sourcebook for the conduct of business for 'Mortgages and Home Finance'. To date, the FSA has received a few applications to offer HPPs by existing providers and more than that by intermediaries to enter this market.

Prudential requirements:- Under Basel 1, Murabaha-based home finance products were considered to have thesame risk as conventional mortgages, risk weighted at 50%. Ijara-based products,however, were risk weighted at 100%, making them slightly more expensive forproviders than conventional mortgages. Under the EU Capital Requirements Directive,the risk weights of all three products are the same in the UK, set at 35%, under thestandardized approach.

Takaful:-Takaful operations are mutual in nature and similar to conventional mutual insurers.Takaful firms and products are structured in a manner to address the specific concernsof Sharia scholars with conventional insurance products, namely uncertainty (gharar),gambling (maisir), interest (riba) and investment strategy. To deal with these concerns,Takaful products have three distinctive features - greater transparency in providing aclear distinction between the Takaful fund, which consists of contributions frompolicyholders akin to premiums, and the Takaful operator who manages the fund; anelement of profit sharing; and limitations on acceptable investments. Specific models for Takaful vary, but Takaful operations often have a two-tier structure consisting of one or more funds belonging to policy holders, above which sits a limited company with share capital which is responsible for overall governance, underwriting of risks, and investment management. Like conventional insurers, Takafulcompanies can generate a return based on their underwriting activity and their investment activity. The remuneration is either based on fixed fee or performance, but is commonly a combination of both, with underwriting subject to a fixed fee and investment management performance related. At times when the Takaful operator's activities generate a loss and the funds are in deficit, this can be made up by an interest free loan provided by the limited company, to be repaid once the funds are in surplusagain. As yet, Takaful activity in the UK remains very limited, From a regulatory perspective, the FSA would treat a Takaful provider as it would any other insurance provider, assuming there was enough similarity in function and form. Given the parallels drawn between Takaful providers and conventional insurers, particularly mutual insurers, ratings agencies are also assessing them using the samemethod.

wholesale markets:-In the last few years, the number of firms offering Sharia-compliant products and serviceshas increased significantly. This has been particularly the case in London, as many international banks have situated their Islamic banking and advisory activities here. London's strength in financial engineering and product design has meant that many Islamic products and solutions are now structured in London and marketed in the Middle East as well as to Western markets. The wholesale Islamic finance activities offered by the 25 or so firms active in London, including the two wholly Islamic banks, range from traditional banking activities and project and trade financing to structured products, asset management and private banking. The number of firms involved is growing.

Market developments:-The greatest growth has been in Sukuk markets. The volume of outstanding issues isestimated to $114.7 billionglobally, a considerable portion of which is listed in Bahrain andDubai.Sovereign issuances accounts for almost 80% of total issuances. London has, however, started to follow suit. It recently took a positive steptowards becoming a global center for Islamic finance and a center of choice for listingSukuk by establishing the world's first secondary market for Sukuk. According to theFinancial Times, trade volumes in London 'is trickling up. The first Sukuk was listed on the London Stock Exchangein July 2006. A few more have been listed since then with the listing by 'AldarProperties' the largest to date.The industry is also very supportive of the idea of the UK government issuing asovereign Sukuk.Their hope is that a sovereign Sukuk will provide abenchmark for pricing, enhance liquidity in the markets and boost London's ability toattract further Sukuk structuring activity. UK government has now issued first of its sovereignSukuk amounting Pounds 200 million against demand of pounds 2.3 billion maturing on 22nd July 2019. The profit rate on the Sukuk has been set at 2.036% in line with the yield on gilts of similar maturity. Britain's sovereign Sukuk uses the Al-Ijara structure, the most common structure for sovereign Sukuk, with rental payments on property providing the income for investors. The Sukuk is underpinned by three central government properties. Today's issue will be listed on the London Stock Exchange

Regulatory treatment of Sukuk:-The structures of Islamic products have created some challenges over their regulatorydefinitions in the UK and other centers around the world. Sukuk have been noexception to this. While similar in economic terms to conventional bonds, Sukuk mayhave significantly different underlying structures. The Accounting and AuditingOrganization for Islamic Financial Institutions (AAOIFI) has identified at least 14possible structures for Sukuk and

more are being developed. It is therefore evident thatit may not be possible to find one overarching regulatory definition for all types ofSukuk. These instruments need to be examined on a case-by-case basis.

Treatment of Sukuk for listing purposes:-Any entity wishing to list an instrument, including Sukuk, on the London StockExchange is required to apply to the UK Listing Authority (UKLA), a division of theFSA. Listing procedures, prospectus and transparency regime and classification ofinstruments are based on the governing EU Directives and/or FSA listing rules. Theclassification of Sukuk as a CIS under FSMA does not conclusively determine how it should be classified for listing purposes. In this context, it has been and is possible for Sukuk to be classified as a debt security, subject to the information from the issuer being supplemented by including appropriate additional information as required. This appears to be better than, say, treating the Sukuk as an 'asset-backed' security since this would detract from the role of the originator as providing what could be said to amount to credit protection for the periodic dividend payments and repayment of principal. Although derivative products are well established tools for managing risks in conventional financial markets, there has been considerable difficulty developing Sharia compliantproducts which mirror these instruments. These products are controversial and have not been readily accepted by scholars because of their speculative nature. A small number of products have been developed by various banks, for example, Citi have products for managing currency and interest rate risk and other firms such as Deutsche Bank have developed a technique for Islamic derivative products. Indicative of the widening interest in this area, the International Swap and Derivatives Association (ISDA) and the International Islamic Finance Market (IIFM) have signed a Memorandum of Understanding (MoU) to develop a master agreement for Sharia compliantderivative products. It is difficult to assess exactly what type of instrumentsmay result but the FSA is following this closely.

Hedge funds:-Several hedge fund managers have Sharia-compliant funds within their portfolios. InJanuary 2007, Amiri Capital was authorized as astand-alone Islamic hedge fund manager and more applications may be in prospect. The growth will to a great extent depend on whether the investors approve the methods proposed by fund managers. As with the UK managers of conventional hedge funds, managers of Islamic funds would also be regulated by the FSA. As now, the main regulatory focus would be on systems and controls, valuations, disclosure and conflicts of interest. So far as we know, there arecurrently no major regulatory issues with regard to Islamic hedge fund managers.

EU pass porting:-Under the relevant European Union directives, one avenue for financial institutions inthe UK, including Islamic ones, to expand is to 'passport' their business activities intoany one of the European Union member states (and vice versa). Concerted efforts have been made within the European Union to form a single market for financial services; and UK-authorized institutions may offer products throughout the European Union without the need to have separate authorization in each member country. This means that Islamic institutions that 'passport' would have access to an estimated 15 million potential customers. The Bank of London and the Middle East is the first Islamic bankto have taken advantage of a cross-border services passport, which enables it to offer its products and services across all EU member states, without a physical presence in the host country.

