

The tipping balance of the global economy and the search for new sources of liquidity are driving the growth of Islamic finance. With the size and number of transactions in Muslim countries growing, and global deals done every day, International Institute of Islamic Finance's CEO **Dr Mohd Daud Bakar** tells Jim Banks that it is only a matter of time before it becomes a prominent, global financial system.

# The future of finance



There is little hard data on which to base a precise estimate of how fast the global market for Islamic finance is growing, but ask any Muslim scholar involved in these transactions and they will surely tell you there are more demands on their services with every passing day.

According to the International Institute of Islamic Finance (IIIF), many people in the market are quoting annual growth rates of 15-20% though, in some subsets of the market, the figures are much higher. The market for sukuks – Shari’ah compliant bond structures – is reckoned to be growing at an impressive 40% per annum.

As investors around the world look for liquidity and oil-producing countries in the Middle East look to put their petrodollars to work, it is inevitable that the spotlight has fallen on Islamic finance. The future development of the market will depend to some degree on its ability to handle capacity, but for now it is feeling the spur of many drivers and is set to continue expanding.

‘Everyone is looking at Islamic banking. There are new investors coming to the market, and existing investors are conducting more business. They now have Shari’ah compliant ways to invest, so why would they need conventional products?’ wonders IIIF CEO Dr Mohd Daud Bakar.

‘Investment banks like Morgan Stanley are now in the market. They are being asked to find Shari’ah compliant products, so they must know what they are doing. When demand is growing, supply must respond and that means banks offering the right products,’ he adds.

Bakar has had a front row view of the recent boom in Islamic finance. He is a renowned Shari’ah scholar whose expertise is in demand around the world. As well as being the IIIF’s CEO, he is also a member of both the Advisory Council of the Central Bank of Malaysia and the Securities Commission of Malaysia, and he acts as Shari’ah advisor for many of the world’s leading financial institutions and regional organisations.

He is certainly optimistic about the future of the market, but he admits that there will be challenges to overcome in the years ahead.

### Islamic finance: the role of scholars

Before any Islamic finance transaction can be completed, its structure must receive a fatwa from a recognised scholar, who will not only have an accepted qualification in Shari’ah law, but will also usually have some experience in global financial markets.

Key among their considerations is Riba, which has been the subject of intense debate among Muslim scholars for centuries. In simple terms, Riba equates to interest. Shari’ah law forbids usury and returns must be generated from investment in tangible assets.

Currently, debate is around precise definitions of the term Riba and what can be accepted as a tangible asset.

Islamic law also prohibits investment in businesses that are engaged in activities that are considered unlawful – haraam – including those that sell alcohol or pork, or those that produce forms of media such as gossip columns or pornography.

### Coping with rapid growth

One issue that has made the headlines over the last year has been the concern over the number of Muslim scholars available to consult on the structuring of

Furthermore, Bakar points out that there is more than one path a candidate can take to become a scholar. The hope is that this will enable the number of recognised scholars to grow relatively quickly.

Usually, the basic requirement is a first degree in Shari’ah from a recognised university, which assures a basic understanding of the law through a thorough and highly structured programme. There are some individuals, however, who have no formal education in Shari’ah law, but have an informal education through close association with an existing senior scholar.

There are also lawyers, accountants, economists and the like, who pick up Shari’ah law and can formalise their knowledge and become recognised scholars.

‘New scholars can be degree- or CV-based, as long as they are recognised as having the skills. We hope, therefore, that the number of scholars will grow, and we are seeing that happen in some areas. There are also efforts to make the process more formal,’ notes Bakar.

‘We must also remember that people must be proficient enough to compete well in highly competitive markets, and while a scholar may do well lecturing at a university, he must also have the passion to act quickly when advising on a deal. Not all scholars have those skills,’ he warns.

A further caveat is that it will take time for new scholars to build up their skills, even though they may have the required qualifications.

## ‘Everyone is looking at Islamic banking. There are new investors coming to the market, and existing investors and conducting more business.’

Shari’ah compliant transactions. Every deal must receive a fatwa – clearance from a recognised scholar [see box above] – and some fear that there are simply too few scholars with the necessary skills to support the market’s rapid growth.

Bakar notes this concern, but is hopeful that the balance will change before any bottlenecks occur.

‘There is a limited number of scholars, that is true, and many people in the market agree that this could pose a significant challenge to the development of Islamic finance. The market, however, moves quickly and we have not seen the lack of scholars slowing down the process of completing transactions. Pressure just means we respond more quickly,’ he observes.



## Islamic finance: global centres

The development many international centres for Islamic finance is a strong sign that it could indeed grow to be a prominent global financial system, just as International Institute of Islamic Finance's CEO Dr Mohd Daud Bakar foresees. Within the GCC region there are centres like Dubai, Qatar and Bahrain, which act as gateways for international investors to key market such as Saudi Arabia.

Bahrain is rapidly growing in terms of the number and size of transactions and is particularly active in arranging Shari'ah compliant mutual fund structures.

Focusing on a specific sub-sector of the Islamic finance market could also allow London, for instance, to develop as a major force in the global market.

'London knows that there are many sectors in the Islamic finance market, so it is looking to be the global centre for sukuks. Bahrain could achieve a similar position in terms of Shari'ah compliant mutual funds. That leaves other such as Qatar to focus on infrastructure finance,' notes Dr. Bakar.

