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Islamic Finance

The New Regulatory Challenge

SECOND EDITION

SIMON ARCHER
RIFAAT AHMED ABDEL KARIM

WILEY

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The New Regulatory Challenge

Second Edition

EDITED BY

SIMON ARCHER

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To our beloved wives Eveline and Iglal

About the Editors

Simon Archer is Visiting Professor at the ICMA Centre, Henley Business School, University of Reading, United Kingdom, with particular responsibility for Islamic finance, and Adjunct Professor at the International Centre for Education in Islamic Finance (INCEIF), Kuala Lumpur, Malaysia. Previously, he was Professor of Financial Management at the University of Surrey, after being Midland Bank Professor of Financial Sector Accounting at the University of Wales, Bangor. After studies in Philosophy, Politics, and Economics at Oxford University, he qualified as a chartered accountant with Arthur Andersen in London and then moved to Price Waterhouse in Paris, where he became Partner in Charge of Management Consultancy Services. Since beginning an academic career, Professor Archer has undertaken numerous consultancy assignments, including acting as consultant to the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB). He has been a visiting professor at a number of universities and business schools, including IIUM in Malaysia, Bordeaux, Metz, and Paris-Dauphine; HEC and EAP-ESCP in France; Copenhagen Business School in Denmark and Frankfurt, and Koblenz in Germany. Professor Archer is the author and co-editor of a considerable number of works and academic papers on international accounting and on issues in Islamic finance, including *Islamic Finance: Innovation and Growth* (Euromoney Publications, 2002) with Rifaat Ahmed Abdel Karim; *Islamic Finance: The Regulatory Challenge, 1st edition* (John Wiley & Sons Singapore, 2007) with Rifaat Ahmed Abdel Karim; and *Takaful Islamic Insurance: Concepts and Regulatory Issues* (John Wiley & Sons Singapore, 2009) with Rifaat Ahmed Abdel Karim and Volker Nienhaus. In 2010, Professor Archer received an award from the Central Bank of Bahrain and Kuwait Finance House, Bahrain, for his “outstanding contribution to the Islamic Financial Services Industry.”

Rifaat Ahmed Abdel Karim is one of the world’s foremost and renowned leaders and authority in the Islamic financial services industry (IFSI) both at the professional and academic levels. He has played a pioneering role in the development of Islamic finance, while his leadership in the drafting of

accounting, auditing, governance, *Shari'ah*, and regulatory standards has been instrumental in establishing the position of the IFSI in the mainstream of global financial services.

In addition to the international recognition of his academic publications, which are mainly in tier one international journals in the field of Islamic finance, Rifaat also earned international respect for the two organisations he has played an instrumental role in creating, and for which he served as (their inaugural) Secretary-General—the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB).

Professor Karim's contribution to the IFSI has been recognised by the many prestigious international awards that have been bestowed upon him during his career, which spans 30 years dedicated to high achievement in professional activities, as well as in research and academic work. These include, among others, the (inaugural) 2004 Euromoney Outstanding Contribution in the Development of Islamic Finance, and the 2010 Islamic Development Bank Prize in Islamic Banking and Finance. In 2010, the King of Malaysia awarded Professor Karim the Royal Malaysian Honorary Award of Darjah Kebesaran Panglima Jasa Negara (P.J.N.), which carries the title "Datuk."

Professor Karim is currently the Chief Executive Officer of the International Islamic Liquidity Management Corporation (IILM). Professor Karim has been Visiting Professor at the ICMA Centre, Henley Business School, University of Reading, United Kingdom, since 2008, and Adjunct Research Professor at the International Centre for Education in Islamic Finance (INCEIF), Kuala Lumpur, Malaysia, since 2011. He served on the advisory council of the Basel Committee for Banking Supervision, International Accounting Standards Board, and International Auditing and Assurance Standards Board.

