

Islamic Finance and Global Financial Stability

April 2010



**ISLAMIC FINANCIAL
SERVICES BOARD**



Islamic Development Bank



Islamic Research and
Training Institute

Table of Contents

Preface

Foreword

Acronyms

Task Force on Islamic Finance and Global Financial Stability	11
Introduction: Financial Crisis and the Financial Reform Agenda	13
A. Appreciating the Islamic Finance Model	16
I. Key Principles	
Box 1: Basic Principles of Islamic Finance	16
Box 2: Participatory Mode in Fund Mobilisation	17
Box 3: Distinct Features of Islamic Financial Transactions: Perspective on <i>musharakah mutanaqisah</i> (Diminishing Partnership)	21
Box 4: Non-Profit/Unilateral Contracts in Islamic Finance	23
Box 5: Islamic Microfinance: <i>Ar-Rahnu</i>	24
B. The State of Islamic Financial Services Industry	26
I. Increasing Significance of Islamic Finance in the Global Financial System	27
II. Performance of Islamic Banks	34
III. Performance of Islamic Indices	37
C. Challenges and Strategies for Strengthening Financial Stability in the Islamic Financial System	40
I. Strengthening Islamic Financial Infrastructure	41
II. Accelerating Effective Implementation	48
III. The Establishment of a Platform for Constructive Dialogue: Islamic Financial Stability Forum	51
Conclusion	53
Appendix I : Standards and Guidelines Issued by the IFSB	54
Appendix II : Comparative Table on Standards and Guidelines Issued by the Islamic Financial Service Board and Basel Committee on Banking Supervision	57
Appendix III : Comparative Table on Standards Issued by Islamic Financial Service Board and International Association of Insurance Supervisors	61
Appendix IV : Al-Qur'an: Surah Yusuf (Joseph) Verses 43 - 49	68
References	69

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ


PREFACE

The Task Force on Islamic Finance and Global Financial Stability was formed on 29 October 2008 in response to the recommendations of the Forum of the Global Financial Crisis and its Impact on the Islamic Financial Industry, which was organised by the Islamic Development Bank (IDB) Group. The Task Force headed by H.E. Dr. Zeti Akhtar Aziz, Governor of Bank Negara Malaysia includes an international group of eminent scholars, practitioners and experts in Islamic finance.

The first meeting of the Task Force on 20 January 2009 led to the formation of three working groups to (1) examine the conceptual aspects of Islamic finance and its role in enhancing financial stability; (2) conduct stocktaking of the state of the Islamic financial services industry following the global financial crisis; and (3) examine the financial architecture of the Islamic financial industry amidst the more challenging post crisis environment.

The report of the three working groups were presented and discussed at the second meeting of the Task Force held at the IDB headquarters on 28 March 2009 in Jeddah. This document has drawn on the work of the three reports, incorporating the discussions and comments by the members of the Task Force. This report concludes with recommendations to strengthen further the institutional arrangements in the Islamic financial system.

As authorities worldwide are working hard to reform financial systems and policies, this will be a suitable time to give the Islamic financial industry the opportunity to participate in the process. The global financial crisis has demonstrated that we face common challenges. In joining and sharing lessons with international organisations, we can work towards avoiding such financial crises in the future. We believe that there is much that Islamic finance can



contribute to this process. From this perspective, the new financial order would be more inclusive and more global in nature, lending it more support and sustainability. Collectively, we hope that we will be able to build a more stable and more peaceful world for the future generations.

I would like to thank H.E. Dr. Zeti Akhtar Aziz for her pioneering endeavours in supporting Islamic financial industry in general, and for guiding the work of the Task Force in particular. I would also like to thank each and every member of the Task Force, as well as all the supporting staff at IRTI and IFSB. I pray that this effort will be a helpful step towards the good of mankind and, subsequently, for the blessings from the Almighty.

Dr. Ahmad Mohamed Ali
President of the IDB Group

FOREWORD

As a form of financial intermediation, Islamic finance incorporates several elements that guide the process of the mobilisation and allocation of funds to generate productive economic activity and inclusive development. Fundamental to Islamic finance is the requirement that financial transactions must be supported by real economic activity. In addition, Islamic finance promotes profit sharing and hence risk sharing. These elements limit the extent of leverage and place emphasis on transparency and disclosure in the documentation of contracts. Embraced in its entirety, Islamic finance promises to enhance the discipline that contributes towards ensuring growth and financial stability.

The global financial crisis of 2008-09, unprecedented in modern history, has brought to the forefront wide ranging issues concerning the stability and soundness of financial systems. This has prompted an extensive global re-examination by the international community on the need for regulatory reform and the adequacy of the existing international financial architecture and the search for a more enduring solution. This Task Force on Islamic Finance and Global Financial Stability was formed to examine the key elements in Islamic finance that contribute to its viability and resilience and to review the advancement of the Islamic financial services industry in the face of the challenges of the current global environment.

Amidst this more challenging environment presented by the recent international financial crisis, the global expansion of Islamic finance has continued and its development has remained dynamic. Today, Islamic finance has become one of the fastest growing financial segments in the international financial system. Its phase of development that began in earnest as domestic-centric for Muslim economies, has rapidly transformed in this recent decade to become internationally recognised and accepted as a competitive and robust form of financial intermediation by all communities. As Islamic finance extends its reach to serve the global community and becomes an integral part of the global financial system, it will however be increasingly tested by risks and developments in the international financial system. The Islamic financial services industry is also entering into a fundamentally different environment that will be significantly influenced by the international regulatory reform that is being undertaken in the post crisis era.

For the Islamic financial services industry to thrive in this new environment and to transition to the next level of development and trend towards greater international integration, its level of resilience needs to be strengthened further. Eight important building blocks have been identified in this report to further strengthen the foundations of the Islamic financial system. This is not only to ensure sustained orderly development and integration of the industry into the international financial system, but also to enhance the capacity of the industry to address the increased risks and vulnerabilities in the newly evolving international financial environment.

While the endeavour to strengthen the Islamic financial system and the international Islamic financial architecture is important in this highly integrated international financial system, equally important is to have in place a platform for greater international engagement on the developments and issues concerning maintaining financial stability in the Islamic financial system. Thus, included in the recommendations by the Task Force is the proposal to establish the Islamic Financial Stability Forum (IFSF) to serve as a platform for the deliberation of issues relevant for ensuring financial stability in the Islamic financial system. Whilst it will represent an important platform for addressing such challenges confronting Islamic finance, the establishment of the IFSF would also allow for an interface process with the international financial community in the conventional finance given the common interest of global financial stability.

In the course of preparing this report, numerous meetings were organised, including consultations and consensus-building dialogues, to obtain views from an extensive spectrum of participants in the Islamic financial system. This was aimed at achieving a common understanding on the important issues affecting financial stability in the Islamic financial system. I would like to take this opportunity to thank members of the Task Force for their unwavering commitment and contribution to achieving our mandate. It is hoped that the report will provide useful insights on Islamic finance and the important focus that needs to be given to financial stability in the rapidly changing international financial environment. Equally important is the capacity to contribute to global financial stability. The priorities identified in this report are also aimed at strengthening further the foundations that will ensure the sustainability and capacity of Islamic finance to contribute towards global growth and a greater shared prosperity.

Dr. Zeti Akhtar Aziz
Chairperson, Task Force on
Islamic Finance and Global Financial Stability

ACRONYMS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
CDO	Collateralised debt obligation
CIBAFI	(General) Council for Islamic Banks and Financial Institutions
CIS	Collective investment scheme
IAH	Investment account holders
IDB	Islamic Development Bank
IFSB	Islamic Financial Services Board
IFSI	Islamic financial services industry
IIFM	International Islamic Financial Market
IIFS	Institutions offering Islamic financial services
IMF	International Monetary Fund
IRTI	Islamic Research and Training Institute
LOLR	Lender of last resort
PSIA	Profit sharing investment accounts
UPSIA	Unrestricted profit sharing and loss bearing investment accounts

Task Force on Islamic Finance and Global Financial Stability

I. Introduction

The Task Force on Islamic Finance and Global Financial Stability (Task Force) was initiated by the Islamic Development Bank (IDB) on 29 October 2008 in response to the recommendations of the Forum of the Global Financial Crisis and its Impact on the Islamic Financial Industry, organised by the IDB Group.

II. Key mandates

The Task Force was entrusted with three mandates as follows:

- i. To analyse the role and relevance of Islamic finance in promoting global financial stability;
- ii. To take stock of the progress of the Islamic financial services industry in the face of the challenges of the current global financial environment; and
- iii. To examine important strategies and key building blocks towards further strengthening the resilience of Islamic finance and advancing global engagements towards promoting financial stability in the Islamic financial system as part of the current reform process of the international financial system.

III. Members


The Task Force is headed by H.E. Dr. Zeti Akhtar Aziz, Governor of Bank Negara Malaysia and includes an international group of eminent scholars, practitioners and experts in Islamic finance. The members of the Task Force are as follows:

1. H. E. Tan Sri Dr. Zeti Akhtar Aziz, Governor, Bank Negara Malaysia, **Chairperson**
2. Shaikh Saleh Kamel, Chairman, General Council of Islamic Banks & Financial Institutions
3. Professor Rifaat Ahmed Abdel Karim, Secretary-General, Islamic Financial Services Board
4. Shaikh Yousef Talal DeLorenzo, Chief Shari'ah Officer and Board Member, Shari'ah Capital, Inc.
5. Mr. Michael McMillen, Partner, Fulbright & Jaworski LLP, New York
6. Mr. Sameer Abdi, Lead Partner - Islamic Financial Services Advisory Services, Ernst & Young Bahrain
7. Dr. Mohd Daud Bakar, Chairman, Shari'ah Advisory Council, Bank Negara Malaysia
8. Dato' Khawaja Mohammad Salman Younis, former Managing Director, Kuwait Finance House (Malaysia) Berhad
9. Prof. Dr. Volker Nienhaus, President, University of Marburg, Germany
10. Dr. Abbas Mirakhor, former Executive Director, International Monetary Fund
11. Dr. Ahmed Ali Abdallah, Advisor to Governor and Secretary General, Shari'ah Supervisory Board, Central Bank of Sudan
12. Dr. Sami Ibrahim Al-Suwailem, Deputy Director, IRTI, Islamic Development Bank Group

Introduction:

Financial Crisis and the Financial Reform Agenda

1. The global financial crisis of 2008-09 has brought to the forefront issues concerning the stability and resilience of financial systems. At the heart of the crisis is the near-breakdown of the functioning of the financial intermediation process, amid a generalised loss of confidence in the financial system.
2. Many factors have been cited as the cause of the crisis. They include a combination of misalignments in the incentive structure and unbridled financial innovation which led to indiscriminate lending and excessive risk-taking. Other contributory factors include the erosion of sound prudential practices, with banks compromising on underwriting and risk management standards in pursuit of short-term gains and market share. While the banking institutions had employed increasingly sophisticated financial engineering techniques to repackage mortgages into complex structured securities, such financial innovation was not supported by commensurate enhancements to their governance processes and risk management infrastructure and practices.
3. In the wake of the crisis, the global financial community has intensified efforts to reform the international financial architecture to ensure its stability and resilience in a more challenging environment. The challenge before us is to not only undertake the necessary regulatory reform that will minimise potential risks, but to also build a new financial architecture that will promote greater efficiency in the financial intermediation process, including across borders.

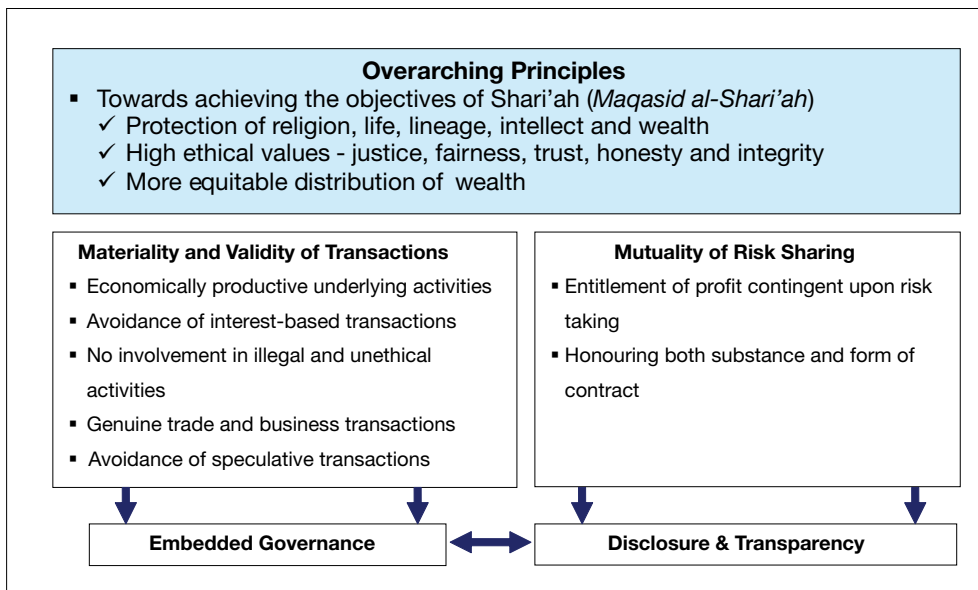
- 
4. In the search for a new financial architecture, there is a general consensus on the need to return banking to its basic function - to provide financial services that add value to the real economy. This in fact represents the very essence of Islamic finance. These are the very elements found in the Shari'ah principles that form the foundation of Islamic finance. It is these inherent elements that contribute towards the overall stability and resilience of the Islamic financial system. This foundation is further reinforced by the values that are extolled in Islamic finance that are similar to those found in ethical finance and socially responsible investment. The key strength of the Shari'ah injunctions is its emphasis on a strong linkage to productive economic activity, its inbuilt checks and balances and its high level of transparency and disclosure. The Islamic financial services industry has thus been in a relatively stronger position to weather the global financial crisis, demonstrating its robustness as a stable form of financial intermediation. The inherent features of Islamic finance have the potential to serve as a basis to address several of the issues and challenges that have surfaced in the conventional financial system during the current crisis. As the role and relevance of Islamic finance in the global financial system gains significance, it has potential to contribute to greater global financial stability and towards strengthening global growth.