Government initiatives:-The government has taken important steps to promote the industry. In April2007, the Treasury established an 'Islamic Finance Expert Group' representing a broadcross-section of opinion from the industry, the City, Muslim organizations and other bodies, including the FSA. The general objective is to advise the government on opportunities to help Islamic finance in the UK. More specifically, the group is overseeing an official study by the Treasury and the UK Debt Management Office on the possibility of the UK government issuing a sovereign Sukuk in the wholesale market. As to be expected, the study is examining the practical, legal and tax implications of doing so as well as structural issues such as the need for primary legislation. It has already generated a good deal of interest among market participants and the government will publish a consultative document later in 2007.

Looking further ahead, there is scope to expand the market for Islamic products andservices to non-Muslims as well as Muslims in UK. The market is not confined to a particulargroup of consumers and Islamic finance providers can position their products to appealmore to the much larger non-Muslim population. Their success in doing so will in partdepend on the ability to demonstrate how the products are underpinned by generally acceptedethical principles. If Sharia-compliant products are no longer seen as 'exotic'or niche products, the industry could benefit from economies of scale which would helpto sustain it over the longer-term.The potential for the future growth of Islamic finance, in the retail and wholesale markets, is clear and both the government and the City are actively promoting this objective. London's emerging role as a hub for Islamic finance is underpinned by the factors, in particular, a wide skills base, innovation and flexibility and historical links with the Middle East. These will remain strong. The government's tax and legislative framework has established a level playing field for a variety of Islamicproducts such as mortgages, bonds and insurance. This could lead to the availability of new retail products, the expansion of wealth and asset management services and the development of Sukuk and other wholesale markets.The FSA has been, and is, willing to play its part in supporting these developments,within its regulatory powers under FSMA. "Although we cannot promote Islamic finance(or any other particular kind of finance), we can give a clear regulatory framework which is flexible enough to adapt to changes in the market. We are keen to see the industry expand, although we recognize this will bring new regulatory challenges. If there is future growth in this market, it should benefit UK consumers and develop London further as an international financial center" FSA (UK) says.

9 .Takaful (Islamic Insurance)

Global gross Takaful contributions are estimated to have amounted to USD21.5bln as at 1H2014. Annual growth in contributions was forecasted to be more than 15% by end of 2014.

Saudi Arabia and Malaysia are the largest Takaful markets by gross contributions. Saudi Arabia generated an estimated USD6.4bln in gross Takaful contributions in 2013, while Malaysia gathered about USD2.29bln.

With the continued buoyancy in the estimated US$2 trillionglobal Islamic finance markets to be reached, the global Takaful market isestimated to continue its double-digit growth momentum ofabout 14% in 2014. By 2017, the global Takaful industry mayreach over US$20 billion.

Takaful Industry is growing rapidly around the world with more than 230 Takaful Companies, 13 Re-Takaful companies.

In Pakistan Takaful was started in 2005 when Securities and Exchange Commission of Pakistan (SECP) introduced Takaful Rules 2005 according to which only full fledge takaful companies had the permission to operate and in this regard, 5 Takaful companies came into being due to efforts of investors of Malaysia, Qatar, Kuwait, UAE, Saudi Arabia and Pakistan. Among these 5 companies, 3 takaful companies are general whereas 2 takaful companies are providing the services of Sharia's compliant life insurance. But in accordance with the recently issued SECP takaful rules 2012, conventional insurance companies can open window operations of Takaful due to which takaful industry would get promotion rapidly at national level.

Takaful is an Islamic insurance concept which is grounded in Islamic muamalat (banking transactions), observing the rules and regulations of Islamic law. This concept has been practiced in various forms for over 1400 years. It originates from Arabic word Kafalah, which means "guaranteeing each other" or "joint guarantee". In principle, the Takaful system is based on mutual co-operation, responsibility, assurance, protection and assistance between groups of participants. It is a form of mutual insurance.

These fundamentals are based on the sayings of Prophet Mohammed (PBU). Based on the hadith and Quranic verses mentioned below, Islamic scholars had decided that there should be a concerted effort to implement the Takaful concept as the best way to resolve these needs. Some of the examples are:

(1) Basis of Co-operation Help one another in al-Birr and in al-Taqwa (virtue, righteousness and piety): but do not help one another in sin and transgression. (Surah Al-Maidah, Verse 2)

(2) Allah will always help His servant for as long as he helps others. (Narrated by Imam Ahmad bin Hanbal and Imam Abu Daud)

(3) Basis of Responsibility The place of relationships and feelings of people with faith, between each other, is just like the body; when one of its parts is afflicted with pain, then the rest of the body will be affected. (Narrated by Imam al-Bukhari and Imam Muslim)

(4) One true Muslim (Mu'min) and another true Muslim (Mu'min) is just like a building whereby every part in it strengthens the other part. (Narrated by Imam al-Bukhari and Imam Muslim)

(5) Basis of Mutual Protection By my life, which is in Allah's power, nobody will enter Paradise if he does not protect his neighbor who is in distress. (Narrated by Imam Ahmad bin Hanbal)

(6) The basic fundamentals underlying the Takaful concept are very similar to co-operative and mutual principles, to the extent that the co-operative and mutual model is one that is accepted under Islamic Law."

The principles of Takaful are as follows:

(a) Policyholders co-operate among themselves for their common good.

(b) Every policyholder pays his subscription to help those that need assistance.

(c) Losses are divided and liabilities spread according to the community pooling system.

(d) Uncertainty is eliminated in respect of subscription and compensation.

(e) It does not derive advantage at the cost of others.

Takaful is an alternative form of cover that a Muslim can avail himself against the risk of loss due to misfortunes. Takaful is based on the idea that what is uncertain with respect to an individual may cease to be uncertain with respect to a very large number of similar individuals. Insurance by combining the risks of many people enables each individual to enjoy the advantage provided by the law of large numbers.

In modern business, one of the ways to reduce the risk of loss due to misfortunes is through insurance which spreads the risk among many people. The concept of insurance where resources are pooled to help the needy does not contradict Sharia. However, conventional insurance involves the elements of uncertainty (Al-gharar) in the contract of insurance, gambling (Al-maisir) as the consequences of the presence of uncertainty and interest (Al-riba) in the investment activities of the conventional insurance companies that contravene the rules of Sharia. It is generally accepted by Muslim jurists that the operation of conventional insurance does not conform to the rules and requirements of Sharia.

