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IRTI-WB Annual Symposium on Islamic Economics and Finance

The Inaugural Islamic Economics and Finance Symposium was held on September 8-9, 2015, at Boğaziçi University, Istanbul. It was jointly organized by Islamic Research and Training Institute (IRTI), Islamic Development Bank (IDB), the World Bank Group`s Global Islamic Finance Development Center (GIFDC), BORSA İstanbul and Guidance Financial Group. The symposium brought together a broad range of participants from the academia, policy-making circles, and the private sector.

The main aim of the annual symposium was to promote exchange of cutting-edge ideas and foster free discussion on Islamic finance among academicians, policy makers, the private sector and development practitioners. The theme of the 2-day Inaugural Symposium was ***Islamic Finance: A Catalyst for Shared Prosperity***. It was in resonance to the emphasis of Islamic finance on risk sharing in financial and social contracts. While research on Islamic economics and finance has progressed in many areas, important aspects of risk sharing and its relevance to shared prosperity are yet to be explored and developed. The keynote addresses and the papers presented focused on these aspects and contributed towards a better understanding of the role that Islamic finance can play in promoting inclusive growth, reducing inequality, and accelerating poverty reduction.

Welcoming and opening remarks were made by Dr. Zamir Iqbal (Head of World Bank Group`s Global Islamic Finance Development Center (GIFDC)), Dr. Ali Coşkun (President, Center for Applied Research in Finance (CARF), Boğaziçi University), Dr. Talat Ulussever (Chairman, BORSA İstanbul), Prof. Mohamed Azmi Omar (Director General, Islamic Research and Training Institute (IRTI)), and Dr. Mohamad Hammour (Chairman, Guidance Financial Group).

The Keynote speakers in various sessions were; Dr. Andrew Sheng via Skype VC, (Distinguished Fellow, Fung Global Institute); Prof. Dr. Abbas Mirakhor (First Holder, INCEIF Chair of Islamic Finance), Dr. Muhammed Umer Chapra, Prof. Hossein Askari, and Prof. Dr. Murat Çizakça. In addition, twelve papers were presented by scholars and practitioners. These papers analyzed the potential and actual contribution of Islamic finance to shared prosperity, opening up new questions and directions for further analysis. The full program and presentations are available online at http://www.worldbank.org/en/events/2015/09/08/inaugural-annual-symposium-on-islamic-finance#2

The best paper award went to Luqyan Tamanni from University of Glasgow for his paper entitled "Islamic Microfinance Institutions: Pro-poor or for profit?" co-authored with Frank Hong Liu.

Summarized by Salman Syed Ali &Turkhan Ali

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Islamic Social Finance Report 2015

The present issue of the Islamic Social Finance Report 2015 focuses on the *zakāh*, *awqāf* and Islamic microfinance sectors in six countries in the sub-Saharan Africa - Sudan, Nigeria, Kenya, Mauritius, South Africa and Tanzania. This is in continuation of the 2014 issue of ISFR focusing on six countries in South and South East Asia.

The Report has benefited from the comments of and presentations by several scholars and representatives of Islamic organizations from the region under focus. Most of them actively participated in the preparatory events for the study that included a workshop on *Awqāf* in association with *Awqāf* S.A. at Pretoria, South Africa and a workshop on *Zakāt* in association with the South African National *Zakāt* Foundation (SANZAF) at Cape Town, South Africa. These were attended by participants from over ten countries in the region.

The Report has been prepared by an internal team of IRTI researchers with additional contribution from scholars and practitioners from Sudan, Nigeria, Mauritius and South Africa. The Report also benefitted from external contributors.

Major findings of this Report were presented at the 10th IDB Global Forum on Islamic Finance on “Exploring Innovative Solutions for Affordable Microfinance in Africa” held in Maputo, Mozambique in June 2015.

A brief summary of key findings of the Report is presented below.

Comparing *zakāt* potential of the sampled countries with their resource requirement to alleviate poverty, it is found that countries like Sudan, Nigeria and South Africa can easily generate resources for poverty alleviation. However, actual *zakāt* collected falls far short of the potential. There is a strong need therefore, to enhance professionalism and efficiency in *zakāt* management and to ensure a movement away from individual to institutional management of *zakāt*.