A: Appreciating the Islamic Finance Model

I. Key Principles

5. Islamic finance derives its key strength from its inherent underlying principles. Islamic financial transactions must be accompanied by an underlying productive economic activity that will generate legitimate income and wealth, thereby establishing a close link between the financial transactions and productive flows. This reduces the Islamic financial system from over exposure to risks associated with excessive leverage and imprudent risk taking. Thus, in the Islamic finance business model, financing or equity participation can only be extended to activities in the real sector that have economic values. As a result, Islamic financial assets are expected to grow in tandem with the growth of underlying economic activities (see Table 1 and Box 1).

Table 1: Essential Features of Islamic Finance



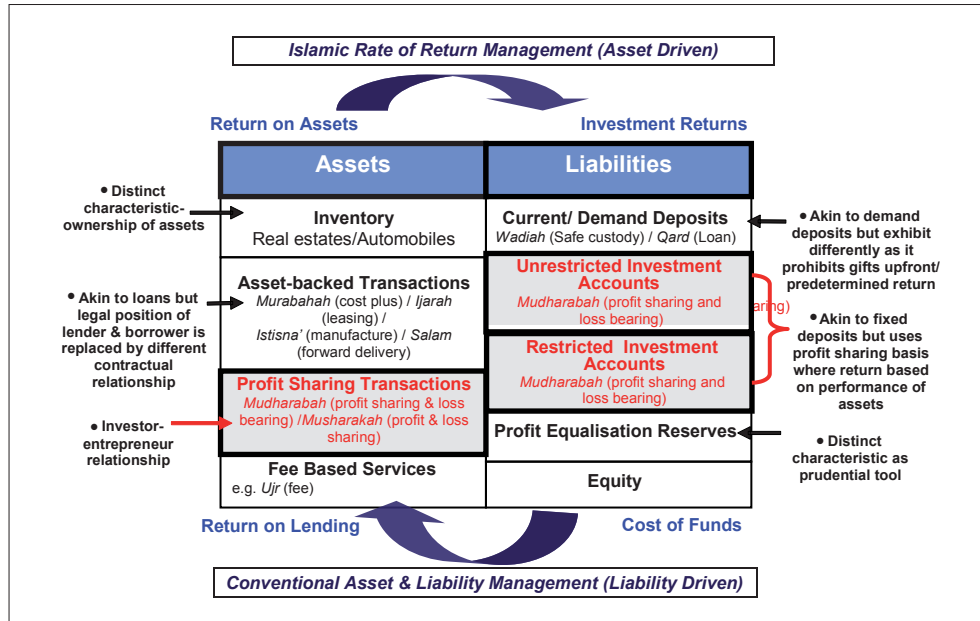
Box 1: Basic Principles of Islamic Finance

- Prohibition of interest (*riba*). Prohibition of *riba* – a term literally “an excess” and interpreted as “any unjustifiable increase of capital whether in loans or sales”.
- Money as “potential” capital. Money is not a commodity, but a medium of exchange, a store value and a unit of measurement. Money represents purchasing power and cannot be utilised to increase the purchasing power without any productive activity. Islamic finance advocates the creation of wealth through trade and commerce.
- Risk sharing. Because interest is prohibited, suppliers of funds become investors, rather than creditors.
- Prohibition of speculative behaviour. Islamic finance discourages hoarding and prohibits transactions featuring extreme uncertainties (*gharar*), and gambling (*maysir*).
- Sanctity of contracts. Islamic finance upholds contractual obligations and the disclosure of information as a sacred duty. This feature is intended to reduce the risk of asymmetric information and moral hazard.
- Shari’ah approved activities. Only those business activities that do not violate the rules of the Shari’ah qualify for investment. For example, any investment in a business dealing with alcohol or gambling is prohibited.
- Social justice. Any transaction leading to injustice and exploitation is prohibited.

Source: Adapted from Askari, et. al (2010)

6. Islamic finance promotes transactions that are based on profit and risk sharing. It encourages participatory finance or active participation in the business, through *mudarabah* (partnership of work and capital) and *musharakah* (joint venture) contracts (see Box 2 and Table 2). This approach promotes participation in the risk-reward and financial results or outcome of such businesses. This risk sharing requires the IIFS to undertake the appropriate due diligence on the viability of business proposals. Oversight and review by the relevant parties such as Shari’ah boards or Shari’ah compliant review process provide additional safeguards against irresponsible practices. In contrast, conventional financial instruments generally separate such risks from the underlying assets. As a result, risk management and wealth creation may, at times, move in divergent directions, with adverse consequences for effective risk management. Conventional financial instruments also allow for the commoditisation of risks. This has led to its proliferation through multiple layers of leveraging and disproportionate distribution, which, in turn, could result in higher systemic risks, thus, increasing the potential for instability in the financial system.

Table 2: Islamic Banking Balance Sheet: Distinct Contractual Relationship




Box 2: Participating Mode in Fund Mobilisation

- Financial intermediation through IIFS involves mobilising funds from savers or investors with excess liquidity, using a combination of non-return-paying current or demand accounts and profit sharing investment accounts (PSIA), and providing these funds to firms or individuals for financing assets or business activities. The banker-customer relationship is not the conventional debtor-creditor relationship but is based on different contracts that are entered into by the IIFS and the customer.
- A typical Islamic banking balance sheet is as follows:
- **Liability Side:** The liability structure of Islamic banks (i.e. funding structure) is characterised by two distinct categories of funds:
 - o Non-return-paying demand/current accounts for which the principal is guaranteed; and
 - o PSIA which refer to deposit products structured based on *mudharabah* (profit sharing-loss bearing contract) where customers and Islamic banks agree to share profits generated from the assets funded by PSIA based on a mutually agreed profit sharing ratio, while the loss shall be borne by the customers.

- Mobilising funds on a profit sharing basis means that, in principle, the value of liabilities adjust accordingly in response to any change in the price of assets. Even if the price of the financed assets remains unchanged, the expected returns for the partners may fall (for example, because of weak demand), which will subsequently reduce the profit to be shared.
- This modus operandi serves as a major constraint on leverage and the resultant credit creation, and ensures a better alignment of the values of assets and liabilities. The use of profit sharing modes to mobilise funds may imply that Islamic banks follow a model that is closer to that of mutual funds, which in principle, are less vulnerable to runs and panics than the conventional banking model¹.
- **Asset Side:** On the asset side, Islamic banks enter into different financing modes which have a distinct intrinsic characteristic dictated by its underlying Shari'ah principles.
 - o The wide range of financing modes based on trade and commerce offered by Islamic banks, such as *murabahah* (cost-plus credit sale financing), *istisna'* (manufacturing or construction financing contract), *salam* (forward sale of fungible goods for immediate payment), *ijarah* (leasing), etc. indicates that the IFSI has a sufficient range of products that can be used in meeting the needs of its customers; and
 - o An Islamic bank may enter into joint venture as a means of financing where the Islamic bank acts as joint partner in a specific economic activity based on a pre-specified profit-and-loss sharing arrangement.
- This form of intermediation is not merely the collection of a 'spread' between the cost of funds mobilised and the return on funds advanced in the context of the conventional debtor-creditor relationships but a more active economic role involving either the provision of assets or services or entering into partnerships.

¹ Khan and Mirakhor, 1987; Cowen and Kroszner, 1990; Jacklin, 1993

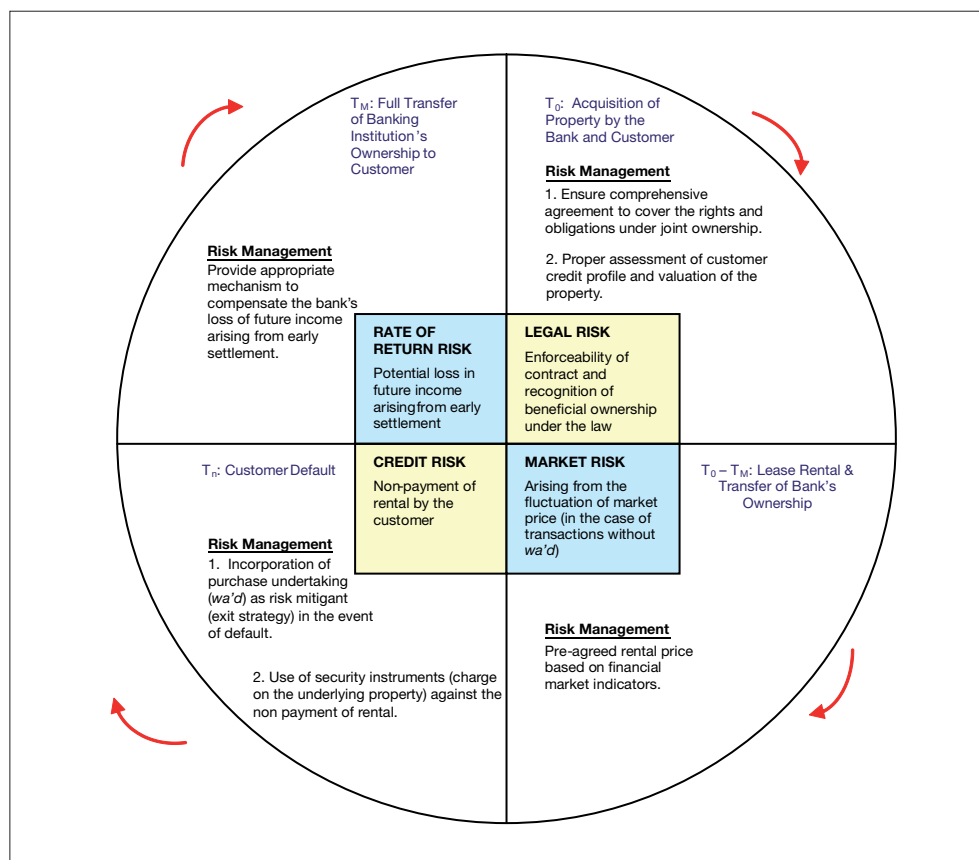
7. The key thrust of Islamic financial transactions is to have high degree of transparency and disclosure in preserving the rights and responsibilities of the parties to a contract. Islamic finance requires the Islamic financial institutions to undertake the appropriate due diligence on the viability of business proposals and to meet the requirement for transparency and disclosure. Market conduct disclosure and customer relationship management form the core of these principles. Addressing the information asymmetry between Islamic banking institutions and the depositors/investors is of vital importance. Under the *mudarabah* principles, there is a need for disclosure by Islamic financial institutions to investors on how the funds are being managed so as to provide the assurance that the underlying business operations, the risk profile and the risk control mechanisms are in place. Disclosure of the true and fair value of the Islamic banking operations in the financial statements is also essential for depositors to undertake an informed assessment of the bank's performance. In the case of equity and investment instruments, proper screening processes and disclosures are imperative to increase the level of assurances that the investments are invested in a Shari'ah compliant manner. The funds of the Islamic investment product and those of the financial institution in which Shari'ah injunctions are not observed must be completely segregated. This calls for the maintenance of separate accounts and disclosures, evidencing the complete segregation of funds. Non-commingling of funds is essential and should be enshrined and expressly stated in the statutes or the prospectus. The role of the Shari'ah board in ensuring that all aspects of the business operations of Islamic financial institutions are in accordance with the Shari'ah principles, adds another level of oversight which inherently safeguards against irresponsible practices. These in-built dimensions of governance and risk management contribute to safeguarding Islamic finance from the potential risks of financial stress arising from excessive leverage or speculative activities.

- 
8. These distinct features of Islamic finance represent the core principles in determining whether a particular transaction or institution fall within the parameters of Shari'ah. When embraced in its entirety, these essential Shari'ah features reduce the risk of financial instability. These principles are also integral to the orderly development of innovative Islamic financial products and services. Financial innovation in Islamic finance must be within these Shari'ah parameters and tested against the '*Maqasid al-Shari'ah*' (objectives of the Shari'ah), where the primary objective is the realisation of benefits to the people. This demands the internalisation and preservation of Shari'ah principles in Islamic financial transactions, both in form and substance in order to ensure that the religious and ethical principles are not compromised. This is illustrated in the example of *musharakah mutanaqisah*, an equity-based contract which has been widely accepted in many jurisdictions (see Box 3). These inherent features of Islamic finance significantly contribute towards the financial stability of the Islamic financial system.