Theoretically, Takaful is perceived as cooperative insurance, where members contribute a certain sum of money to a common pool. The purpose of this system is not profits but to uphold the principle of "bear ye one an others burden." Commercial insurance is strictly not allowed for Muslim as agreed upon by most contemporary scholars because it contains the following elements: i) Al-Gharar (Uncertainty) ii) AlMaisir (Gambling) iii) Riba (Interest)

There are three models and several variations on how tearful can be implemented:

(1) Mudharabah Model (2) Wakalah Model (3) Combination of both.

The Qur'an prohibits gambling (games of chance involving money). The hadith, in addition to prohibiting gambling (games of chance), also prohibits bayu al-gharar (trading in risk, where the Arabic word gharar is taken to mean "risk").

The Hanafi school of thought in Islam defines gharar as "that whose consequences are hidden." The Shafi legal school defined gharar as "that whose nature and consequences are hidden" or "that which admits two possibilities, with the less desirable one being more likely." The Hanbali school defined it as "that whose consequences are unknown" or "that which is undeliverable, whether it exists or not." IbnHazm of the Zahiri school wrote "Gharar is where the buyer does not know what he bought, or the seller does not know what he sold." The modern scholar of Islam, Professor Mustafa Al-Zarqa, wrote that "Gharar is the sale of probable items whose existence or characteristics are not certain, due to the risky nature that makes the trade similar to gambling." There are a number of hadith who forbid trading in gharar, often giving specific examples of gharhar transactions (e.g., selling the birds in the sky or the fish in the water, the catch of the diver, an unborn calf in its mother's womb etc.). Jurists have sought many complete definitions of the term. They also came up with the concept of yasir (minor risk); a financial transaction with a minor risk is deemed to be halal (permissible) while trading in non-minor risk (bayu al-ghasar) is deemed to be haram.

What gharar is, exactly, was never fully decided upon by the Muslim jurists. This was mainly due to the complication of having to decide what is and is not a minor risk. Derivatives instruments (such as stock options) have only become common relatively recently. Some Islamic banks do provide brokerage services for stock trading and perhaps even for derivatives trading.

Life insurance in Takaful is a new contract not known in the history of Fiqh. Muslim scholars have different opinions regarding this kind of insurance.

Responding to the question, Dr. MonzerKahf, Scholar in Islamic Economics & Financial Expert, states the following:

In the circles of contemporary Sharia's scholars, there are three opinions about life insurance. They all recognize that it is a new contract not known in the history of Fiqh. A minority consider it haram and with all kinds of argument against it including Riba, gambling, gharar and speculation on the will of Allah. This view does not carry much weight.

The second view is that it contains gharar because no one knows whether the liability of the insurer (the company) will ever materialize nor when it will, if ever. This is a serious gharar that leads to a major defect in the contract. It is therefore forbidden.

The third opinion is presented by the late Sheikh Mustafa al Zarka. He argued that the gharar in the contract is remedied by the fact that it is a contract based on overwhelming statistical knowledge and the application of the theory of probability. With this in mind, there is no ghararon the part of the insurer and the contract is permissible with two conditions: that it con-

tains no Riba clause and that its subject (insured thing) be legitimate. These two conditions rule out regular fixed return life insurance because the value of the policy is the outcome of investment premiums at a compounded rate of interest, (while variable - return life is permissible if the funds are invested in the sharia approved stocks or mutual funds). They also rule out insuring a prohibited activity such as casinos.

The advocators of the second opinion argue that the gharar problem applies only in exchange contracts. If the contract is modified and restructure on the basis of cooperation or mutuality, where there will be an association of the insured instead of a profit motivated insurer company, the gharar is then tolerated. This is so because the relation between the association and its members become based on contribution or tabarru' rather than exchange and a tabarru' can accommodate certain conditions (i.e., that the association compensate in case a hazardous event happens). On the basis of this all the "Islamic insurance companies" were established.

In this regards, al-Zarka adds, that if a mutual or cooperative insurance exists he prefers it to profit motivated insurance out of his respect to the opinion of opponents. There is an old argument (from the 1950s), even by those who oppose insurance, that whenever insurance is forced by law, one must do it and one is excused, from the Sharia's point of view. This include car insurance, social security, workman compensation, and employer's imposed insurance if it is not optional for the employee to this we add another element that if the insurance provided by the employer is paid completely from the employer, i.e., given as a fringe benefit without deducting any part of the premium from the pay checks, then it is a kind of grant from the employer and if a hazard happens the paid policy amount is halal because it is an outcome of the grant.

Now think for yourself: if your life insurance is only term life, you may apply the opinion of Sheikh al-Zarka, and if it is imposed by employer, you also have room to accommodate, and if it is a grant from employer it is also tolerated. Otherwise you need to see the specifics of the contract you have and determine, in the light of the above briefing, whether you keep or seek to withdraw from it.

Finally with more clarity on concept on Takaful and public awareness the business of Takaful would get its roots among general masses in the time to come.

10. SMEs/Microfinance in Islamic Finance

A group of people or individuals with all their efforts are trying in the field of economy in a very limited scale, that is what is called the SME (Small and Medium Enterprises). There are many factors that limit the movement of MSME business. The main factors that affect their movement is limited difficulty of access to education, capital, and technology. However in objective reality, with all its limitations, the SMEs still able to survive in the storm of economic crisis.

If traced in depth, proves the existence of SMEs supported by the flexibility of their respective fields of business, whether starting from a small capital, simplicity of technology, limited human resources in quality and quantity, as well as the limited market. Such characteristics are also supported with a high morale to maintain self-esteem.

Taking example of Indonesia i.e. leading SME sectorial activities it is evident that most SMEs in Indonesia that have shaped their own characteristics in accordance with the reality of the Indonesian economy. They run their businesses that can stand on their own feet and be independent without having a group or under other corporate groups. Most production is not a service but the goods using relatively low technology. The orientation focused on the local market so that any location in rural or suburban. Their capital is also limited, and that certainly was a very difficult business to get loans or financing from banks, in other words un-bankable category.

While occupying the foundations of economic structures, Indonesia has become the driving force of economic development, but yet its capital support from MSMEs is still minimal. In such circumstances, financial assistance, technology, and management for the development of their institutional capacity is needed. One unique thing that currently found in the MSMEs is their commitment and concern for morality. At the time of the big businessmen and tycoons committing all kinds of business crimes that violate the law, people working in the field of MSME clung to business ethics and morality. By looking at the contribution of SMEs and the urgency of the nation's economic development, so it's natural for sharia banking industry reorientation to focus on the real sector by empowering the SME entrepreneurs.