There is great diversity in the *zakāt* management practices. Unlike South and South East Asian countries, in most Sub-Saharan African countries a major part of *zakāt* is in the nature of in-kind *zakāt* in the form of crops and livestock. Collection of in-kind *zakāt* from the actual locations, e.g. farms that are stretched far and wide entails huge collection costs. Therefore, the cap on operational costs that is traditionally placed on one-eighth of *zakāt* funds collected in South East Asia needs to be revisited.

Sudan provides supporting evidence for compulsory *zakāt*. The voluntary *zakāt* organizations in South Africa have also generally reported good performance. Irrespective of whether *zakāt* is compulsory or voluntary, a policy of decentralization seems to have paid off. Thus, *zakāt* is observed to be institution-elastic. It is the presence of a network of healthy institutions at multiple levels – in public or private domain - that seems to lead to greater public awareness and greater public participation in the process of poverty alleviation through *zakāt*.

The issue of incentivizing *zakāt* payment is quite crucial. Where *zakāt* payment is made compulsory and non-compliance invites penalties and punishment, weak enforcement can cause *zakāt* collection to be poor. Where *zakāt* collection and distribution is entrusted entirely to the state, *zakāt* may be seen as a component of aggregate resources available to the state. In this sense, *zakāt* payment may be seen as a perfect substitute of the direct taxes to the state and may be allowed as deductions to tax payable. However, there must be absolute clarity on the issue as well coordination between *zakāt* and Inland Revenue bodies.

The following are the major findings in relation to the *waqf* sector.

Waqf law should provide a comprehensive definition of *waqf* that includes both permanent and temporary *waqf*. It must explicitly cover various types of *waqf*: family and social *waqf*, direct and investment *waqf*, cash *waqf*, corporate *waqf*.

Preservation of *waqf* is undoubtedly the most important concern in *waqf* management. The legal framework must clearly articulate that all *awqāf* (with the exception of temporary *waqf* or *waqf* for a finite time period) must be governed by the principle of "once a *waqf*, always a *waqf*". In case old laws fail to ensure protection, they must be replaced with new provisions that enable recovery of lost *waqf* assets.

While preservation is important, law must clearly recognize the importance of sustaining and enhancing the benefits flowing out of the *waqf*, this being the ultimate purpose of the act of *waqf*. This is possible only when the importance of development of *waqf* is clearly recognized. An undue emphasis on preservation (e.g. constraints on leasing) would lead to neglect of developmental possibility with private participation. Similarly, an undue emphasis on development, to the extent that it results in loss of full or partial ownership of asset to private developers) would dilute and vitiate the very concept of *waqf*. The regulatory framework must seek to strike a balance between concerns about preservation and development.

The legal framework must not put undue restriction on creation of new *waqf*. Legal requirements that make the process more difficult, e.g. approval of the head of the state, are both unnecessary and undesirable. A simple process of registration with the regulatory body is both desirable and adequate. While obstacles to *waqf* creation must not be there, the legal framework should actually encourage creation of new *waqf* by minimizing financial and non-financial costs of *waqf* creation and management.

Most observers and scholars of *waqf* believe that the institution of family *waqf* must be revived. The laws should consider explicit provisions, such as, the possibility of restricting the benefits to one or two generations, the method of distribution of *waqf* benefits etc. with adequate clarity.

Waqf is an institution originally and always meant to be in the voluntary sector with management of *waqf* entrusted to private parties. However, state has often sought to play a role in the ownership and management of *awqāf*, at times governed by motives to expropriate and at other times, by need to curb corrupt practices of private trustee-managers. Whether ownership and management of *awqāf* should be in private hands or with the state has no clear answer. There is mixed evidence from both public management as well as private management.

Where *waqf* management is in private hands as in case of Mauritius, the state agency as regulator should clearly stipulate elaborate and clear eligibility criteria for a mutawalli or nazir or trustee-manager not only covering aspects of integrity and trust-worthiness but also professional competence. Given that the individual or institution so nominated meets the criteria, the regulator must respect the expressed intention the waqif or endower. Laws must clearly articulate the responsibility of *waqf* management that should not only emphasize preservation and protection of *waqf* assets, but also their development. The responsibility should also include transparent and honest reporting of financials. Laws must clearly stipulate the method of determination of remuneration of managers, sufficiently incentivizing sound and professional management of *waqf* assets.