Box 3: Distinct Features of Islamic Financial Transactions: Perspective on *Musharakah Mutanaqisah* (Diminishing partnership)

- *Musharakah mutanaqisah* can be applied in home financing products. Based on the joint-ownership concept, the banking institution and the customer contribute their respective shares of the capital required to acquire the property according to a mutually-agreed, pre-determined ratio at the beginning of the contract. The banking institution leases the property to the customer who undertakes to incrementally acquire the full ownership of the property from the banking institution over an agreed period. Once the customer has fully acquired the banking institution's share of the property, the partnership comes to an end with the customer becoming the sole owner of the property. This contract incorporates elements of both sale and lease (*ijarah*) contracts, which are integral in ensuring that no element of *riba'* (interest) is involved in the *musharakah mutanaqisah* transaction.
- The application of Shari'ah principles in *musharakah mutanaqisah* contracts creates distinct relationships, rights and obligations of the parties to the contracts. As a result, banking institutions are exposed to both market risk associated with the joint ownership of the underlying asset, as well as credit risk associated with the obligation on the part of the customer to acquire, and on the banking institution to sell its share of ownership in the asset. This distinct risk exposure requires the banking institution to adopt more robust methodologies supported by reliable and timely data and systems that are able to detect and provide best estimates of potential losses arising from adverse developments in the credit profile of the customer. The risk management processes and infrastructure of a banking institution offering such a product also need to be dynamic in identifying, measuring, controlling and managing all the relevant risks associated with *musharakah mutanaqisah* transactions. Chart 1 shows the key risk exposures and risk management practices at the different stages of a transaction in *musharakah mutanaqisah*, as well as additional risk mitigants that can be introduced.

Chart 1: Management of Key Risks in *Musharakah Mutanaqisah* Contracts



9. The essential features of Islamic finance, notably its value proposition of the sharing of risks and profits is reinforced by an ethical approach to financial transactions. Thus, this also involves greater attention to non-profit transactions and the segments of society with scarce capital, as well as attention to responsible and ethical financing. In this regard, the Islamic financial services industry is also attractive and viable for the less privileged segments of society that generally do not have recourse for funds except from the informal or shadow financial sector. In the process, the economic empowerment of the less fortunate would elevate their status from the “non-bankable” to the “bankable” segment, thereby benefiting the borrowers, the financial system, and the community at large, as well as increasing financial inclusion (see Box 4 and 5). The promotion of a more inclusive financial system

would in turn improve the financial intermediation process and enhance the overall efficacy of financial policies. Finally, through increased financial flows across borders, Islamic finance can also contribute to closer economic and financial linkages across the world by promoting mutually reinforcing growth in the world economy.

Box 4: Non-Profit/Unilateral Contracts in Islamic Finance

- While the non-profit domain in Islamic finance has been in operation for many centuries, it is less well known. This domain comprises institutions such as *zakat*, *sadaqah*, *awqaf* and similar philanthropic and social responsibilities, which are considered just as essential as the for profit domain within Islamic finance. They also perform beneficial economic support in serving the ‘safety net’ arrangement.
- *Zakat* may be compared to a type of ‘wealth tax’, being an obligation related to defined types of assets from which a part is to be paid by the owner of the assets when the assets reach a certain amount (*nisab*). For example, *zakat* on savings requires, inter alia, a holder of idle funds to contribute at a rate of 2.5% per annum to the eligible beneficiaries. It becomes payable if the holder’s monetary funds have been idle for one year. This negates the incentive for hoarding, which the Holy Qur’an takes a strong position against.
- *Awqaf* represents the creation of an endowment whereby an asset or pool of assets is dedicated in perpetuity, primarily for charitable purposes. Historically, *awqaf* has proven to be a useful institution in mobilising idle assets for addressing poverty, as the beneficiaries of *awqaf* can enjoy the benefits of education, healthcare, basic infrastructure and entrepreneurial assistance.
- The economic empowerment of the less fortunate, if carried out in a systematic and structured manner, may elevate them from the “non-bankable” to the “bankable” segment, thereby benefiting the individuals themselves, the financial system, and the community at large, as well as increasing financial inclusion.

Box 5: Islamic Microfinance: *Ar-Rahnu*

- The *Ar-Rahnu* (Islamic pawn broking) scheme can demonstrate its role as a viable microcredit product of the financial institutions in meeting the different customer requirements. Firstly, it represents a credit channel to those who want to use the *Ar-Rahnu* scheme to obtain financial resources to meet their daily financial requirements; and secondly, it can be a credit channel to those who require temporary working capital, particularly for small businesses.

The objective of *Ar-Rahnu* is to create an alternative financing channel to the conventional pawn broking, that is not only more transparent but that also complies with *Shari'ah* principles. *Ar-Rahnu* is a form of microcredit product where the borrower places valuable assets, such as gold, jewelry, as collateral for the financing. In the conventional pawn-broking, interest is charged on the loan and the collateral will be used in the event of default. In the *Ar-Rahnu* scheme, there is no element of interest and the financing is usually given on *qard* (loan). However, the borrower must pledge a valuable asset as collateral on the financing. The maximum amount of the financing as practised in Malaysia, Brunei and Indonesia is around 60 to 75 per cent of the value of the pledged item. The financial institution (the lender) would accept the pledge on *wadi'ah* (safe-custody) concept where the financial institution promises to safe-keep the pledged asset until the financing is settled. The financial institution would impose a charge on the borrower for services rendered which may include *takaful* coverage and security for the pledged asset. In the event of a default, the pledged item will be sold to a third party. The proceeds will be used to settle the outstanding balance while any excess will be returned to the borrower, unlike conventional pawn broking where the excess will not be returned to the borrower.

10. In summary, the features and value proposition inherent in the Islamic financial model can have the potential to contribute to global financial and economic stability through the following channels:
 - a. Finance can only be extended to projects, trade, economic and commercial transactions. Financial assets can therefore grow in proportion to the growth in real economic activities and minimise the possibility of excessive leverage.
 - b. “Don’t sell what you don’t have” is one of the fundamental principles of Shari’ah, which restricts the possibility of excessive speculation.
 - c. Investments in public and private equities have to pass a set of screening processes where social and ethical responsibilities are an integral part of investment decisions.
 - d. Preserving genuine liquidity (as opposed to synthetic liquidity) further adds to the stability of the IIFS.
 - e. Managing procyclicality (such as dynamic provisioning) is strongly encouraged where the concept has been narrated in the Holy Qur’an².

² Surah Yusuf - verses 43 to 49. Refer to Appendix IV for details

B. The State of Islamic Financial Services Industry

11. The crisis had initially emanated from the sub-prime market in an advanced economy largely due to excessive credit activity in the sub-prime mortgage sector. This was primarily facilitated through financial derivatives such as Collateralised Mortgage Obligations (CMO), Collateralised Debt Obligations (CDO) and Credit Default Swaps (CDS). With integrated financial markets and cross border capital flows, the crisis spread to all regions of the globe resulting in a sharp decline in investor confidence, which consequently saw the evaporation of liquidity in the global financial system.

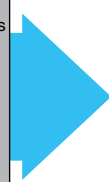
12. Islamic financial institutions, which are subject to Shari'ah regulations, are forbidden from investing in such derivative instruments and therefore did not have exposure to such derivatives. Also the holding of shares or the investment in conventional financial institutions which are involved in usury or *riba'* are not permitted. The combination of these factors minimised the impact of the financial crisis on Islamic financial institutions. However, the subsequent tightening of liquidity and credit in the global financial markets did adversely impact all financial institutions in general, including Islamic financial institutions. As the financial crisis become prolonged, the global recession, the collapse in commodity and oil prices, and the sharp erosion of asset values that followed, affected the performance of the Islamic financial institutions.

I. Increasing significance of Islamic finance in the global financial system

13. Islamic finance has become an increasingly integral part of the global financial system. Since the developments of the modern Islamic finance in the 1960s, the IFSI has evolved from a “fringe industry” that catered to the specific banking requirements of the Muslim community to a global industry encompassing banking, insurance and capital market. The Islamic financial landscape has now been dramatically transformed with more diverse players with an extensive range of financial products and services. Table 3 illustrates the significant developments that have taken place in the IFSI since the 1970s.

Table 3: Significant Developments in Islamic Finance

Prior to 1970s	1970s	1980s	1990s	Contemporary
Primarily Retail Banking	Commercial Banking	Property Finance and Syndication Islamic Insurance (Takaful)	Equity Funds Leasing Islamic Securitisation	Advanced Treasury Services Balance Sheet Management Innovative Asset Management



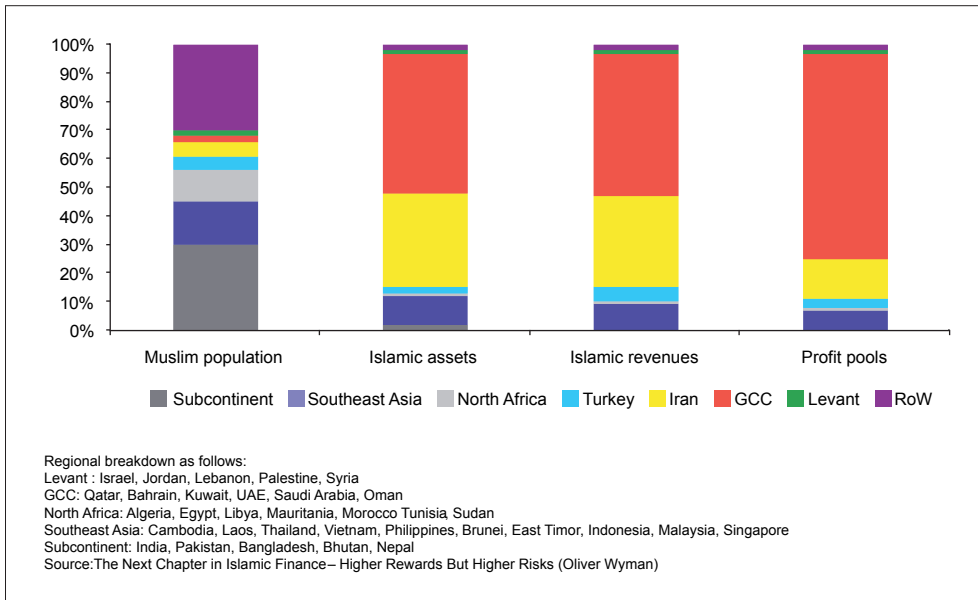
The rapid expansion of Islamic finance as a viable form of financial intermediation reflects its ability to meet the changing pattern of demand by consumers and businesses, its competitiveness and its ability to withstand the more challenging environment. This has encouraged strong interest from conventional global players from the developed economies that have increased their participation in Islamic financial markets. More recently, there has been increased initiatives to acquire strategic stakes in Islamic financial institutions in different parts of the world. With increased liberalisation, the Islamic financial system has become more diversified and the Islamic financial markets have deepened. As a result, Islamic finance has now emerged as among the fastest growing segments in the international financial services industry.

- 
14. While the Islamic financial services industry currently represents approximately only 1% of global assets, it has been growing by more than 20% annually since 2000. As at the end of 2007, the combined revenue of international Islamic financial services is estimated to amount to USD53 billion, while Islamic profits totalled USD15 billion and is expected to more than double to USD32 billion over the next 5 years. It is estimated that by 2012, Islamic assets will reach about USD1,600 billion, with revenues of USD120 billion.
15. Several key developments highlight the increasing significance of Islamic finance in the global financial system:
- a. ***The expanding asset base.*** The industry has recorded strong growth with total Islamic banking assets of USD660 billion at the end of 2007³. In terms of geographical distribution, the Middle East is now the largest Islamic finance market, accounting for about 80% of global Islamic finance assets. Chart 2 illustrates the regional distribution of Islamic assets, revenues and profits and the relative regional Muslim population⁴.

³ Oliver Wyman, 2009

⁴ Oliver Wyman, 2009

Chart 2: Muslim population, Islamic assets, revenues and profit pool breakdown by region, 2007



A more recent survey encompassing the top 500 IIFS showed that assets held by fully Shari’ah-compliant banks including Islamic banking windows of conventional banks rose by 28.6% to USD822 billion, from USD639 billion in 2008⁵. During this period, the world’s top 1,000 conventional banks achieved an annual asset growth of just 6.8% as of July 2009 to amount to USD96,395 billion.

- b. **Strong performance.** The strong performance of Islamic financial institutions amid the crisis has further supported its growing significance. Table 4 shows the comparison in terms of aggregate size and performance of Islamic banks and conventional banks in the Gulf region (Saudi Arabia, Kuwait, Qatar, United Arab Emirates and Bahrain).