Professor Karim is the co-author/co-editor of *Business and Accounting Ethics in Islam* (Mansell Publishing Co., 1991) with Trevor Gambling; *Islamic Finance: Innovation and Growth* (Euromoney Publications, 2002) with Simon Archer; *Islamic Finance: The Regulatory Challenge* (1st edition) (John Wiley Asia, 2007) with Simon Archer; and *Takaful Islamic Insurance: Concepts and Regulatory Issues* (John Wiley & Sons Singapore, 2009) with Simon Archer and Volker Nienhaus.

About the Contributors

Daud Abdullah (David Vicary) is the President and Chief Executive Officer of INCEIF, The Global University of Islamic Finance. He has been in the finance and consulting industry for more than 38 years, with significant experience in Asia, Europe, Latin America, and the Middle East. Since 2002, he has focused exclusively on Islamic finance where he has contributed to a number of books on the subject and has co-authored a book on Islamic finance entitled *Islamic Finance: Why it Makes Sense*. He is also a frequent speaker and commentator on matters relating to Islamic finance. He is a Chartered Islamic Finance Professional (CIFP), a Distinguished Fellow of the Islamic Banking and Finance Institute of Malaysia (IBFIM) and a former Board member (2003–2007) of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). Prior to INCEIF, he was the Global Islamic Finance Leader with Deloitte. He was also previously acting CEO of Asian Finance Bank, an Islamic bank based in Malaysia, and Managing Director of Hong Leong Islamic Bank.

Anand Balasubramanian is currently a Director in Ernst & Young's Financial Services Risk Management (FSRM) practice in Dubai. He has more than 12 years' experience in the area of risk and financial consulting across the Middle East, South East Asia, and the United States. He has executed several engagements in the area of risk quantification and model validation for credit risk, market risk, and operational risk.

He has prior experience with Oracle Financial Services Consulting, GE, and ICRA. Anand holds an MBA in Finance from the Indian Institute of Management, Calcutta, India and is certified FRM from Global Association of Risk Professionals (GARP).

John Board has been Dean of the Henley Business School at the University of Reading since October 2010. Before that he was Director of the ICMA Centre at the University of Reading, which he joined after being on the faculty at the London School of Economics.

His recent research has focused on the organisation and regulation of financial markets and the development of Islamic financial markets. Some of this work has been based on large scale analyses of trading data, while

other parts have considered more general issues of the effects of market fragmentation as well as the various scandals and crises in financial markets. As a result of this work, he has been widely published in books and academic and professional journals, as well as radio and television. He has acted as consultant to many U.K. and overseas markets, regulatory organisations, and trade bodies. These include the House of Commons, the Financial Services Authority, the City of London Corporation, and the European Commission. He also has an interest in the development of Islamic finance, on which he has recently acted as consultant on a major project on Islamic market developments around the world.

He has successfully supervised some 30 PhD students and acted as examiner for many more. His teaching work has taken place in some 20 countries, including: the United Kingdom, China, India, France, Japan, Korea, Saudi Arabia, Egypt, Spain, Argentina, Serbia, Montenegro, Russia, Thailand, Qatar, Sharjah, Abu Dhabi, Egypt, Libya, Kenya, South Africa, and others.

Peter Casey recently retired as Senior Director, Policy and Strategy, and Head of Islamic Finance in the Dubai Financial Services Authority (DFSA).

Peter has been involved in standards development in Islamic finance through membership of the IFSB Technical Committee and several IFSB Working Groups, including those on Special Issues in Capital Adequacy, Governance of Takaful Operations, and Solvency Requirements for Takaful Operators. He participated in the joint IFSB-IAIS working group on *takaful*, and in the IOSCO working group which analysed the application of IOSCO's Objectives and Principles of Securities Regulation to Islamic products. He has also been a member of the Islamic Finance Working Group of the Asian-Oceanian Standard-Setters Group. He has written two book chapters and numerous articles on Islamic finance topics.