There is every reason for the state to take punitive action against mutawallis who fail the tests of efficiency, integrity, transparency. The measures must act as effective deterrent against further acts of apathy, neglect and misappropriation. At the same time, the state should not be allowed to wield absolute power to engage in irrational or whimsical action against the mutawalli. Instances of unfair and unlawful action by state are numerous, as are cases of corrupt mutawallis. There need to be effective checks and balances in the law against wrongful acts by both the state as well as the private mutawallis. Power has a tendency to corrupt and the possibility of such action can significantly increase the non-financial cost of creating new *waqf*. Endowers are likely to seek alternative forms of organizing their charitable activities if there is a possibility of undue state interference in the management of the endowed assets or outright usurpation of the endowed assets by the state.

Zakāt and *awqāf* management in Sub-Saharan Africa in general seems to have suffered a great deal due to absence of meso-level organizations, e.g. networks, training and education providers, consultancy and standard-setting bodies and advocacy organizations. As a result, public awareness about these institutions is extremely low in many part of the region. Data is extremely scarce. Capacity building is extremely important but neglected. A major change in mindset of all stakeholders is needed. There is a lot to be done in the matter of improving the administration and governance and disclosures. Transparency and accountability is a precondition to credibility and fund raising.

The Report includes several case studies on integration of *zakāt* and *waqf* with microfinance for provision of safety nets, provision of social goods and affordable financial services. The key lessons from these case studies are highlighted below.

- A review of various Islamic modes that are used for provision of finance to farmers reveals that there is no one-size-fits-all mode, even though *bayʿ salam* is widely seen to be the appropriate mode for agricultural finance.

- Islamic finance discourages debt-based products and encourages equity and partnership based products in general. Given that conventional MFIs derive their income from interest, they seem to be inclined to push their clients into larger and larger amounts of debt. In the Islamic approach, debt is not just discouraged; there are built-in mechanisms, such as *zakāt* to address over-indebtedness of an individual.

- Islamic finance requires "simplicity" in contracts where the rights and obligations of the parties are well understood by them. Even where an Islamic finance model includes future obligations, or composite structures, the uncertainty and ambiguity factor is kept to the minimum. The diminishing *mushārakah* based models used in Sudan are apparently complex but quite "definitive" in terms of transfer of ownership of the key assets into the hands of farmers over a finite period.

- While credit and finance are key inputs for transforming the lives of the farmers, they often require a wide range of non-financial services. Identifying these non-financial needs and finding creative and innovative solutions thereto is critical for success of any intervention.

- A related question is how these non-financial services are to be funded. Should they be priced? Should the farmers pay for these services? The cases highlight both commercial and philanthropic approaches to the issue.

- MFIs that focus on financing the need for physical assets by farmers through conventional or Islamic credit, or through leasing often ignore the importance of providing for basic consumption needs. It should not come as a surprise if farmers resort to diversion of funds from the so-called income-generating project or even distress sale of the assets (funded by MFIs) if the basic consumption needs remain unfulfilled.

- The projects discussed in this study not only seek to leverage existing skills, but also develop new skills, such as in the application of better farming technology on a sustained basis. The projects use an approach similar to conventional venture capital funding (with some differences, of course) and focus on the economic viability of project. They carefully seek to identify risks and mitigate them. They also provide a unique example of combining benevolence with commercial viability.

- In confronting the multitude of challenges facing the poor farming communities, the MFIs may have to limit their outreach significantly. While in case of credit-based finance, the size of financing per beneficiary is very small, the same is very high in case of project-based approaches that seek to finance the entire value-chain.

- Grant money or cash flows from dedicated *awqāf* may be used to absorb operational cost, thereby making it possible to offer financing at a modest rate. Given the widely expressed concern about affordability of high-cost microfinance, such a possibility offers great promise.