⁵ The Banker, Nov 2009

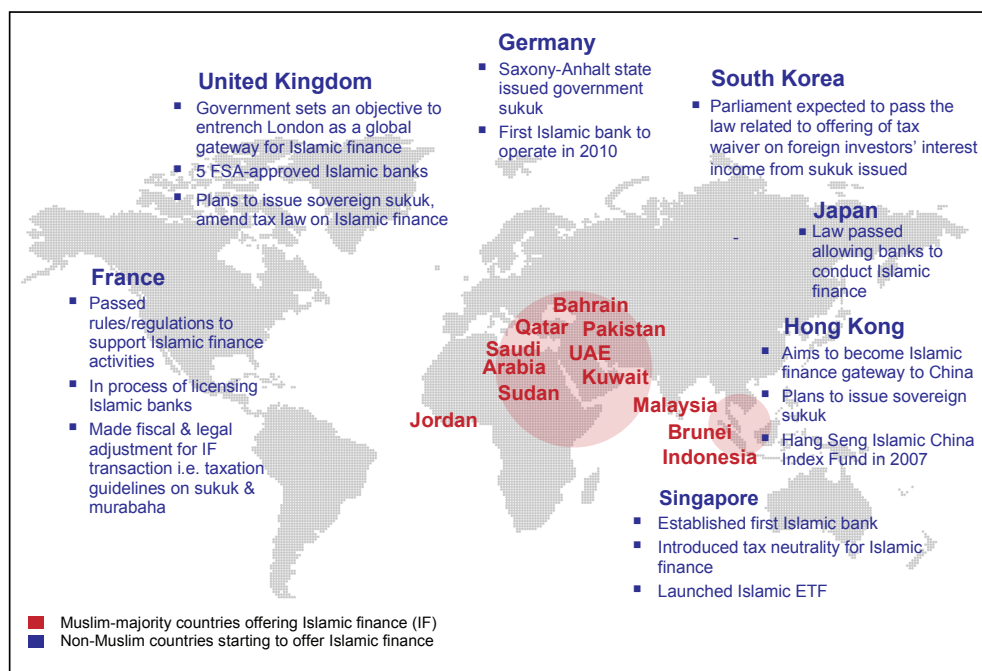
Table 4: Islamic and Conventional Banks in the Gulf Region, 2008

	Conventional Banks	Islamic Banks
Assets (USD billions)	1,135,669	232,189
Profits (USD billions)	22,008	7,666
Asset growth 2007-08	16.3%	38.2%
Profit growth 2007-08	-6.1%	20.1%
Profits/Assets	1.9%	3.3%

Source: El-Jarhi, 2009. Islamic windows in conventional banks are not included in Islamic banks.

c. ***Growing significance across regions, beyond predominantly Muslim markets and jurisdictions.*** From being concentrated in Muslim populated regions, Islamic finance has drawn significant participation by non-Muslims. Exceptional growth in Islamic finance has been registered not only in the Muslim world, where its growth is premised on religious considerations, but now spans across the western world and the Asia Pacific region where the growth is driven by commercial and business considerations. Although the Middle East and Asia remain by far the largest Islamic financial markets in the world, other regions and countries are also pursuing Islamic finance as a new asset class. Its potential for growth and development in the future has triggered strong interest from beyond Islamic incumbents. Chart 3 includes non-Muslim countries such as Australia, China, France, Germany, Hong Kong, Italy, Japan, Korea, Luxembourg, Singapore and United Kingdom, in which there are some initiatives in introducing Islamic finance in their financial systems. China has issued its first licence for Islamic banking, while five Islamic banks have been established in the United Kingdom as at end 2009. Countries such as France, Korea and Japan have also initiated changes to their legal and tax structure to facilitate the introduction of Islamic financial products into their markets. Other countries including Hong Kong and Australia have indicated their intention to advance this forward. This trend is expected to contribute towards greater cross-border flows in terms of increased trade and investment transactions, thereby strengthening economic linkages.

Chart 3: Emerging interest in Islamic Finance

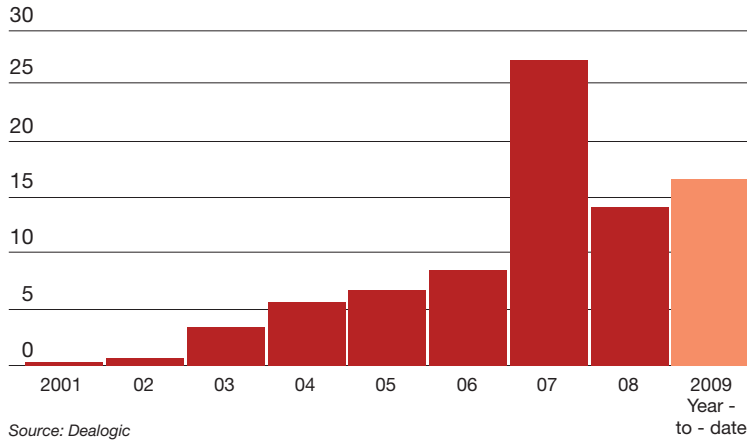


d. **Rapid expansion of the sukuk market.** With regard to Islamic securities or sukuk, Thomson Reuters reported that the sukuk market grew from USD6 billion to USD24 billion between 2004 and 2007. However, in 2008, the sukuk market registered a decline of about 30% due to the uncertainty in the global capital markets⁶. Nevertheless, as the overall market conditions improved, the sukuk market rebounded in the second half of 2009 (see table 5). The huge potential in the Sukuk market is evident from the active participation of global players including international investment banks, Islamic banks and securities firms that have participated in the issuance of sukuk.

⁶ Tayyebi, 2009

Table 5

Sukuk issuance shows improvement from 2008 setback
USD billion



e. Growth potential of takaful in new and existing markets.

Takaful premium contributions have grown from USD1.4 billion in 2004 to over USD3.4 billion in 2007. The largest global markets include Saudi Arabia and Malaysia. Saudi Arabia remains the largest takaful market in the GCC with contributions of USD1.7 billion in 2007. Malaysia remains the largest takaful market in Asia with contributions of USD0.8 billion in 2007. The other markets for takaful are Bahrain, Sudan, Kuwait and Indonesia. Globally, takaful continues to record rapid growth in new and existing markets⁷.

f. Strong upside potential of Islamic fund management industry.

In terms of Islamic funds, Shari’ah-compliant investible assets in 2008 in the GCC and Asia reached USD736 billion compared to USD267 billion in 2007⁸. This represents a potential annual revenue pool of USD3.86 billion for the Islamic asset management industry. Fund sizes however remain small, with more than 50% having assets under management of USD20 million or less.

⁷ Ernst & Young, 2009a

⁸ Ernst & Young, 2009b

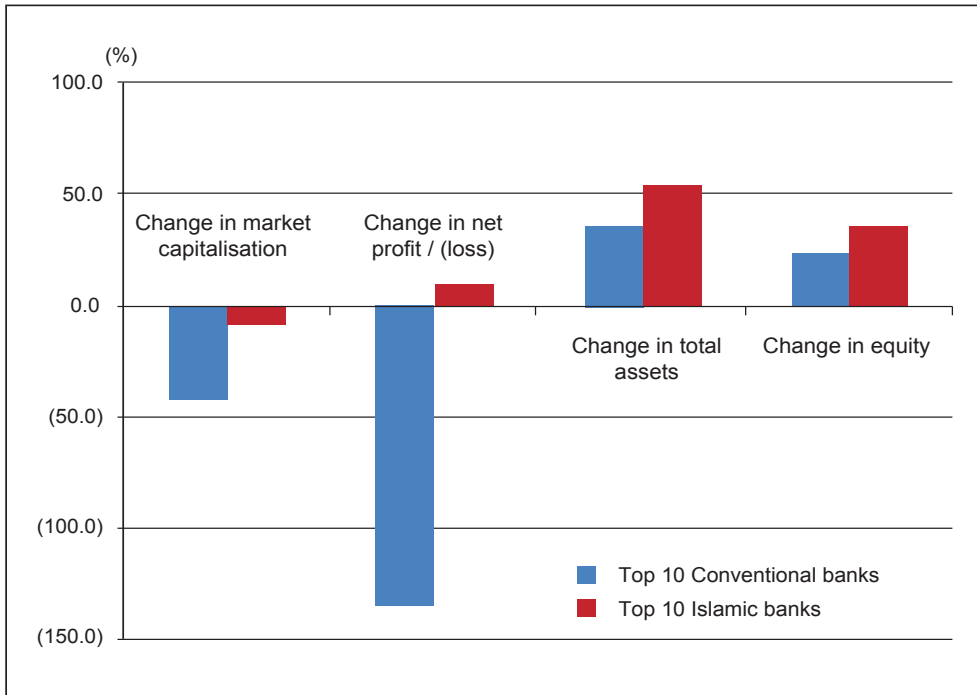
g. ***Development of comprehensive Islamic financial infrastructure.*** Several key institutions have been established to provide the infrastructure for the continuous growth of Islamic finance. Among the key institutions are the IFSB, AAOIFI and specialised institutions that provide Islamic financial services such as rating agencies, deposit insurance corporations and mortgage corporations. IFSB, an international prudential standard setting body was established in 2002 to develop and disseminate prudential standards for regulation and supervision of the Islamic financial services industry. AAOIFI, an accounting and auditing organisation, is responsible to develop accounting and auditing standards for the Islamic financial institutions. Several international rating agencies have developed ratings methodologies that recognise and incorporate the unique features of Islamic finance. Specific scheme on Islamic deposit insurance has also been developed, while mortgage corporations have issued sukuk to facilitate the widening of asset classes available to investors in the Islamic capital markets. Complementing these initiatives are the efforts by the central banks in issuing Islamic monetary instruments which is integral to the functioning of the Islamic money market and the Islamic financial system.

II. Performance of Islamic Banks

16. The resilience of the Islamic financial institutions during the recent crisis epitomises the intrinsic strengths in Islamic finance, which purpose and objectives are guided by the Shari'ah principles. A study on the performance of the top 10 conventional banks with the top 10 Islamic banks indicate the following⁹:
- a. The combined market capitalisation of top 10 conventional banks suffered a decline of 42.8% vs. 8.5% decline in market capitalisation by Islamic banks for the period between December 2006 and May 2009.
 - b. Aggregate net profits of conventional banks fell dramatically from USD116 billion in 2006 to a net loss of USD42 billion in 2008. In contrast, Islamic banks' net profit increased 9% during the same period from USD4.2 billion to USD4.6 billion while four of the conventional banks experienced losses (none of the Islamic banks suffered losses in 2008).
 - c. Between 2006 and 2008, total assets of conventional banks grew by 36% to USD17.4 trillion while assets of the Islamic banks grew by 55% from USD94 billion to USD147 billion. The growth in total equity during this period was 24% and 36% for conventional and Islamic banks, respectively.
 - d. Conventional banks' leverage ratio (Assets/Equity) was 16.6 times in 2006 which increased further to 18.2 times in 2008. This was nearly three times the leverage ratio of Islamic banks, which was 5.8 times in 2006 and 6.6 times in 2008.
 - e. Five of the top 10 conventional banks received government financial assistance to the extent of USD163 billion in aggregate, or 26% of the affected banks' combined equity. In contrast, only one Islamic financial institution required government assistance to restructure and trading of its shares was suspended. As at end 2009, none of the Islamic banks needed any government rescue scheme.

⁹ Ernst & Young, 2009

Chart 4: Changes in market capitalisation, net profit, assets and equity - pre and post crisis



17. Chart 4 compares the changes in market capitalisation, net profit/(loss), total assets and equity between conventional banks and Islamic banks pre and post crisis. The following charts (chart 5-8) show the performance of individual banks with respect to market capitalisation, profitability, assets and leverage.