'There is no problem with having more than one centre. One centre can't do everything. The market is too big,' he remarks.

'An inexperienced scholar will take a lot of time to absorb all the issues before giving a fatwa. Experienced, hands-on scholars are much quicker. It is good that we have both, because we need to train new scholars. For

the moment, their limited number is not affecting the market,' he adds.

Another potential worry that Bakar puts to rest is the question of different

interpretations of Shari'ah law in various Islamic countries. One might, for instance, compare the stricter interpretation in Saudi Arabia with a less stringent approach in Malaysia.

'Is it important? Yes and no. For research purposes, for academia then yes there is a need to go into the details of different interpretations, but if you want to be flexible or you are issuing a fatwa for a product on the global market, then you must take into account the most common interpretation. Sukuks, mutual funds and other instruments have succeeded because the market has done so,' remarks Bakar.

'The issuer must follow a standard that can be accepted anywhere, so it must suit companies in the GCC region,' he adds.

### A global financial system

Many drivers are now in place as more regional centres for Islamic finance develop [see box above]. There is a huge

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## CIMA – the first accountancy body to offer a global Islamic finance qualification

CIMA is the first professional chartered accountancy body to offer a global qualification in Islamic finance, which the CIMA Centre of Excellence launched in December.

The Islamic finance industry is thought to be worth between £150bn and £250bn, and is growing at an estimated rate of 15–20%. To date, few courses are available in this area of finance and normally comprise of short 1–3 day events. CIMA's self-study qualification has been developed alongside the International Institute of Islamic Finance, with detailed input from its CEO Dr Mohd Daud Bakar, a renowned Shari'ah scholar.

Robert Jelly, Director of Education at CIMA, says: 'CIMA has identified that there is considerable demand from the global business community to develop the knowledge and skills required to service this increasingly important market. The CIMA Certificate in Islamic Finance is the first to be



**The four modules of CIMA's Islamic qualification study guides**

created in conjunction with an advisory group made up of academics, practitioners and scholars of Shari'ah, and will assist employers in the City of London and other major financial centres throughout the world in equipping their employees to develop financial products.'

CIMA's new qualification is available at certificate level and comprises four modules: Islamic Commercial Law; Islamic Banking and Takaful (insurance); Islamic Capital Markets and Instruments; and Accounting for Islamic Financial Institutions. It is estimated

that a student can complete these modules in 2–6 months, depending upon prior experience.

The qualification is available across the globe as a series of study guides, revision kits and a microsite and provides students with a thorough knowledge of the theoretical and religious aspects that underpin Islamic finance. On completing the certificate, students will be comfortable with the array of Arabic terminology used throughout as well as the regulations which govern Islamic finance in practice.

volume of Shari'ah compliant deals within the GCC region, and Western investors and their banks are increasingly sophisticated in their understanding of the market. Their thirst for liquidity, along with the many large infrastructure projects scheduled or under way in Muslim countries, is likely to fuel further rapid growth.

They are also more attracted to the market now that perceived difference in cost between Shari'ah compliant and 'conventional' structures has narrowed.

'The cost depends on the product, and some instruments absorb the cost well. In Islamic banking, for example, there is no additional cost. For sukuks and mutual funds, the relevant thing to look at is the cost of compliance and monitoring, but many players in the market are trying to absorb that in the management fee and go for volume,' says Bakar.

'I feel that investors cannot be asked to pay more for Shari'ah compliance. Management teams issuing products often pay the ongoing compliance costs, not the investors, so cost is not a big issue any more,' he continues.

Capacity should also be manageable, provided the number of scholars starts to increase. The IIIF is certainly predicting a rosy future for the market.

'Now, Islamic finance is a small pocket in the whole investment landscape, but in ten years it will have become a real, global financial system. Investors will have a choice between conventional instruments and Shari'ah compliant products,' comments Bakar.

In fact, the challenges he perceives in the future stem more from the Islamic banking sector than from the international finance perspective.

'For normal banking, the activity of SMEs in Muslim countries is not that strong. There is room for growth there, and in the capital market infrastructure. There are many gaps to fill,' he remarks.

The IIIF is focused on providing an extensive range of training courses that are designed to equip finance professionals with the necessary skills to find their way through the Islamic finance market. It also acts as a key source for advice on many issues including product development, and

provides Shari'ah endorsement of proposed transactions.

Bakar knows from the IIIF's contact with banks and other financial services organisations that their appetite for skills, training and advice is getting stronger. This momentum could soon make many Islamic finance structures familiar to us all. ■

### Author

Dr Mohd Daud Bakar is a renowned Shari'ah scholar whose expertise is in demand around the world. CEO of the International Institute for Islamic Finance, he is currently a member of both the Advisory Council of the Central Bank of Malaysia and the Securities Commission of Malaysia.

He acts as Shari'ah advisor for the Accounting and Auditing Organisation for Islamic Financial Institutions, International Islamic Financial Market, BNP Paribas, Dow Jones Islamic Market Indexes, the HSBC Amanah Global Shari'ah Committee, Oasis Asset Management and Unicorn Investment Bank amongst others. He also consults on structuring Islamic capital market products such as sukuks.