Before joining the DFSA in 2002, Peter was Head of the Non-Life Insurance Department of the UK Financial Services Authority. Before that, he held senior regulatory posts in the Treasury, the Department of Trade and Industry and the Office of Fair Trading. He has wide experience of UK Government, having also served in the Cabinet Office and Science Research Council, and having worked in areas ranging from export promotion to the creation of computer misuse legislation.

He was educated at Cambridge University.

Brandon Davies is Non-Executive Chairman of Premier European Capital Limited, a private equity company; he is also the CEO of dRisk.biz, a company he founded, and Senior Independent Non-Executive Director (SINED) of Gatehouse Bank plc. (an Islamic Bank in London), where he

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Brandon holds a degree in economics from University College London. He is a member of the Financial Markets Group at the London School of Economics (LSE), lectures extensively on subjects in banking and risk management, and has written numerous papers and articles on these subjects for organisations such as the ACCA, Cass Business School, Central Banking, the LSE, Lombard Street Research, and the *Financial Times*.

Until December 2009, Brandon was Managing Director of the Global Association of Risk Professionals Risk Academy. In that capacity Brandon produced five books on Basel II and risk management, governance, supervision, and enterprise risk management. These books form the basis of certification programs in both banks and central banks in China and Indonesia.

Brandon has over 40 years of work experience in the banking sector; his positions included Head of Retail Market Risk and Treasurer of the retail businesses of Barclays Bank, and he was also a member of the bank’s executive committee. Prior to this appointment he was Managing Director of Financial Engineering at BZW and later of Structured Products at BZW and Barclays Capital. Brandon retired from Barclays in March 2004 after 32 years with the bank.

Yusuf Talal DeLorenzo of Malfa Inc. (www.malfainc.com) is a scholar of Islamic transactional law whose 30-year career has been noted in the *Financial Times*, the *New York Times*, *Fortune*, the *Wall Street Journal*, the *Middle East Banker*, and others. Based in Florida, he serves as a *Shari’ah* advisor to international financial entities, including index providers, institutional investors, mutual funds, hedge funds, real estate funds, private equity funds, home finance providers, and investment banks. Shaykh Yusuf is the author of the three-volume *Compendium of Legal Opinions on the Operations of Islamic Banks*, the first English/Arabic reference on the *fatawa* issued by *Shari’ah* boards. In addition, he wrote the introduction to *Islamic Bonds*, the 2003 book that introduced *sukuk* and transformed the world’s Islamic capital markets. His work has appeared in journals and newsletters and as chapters in books, including *Islamic Asset Management* (Euromoney Books, 2004), *Islamic Retail Finance* (Euromoney Books, 2005), and *Islamic Finance: Innovation & Growth* (Euromoney Books, 2002). His entries on the terminology of Islamic finance appear in *The Oxford Dictionary of Islam*.

Baljeet Kaur Grewal is the Managing Director and Vice Chairman at KFHR Research Limited (KFHR), the investment research subsidiary of Kuwait Finance House. In her capacity, Baljeet heads the Global Economic and

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Prior to this, Baljeet was the head of Investment Banking Research at Maybank Group, Malaysia. Prior to that, she was attached with ABN AMRO Bank and Deutsche Bank, London, with experience ranging from credit structuring, loan syndication, and economic and capital market research. She has broad experience in investment banking, having participated in notable Islamic fund raising transactions in Asia and the Middle East; as well as in strategic planning and execution of investment banking organisational change. To date, she has undertaken research in Islamic finance with a principle focus on debt capital markets and *sukuk* in emerging markets. She has written and published numerous articles and papers on developing economies and debt markets, Islamic debt structures, and South East Asian economies; and has addressed numerous international Islamic conferences and forums. Since its inception, KFH Research Limited has been awarded nine international awards of research excellence, and is widely regarded as the best Islamic finance research house globally.