Chart 5: Market capitalisation of top 10 conventional and Islamic banks – pre & post crisis

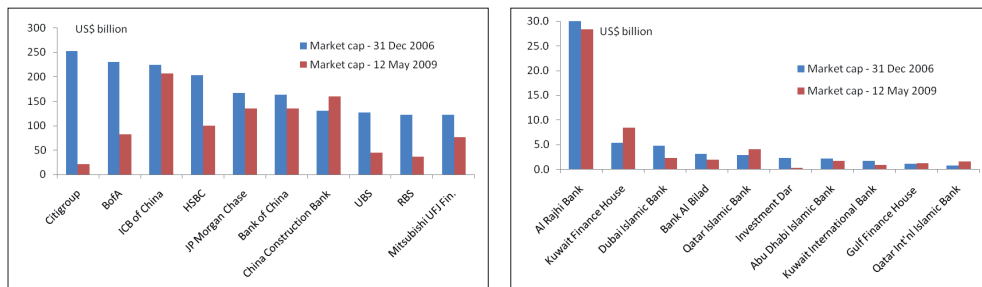


Chart 6: Net profit/(loss) of top 10 conventional and Islamic banks – pre & post crisis

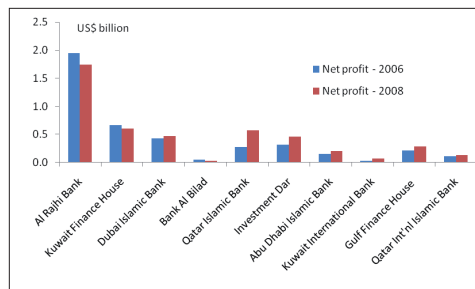
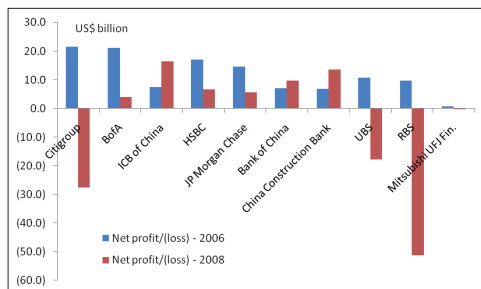


Chart 7: Total assets of top 10 conventional and Islamic banks – pre & post crisis

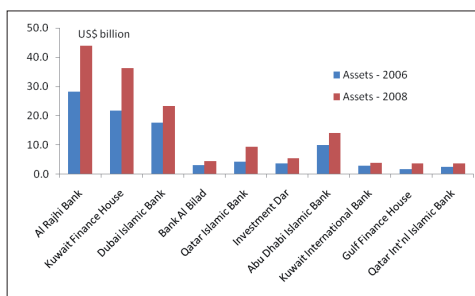
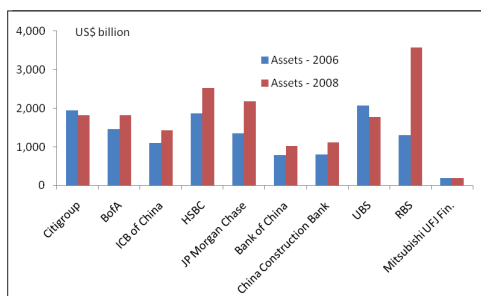
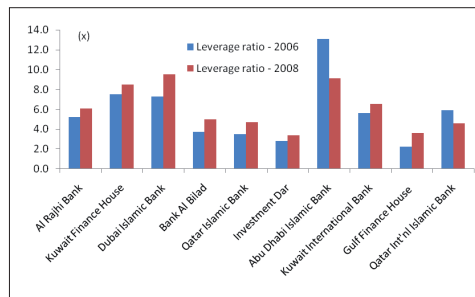
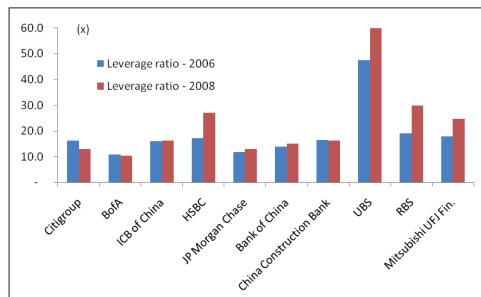


Chart 8: Leverage ratios (Assets/Equity) of top 10 conventional and Islamic banks – pre & post crisis



Sources:

- Company annual reports and websites; financial database websites (Thomson Reuters etc.)
- The Banker, November 2008 report on top 500 Islamic financial institutions
- Ernst & Young Analysis

Note:

- All financial figures have been converted to USD on current exchange rates.
- All figures are for December year-end, except Mitsubishi UFJ Financial which has March year-end. Its 2006 numbers are actually for 12 months ended March 2007. Its 2008 numbers are as of 30 September 2008, the last reported figures. Net profit for 2008 is for six months.
- The 2008 numbers for Investment Dar are for 9 months – up to 30 September 2008.
- As of 1 April 2009, the Kuwait Stock Exchange suspended trading in Investment Dar's shares until further notice as a result of the postponement of the release of its full year financial results for the year ended 31 December 2008.
- The list of top 10 Islamic banks in terms of 2006 market cap does not include some large Iranian banks which claim to be Shari'ah compliant but their market data is not easily available.

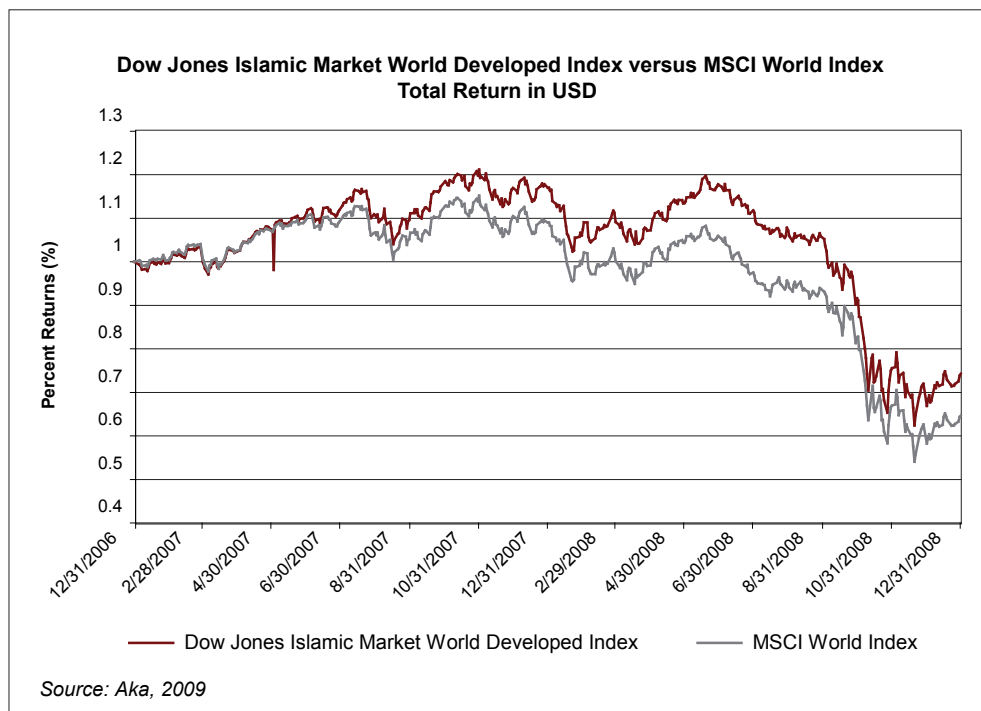
18. It is important to note, however, that the above observations are subject to some important caveats:
 - a. The size of the Islamic banks is a fraction of that of the conventional banks. The top 10 Islamic banks' market capitalisation was only 3.1% of the top 10 conventional banks' market capitalisation in 2006. While this has improved to 4.8% in 2008, it remains small. The size of Islamic bank assets as a percentage of total bank assets was less than 1% in 2008.
 - b. In the case of Gulf-based Islamic banks, their relatively large exposure to the real estate sector has been a key reason for their weaker performance. As a result, they suffered from price corrections in the Gulf property market.
 - c. Islamic banks are currently in an evolutionary and transitory phase where there is a concentration of their assets in a few products which have been carefully structured to largely replicate the risk and return characteristics of conventional financial products. To the extent that this is diluting the distinctiveness of Islamic finance, it could also expose the Islamic banks to the destabilising forces inherent in the conventional financial system.

III. The Performance of Islamic Indices

19. The Islamic financial services industry has developed a stringent set of criteria for investment, specifically to facilitate investments in the various stock markets around the world. These criteria represent part of the screening process to identify companies which business activities do not comply with a minimum Shari'ah compliant standard, thereby rendering their stocks ineligible for purchase by Shari'ah based investors. The criteria include tests at the level of a company's primary business and at the level of its financial or capital structure. In the more recent decade, such Shari'ah "screens" have been adopted by the major international index providers to establish specialised Islamic market indices.

20. During the recent stock market crash, Islamic indices had fallen together with the conventional stock indices across the world, but to a lesser extent. This could be due to the exclusion of conventional banking and insurance stocks from Islamic indices, including stocks that failed to pass the screens owing to the nature of their business (e.g. dealing in interest). Other companies that were designated as being non-Shari'ah compliant are those involved in gambling and other certain entertainment.

Chart 9: Dow Jones Islamic Index vs. MSCI World Index

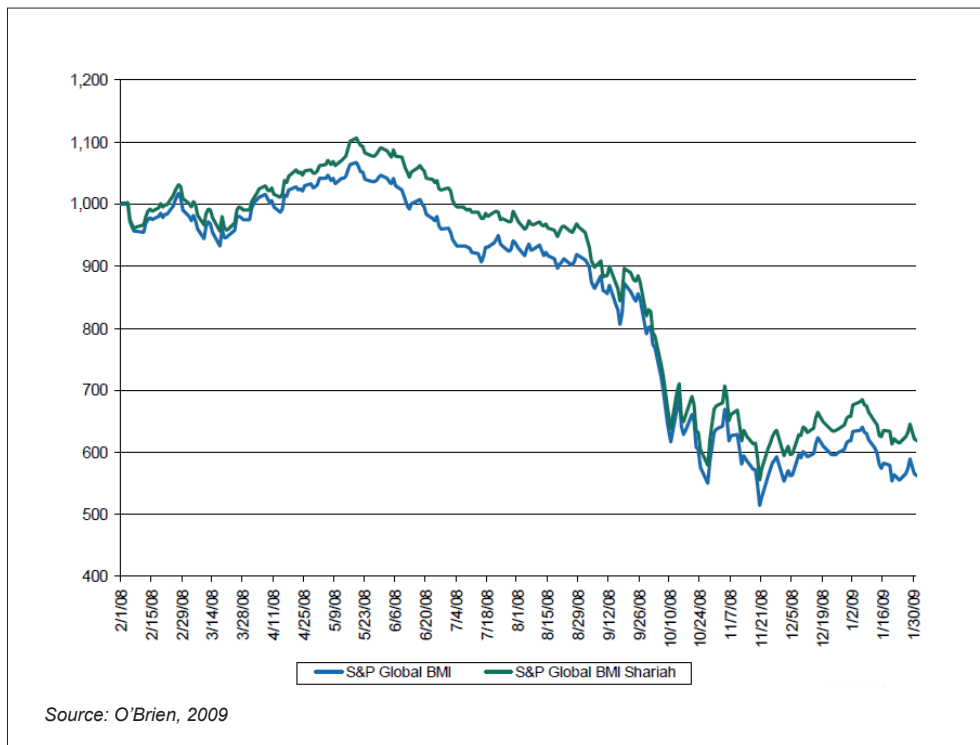


21. As shown in Chart 9, during 2007-2008, the total returns on the Dow Jones Islamic Market World Developed Index declined by 24.7%, while the outturn for its counterpart/proxy, the Morgan Stanley World Index declined by 34.7%¹⁰.

¹⁰ Aka, 2009

22. A similar outcome is apparent in Chart 10, which compares the performance of the Standard & Poor's Global Shari'ah Index vis-à-vis its Global Conventional Index. In 2008, the S&P Global Index lost 42.5%, while its Islamic counterpart fell by 36.8%. This trend is mirrored in the performance of the S&P 500, which lost 38.6%, compared with its Islamic counterpart which declined by 28.9%.

Chart 10: S&P Global Shari'ah Index vs. S&P Global Index



23. Going forward, it is envisaged that the strong growth in Islamic finance will be sustained, given the potential for widening the current range of Islamic financial products and services on offer, as well as increasing demand, particularly from the high number of untapped markets.

C: Challenges and Strategies for Strengthening Financial Stability in the Islamic Financial System

24. The recent international financial crisis has revealed that fragilities exist in the world's financial system, including in the more advanced economies. These have brought to the forefront key issues regarding financial intermediation, financial innovation and the regulatory and surveillance framework that needs to be put in place to provide the necessary oversight over such activities. Although the Islamic financial services industry was relatively less affected by the crisis, its underlying causes bear important lessons for the Islamic financial industry going forward. This is even more important as Islamic finance operates within the global financial system that is characterised by increasingly large and volatile cross-border capital flows amid an environment of deeper international financial integration.
25. To support the orderly development of Islamic finance for sustained global financial stability, it is vital to accelerate the development of critical building blocks of the Islamic financial system to respond to the changing economic and financial landscape. This is important to ensure a more integrated Islamic financial services industry globally that is able to withstand shocks and adverse market developments through putting in place building blocks that will strengthen the resilience of the Islamic financial system and by the application of mutually acceptable rules and standards.
26. Moving forward, **three key areas of priority** warrant greater policy attention to further strengthen and enhance the entire Islamic finance ecosystem:
 - a. Strengthening the **infrastructural building blocks** of the Islamic financial services industry to further enhance the industry's resilience;


- b. Accelerating the **effective implementation** of Shari'ah and prudential standards and rules to facilitate the creation of a more stable, efficient and internationally integrated Islamic financial services industry; and
- c. Creating a **common platform** for the regulators of the Islamic financial services industry to enhance constructive dialogue.

I. Strengthening Islamic Financial Infrastructure

- 27. It is critical to build the robust components of the financial infrastructure as well as strengthen the key institutions, at both the national and international level, to ensure the stability and dynamism of Islamic financial system. This report has identified eight building blocks aimed at further strengthening the Islamic financial infrastructure at the national and international levels to promote a resilient and efficient Islamic financial system.