The role of Islamic banking in the real sector development can be seen from the scheme developed in the Islamic bank financing, but in the real contributions donated by Islamic banks through their duties as a financial intermediary institutions. Viewed from the financing schemes that were developed by the Islamic banks to channel funding to the real sector. Business dynamics that occur in the real sector will be reflected directly in Islamic banking activities. In channeling financing, Islamic banks use the akad-akad which is always associated with the real sector and financial sector growth that simply follow the growth of real sector.

Financing with akadmurabaha, greetings, and channeled throughijara if there is a good or service (real sector) that are funded. Even with the covenant Musharaka financing / mudaraba, they not only channel thefinance to the real sector, but also make perfect correlation between the cost of capital and return on capital. This is obviously very different from lot of conventional banks as they are not disbursing credit to the real sector because of speculation in the financial markets. Islamic banks are not based purely on financial sector as conventional banks are. Instead, Islamic banks are based on real sector.

Most conventional bank funds are not having an impact on the growth of real sector since bought SBI (Bank Indonesia Certificate) to obtain revenue without the risk of interest rates. What's worse, a large number of conventional bank loans are used for speculation in financial markets, or at least can be said, are not used to encourage the growth of real sector.

Some things that can be provided by Islamic Bank for SMEs is to do with the achievement of targets and the vision above, among others: First, extensive alternative products with the result as the main product. Products with a system of profit and loss sharing partnership is appropriate paradigmatic to empower MSMEs. Second, business management based on moral and transactions in accordance with Islamic principles. This is matched to the characteristics of people engaged in the MSMEs, who want to stick firmly to business ethics and morality. Third, manage and have access to funds in the voluntary sector. This is in accordance with the commitment of Islamic Banking concerned with the development of SMEs as part of poverty alleviation through economic instruments of Islam (Zakat, infak, Sadaqah, Endowments) Is applicable to the concept of the above services that can be implemented by the Bank Syariah (An Indonesian Bank) through strategic programs that follows: First, Islamic banks haveto give top priority to serve the financing of SMEs. Financing SME segment itself can be executed directly by the branch offices of banks or do Channeling sharia or joint financing through linkage programs. But according to World Bank findings, the most appropriate approach for SMEs is that Microfinance Institutions here Sharia bank linkage programs with LKMS (LKMS stands for LembagaKeuanganMikroSyariah (Indonesian: Islamic Microfinance Institutions)) needs to be optimized to reach SMEs.

Islamic Bank Linkage Program with BMT (BaitulMaalWatTamwil) group of business in Indonesia:- This partnership program is the most important step in Indonesia because the condition of SMEs (small-scale, limited collateral, no legal status, remote location, and the administration is weak) is very difficult to reach even by the Bank Syariah (high costs, high risks, legal requirements, difficult to reach, and the difficulties business rate). Existence LKMS as BMT is indispensable as a mediation between the SME sector with the Bank Syariah. This is because the characteristics of the BMT is matched with the needs of SMEs, which provide savings services, financing, payments, deposits; focus to serve SMEs; using the procedures and mechanisms for contextual and flexible; and was in the midst of a small or rural communities. BMT as a representative of the Islamic Bank to channel financing has been mandated to him so that his own Islamic Bank need not fear taking a huge risk.

The second program, the pilot project as well as the development of SMEs empowerment scheme or sharia investment models for SMEs:- With this pilot project, a good example will appear that would prove that the Islamic financing scheme is very beneficial and equitable. Islamic Banking can also jump directly handle mudaraba and musharaka financing with joint responsibility. As a first step of the pilot project, Bank Syariah can work with BMT to declare the agenda of "one SME, one superior product". This can improve the competitiveness of SMEs and encourage them to continue to innovate. The project was conducted by mentoring and education, especially in the management aspects of shari'a schemes and paradigms for the system.

Furthermore, Third, the Islamic Banking Program Human Care and Development Sector Voluntary Blueprint Sharia:- Through the ability to access and manage the social funds, Bank Syariah should make the stages and strategic steps to optimize the potential of social. To raise funds, for example, Bank Syariah can issue social philanthropy to its customers or perhaps even implement CSR (Corporate Social Responsibility). Through the development of products qardhulhasan, Bank Syariah can reduce the difficulties experienced by SMEs that experienced natural disasters or natural disaster. Grants, gifts, or free assistance in the form of equipment or business can be conducted infrastructure as a manifestation of concern to the people of Islamic Banking.

Fourth, improving SMEs capacity building by providing technical assistance in the form of management assistance, SOP standardization, the use of IT systems, and marketing products can be very helpful. This increased effort may involve relevant departments of the cooperatives and SMEs, industry and trade, as well as PNM SOEs or even NGOs in their respective fields.

Poverty alleviation programs through the empowerment of SMEs who became one of the mission of Islamic banks today will not by itself make the community prosper, as long as there has been no effort to remove barriers simultaneously the source of problems in the development of small and micro businesses. Barriers should be eliminated in efficiency, increase output quality, reduction of unemployment, increasing rural incomes, and reduce the gap between the rich and the poor. For that, the Government must be able to make policies that do not harm the perpetrator parties small and micro businesses in the attempt. Unfair regulation will cause reduced output, increased reliance on imports, reduction in export competitiveness, and pressing the lower income communities both rural and urban, so the development of small and micro businesses and social welfare in the area are difficult to materialize.

This classic is always is questioned why the perpetrators of micro and small businesses cannot grow is not the availability of funding sources (financial) as capital to run its business. Actually it is not enough funding to develop a business. If we look at periods of the previous governments of Indonesia, how much funding assistance programs (financial) loans were disbursed in the form of government to develop a variety of businesses but that did not bring results, but instead made efforts to have run into bankruptcy because they were unable to compete in developing a business that were not can repay their loans. The main cause of the failure of these programs, is not running an equal partnership between the stakeholders involved in the program, in addition to other reasons.

Therefore, Bank Syariahof Indonesia have now taken lessons from programs that have been made in the past. Programs that have succeeded, can be taken advantage by the Bank of sharia by reducing the weaknesses that caused the end of the program. All stakeholders need to be aware of development, that is currently developing an economic system based on the values of the Islamic Sharia as an alternative to the system running right now. Prevailing economic system currently cannot solve the perceived problems of distribution as they are not well balanced and widen the gap between the rich and the poor. Thus, in a development program for the public welfare, there is a need to examine the concepts of Islamic economy as an alternative solution of the prevailing economic system so far.

However, the most important of all the above programs is the lack of awareness of Islamic Banking to MSMEs. For that in concrete terms, the commitment of sharia banking in microfinance development is must, particularly by ensuring the allocation of significant funds in the banking business-plan for the micro entrepreneurs. This, can be actually channeled through Islamic microfinance institutions that have already proven integrity and capability.