Baljeet has a First Class Honours degree in international economics from the University of Hertfordshire and has undertaken extensive research in development studies with the London School of Economics.

She is also the award recipient of the prestigious Sheikh Rashid al-Makhtoum award for Regional Contribution to Islamic Finance in Asia 2006, as well as accolades honouring women in Islamic finance.

Abdullah Haron is Assistant Secretary-General of the Islamic Financial Services Board. Previously, he was a Project Manager; his main area of work was the preparation of guidance on risk management and the supervisory review process. He has also participated in task forces on *takaful* regulation and supervision, as well as a compilation guide on prudential databases of Islamic financial services institutions. His prior experience includes the development of a risk management and measurement framework, and insurance prudential regulation and supervision. Abdullah received a BSLAS in actuarial science from the University of Illinois and an MBA from Ohio University.

Chen Mee King is Senior Vice-President, General Counsel, and Head of Legal and Shari'ah Group of The Islamic Bank of Asia Limited, the first full-fledged Islamic bank in Singapore. She is also an Adjunct Associate Professor of Law in Singapore Management University's Masters (LLM) in Islamic Law and Finance programme. During nearly 25 years of law practice, Mrs. Chen has engaged in private practice as well as acting as in-house counsel for an Asian commercial bank, two European commercial banks, and an Asian multinational investment group, before joining The Islamic Bank of Asia Limited.

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Dr. Mohamad Akram Laldin is currently the Executive Director of International Shari'ah Research Academy for Islamic Finance (ISRA). Prior to joining ISRA he was an Assistant Professor at the Kuliyah of Islamic Revealed Knowledge and Human Sciences, International Islamic University, Malaysia (IIUM). In the period of 2002–2004, he was a Visiting Assistant Professor at the University of Sharjah, Sharjah, United Arab Emirates. At present, he is a member of the Bank Negara Malaysia Shari'ah Advisory Council, member of the Accounting and Auditing Organization of Islamic Financial Institution (AAOIFI) Shari'ah Board, member of the Law Harmonisation Committee Bank Negara Malaysia, member of Shari'ah Board of Employees Provident Fund Malaysia (EPF), member of Maldives Monetary Authority Shari'ah Board, member of Yassar Limited (Dubai) Shari'ah Advisory Board, member of Nigerian Central Bank Council of Experts, Chairman of the Islamic Advisory Board of HSBC Insurance Singapore, Shari'ah Advisor to ZI Syariah Advisory Malaysia, member of Shari'ah Advisory Council International Islamic Financial Market (IIFM), Bahrain, member of Thomson Reuters Islamic Benchmark (IIBR) Shari'ah Committee, member of Shari'ah Advisor of Dar Al Takaful (Dubai), and of other boards locally and internationally.

In addition, he is also the Member of the Board of Studies of the Institute of Islamic Banking and Finance, International Islamic University Malaysia, and member of the Board of Trustees of the Islamic Research Training Institute under Islamic Development Bank, Jeddah. Dr. Akram holds a BA Honours degree in Islamic Jurisprudence and Legislation from the University of Jordan, Amman, Jordan and a PhD in Principles of Islamic Jurisprudence (Usul al-Fiqh) from the University of Edinburgh, Scotland, United Kingdom. He has presented many papers related to Islamic banking and finance and other *fiqh* topics at the national and international levels and has conducted many training sessions particularly on Islamic banking and finance for different sectors since 1999. He is a registered *Shari'ah* Advisor for Islamic Securities with the Securities Commission of Malaysia, and has acted as *Shari'ah* advisor in several *sukuk* issuances. In addition he is a prolific author of academic works, specifically in the areas of Islamic Banking and Finance. He is the recipient of the Zaki Badawi Award 2010 for Excellence in Shari'ah Advisory and Research.