Comprehensive set of cross-sectoral prudential standards

- 28. The **first building block** in securing financial stability is the development of a set of comprehensive, cross sectoral prudential standards and supervisory framework covering Islamic banking, takaful and capital market which takes into account the specificities of the IIFS.
- 29. The IFSB has issued a whole spectrum of prudential and supervisory standards which constitute the equivalent of Basel II in Islamic finance – covering risk management, capital adequacy, corporate governance, transparency and market discipline. These standards take into account international prudential standards across the banking, investment and securities and insurance markets issued by the Basel Committee on Banking Supervision (BCBS), the International Organization for Securities Commission (IOSCO) and International Association of Insurance Supervisors (IAIS), respectively, and simultaneously cater effectively for the specificities of Islamic financial firms, their risks and Shari'ah compliance. Appendix I provides a full list of the standards and publications issued by the IFSB.

- 
30. Significant efforts to issue comprehensive prudential standards for the Islamic banking sector have contributed towards establishing an internationally consistent framework for Islamic banking that is equally robust as those applicable to the conventional banking sector. This includes a sound capital adequacy framework equivalent of Basel II for Islamic banking. Appendix II provides comparison between IFSB and BCBS standards.
31. However, greater attention is needed to expedite work on a more comprehensive set of prudential standards for the takaful sector. IFSB spearheads this effort through a number of key initiatives. In August 2006, IFSB and IAIS issued an “Issues paper” on the applicability of the existing insurance core principles¹¹ (ICPs) to the regulatory and supervisory standards for takaful to be developed by the IFSB. Some of the ICPs are universally applicable and require no adaptation to apply to takaful. However, some of the ICPs appear to require some adaptation, for example, in the areas of corporate governance, financial regulation and market conduct. In December 2009, IFSB issued a standard on the governance of takaful. A standard on the solvency of takaful is at an advanced stage of preparation. Appendix III shows the comparison of standards between IAIS and IFSB.
32. It is also important to ensure closer cooperation among policymakers and financial supervisors with different mandates and in different jurisdictions in order to enhance the resilience and stability of the IFSI. In this regard, the IFSB has emphasised the need for the adoption of a coordinated cross-sectoral approach to the regulation and supervision of IIFS that encompasses the banking, the investment and securities market and the takaful sectors. To address contagion risks, the regulation of non-financial activities of financial conglomerates would also need to be appropriately structured.

¹¹ The IAIS insurance core principles (ICPs) provide globally accepted principles for the regulation and supervision of insurance sector.

Development of a liquidity management infrastructure

33. The **second building block** in enhancing financial resilience and stability of the IFSI is the development of a robust national and international liquidity infrastructure, which encompasses the potential for monetary policy and money market operations. This is important not only to reduce the cost of intermediation, but also to influence the level of liquidity in the financial system and achieve effective management of monetary policy. Robust liquidity management infrastructure is also vital in preserving financial stability for central banks to perform the lender of last resort (LOLR) function and to provide liquidity to the market. The ability of IIFS to weather a liquidity crunch is contingent upon the access to a robust liquidity management infrastructure, which is currently still underdeveloped in most of the jurisdictions in which Islamic financial services are offered. The tools for liquidity risk management presently available for use by IIFS remain rudimentary and markets are insufficiently liquid, leading to inefficiencies in normal times (due to low returns on liquid assets) as well as the potential for systemic risks in times of crisis owing to the relative limited liquidity of the instruments involved.
34. Towards addressing this, the IFSB has established a High Level Taskforce on Liquidity Management (HLTF), mandated to develop a liquidity framework to facilitate and offer liquidity solutions to market players so as to promote better liquidity management by the Islamic financial institutions. The HLTF is also mandated to study the viability of the proposal to establish an entity which would issue Shari'ah compliant instruments that are highly liquid and transferable in the secondary financial market.

Strengthening financial safety nets

35. The **third building block** relates to the strengthening of the financial safety net mechanism, namely, LOLR facilities and emergency financing mechanisms as well as deposit insurance, all of which need to be compatible with Shari'ah principles. While the current

practice of managing liquidity through interbank *Murabahah* or *Wakalah* arrangements, structured finance and enhanced deposit schemes may function well under normal market conditions, more efficient and tradable Shari'ah compliant financial instruments are required for LOLR facilities and emergency financing operations when inter-bank liquidity comes under pressure in a crisis situation. This calls for the development of an adequate range of tools and instruments for LOLR and emergency financing operations that are consistent with the core objectives and principles of Shari'ah both in form and in economic substance.

36. Deposit insurance, together with prudential supervision and the LOLR function, represent the other key components of the financial safety-net arrangements for sustaining financial stability, especially when confronted with a financial shock. The implementation of a well-designed Shari'ah compliant deposit insurance scheme for Islamic financial services is particularly challenging given the intricacies of the funding structure of IIFS. The on balance sheet funding structure of IIFS in almost all countries is composed mainly of current accounts and unrestricted profit sharing and loss bearing investment accounts (UPSIA), and in most IIFS, these investment accounts constitute the major source of funding. While explicit depositor protection may be provided for current accounts under a Shari'ah compliant (takaful based) deposit insurance scheme, an issue arises when insurance coverage is provided for UPSIA. Contractually, UPSIA should bear their own commercial risks, as in the case of investors in a collective investment scheme (CIS). While Shari'ah requirements in this respect would be met by the UPSIA themselves being the participants in the scheme, providing insurance coverage for UPSIA might raise several concerns relating to matters such as: the appropriate fair value of UPSIA that should be insured; the evaluation of the riskiness of the underlying assets; the quality of the asset management for the purpose of setting the levels of the takaful contributions and the unlevel playing field between UPSIA as investors in IIFS vis-à-vis investors in a CIS.

Effective crisis management and resolution framework

37. The **fourth building block** involves the development of a reliable crisis management and resolution framework in addition to financial safety nets, which includes bank insolvency laws and the arrangements for dealing with non-performing assets, asset recovery and bank restructuring, as well as bank recapitalisation. An integrated crisis management framework is essential to ensure that any emerging crisis in the Islamic financial system will be promptly managed. Jurisdictions that offer Islamic financial services are confronted with the challenge of adapting the framework of crisis management and resolution to the specific circumstances of the IFSI, and which has compatibility with Shari'ah principles.
38. The legal challenges relate to the issue of whether the conventional legal systems, common law jurisdictions and codified systems adequately address, among other things, bank liquidation and insolvency issues arising from Shari'ah compliant financial transactions, for example, in terms of the priority of claims of depositors and shareholders during liquidation of an IIFS. The IIFS would also be exposed to a number of risks in jurisdictions with established insolvency rules that are not tailored to deal with insolvency issues in Islamic financial transactions. These legal risks have been highlighted in an IFSB paper, Islamic Finance: Global Legal Issues and Challenges, which was published in 2008. It is therefore important that policy actions be expedited to develop a Shari'ah compliant framework for crisis management and resolution in order to be able to restore stability and confidence in the IFSI, should the need arise.

Accounting auditing & disclosure standards

39. The **fifth building block** consists of accounting, auditing and disclosure standards for IIFS and their counterparties, supported by adequate governance arrangements. This building block would enhance financial reporting to facilitate the effective monitoring and assessment of Islamic financial institutions. For IIFS, the IFSB has developed a standard on the Shari'ah governance systems, and has designed a transparency and disclosure framework to

reflect the risk characteristics of IIFS. In parallel, further progress is needed in updating the accounting and auditing standards for IIFS to that of the international standards, in order to complement the developments in prudential and risk management standards. Above all, there needs to be a monitoring and assessment mechanism to encourage countries to implement the standards.

Macro-prudential surveillance

40. The ***sixth building block*** refers to the development of the macro-prudential surveillance framework and financial stability analysis, which is an integral part of the strategy to strengthen the resilience of the Islamic financial system and to minimise the risks of financial fragility. The traditional micro prudential supervision approach cannot effectively address system-wide stress that might develop due to common exposures of financial institutions. In this respect, there is a need to have a macro prudential surveillance framework that complements the traditional micro prudential supervision of individual institutions.

41. One of the challenges in the implementation of this macro prudential framework relates to the development of indicators that would not only provide a basis for the assessment of financial soundness and risk to vulnerabilities of the financial system as a whole and its components, but also facilitates an analysis and assessment of how these indicators might interact with broader macroeconomic developments. Such an assessment of systemic implications would enhance the ability to anticipate the potential threats to financial stability. In this regard, the IFSB has embarked on an initiative to establish a global database of prudential Islamic finance statistics. This would contribute towards standardising the measurement methods and reporting structures of key financial soundness indicators for Islamic finance, thereby promoting international data comparability. As timely and accurate information and statistics is key enabler to this process, it is therefore necessary to ensure that similar advancement in information technology is made to cater for the unique characteristics and features of Islamic finance.


Strengthening rating processes

42. The ***seventh building block*** is to review the rating process for Islamic institutions or instruments by re-examining and improving the related core processes to encourage greater transparency on the risks involved. A robust rating process is an integral part of the building blocks to address the apparent failure of the rating agencies to assign accurate ratings on new, complex securities, before the onset of any crisis¹².
43. Rating agencies need to fully appreciate the unique features, characteristics and risk profiles of Islamic institutions and instruments. It is important to adopt a more holistic rating process, encompassing the fiduciary aspects and credit risk while giving due consideration to the transparency and visibility of the underlying transactions and the quality of the management.
44. The rating and methodology process also need to be re-examined to encourage greater transparency. As Islamic financial institutions are involved in fiduciary relationship, the rating process should emphasise on the management of risk sharing in certain products and services (such as PSIA), and must be recognised in the credit rating assessment.

Capacity building and talent development

45. Finally, as the ***eighth building block***, international Islamic supranationals and developmental bodies need to consider more involvement in capacity building to promote global financial stability. Islamic finance is an industry that is dynamic and complex with rapid product innovation. To excel and produce results in a more challenging globalised environment, practitioners and stakeholders in the Islamic financial services industry need to be highly qualified and equipped with the

¹² For instance, during the onset of the crisis, rating agencies competed with each other to rate MBS and CDO securities issue by investment banks as the remuneration and incentives are three times more than grading less complex, traditional corporate bonds.



requisite technical knowledge and skills. Of importance is the need for more collaborative efforts by various research and training institutions in different jurisdictions to design and offer capacity building modules in key areas across multiple jurisdictions. Collaboration in this area would also enhance capacity building among countries and Islamic financial services industry players to develop the best practices and standards, harmonise of Shari'ah practices, review standards to facilitate policy development and implement of standards and policy framework.

46. Efforts to enlarge the human capital pool are imperative to keep pace with the rapid growth of Islamic finance. Investments in human capital development through specialised training and educational institutions are important to support the global development of Islamic financial services industry. Talent development and educational institutions specializing in Islamic finance that have been established in several jurisdictions should be encouraged to forge strategic alliances across borders.

II. Accelerating Effective Implementation

47. Going forward, steps need to be taken to implement the eight building blocks. Effective implementation is important to ensure enhanced resilience of the industry and greater linkages among Islamic financial institutions and markets. There are three dimensions to this process:
 - a. Implementation of the prudential standards;
 - b. Mutual understanding of Shari'ah views globally on key issues in Islamic finance; and
 - c. Emphasis to encourage an inclusive system.

Implementation of the prudential standards

48. The ***implementation of the prudential standards*** that have been issued by the IFSB is important. This is critical in the harmonisation of prudential standards, in promoting and enhancing the soundness and stability of Islamic financial services industry, as well as in contributing towards the consistent development of Islamic finance across different jurisdictions. Several jurisdictions have implemented the prudential standards issued by the IFSB, which have been designed based on the unique features of Islamic finance and will contribute towards ensuring its soundness and stability. This should be supported by a transparent and credible assessment process which would serve to assist jurisdictions in evaluating their level of compliance with international standards and make recommendations for improvements such as peer reviews or the Financial Sector Assessment Program (FSAP) process.

Mutual understanding of Shari'ah views on key issues across jurisdictions

49. This is essential as varying interpretations of Shari'ah in key issues in different countries or markets add to the complexity when cross-border transactions are involved. Mutual recognition of financial standards and products across jurisdictions would facilitate the integration of Islamic finance across the world and in bridging the global markets. This convergence and harmonisation is taking place with the greater engagement among the regulators, practitioners and scholars in Islamic finance across jurisdictions. The industry also needs to develop innovative and diversified Islamic financial instruments which can be readily accepted by the Islamic financial institutions in various jurisdictions.
50. Key to this is to ensure that a consistent interpretation across jurisdictions is applied to the issues facing the industry. It is important for the industry to have a general understanding of the fundamentals of Islamic finance and in embracing the uniqueness of Islamic financial structures and their risk profiles. The industry needs to recognise the theoretical merits of Islamic finance as espoused by Shari'ah objectives and principles. When embraced in its entirety, these

essential features reduce the risks of financial instability. While innovation is to be encouraged, it must be consistent with the essential features of Islamic finance that are in compliance with the principles of Shari'ah and aligned to the objectives of Shari'ah. This is an important transformation of Islamic finance from the dominant strategies pursued in previous decade of emulating the products and services of its conventional counterpart. This would separate Islamic finance from the same misalignments between assets and liabilities prevailing in the conventional system, and thus reduce the risks of financial panics. In attaining a sufficient degree of differentiation, Islamic finance can become a valuable partner within the global financial system.