Hence Islamic Micro Finance and SMEs experiences in Indonesia can become a lesson for other countries as well.

Taking another example i.e. of Saudi Arabia. The biggest issue for SMEs in Saudi Arabia is for instance banks in Saudi have liquidity, but they don't have programmes to finance SMEs. These are left to some initiatives that the public institutions have to support SMEs. There are also limitations in terms of size because sometimes the maximum that can be provided is SAR 4 million. Sometimes companies need SAR 10 or 20 million to expand and it is very difficult to get this funding.

Saudis are working to address that. They had established an SME fund that looks to provide SAR 5-50 million. This is where the gap existed. So now they have established a Saudi SME fund with SAR 1 billion capital, and have started the first phase with SAR 400 million to address the issues. This would will not be enough to satisfy the needs of SMEs but at least to provide a solution so that others can look into this and follow suit.

Establishment of a leasing company with the focus on SMEs. Is underway. The finance will be to supply equipment, machines, trucks and more for SMEs.

An estimated 72 percent of people living in Muslim-majority countries do not use formal financial services (Honohon 2007). Even when financial services are available, some people view conventional products as incompatible with the financial principles set forth in Islamic law. In recent years, some microfinance institutions (MFIs) have stepped in to service low-income Muslim clients who demand products consistent with Islamic financial principles-leading to the emergence of Islamic microfinance as a new market niche.

Islamic microfinance represents the confluence of two rapidly growing industries: microfinance and Islamic finance. It has the potential to not only respond to unmet demand but also to combine the Islamic social principle of caring for the less fortunate with microfinance's power to provide financial access to the poor. Unlocking this potential could be the key to providing financial access to millions of Muslim poor who currently reject microfinance products that do not comply with Islamic law. Islamic microfinance is still in its infancy, and business models are just emerging.

In a global survey on Islamic microfinance, CGAP (Certified Government Auditing Professional (CGAP) certification program) collected information on over 125 institutions and contacted experts from 19 Muslim countries. The survey and a synthesis of other available data revealed that Islamic microfinance has a total estimated global outreach of only 380,000 customers and accounts for only an estimated one-half of one percent of total microfinance outreach.

The supply of Islamic microfinance is very concentrated in a few countries, with the top three countries (Indonesia, Bangladesh, and Afghanistan) accounting for 80 percent of global outreach. Nevertheless, demand for Islamic microfinance products is strong. Surveys in Jordan, Algeria, and Syria, for example, revealed that 20-40 percent of respondents cite religious reasons for not accessing conventional microloans.

This provides an overview of the current state of the Islamic microfinance sector and identifies possible challenges to its growth. It is intended as an introduction to Islamic microfinance primarily for the donor community and other potential entrants into the market.

In another example i.e. Sudan, where once there was barren land, the Bank of Khartoum now invests in greenhouse projects and collaborates with cooperatives made up of Sudan's poor, unemployed and recent graduates to farm new crops and create opportunities for cooperative members. For the Bank of Khartoum, offering Sharia-compliant financial products is a central element as part of these projects to reach small-scale farmers.

Sharia-compliant banking offers a profit-sharing model for its members, as it prohibits the acceptance of specific interest or fees for loans or money. This method of banking has made significant changes in the lives of its cooperative members.One man has used his farming profits so far to purchase three goats, a refrigerator, and a television for his family. A woman farmer made enough of a profit through her farming cooperative that she was able to contribute with her family to her wedding.

"Islamic banking is about how much you can contribute to the market, rather than being just an intermediary and taking a cut from the profit," says FadiSalim Al Faqih, CEO of the Bank of Khartoum.

For such Sharia-compliant products serving the poor, the Bank of Khartoum was recognized as one of three finalists in the Islamic Microfinance Challenge. The Consultative Group to Assist the Poor, CGAP, partnered with the Islamic Development Bank, Al Baraka Banking Group, and Triple Jump to sponsor this global contest aimed at spurring innovation and scaling up Islamic financial products. The idea behind the Islamic Microfinance Challenge is to encourage microfinance providers to broaden their range of Islamic microfinance products and, in doing so, find new ways to serve Muslim microfinance clients.

With an estimated 650 million Muslims living on less than $2 a day, examples like the Bank of Khartoum show that Islamic microfinance can play a key role in bringing the poor into the financial mainstream.

11. Financial Sector Integrity Anti Money Laundering and combating the financing of terrorism

Money laundering is the process of transforming the proceeds of crime into ostensibly legitimate money or other assets. However, in a number of legal and regulatory systems, the term money laundering has become conflated with other forms of financial crime, and sometimes used more generally to include misuse of the financial system (involving things such as securities, digital currencies, credit cards, and traditional currency), including terrorism financing and evasion of international sanctions. Most anti-money laundering laws openly conflate money laundering (which is concerned with source of funds) with terrorism financing (which is concerned with destination of funds) when regulating the financial system.

Money obtained from certain crimes, such as extortion, insider trading, drug trafficking and illegal gambling is "dirty". It needs to be cleaned to appear to have been derived from legal activities so that banks and other financial institutions will deal with it without suspicion. Money can be laundered by many methods, which vary in complexity and sophistication.

Different countries may or may not treat payments in breach of international sanctions as money laundering. Some jurisdictions differentiate these for definition purposes, and others do not. Some jurisdictions define money laundering as obfuscating sources of money, either intentionally or by merely using financial systems or services that do not identify or track sources or destinations.

Other jurisdictions define money laundering to include money from activity that would have been a crime in that jurisdiction, even if it were legal where the actual conduct occurred. This broad brush of applying the term "money laundering" to merely incidental, extraterritorial, or simply privacy-seeking behaviors has led some to label it "financial thought crime".

Many regulatory and governmental authorities issue estimates each year for the amount of money laundered, either worldwide or within their national economy. The Financial Action Task Force on Money Laundering (FATF), an intergovernmental body set up to combat money laundering, stated, "Overall, it is absolutely impossible to produce a reliable estimate of the amount of money laundered and therefore the FATF does not publish any figures in this regard." Academic commentators have likewise been unable to estimate the volume of money with any degree of assurance. Various estimates of the scale of global money laundering are sometimes repeated often enough to make some people regard them as factual-but no researcher has overcome the inherent difficulty of measuring an actively concealed practice.