Dr. John Lee Hin Hock is the Group Chief Risk Officer (GCRO) of Maybank Group, the largest banking group in Malaysia. As GCRO, he oversees

the Group Credit and Risk Management function of the Group, which includes commercial banking, investment banking, and insurance business across South East Asian markets. The Group Credit and Risk Management has oversight on matters relating to credit management, assets and liabilities management, liquidity management, market risk management, and operational risk management. As GCRO, he sits on the Executive Committee and on various other management committees in the Group.

Dr. John Lee was a member of the Liquidity Risk Management Working Group and the Risk Management Working Group of the Islamic Financial Services Board (IFSB), an international standard-setting body set up to ensure the stability of the Islamic financial services industry.

Prior to Maybank, Dr. John Lee was a Partner in KPMG, where he was KPMG Global Lead for Islamic Finance, Asia-Pacific Region Head of Financial Risk Management, and Malaysia Head for Financial Services. His consulting experience includes strategic consulting, banking strategies, capital markets, risk management, and performance management, where he completed numerous projects around the Asia-Pacific region.

Before joining KPMG, John was the General Manager of the Kuala Lumpur Options & Financial Futures Exchange (KLOFFE; now known as Malaysian Derivatives Exchange), where he was responsible for the overall operations of the exchange. Prior to KLOFFE, John worked for a Malaysian merchant bank, Amanah Merchant Bank Berhad, now known as Alliance Merchant Bank Berhad, in their corporate finance department.

John Lee has a PhD in financial economics and a bachelor of economics from Monash University. He is also a Fellow Certified Practising Accountant of CPA Australia and a member of the American Finance Association, Econometrics Society, and the Society of Financial Studies.

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Nik Ramlah sits on the board of the Securities Industry Development Corporation (SIDC), the training and education arm of SC, and is a member of the Professional Development Panel of the International Centre for Education in Islamic Finance (INCEIF), the global University of Islamic Finance and is an EXCO member of the Asian Institute of Finance (AIF).

Nik Ramlah holds a First Class Honours degree in Law from University Malaya and an LLM and PhD from the University of London. For her PhD, she was a recipient of a scholarship from the Association of Commonwealth Universities.

Prior to joining the SC in 1993, Nik Ramlah was an Associate Professor in the Faculty of Law, University Malaya.

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Volker Nienhaus was Professor of Economics at the German universities of Trier (1989) and Bochum (1990) before he became President of the University of Marburg (2004). His fields of academic specialisation were economics of the European Union, international and development economics, and political economy. He has made numerous contributions to Islamic economics, banking, and finance since the 1980s. In 2006, he was appointed a member of the Governing Council of the International Centre for Education in Islamic Finance (INCEIF), Kuala Lumpur.

Carol Padgett is a senior lecturer in finance at the ICMA Centre, Henley Business School. She has extensive experience of teaching corporate finance and governance to both academic and professional audiences and has written a textbook on corporate governance. She is Director of Studies of the MSc in Corporate Finance at the University of Reading. Her research interests include governance in financial and nonfinancial institutions and the impact of governance on the performance of acquisitions.

Samir Safa has more than 30 years of international experience in information technology and banking. He has managed large-scale transformation information technology projects, as well as building and implementing multidiscipline financial information solutions successfully across North America, EMEA, and Asia.

Since 1992, Samir has been serving the needs and requirements of the Islamic banking and finance industry in their various formations; i.e., start-ups, conversion of conventional banks to Islamic banks, and setting up Islamic finance units or windows.

Prasanna Seshachellam has over 19 years of experience in the financial services industry sector, which includes over nine years of experience in the regulatory domain. Before entering the regulatory world, he worked in many segments of the financial services industry, including investment banking, equity research, asset management, corporate credit, credit rating, risk management, fund administration, and trade operations for ETFs. Prasanna has worked with Barclays Global Investors Canada Limited and with ICRA Limited, the second largest rating agency in India and an affiliate of Moody's Investors Service.