Emphasis for Islamic finance to be a more inclusive system

51. Islamic finance also emphasises the development of a more inclusive system, within a broader Islamic financial ecosystem. The hardships of the vulnerable segments of the society are often compounded during economic and financial crises. In the Islamic financial ecosystem, the institutions of *zakat* and *awqaf* contribute towards alleviating such hardships. In addition, greater access to financial services enables broader participation in the nation's development process. Islamic finance, in achieving the objectives of Shari'ah (*Maqasid al-Shari'ah*), makes financial services relevant for a larger segment of the world population. Microfinance is an important part of this initiative.

52. Effective strategies for the development of microfinance have been developed by the cooperatives, non-governmental organisations, the Islamic banking institutions through *zakat/awqaf* funds and multilateral institutions including Islamic Development Bank (IDB). With enhanced and strengthened resources, multilateral institutions such as the IDB can have a larger role in improving services to the Islamic microfinance sector.¹³


¹³ A recent IRTI document on "Strategies and Framework for Development of Islamic Microfinance Services" suggests a number of specific initiatives that would go a long way in strengthening financial inclusion and enhancing accesses of the poor to financial services.

III. The Establishment of a Platform for Constructive Dialogue: Islamic Financial Stability Forum (IFSF)

53. Key to achieving financial stability is to have a strategic platform for conducive and constructive dialogue among the regulators of the international Islamic financial system. As Islamic finance continues to become an integral part of the global financial system, there is scope for the current framework of cooperation to be strengthened and broadened to address the new challenges that have emerged.

54. In this regard, the Task Force **recommends the establishment of an Islamic Financial Stability Forum or IFSF based at the IFSB**, which shall, inter alia, be a broad-based and constructive strategic platform for IFSB members to achieve the primary objective of building cross-border dialogue in efforts to promote financial stability within the Islamic financial system. The objective of the IFSF will be to facilitate better understanding of emerging developments in the Islamic financial system and their implications for national and global financial stability. The IFSF also would have the potential to promote collaboration and cooperation in remedial policies to prevent, contain and manage emerging issues in Islamic finance.

55. It is envisaged that the IFSF will provide a strategic platform for IFSB to enhance collaboration in Islamic finance to promote stability in the IFSI and the global financial stability. The IFSF will be a dedicated forum to promote cooperation and collaboration among its members in areas such as surveillance, sharing of experiences in crisis prevention, management and resolution, implementation of international standards as well as international cooperation in capacity building and in the development of emergency infrastructure and facilities.

- 
56. It is envisaged that the IFSF can serve as the forum to deliberate on the following agendas:
- a. Establish an integrated mechanism for macro-monitoring of the developments in the global Islamic financial services industry;
 - b. Assess vulnerabilities and emerging risks to Islamic financial systems and the implications for global financial stability including cross financial systems assessments;
 - c. Propose and advise on policy actions and responses to deal with the identified risks and vulnerabilities;
 - d. Establish an integrated crisis management and resolution framework and arrangements and ensure the continued effective and efficient functioning of the framework and arrangements;
 - e. Develop a communication mechanism to collaborate and exchange information and experiences with the IIFS, regional fora and regulators/supervisors on financial stability issues;
 - f. Promote cooperation and coordination among relevant authorities and Islamic financial institutions on financial stability by facilitating reviews and implementation of international standards; and
 - g. Focus attention on issues of coherence and convergence, and on opportunities to increase the efficiency, integrity and stability of Islamic financial markets.
57. As Islamic finance will continue to be an integral part of the global financial system, it is important to have an integrated initiative, both for conventional and Islamic finance, to preserve financial stability at the global level. Key to this is to maintain an interface between the Financial Stability Board and IFSF so as to ensure there would be constructive exchange from the perspectives of conventional and Islamic finance to maintain global financial stability.

Conclusion

58. Islamic finance continuous expansion to become an integral part of the international financial system, presents unique opportunities and challenges. Islamic finance needs to further strengthen its resilience to withstand all possible market imperfections and future shocks. It has to draw on its intrinsic strengths to solidify its position towards attaining greater robustness of the overall system. Enhanced infrastructural building blocks need to be in place and be effectively implemented. As the synchronisation of policies and actions across jurisdictions and markets is a major task, a broad-based and constructive strategic platform to build cross-border consensus to promote financial stability within the Islamic financial system, as well as having linkages with the conventional financial markets is vital. This proposed platform, the Islamic Financial Stability Forum, will be an important institutional arrangement to facilitate better understanding of emerging issues and challenges in the Islamic financial system and their implications for global financial stability. Equally important is the need to maintain an interface with the Financial Stability Board to facilitate a constructive exchange with the common objective of achieving global financial stability.

Appendix I

Standards and Guidelines Issued by the IFSB

Preparation of standards and guiding principles

List of all the IFSB Standards, Guiding Principles and Technical Notes that have been adopted by the Council and those that are currently being prepared.

PUBLISHED STANDARDS, GUIDING PRINCIPLES AND TECHNICAL NOTES			
No.		Title	Issuance Date
1.	IFSB-1	Guiding Principles of Risk Management For Institutions (Other Than Insurance Institutions) Offering Only Islamic Financial Services ¹⁴	Dec 2005
2.	IFSB-2	Capital Adequacy Standard For Institutions (Other Than Insurance Institutions) Offering Only Islamic Financial Services	Dec 2005
3.	IFSB-3	Guiding Principles on Corporate Governance For Institutions Offering Only Islamic Financial Services (Excluding Islamic Insurance (<i>Takaful</i>) Institutions and Islamic Mutual Funds)	Dec 2006
4.	IFSB-4	Disclosures to Promote Transparency and Market Discipline For Institutions Offering Islamic Financial Services (Excluding Islamic Insurance (<i>Takaful</i>) Institutions and Islamic Mutual Funds)	Dec 2007

¹⁴ IFSB-1, 2, 4 and 5 basically form the equivalent of Basel II framework for IIFS

5.	IFSB-5	Guidance on Key Elements in the Supervisory Review Process of Institutions Offering Islamic Financial Services (Excluding Islamic Insurance (<i>Takaful</i>) Institutions and Islamic Mutual Funds)	Dec 2007
6.	IFSB-6	Guiding Principles on Governance For Islamic Collective Investment Scheme	Dec 2008
7.	IFSB-7	Special Issues in Capital Adequacy Requirements: <i>Sukuk</i> Securitisations and Real Estate Investment	Dec 2008
8.	IFSB-8	Guiding Principles on Governance of Islamic Insurance (<i>Takaful</i>) Operations	Dec 2009
9.	IFSB-9	Guiding Principles on Conduct of Business for Institutions Offering Islamic Financial Services	Dec 2009
10.	IFSB-10	Guiding Principles on <i>Shari'ah</i> Governance Systems for Institutions Offering Islamic Financial Services	Dec 2009
11.	GN-1	Guidance Note in Connection with the Capital Adequacy Standard: Recognition of Ratings by External Credit Assessment Institutions (ECAIs) on <i>Shari'ah</i> -Compliant Financial Instruments	Mar 2008
12.	TN-1	Compilation Guide on Prudential & Structural Islamic Finance Indicators: Guidance on the Compilation & Dissemination of Prudential & Structural Islamic Finance Indicators for Banking & Near-Banking Institutions Offering Islamic Financial Services	Mar 2007
13.	TN-2	Technical Note on Issues in Strengthening Liquidity Management of Institutions Offering Islamic Financial Services: The Development of Islamic Money Market	Mar 2008

STANDARDS, GUIDING PRINCIPLES AND GUIDANCE NOTES: WORK IN PROGRESS			
No.		Title	Targeted Issuance Date
1.	IFSB-11	Solvency Requirement for Islamic Insurance (<i>Takaful</i>) Operations	2010
2.	GN-2	Guidance Note of the Regulatory Capital Treatment of Commodity Trading Transaction as Liquidity Management Instrument in Institutions Offering Islamic Financial Services	2010
3.	GN-3	Guidance Note on Rating for Islamic Insurance (<i>Takaful</i>) Operations	2010

Other IFSB documents

List of other documents that have been adopted by the Council, including those that are published in collaboration with other organisations.

OTHER IFSB PUBLISHED DOCUMENTS			
No.	Title	In Collaboration with	Issuance Date
1.	Issues in Regulation and Supervision of <i>Takaful</i> (Islamic Insurance)	International Association of Insurance Supervisors	Aug 2006
2.	Islamic Financial Services Industry Development: Ten-Year Framework and Strategies	Islamic Research and Training Institute – Islamic Development Bank	May 2007

Appendix II

Comparative Table on Standards and Guidelines Issued by the Islamic Financial Services Board and the Basel Committee on Banking Supervision

Prudential and Regulatory Areas	IFSB Standards	BCBS Standards	Comments / Remarks
Risk management	√	√	<ul style="list-style-type: none">• While BCBS standards have set out sound practices and principles pertaining to credit, market, liquidity and operational risks of financial institutions, IFSB has provided additional guidance to cater for specificities of IIFS:<ul style="list-style-type: none">- Requirement to comply with Shari’ah rules and principles as the essential feature of IIFS’ activities.- Greater fiduciary duty requiring IIFS to apply Shari’ah compliant risk mitigation techniques wherever appropriate.

Prudential and Regulatory Areas	IFSB Standards	BCBS Standards	Comments / Remarks
Measurement of Capital Adequacy Requirement (Pillar 1)	√	√	<ul style="list-style-type: none"> • Areas unique to Islamic banks covered by IFSB standards: <ul style="list-style-type: none"> - Specific structure of Shari'ah compliant products and services offered by IIFS that are not specifically addressed by BCBS (e.g. transformation of risks in different stages of Shari'ah contracts). - Recognition of profit sharing investment account (PSIA) as risk absorbent, whereby IIFS is not required to provide capital charge for credit and market risks of assets funded by PSIA. • While the IFSB's capital adequacy requirement is predominantly based on standardized approach of Pillar 1, supervisory discretion is allowed to adopt more advanced risk management approaches if they can address the infrastructure issues adequately. • Specific issues related to IIFS' exposure to <i>sukuk</i> securitisation and real estate investment, the impact to capital adequacy requirement are addressed in IFSB-7

Prudential and Regulatory Areas	IFSB Standards	BCBS Standards	Comments / Remarks
Components of Capital Base	x	√	<ul style="list-style-type: none"> IFSB does not provide specific guidance on eligible capital base components for IIFS. (Note that BCBS has recently issued consultative paper to review the recognition criteria for eligible regulatory capital of banking institutions)
Supervisory Review Process (Pillar 2)	√	√	<ul style="list-style-type: none"> IFSB-5 acknowledges that the internationally agreed principles underpinning supervisory review in the Basel II are equally applicable for IIFS. However, emphasis is given on areas particular to Islamic finance e.g. treatment of investment account holders (IAH), investor protection issues raised by the IIFS' role as managers of funds placed with them by the IAH, specific issues on Islamic windows operation and real estate investment.

Prudential and Regulatory Areas	IFSB Standards	BCBS Standards	Comments / Remarks
Transparency and Market Discipline (Pillar 3)	√	√	<ul style="list-style-type: none"> • Both the IFSB and BCBS standards are aimed at enhancing market participants' access to relevant, reliable and timely information on the financial institutions. • However, IFSB-4 has recommended additional disclosures with respect to IIFS' management of PSIA, given the distinct contractual relationship established between the IIFS and the IAH under mudharabah contract.
Governance	√	√	<ul style="list-style-type: none"> • IFSB-3 seeks to complement the existing internationally recognised standards of good corporate governance by particularly addressing the specificities of IIFS, including: <ul style="list-style-type: none"> – the rights of investment account holders (IAH); – compliance with Shari'ah rules and principles; and – transparency of financial reporting in respect of investment accounts. • IFSB-7 provides specific guiding principles on governance for Islamic collective investment scheme.