Regardless of the difficulty in measurement, the amount of money laundered each year is in the billions (US dollars) and poses a significant policy concern for governments. As a result, governments and international bodies have undertaken efforts to deter, prevent, and apprehend money launderers. Financial institutions have likewise undertaken efforts to prevent and detect transactions involving dirty money, both as a result of government requirements and to avoid the reputational risk involved. Issues relating to money laundering have existed as long as there have been large scale criminal enterprises. Modern anti-money laundering laws have developed along with the modern War on Drugs. In more recent times anti-money laundering legislation is seen as adjunct to the financial crime of terrorist financing in that both crimes usually involve the transmission of funds through the financial system (although money laundering relates to where the money has come from, and terrorist financing relating to where the money is going to).

For Islamic financial transactions the rules of the game as devised for conventional side are one and the same.However some time reference is made toHawala or Hewala (Arabic: ???????, meaning transfer), also known as hundi. It is an informal value transfer system based on the performance and honor of a huge network of money brokers, primarily located in the Middle East, North Africa, the Horn of Africa, and the Indian subcontinent, operating outside of, or parallel to, traditional banking, financial channels, and remittance systems. Pakistan is also part of this.

However efforts are underway to remove this stigma by strengthening money transfer through formal banking sector.

In this respect we take examplesfrom two Islamic Countries:-

The Financial Transactions and Reports Analysis Center of Afghanistan (FinTRACA) was established as a Financial Intelligence Unit (FIU) under the Anti-Money Laundering and Proceeds of Crime Law passed by decree late in 2004. The

main purpose of this law is to protect the integrity of the Afghan financial system and to gain compliance with international treaties and conventions. The Financial Intelligence Unit is a semi-independent body that is administratively housed within the Central Bank of Afghanistan (Da Afghanistan Bank). The main objective of FinTRACA is to deny the use of the Afghan financial system to those who obtained funds as the result of illegal activity, and to those who would use it to support terrorist activities.

In Bangladesh, this issue has been dealt with by the Prevention of Money Laundering Act, 2002 (Act No. VII of 2002). In terms of section 2, "Money Laundering means (a) Properties acquired or earned directly or indirectly through illegal means; (b) Illegal transfer, conversion, concealment of location or assistance in the above act of the properties acquired or earned directly or indirectly through legal or illegal means". In this Act, "properties" means movable or immovable properties of any nature and description.

Some of the past examples have now become precedents for devising arrangements in future.They are as follows:-

- Bank of Credit and Commerce International: Unknown amount, estimated in billions, of criminal proceeds, including drug trafficking money, laundered during the mid-1980s.
- Bank of New York: US$7 billion of Russian capital flight laundered through accounts controlled by bank executives, late 1990s.
- Ferdinand Marcos: Unknown amount, estimated at US$10 billion of government assets laundered through banks and financial institutions in the United States, Liechtenstein, Austria, Panama, Netherlands Antilles, Cayman Islands, Vanuatu, Hong Kong, Singapore, Monaco, the Bahamas, the Vatican and Switzerland.
- In December 2012, HSBC: paid a record $1.9 Billion fines for money-laundering hundreds of millions of dollars for drug traffickers, terrorists and sanctioned governments such as Iran. The money-laundering occurred throughout the 2000s.
- In May 2013, Liberty Reserve was seized by the United States federal authorities for laundering $6 billion.
- Institute for the Works of Religion: Italian authorities investigated suspected money laundering transactions amounting to US$218 million made by the IOR to several Italian banks.
- Nauru: US$70 billion of Russian capital flight laundered through unregulated Nauru offshore shell banks, late 1990s
- SaniAbacha: US$2-5 billion of government assets laundered through banks in the UK, Luxembourg, Jersey (Channel Islands), and Switzerland, by the president of Nigeria.
- Standard Chartered: paid $330 million in fines for money-laundering hundreds of billions of dollars for Iran. The money-laundering took place in the 2000s and occurred for "nearly a decade to hide 60,000 transactions worth $250 billion".
- Standard Bank:Standard Bank South Africa London Branch - The Financial Conduct Authority (FCA) has fined Standard Bank PLC (Standard Bank) £7,640,400 for failings relating to its anti-money laundering (AML) policies and procedures over corporate and private bank customers connected to politically exposed persons (PEPs).
- In June 2014, BNP Paribas pleaded guilty to falsifying business records and conspiracy, having violated U.S. sanctions against Cuba, Iran, and Sudan. It agreed to pay an $8.9 billion fine, the largest ever for violating U.S. sanctions.

So it can be see that this disease exists everywhere ir-respect of any religion, language or creed. So it has to be eradicated through intergovernmental level with the help of their financial regulators.

12. Public awareness on Islamic Finance

The concept of interest-free financing was practiced by Arabs prior to the advent of Islam, and was later adopted by Muslims as an acceptable form of trade financing. While the system had been used on a small scale for centuries, its commercial application began in the 1970s. Since then Islamic financing has experienced worldwide acceptance, and by early 2003 there were at least 176 Islamic banks around the world, with deposits in excess of $147bn.As of 2014, sharia compliant financial institutions represented approximately 1% of total world assets. By 2009, there were over 300 banks and 250 mutual funds around the world complying with Islamic principles and as of 2014 total assets of around $1.8 trillion were sharia-compliant. According to Ernst & Young, although Islamic Banking still makes up only a fraction of the banking assets of Muslims, it has been growing faster than banking assets as a whole, growing at an annual rate of 17.6% between 2009 and 2013, and will grow by an average of 19.7% a year to 2018.

While Islamic financing has become popular in both Muslim and non-Muslim countries, the system has not achieved widespread success among Muslims on account of awareness about the principles of the system among the population.

Muslim population is increasing at a rapid pace, and based on the requirement of sharia, one would expect an increase in demand for Islamic financial products. This has certainly been true in the case of other non-Muslim majority nations like the UK, where the increase in demand for Islamic products has convinced bank regulators to provide permission for the operation of a purely Islamic Bank.

So it is prudently required to ascertain the awareness and demand for profit-and-loss sharing Islamic financial products among the practicing Muslim population and even non-Muslims.

Even now The International Monetary Fund has endorsed the principles of Islamic finance, saying it could prove safer than conventional finance, but the multilateral lender warned Islamic bankers that they must tighten rules and follow them more consistently which is missing at the moment.

A report released by the IMF shows the lender's growing interest in Islamic banking, which is expanding in much of the world. The IMF's report noted that because Islamic banking forbids pure monetary speculation and stresses that deals should be based on real economic activity, it could pose less risk than conventional banking to the stability of financial systems.

This claim has long been made by proponents of Islamic finance seeking to drum up business; the IMF's endorsement is likely to add weight to their arguments.

"Islamic finance may…help promote macroeconomic and financial stability. The principles of risk-sharing and asset-based financing can help promote better risk management by both financial institutions and their customers, as well as discourage credit booms," the IMF says.