Summarized by Mohammed Obaidullah

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Policy Report on "Leveraging Islamic Finance for SMEs"

Published by:

The World Bank
Islamic Development Bank and Islamic Research and Training Institute

The World Bank, Islamic Development Bank (IDB) and Islamic Research and Training Institute (IRTI) undertook a joint study leading to a policy report on "Leveraging Islamic Finance for SMEs". The report was partly a contribution from the World Bank and IDB-IRTI for the G20 priority agenda for 2015. The main objective of the report is to analyze the potential of Islamic finance for the development of the Small and Medium Enterprises (SMEs) sector, with a view to making policy recommendations to leverage Islamic finance as viable long-term investment financing for SMEs. Specifically, the report discussed the challenges of unlocking the potential of Islamic finance; examined the drivers and obstacles pertaining to SME financing through Islamic financial instruments and institutions (IFIs); and identified actions that can be taken by authorities and relevant policy makers to improve the asset-based and equity finance for SME sector through Islamic financial institutions and markets. The report is consists of two chapters and an Appendix:

Chapter 1: Islamic Banking and SME Financing

Chapter 2: Mobilizing Non-Banking Financial Channels

Appendix A: Comparison of Model Law Provisions and Sharīʿah Principles

Chapter 1 of the report provides an overview of the legal and regulatory framework, the state of the financial sector infrastructure, opportunities and challenges in mobilizing finance for SMEs and banking sector limitations in terms of capacity and technology. It also analyzes SME specific factors, particularly the SMEs landscape in terms of number, size, and focus of operation, as well as the opaqueness of information. The chapter highlights that access to finance is one of the most formidable challenges facing SMEs, particularly in the least-developed-member-countries (LDMC). Given their low capital base, the availability of financial resources is essential for the SMEs growth. Despite the recent growth of Islamic financial institutions and the development of new Islamic financing products, the environment is not favorable for Islamic finance to play a vital role in the development of SMEs. This chapter concludes with some recommendations and identifies key reform areas.

Chapter 2 of the report explores the enabling environment for non-banking sector and capital markets for Islamic financing of SME sector. It provides analysis of the development of SME Stock Exchanges (i.e. Nilex), non-banking financial services such as leasing, crowdfunding, and venture capital and SME Private Equity Funds. The chapter also discusses issues concerning the structuring, governance, and guarantees for SMEs sector. The report highlights that lack of collateral is the main obstacle for IFIs to provide financing to SMEs. While land and buildings are widely accepted as collateral for loans, the use of movable collateral (such as inventory, accounts receivables, crops and equipment) is restricted because many countries do not have functioning laws and registries to govern secured transactions. Reforming the framework for movable collateral lending allows businesses - particularly SMEs - to leverage their assets into capital for investment and growth.

Finally, the report provides the analysis to reform the framework for movable collateral lending, allowing businesses - particularly SMEs - to leverage their assets into capital for investment and growth through Islamic financing markets. The analysis suggests that Modern Secured Transactions Registries increase the availability of credit and reduce the cost of credit. The primary beneficiaries of the reform are financial intermediaries such as banks, non-bank financial institutions, micro finance companies, factoring institutions and other creditors. This analysis also provides an in depth research to assess the extent to which a modern secured transactions framework is compatible with the Islamic Law (Sharīʿah) and therefore what elements of the legal framework can support IFIs to introduce or deter them from developing movable asset based lending products. The analysis provides one-to-one comparison of model law provisions and Sharīʿah principles, and suggestion for reconciliation, but subject to further explication and interpretation by the various schools of Islamic jurisprudence.

The full report is downloadable from:
http://www.irti.org/English/News/Pages/Official-Launch-of-Islamic-SMEs-Finance-Report-and-International-SMEs-Conference-2015.aspx

Summarized by Muhamed Zulkhibri

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A Course in Liquidity Management in Islamic Banking

A 5-days course on the Liquidity Management was conducted in Karachi, Pakistan in collaboration with State Bank of Pakistan during 5-9 October, 2015. It addressed Liquidity Risk Management strategies in banking industry in general and development of comparable methods that suit liquidity risk management in Islamic banking industry in particular.

The main objectives of the course were:

- To allow participants to learn about the nature and characteristic features of techniques of Liquidity Management that can be used for providing banking services in compliance with Sharīʿah rules.

- Study the main elements of Liquidity Management in Islamic Banks in comparison to Conventional Banks. Explore empirical case studies of Sharīʿah -compliant Liquidity Management practices with special reference to experiences of some Islamic financial institutions and Regulatory Bodies in IDB Member Countries.

Summarized by Osman Babiker