APPENDIX III

Comparative Table on Standards Issued by the Islamic Financial Services Board and International Association of Insurance Supervisors

IAIS		IFSB	Remarks
Regulatory Requirement – Financial			
P2.1.1:	Principles on capital adequacy and solvency	√	'ED11: Exposure Draft on Solvency Requirements for Takaful Operations' has been issued
S2.1.1:	Standard on the structure of regulatory capital requirements	√	'ED11: Exposure Draft on Solvency Requirements for Takaful Operations' has been issued
S2.1.2:	Standard on the structure of capital resources for solvency purposes	X	-
GP2.1.1:	Guidance paper on the structure of regulatory capital requirement	√	'ED11: Exposure draft on Solvency Requirements for Takaful Operations' has been issued

	IAIS	IFSB	Remarks
GP2.1.2:	Guidance paper on the structure of capital resources for solvency purposes	X	-
Regulatory Requirement – Governance			
S2.2.1:	Supervisory standard on licensing	X	-
S2.2.2:	Supervisory standard on derivatives	X	-
S2.2.3:	Supervisory standard on asset management by insurance companies	√	'IFSB-8: Guiding Principles on Governance of Takaful Operations' has been issued
S2.2.4:	Supervisory standard on fit and proper requirements and assessment for insurers	√	'IFSB-8: Guiding Principles on Governance of Takaful Operation' has been issued

	IAIS	IFSB	Remarks
S2.2.5:	Standard on asset liability management	√	IAIS standard is applicable. 'IFSB-8: Guiding Principles on Governance of Takaful Operations' states that reference should also be made to standard S2.2.5
S2.2.6:	Standard on ERM for capital adequacy and solvency purposes	X	-
S2.2.7:	Standard on the use of internal models for regulatory capital purposes	X	-
GP2.2.2:	Guidance paper on stress testing by insurers	X	-
GP2.2.3:	Guidance paper on investment risk management	√	'IFSB-8: Guiding Principles on Governance of Takaful Operations' has been issued
GP2.2.4:	Guidance paper on risk transfer, disclosure and analysis of finite reinsurance	X	-

	IAIS	IFSB	Remarks
GP2.2.5:	Guidance paper on enterprise risk management for capital adequacy and solvency purposes	X	-
GP2.2.6:	Guidance paper on the use of internal models of risk and capital management purposes by insurers	X	-
Regulatory Requirement – Market Conduct			
P2.3.1:	Principles for conduct of insurance business	√	‘IFSB-9: Guiding Principles on Conduct of Business for Institutions Offering Islamic Financial services’ has been issued
S2.3.1:	Standard on disclosures concerning technical performance and other risks of non-life insurers and reinsurers	√	IAIS standard is applicable. ‘IFSB-8: Guiding Principles on Governance of Takaful’ Operations states that reference should be made to this IAIS standard on disclosures practices and regime

	IAIS	IFSB	Remarks
S2.3.2:	Standard on disclosures concerning investment risks and performance for insurers and reinsurers	√	IAIS standard is applicable. 'IFSB-8: Guiding Principles on Governance of Takaful' Operations states that reference should be made to this IAIS standard on disclosures practices and regime
S2.3.3:	Standard on disclosure concerning technical risks and performance for life insurers	√	IAIS standard is applicable. 'IFSB-8: Guiding Principles on Governance for Takaful' Operations states that reference should be made to this IAIS standard on disclosures practices and regime
GP2.3.1:	Guidance paper on public disclosure by insurers	X	-
GP2.3.2:	Guidance paper on anti money laundering and combating the financing of terrorism	√	IAIS standard is applicable & require no adaptation to apply to takaful
GP2.3.3:	Guidance paper on combating the misuse of insurers for illicit purposes	X	-

	IAIS	IFSB	Remarks
GP2.3.4:	Guidance paper on preventing, detecting and remedying fraud in insurance	√	IAIS standard is applicable & require no adaptation to apply to takaful

	IAIS	IFSB	Remarks
Supervision			
P3.1	Principles applicable to the supervision of international insurers and insurance groups and their cross-border business operations	X	-
P3.2	Principles on the supervision of insurance activities on the internet	X	-
P3.3	Principles on minimum requirements for supervision of reinsurers	X	-
P3.4	Principles on group-wide supervision	√	IAIS standard is applicable & require no adaptation to apply to takaful
S3.1	Supervisory standard on on-site inspections	√	IAIS standard is applicable & require no adaptation to apply to takaful
S3.2	Supervisory standard on group coordination	X	-
S3.3	Supervisory standard on the exchange of information	√	IAIS standard is applicable & require no adaptation to apply to takaful

IAIS		IFSB	Remarks
S3.4	Supervisory standard on the evaluation of the reinsurance cover of primary insurers & the security of their reinsurers	X	-
S3.5	Standard on supervision of reinsurers	X	-
GP3.1	Guidance paper for insurance regulation and supervision for emerging market economies	X	-
GP3.2	Guidance paper on a model memorandum of understanding	X	-
GP3.3	Guidance paper on solvency control levels	X	-
GP3.4	Guidance paper on the use of actuaries as part of supervisory model	X	-
GP3.5	Guidance paper no 3.5 on the mutual recognition of reinsurance supervision	X	-
GP3.6	Guidance paper no 3.6 on regulation and supervision of captive insurers	X	-
GP3.7	Guidance paper no 3.7 on the role and responsibilities of a group wide supervisor	√	IAIS standard is applicable & require no adaptation to apply to takaful
GP3.8	Guidance paper no 3.8 on the use of supervisory colleges in group wide supervision	√	IAIS standard is applicable & require no adaptation to apply to takaful

APPENDIX IV

Holy Qur'an: Surah Yusuf or (Joseph) - verses 43 to 49

43. The king (of Egypt) said: "I do see (in a vision) seven fat kine, whom seven lean ones devour, and seven green ears of corn, and seven (others) withered. O ye chiefs! Expound to me my vision if it be that ye can interpret visions".
44. They said: "A confused medley of dreams: and we are not skilled in the interpretation of dreams".
45. But the man who had been released, one of the two (who had been in prison) and who now bethought him after (so long) a space of time, said: "I will tell you the truth of its interpretation: send ye me (therefore)".
46. "O Joseph!" (he said) "O man of truth! Expound to us (the dream) of seven fat kine whom seven lean ones devour, and of seven green ears of corn and (seven) others withered: that I may return to the people, and that they may understand".
47. (Joseph) said: "For seven years shall ye diligently sow as is your wont: and the harvests that ye reap, ye shall leave them in the ear¹, - except a little, of which ye shall eat.
48. "Then will come after that (period) seven dreadful (years), which will devour what ye shall have laid by in advance for them, - (all) except a little² which ye shall have (specially) guarded.
49. "Then will come after that (period) a year in which the people will have abundant water, and in which they will press (wine and oil)".³

Commentary by Abdullah Yusuf Ali*

¹ Joseph not only shows what will happen, but, unasked, suggests the measures to be taken for dealing with the calamity when it comes. There will be seven years of abundant harvest. With diligent cultivation they should get bumper crops. Of them they should take a little for their sustenance and store the rest in the ear, the better to preserve it from the pests that attack corn-heaps when they passed through the threshing floor.

² There will follow seven years of dreadful famine, which will devour all the stores which they will have laid by in the good years. They must be careful, even during the famine, not to consume all the grain; they must by special arrangement save a little for seed, lest they should be helpless even when the Nile brought down abundant waters from the rains at its resources.

³ This is a symbol of a very abundant year, following the seven years of drought.

* The Holy Qur'an: Text, Translation and Commentary is a translation and commentary on the Qur'an by Abdullah Yusuf Ali, first published in 1934 by Sh. Muhammad Ashraf Publishers Lahore in India (later Pakistan), which has become among the most widely known English translations.

References

Aka, Jahangir (2009) "Update on Performance of Shari'ah-based Indexes", SEI, April.

Allen, Franklin and Douglas Gale (2002) "Financial Fragility", paper presented at Third Joint Central Bank Research Conference on Risk Measurement and Systemic Risk, BIS, Basel, March.

Allen, Mark, Christoph Rosenberg, Christian Keller, Brad Setser, and Nouriel Roubini (2002) "A Balance Sheet Approach to Financial Crisis", IMF, WP 02/210, December.

Ang, Elaine (2009) "Analysts: Islamic banks perform as expected", Starbiz, 7 September.

Askari, Hossein, Zamir Iqbal, Abbas Mirakhor, and Nouredine Krichenne (2010) "The Stability of Islamic Finance: Creating a Resilient Financial Environment for a Secure Future", John Wiley & Sons (Asia) Pte. Ltd., Singapore

Bank Negara Malaysia (2007, 2008) "Financial Stability Report 2007 & 2008".

Banker, The (2009), Top 500 Islamic Financial Institutions, November.

Baily, Martin Neil, Robert E. Litan, and Matthew S. Johnson (2008) "The Origins of the Financial Crisis", Brookings Institute, November.

Bank of International Settlement (2008) "Credit Risk Transfer: Developments from 2005 to 2007", The Joint Forum, July.

Bookstaber, Richard (2007) "A Demon of Our Own Design", John Wiley & Sons.

Borio, Claudio (2003), "Towards a Macro-prudential Framework for Financial Supervision and Regulation", BIS Working Paper.

Borio, Claudio (2009) "The Macroprudential Approach to Regulation and Supervision", Vox, www.voxeu.org, April 14.

Brock, Horace W. (2002) "The Transformation of Risk: Main Street versus Wall Street", Strategic Economic Decisions, May.

Brunnermeier, Markus (2008) "Deciphering the Liquidity and Credit Crunch 2007-08", presented at International Research Forum on Monetary Policy Fifth Conference, European Central Bank, Frankfurt, June.

Brunnermeier, Markus, Andrew Crockett, Charles Goodhart, Avinash D. Persaud and Hyun Shin (2009) "The Fundamental Principles of Financial Regulations, International Center for Monetary and Banking Studies, Geneva Reports on World Economy", preliminary draft, January.

Calomiris, Charles (1998) "Blueprints for a New Global Financial Architecture", presented to the Joint Economic Committee, House of Representatives, USA, October.

Cowen, Tyler and Randall Kroszner (1990) "Mutual Fund Banking: A Market Approach", Cato Journal, vol. 10, pp. 223-37.

Danielsson, Jon and Hyun Song Shin (2003) "Endogenous Risk", in Peter Field, ed., Modern Risk Management: A History, Risk Books.

Das, Satyajit (2009) "Credit Default Swaps and Amplified Losses", Financial Times, Mar. 04.

Diamond, Douglas and Philip H. Dybvig (1983) "Bank Runs, Deposit Insurance, and Liquidity", Journal of Political Economy, vol. 91, pp. 401-19.

Ernst & Young (2009a), World Takaful Report 2009, April.

Ernst & Young (2009b), Islamic Funds and Investments Report 2009, May.

Ernst & Young (2009c), Ernst & Young Research 2009.

ERP (2009) “Economic Report of the President”, U.S. Government Printing Office.

Eichengreen, Barry and Ricardo Hausmann (1999) “Exchange Rates and Financial Fragility”, NBER, WP no. 7418.

El-Erian, Mohamed (2008) “When Markets Collide”, McGraw Hill.

Financial Times (2009), Islamic Finance Special Report, November.

El-Jarhi, M. (2009) Emirates Islamic Bank Report, UAE, March.

FSA (2009a) “A Regulatory Response to the Global Banking Crisis”, Discussion Paper 09/2, Mar.

FSA (2009b) The Turner Review: “A Regulatory Response to the Global Banking Crisis”, Mar.

Goodhart, Charles (2007) “Discussion of ‘Success and failure of Monetary Policy since the 1950s’”, presented at Monetary Policy over Fifty Years Conference, Deutsche Bundesbank, Frankfurt, September.

González-Páramo, José Manuel (2008) “Whither Liquidity? Developments, Policies and Challenges”, speech delivered at 28th Nomura Central Bankers Seminar, Tokyo, 14 April.

Group of Thirty (2009) “Financial Reform: A Framework for Financial Stability”, Jan.

Guidance Institute Pakistan Research (2009).

Jacklin, Charles (1993) “Market-rate versus Fixed-rate Demand Deposits”, Journal of Monetary Economics, vol. 32, pp. 237-58.

ICMIF (2008) “Global Crisis Could Be Mutual Opportunity”, Voice, issue 63, November, p. 8.

ISDA (2009), Surveys and Market Statistics, International Swaps and Derivatives Dealers, www.isda.org.

Mainelli, Michael (2008) "Liquidity = Diversity", *Journal of Risk Finance*, vol. 9, pp. 211-16.

Khan, Mohsin and Abbas Mirakhor, eds. (1987) "Theoretical Studies in Islamic Banking and Finance", Institute of Islamic Studies, Texas.

Kotlikoff, Laurence (2009) "Run on Banks Persistent Risk Without LPB", Bloomberg, April 16.

Kotlikoff, Laurence and Edward Leamer (2009) "A Banking System We Can Trust", *Forbes*, April 23, www.forbes.com.

Mandelbrot, Benoit and Richard Hudson (2006) "The Misbehavior of Markets: A Fractal View of Financial Turbulence", Basic Books.

O'Brien, Christopher (2009) "Applying Globally Accepted Shari'ah Standards across Markets", Standard & Poors, March.

Oliver Wyman (2009), "The Next Chapter in Islamic Finance – Higher Rewards But Higher Risks".

Rosenberg, Christoph, Ioannis Halikias, Brett House, Christian Keller, Jens Nystedt, Alexander Pitt, and Brad Setser (2005) "Debt-Related Vulnerabilities and Financial Crises: An Application of the Balance Sheet Approach to Emerging Market Countries", IMF Occasional Paper 240.

Shiller, Robert (2000) "Irrational Exuberance", Princeton University Press.

Tayyebi, Aziz (2009), "Eclipse by the Crescent Moon: Islamic Finance provides some light in the Global Financial Crisis", *Financial Services Review*, ACCA Global, June.

Tett, Gillian (2007) “Why Financiers Missed the New Monster?”
Financial Times, September 6.

Trichet, Jean-Claude (2009) “A Paradigm Change for the Global Financial System”, speech delivered at the International Colloquium “Nouveau Monde, Nouveau Capitalisme” roundtable, Paris, 9 January.

Varchaver, Nicholas and Katie Benner (2008) “The \$55 Trillion Question”,
<http://money.cnn.com>, Sep. 30.

WDI (2009) World Development Indicators, various data series.

World Bank-IMF (2005) *Financial Sector Assessment: A Handbook*,
World Bank Institute.