However, the industry could fail to achieve its promise - and even have a destabilizing effect - if it does not design its rules more carefully and implement them more consistently, the report adds.

Christopher Towe, deputy director at the IMF's monetary and capital markets department, said in a conference call that there were worrying differences in regulators' handling of Islamic finance, particularly where the industry was relatively young. "Our analysis suggests that these standards are not being applied consistently, and this could either stifle the development of Islamic finance or encourage its growth in a manner that creates systemic vulnerabilities."

Towe added: "I think for Islamic finance to achieve the promise that we see it having, to reduce systemic risk, I think that the key criteria are that it has to be truly asset-based, and the requirements for risk-sharing that underlie Islamic finance have to actually be applied in practice and not just in principle."The IMF will continue working in Islamic finance, conducting research and providing technical assistance to member countries,"Towe said.

" Other issues which Islamic finance needs to tackle include a shortage of tools to manage the short-term funds of Islamic banks, the limited scope of sharia-compliant financial safety nets for banks, and the need for greater legal clarity on the rights of investors, the IMF's report says.

Some of these issues are now being tackled by standard-setting bodies such as the Bahrain-based Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Malaysia-based Islamic Financial Services Board (IFSB). The IFSB has recently said it had finalized a standard on "core principles" for use by regulators as well as a guidance note on liquidity management. This standard will provide a coherent framework for regulators to use in handling Islamic finance, said (Mohamed Norat, senior economist at the IMF's monetary and capital markets department). One positive sign, he said, is the growing use of profit-sharing investment accounts by Islamic banks; such accounts have loss-absorption qualities which help investors share risk.

In the last two or three years, profit-sharing investment accounts have gone from around 2 to 3 percent of Islamic banks' balance sheets to around 15 to 20 percent, and they are continuing to expand, Norat said. "So we've seen an element of moving towards a more fully risk-based Islamic financial system, which is a good sign."

Now immense need has arrived that the IDB and Regulators of particularly Muslim Countries should come forward by bringing correct information on Islamic Finance to the general masses. Currently masses are generally relying on pure perceptions and beliefs which is not enough. Multilayered positive aspects of Islamic Finance are needed to be brought in to the notice of general masses.

13.Education regarding Islamic Finance

Muslims agree that the Quran condemns Riba, but do not all agree over what riba is.

While Muslim activists (and most Pakistanis) agree that riba is interest on debt, others believe that riba is usury (unethical loans that unfairly enrich the lender) and not interest charged under state-regulated banking practices. Such people were to be found disproportionately among "the economists, bankers, politicians, and bureaucrats" who "would be responsible to administer an interest free system".

To convince these people and others, like-minded groups have sponsored, and Saudi Arabia has financed, numerous symposia "dedicated to the task of defining the modalities of an interest-free economy." A "vibrant" and abundant literature has emanated from these conferences, but many mainstream economists have remained un-persuaded. Activists also had no luck getting a law enacted to make the constitution subordinate to shariat, but had more luck in the courts.

It is again reiterated that Islamic banking has emerged as a market phenomenon in 70's era and then started spreading. It got pace in 21st century but still is less than 1% of overall banking assets in the world. The main question arising is lack of its awareness amongst the general masses.

But ideas are still in development. Like State Bank of Pakistan in its second phase of media campaignhave tried to focus on preparation of documentaries on Islamic finance explaining the basic concepts, practices and general misconceptions, intensive use of print media, engaging electronic media for initiating talks on Islamic banking and finance by renowned Islamic finance professionals, highlighting value proposition and Sharia compliance of Islamic banking and dissemination of brochures and pamphlets. But in outcome it came with one theme that "for my heart satisfaction I go to Islamic Banking". This approach is absolutely shallow as it misses that Islamic Banking can bring social justice by directly connecting Monetary side with Real sector. It also misses that through this we can create a non-criminal society as it prohibits to invest in Haram kind of businesses.

Going forward as per plans third round Financial Innovation Challenge Fund would be launched soon by the State Bank of Pakistan with the theme to invite business schools and universities for the establishment of a "Centre of Excellence for Islamic Banking and Finance". But here we must understand that launching of such fund should come from the market itself and not from the regulator as its job is to frame regulatory structure equitable to all. Hence adopting this way can create confusion in the market which should be avoided. In particular case of Pakistan, State Bank of Pakistan has its own education center known as NIBAF that can be further refined and can be elevated to the level of University in case of delivering education on Islamic Banking and Finance.

Here we must understand that for developing Islamic Banking one needs to develop qualified and trained human resource, and penetrate deeper into the promising but least-exploited sectors of the economy. In this context all persons including minorities and particularly the females should be encouraged and given all the facilities for training in Islamic Banking.

One big opportunity for banks around the world is to take an advantage of enhanced awareness about Sharia-compliant banking. Banking products in general and Islamic banking products in particular are quite complicated. People want simple, easy-to-understand.

Islamic banking around the world tends to focus more on producing qualified Sharia advisors than grooming people working in treasury or product development departments which is absolutely wrong. Every area has its special features. Hence for developing Islamic Banking Sharia Scholars, Bankers, Market Practitioner and Legal Experts all are needed. One must recognize that most credible Islamic Banking experts in the world are non-Muslim as they work to develop the market products by considering all aspects pertaining to market requirements.

Further Intensive use of print media, engaging electronic media has always been tried but it has not proved successful so far.

In Malaysia, the National Sharia Advisory Council additionally set up at Bank Negara Malaysia (BNM) advises BNM on the Sharia aspects of the operations of these institutions, as well as on their products and services. In 2006, Bank Negara Malaysia setup International Centre for Education in Islamic Finance (INCEIF) a dedicated University to provide skilled and certified personnel for Islamic Finance in Malaysia. The university was established as part of the Malaysian Government's initiative to further strengthen the country's position as an international Islamic finance center. It is the only university in the world that is wholly dedicated to postgraduate study in Islamic Finance.

14.Education for Staff working in Islamic Financial Institutions

"The main challenge in Islamic Finance is human capital to foster awareness and development in the area . Also for me, working in different regions in the world, we need more and more people who understand how Islamic finance works, and understand not only basic Sharia knowledge and issues. This is a problem all over. In many countries like the GCC and Malaysia there has been an improvement, but there's still a long way to go." .(Islamic Corporation for the Development of the Private Sector (ICD) CEO Khaled Al-Aboodi).

For companies purposely to achieve better performance and Understanding, the assessment and evaluation of its important elements are required. Islamic banking products are vitally crucial to the Islamic banking industry ,hence the same rules apply here.