In his current role at the Dubai Financial Services Authority (DFSA), Prasanna Seshachellam leads the team responsible for the prudential supervision of a number of authorised firms, with primary focus on firms operating in the banking and insurance sectors. Prior to his current role at the DFSA, Prasanna was with the Office of Superintendent of Financial Institutions (OSFI) Canada as a Senior Supervisor overseeing a portfolio of banks and other lending institutions.

Prasanna has been a key contributor to various initiatives of the DFSA in the regulation of Islamic finance. Prasanna has represented the DFSA in many working groups of the Islamic Financial Services Board. Prasanna also plays a leading role in many of the critical projects aimed to enhance the supervision framework of the DFSA.

Prasanna has a bachelor of technology degree from Anna University, India, and a masters in management from Indian Institute of Management, Bangalore. Prasanna is a CFA charter holder and also holds the FRM designation awarded by the Global Association of Risk Professionals, New York.

Dr. Sandeep Srivastava is currently a Senior Director in Ernst & Young's Financial Services Risk Management (FSRM) practice in Dubai. He has more than 15 years of experience spanning all areas of risk management and has led several projects for investment banks, commercial banks and insurance companies. He has prior experience with KPMG in the Middle East, South Asia, and Europe. He holds a PhD in finance from Indian Institute of Technology (IIT), Delhi, India, and has completed his masters and MPhil. in finance from Delhi School of Economics, Delhi, India.

He also has taught at a reputable business school in India and has authored a book titled *Volatility Forecasting and Derivative Trading in India* published by Macmillan.

Venkataraman Sundararajan (who died suddenly in 2010) was an internationally recognised financial economist with over 30 years' experience in the International Monetary Fund (IMF), advising governments in central banking and financial sector issues as well as in macroeconomic policy,

covering over 50 countries in Asia, the Middle East, Europe, and parts of Africa. He also brought expertise in Islamic finance issues based on his advisory work with many governments on risk management, governance, and regulation of Islamic finance. He joined Centennial as Director and Head of Financial Sector Practice and was the Deputy Director of the Monetary and Financial Systems Department at the IMF. He earned a PhD in economics from Harvard University and taught at New York University before joining the IMF in 1974.

Sami Al-Suwailem, obtained his bachelor's degree in science from King Saud University in Riyadh, Saudi Arabia, in 1987. He obtained his master's degree from Southern Illinois University in Carbondale, Illinois, in 1990, and in 1995 obtained his PhD from Washington University in St. Louis, Missouri, both in economics. He joined Al Rajhi Bank in 1995 as a chief consultant, and in 1998 became Manager of Research & Development in the Shari'ah Group at the Bank. He joined Islamic Development Bank Group in December, 2004 as a Senior Economist. Currently he is Head of the Financial Product Development Center at the IDB Group. He published several papers and books on Islamic finance in Arabic and English.

Dr. Hatim El-Tahir is a Director at Deloitte's Islamic Finance Group, and Leader of the Deloitte ME IFKC, a think tank and thought leadership initiative in Islamic finance aimed at prompting best practices in the industry.

Hatim worked extensively with regional and global Islamic financial institutions and leads the practice's development in MENA region and coordinates initiatives globally at Deloitte's member firms. His areas of specialisation include Islamic financial regulation, risk management, and Islamic finance research and education.

Hatim's experience spans many regions in the EMEA, including the United Kingdom, Africa, and 10 years in the GCC region. His recent representative accomplishments include advising on the development of a *takaful* act for an insurance regulator as well as leading a capacity development program in Islamic finance for a central bank in the Gulf.

He has authored numerous articles in credible industry journals, including Harvard University's *Islamic Finance Project* publication, and has been a regular speaker in major Islamic finance conferences, seminars, and training workshops.

Hatim is a regular participant in industry standards development discussions, exposure drafts, consultation papers, and task forces.

Richard Thomas OBE, is Chief Executive Officer of Gatehouse Bank plc. Gatehouse received its licence to operate as a *Shari'ah*-compliant investment