

## Is Islamic finance suffering from the wrong model of implementation?

By Rosana Gulzar

In this blog's latest post 'Disruption: Islamic contracts', there holds an imminent danger. The Islamic banks in Malaysia are not so much inching towards becoming just like the interest-based conventional banks they were supposed to replace but in fact, running towards them. Even as the industry celebrates its trillion size assets and formerly astronomical growth, there lies a darker truth. In a recent class I taught on the dichotomy between Islamic banking theory and practice, a participant, a new 'Islamic' banker, came up to me and wanted to discuss commodity *murabaha*. She said her team had just tabled the product for the bank's approval but she did not feel comfortable. The head of the Shariah committee also seemed disappointed. His comment, according to her, was that we no longer need Shariah advisers. The industry only needs commodity *murabaha* experts now.

Post-IFSA 2013 which fines and jails CEOs and everyone above and below for any wrongdoing and a flurry of policy documents telling banks how to implement Shariah contracts, 'Islamic' banks in Malaysia are seeking refuge in *tawarruq*, *Musharakah* and *mudarabah*? All that is left of profit and loss sharing contracts, which some scholars say are at the heart of the ideal Islamic financial system, is the policy documents by Bank Negara Malaysia (BNM). I would be pleasantly surprised if anyone can show me a bank which is genuinely implementing them. The supposed *mudarabah*-based products brought on by IFSA, namely the investment accounts and the IA platform, are currently being mutilated to look almost like any guaranteed and fixed return deposit. The IAP, I believe, are unlikely to be successful for laughable reasons.

When commercial banking, with its inherent tendencies for excesses, profit maximisation and desensitisation to social welfare, *is* the problem, how does crowdfunding through commercial banks become the solution? Won't the banks still look for credit-worthy companies with an almost guaranteed future to fund? Who then takes care of the small and medium-sized entrepreneurs who are also seeking financing? Are not the SMEs the backbones of the economy? Not to mention, where is the upholding of Islamic values such as justice, equitability and social well-being? Granted there are other organisations in Malaysia meant to help the lower incomes and SMEs but why do 'Islamic' banks call themselves 'Islamic' if they are far from embodying the ideal values in Shariah? Unfortunately, this sad state of affairs extends to other parts of Islamic finance such as *takaful* (apparently 'Islamic' insurance), *sukuk*, the other beauty pageant contestant in this parade, and other capital market products such as interest rate, oh wait, 'profit' rate swaps.

How did BNM envision the success of IFSA with *no* changes to the current environment? We are still in a dual system where 'Islamic' banks are pitted head-to-head against interest-based conventional banks. 'Islamic' assets are still only a quarter of the entire system despite the country allowing all sorts of controversial contracts such as *bai al dayn*, *bai al inah* and the one that takes the cake, *tawarruq*. Where are the educational campaigns to explain to customers this shift in the industry that the central bank expects to happen?

When customers, including 'Muslims', have been accustomed to deposit guarantees and fixed returns their whole lives, how do banks suddenly sell them an 'investment account' that promises neither? Is it any surprise that conventional bankers are using this as a selling point?

They are telling customers to avoid 'Islamic' products because there are no guarantees. Theirs still do. When the chiefs of 'Islamic' banks themselves seem cloudy in their understanding of the new regulations, how did BNM envision people on the street, who are banking with its 'Islamic' banks, to embrace the changes? A deputy director unfortunately got defensive when I asked. Other central bankers claimed ignorance because they "are not from that department".

While BNM seems keen to reform the industry, perhaps the answer it has been looking for is that the Islamic finance industry, and within it, Islamic banking, has been built the wrong way. Trying to make it work in the commercial banking space is what has led to the frequent comment that it is like squeezing a square peg into a round hole. Commercial banking, with its profit maximisation mantra and desensitisation to social welfare, is antithetical to the Shariah ideals of justice, equitability and social well-being as embodied in the *maqasid*. And isn't it the one that has been leading the world from one crisis to another? Why then are we so busy emulating them? Isn't it time the powers that be wake up and face facts?

So why did all the big organisations in Islamic finance, from the global standard-setters such as AAOIFI and IFSB to each country's central banks and each 'Islamic' banks' Shariah committees condone these practices? Perhaps because they were the easiest thing to do and allows for a fast build if the intention is to grab fame and fortune through one's achievements in Islamic finance. The countless Islamic finance awards and conferences and the effusive back slapping there are testaments to this. Bankers are such happy people.

So what is the solution? I believe it is cooperative banking. The true, genuine type practiced in Europe and not the ones in Muslim countries because they are largely used to fund political cronies and thus suffer from questionable management and corruption. My next article will thus explain cooperative banking, how the model works and why they are a better fit for Islamic finance than the current commercial banking model. In the meantime, I look forward to your thoughts. Students of Islamic finance intuitively get it when I explain these arguments while some practitioners acquiesce (quietly agree). Another group reminds me of this statement in a book by Upton Sinclair, who ironically was also an investigative journalist (uncovered scandals and corruption) as I was in my former life and whose solution to the 1930s Depression in California is to create cooperative ventures for the unemployed. The idea, to his surprise, received wide support but his bid to run as governor was waylaid, according to him, by the oppositions' "dirty tricks". He wrote this statement in his book about the political adventure, "It is difficult to get a man to understand something, when his salary depends on his not understanding it." The reaction of the other group of bankers brings to mind this quote.

## **About Rosana**

*If a cat has nine lives, Rosana has had four. She started as a business journalist in 2003 in Singapore after graduating from the Nanyang Technological University. Following stints with several news agencies, she joined what is probably the biggest blood-sucking vampire squid in London's Canary Wharf, HSBC. Aghast at the endless parade of Prada bags among colleagues, she thought joining an 'Islamic' bank would be better for her sanity. So she moved in 2010 to Dubai to join HSBC's global 'Islamic' banking business. The stint at the now defunct bank left her with more questions than answers so she tried doing a Master of Science in 'Islamic' finance to again reclaim her sanity. The academic world turned out to be on a league of its own. Comforted by the supposed superior knowledge and payscale, the dichotomy between 'Islamic' banking theory and practice was largely glossed over. Bankers, we are told, are just evil people who refuse to listen to our solutions. Rosana did not agree. In her quest for a better form of Islamic finance, she came out tops in her batch and to her own surprise, is continuing her study of 'Islamic' finance into PhD. The title of her thesis is 'Has the dichotomy between theory and practice made Islamic banks less stable? A comparison with cooperative banks in Europe during the 2008 crisis'. Absolutely excited by her research, she needs to sign off now. Till the next article.*