The Islamic Banks and other institutions employees must be the first segment in the system whereby they should be aware of the goodness of its products. No doubt its assets have risen from 2% in the late 1970s to 15% . Since 1971, Islamic banks have grown mostly on the perception of its customers. Admittedly, the employees of these institutions knew less of what they were promoting and selling to the customers .

The employees of Islamic banks should know about financial products they are offering and services ,using the principles of Islam toconvince their customers. For this they are required to know full ABC of current banking by adding full knowledge and teachings of Islam. To realize their own mission, it is the products and its benefits that are important. As it is been stated that all essentials for Islamic banks is based upon to study the principles of Islamic Banking and Finance guided with enhancing behavior, attitude and awareness of their clients.First than comes to adhere to Al-Qur'an and HadithNabvi,s knowledgethat are pivotal to the clients mainly in the retail segment who usually acknowledge and comprehensively understand and constitutes as the mainelement of the banking business in practice. The possession of knowledge and experience by awareness, attitude and understanding of conventionaland Islamic sides,the employees can be used as the vital resource for the banking amongst their customers.

There is no other opinion that government, regulators and banks themselves can become the main source to ensure proper training of the bankers and also to develop a research-oriented mechanism to improve wide range understanding about Islamic Banking system. By going this way we can ultimately pave way for actual and successful implementation of Islamic Finance in the world. IDB and other world bodies have also to play main role in this regard.

Growing numbers of Islamic banks and branches of conventional banks offering Islamic banking products to the people is not enough. Economists, bankers, market practitioners and sharia scholars with full knowledge of Islamic Financehave to play main role in development of Islamic Financial Market so asto achieve optimum of the present government's commitment towards "Sharia based Islamic Banking."

15. Challenges

Islamic banking is doing well in the world but some of the potential opportunities andchallenges should be taken up to make Islamic banking more user friendly in every segment of economy and society. There is need to make a clear and transparent system of general Islamic banking which should concern to all sectors of society and economy in order to address the challenges and threats of the future needs of the financial sector.

Islamic banking has been facing so many challenges since its origin. Islamic banking has been in transition and development phase in different countries for the last two decades. According to (Khalaf) Islamic banking industries have always suffered with the issue of different opinions of Islamic scholars, suppose a product or practice may be accepted to one scholar, could be considered un-Islamic by another scholar.

Malaysia has established a standard sharia board which is supported by the government. The same thing goes in case of Pakistan but here legislation is missing. The Bahrain-based Accounting and Auditing Organization for Islamic Financial Institutions has established a group of religious advisors or scholars who's authorized to issue fatwas (order, decision) on Islamic financial products. But it remains a voluntary body; they are not strictly imposing these rules on these organization. Due to this some banks are ignoring the decisions of the board (Khalaf,).It is true that Islamic banking is facing the difficulties of lack of authentication of decisions because there is no unity in the Muslim community they have the different believes, it is possibility that some decisions are not acceptable to one part ofcommunity.

In Islamic banking system there is a serious shortage of scholars and qualified managers. Unfortunately the managers are not well trained in the use of Islamic financial practices (Iqbal, Ahmad and Khan,). Islamic banking in Muslim countries and rest of the world leaving aside Malaysia is facing the problem of legal system because Islamic banking is not yet proper regulated, due to this there is a possibility to create tension between Islamic banking and regulators (Karbhari, Naser and Shahin,).

Currently Islamic banking is facing the challenge of the new mode of conventional banking in opening of Islamic banking windows. It will improve the services of Islamic banking but there is a need that Islamic scholars to work hard to maintain the priority of Islamic Sharialaw (Iqbal).

The main hypothesis presented in favor of Islamic Banking is that Muslimpopulation wants to spend their lives according to their faith. According to Islamic teachinginterest is strongly prohibited in Islam and they want to take banking services such as savingaccounts, current accounts, home finances, insurance and loan according to Islamic Sharialaw. Since in most of the countries their banking and financial rules are most in favor of conventional banking system hence due to this Islamic banking is facing some difficulties in the way of itsprogress. In other word these problems are great challenges for Islamic banking. If they workhard Islamic banking will be developed in short period of time.

Question about faith would always remain the main question in this regard. what we mean by it, since Islam is a natural religion and all its beliefs are based on scientific principles or some understandable arguments. Islamic finance means business and no business can go without profit and loss. This is contrary to conventional finance where profit Is already fixed irrespective of the fact whether business is at loss. Apparently this is exploitation. But if Islamic Banks get loss in its investment on trading basis than it is not liable to pay any profit under arrangement of Mudarbah or Musharkah. This also creates exploitative kind of business in environment of inflation or time value of money which is also not permissible in any religion or on moral values. From this angle Islamic finance becomes more risky, hence to cover this risk, element of higher return becomes inevitable. However most of the Islamic Banks normally pay less return than conventional banks due to some obvious reasons. The reasons arise from the following questions:-

1. Is Islamic banking sector has a potential for product development? Whether Islamic banking is in a position to satisfy its customers?
2. Is Islamic banking has a potential to perform active role in the Financial Market

and its growth in market development?

3. Do Islamic banking able to enhance the investment opportunities in the country and whether it can play prominent role for the country's economy?

4. Is there any effect of the any country's environment (political, social and geographical) for growth and development of Islamic banking?

5. Is Islamic banking has proper regulatory and institutional framework in thejurisdiction where it is working ?

6. Whether Islamic banking has any problem in any country in respect of supervision and scholarly committees?

7. Is Islamic banking full informative to its customers or facing any difficulty in its marketing sector?

8. Is Islamic banking in a position to survive and develop in the age of competition and globalization?

Unfortunately we have no cogent answers for the above questions. This requires immense research which cannot be done by the degree holders coming out of Madrasahs and Universities. For this a joint effort is required from the Bankers having full knowledge of conventional and Islamic Banking, legal experts, Sharia Advisors and Market practitioners. This combination on joint basis can come up with the required answers.

16. Final Words

There is no other opinion that Islamic Finance with a history of 1400 years and revival of it in 1970's era is now on the road towards expansion but still this expansion is very dismal so lot is required to be done using every prerequisite as required for development of any financial market in the age of globalization.

This requires immense research to set right its foundations, techniques and product development in the best interest of its customers and as a whole full economy. It should now come out of old rhetoric that its pace of development is too fast as every area withnarrow base grows with faster pace as compared to its counterpart.

So focus should be on bringing awareness on Islamic Finance, going for better macro results, preparing manpower for the growth of Islamic Finance, set right legal and supervisory structure, encourage research and market developments with its products and finally to stress on mitigating risk element on Islamic financial transactions and to become part of world economy showing better results as compared to its counterpart.

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