



AAOIFI – World Bank 14th Annual Conference on Islamic Banking and Finance 2019

The revolution in the global Islamic finance ecosystem: the need for governance, standardization and regulatory support

Irshad Mahmood | 3-4 November 2019

Agenda

Topics to be covered today

Item Topic

- | | |
|---|--|
| 1 | Introduction |
| 2 | Aim of AAOIFI standards |
| 3 | Perceived gaps in FAS |
| 4 | Known differences from IFRS |
| 5 | Emerging areas for new guidance |
| 6 | Characterization of Islamic finance transactions |



1. Introduction

Presenter's background:



Irshad Mahmood

Partner

Audit and assurance
Deloitte and Touche (M.E.)

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- ✓ **Over 25 years of professional experience** specializing in financial services including banking, Islamic banking, private equity and real estate funds, insurance and capital markets
- ✓ **Significant industry experience** having led the finance function of Samba Financial Group in Saudi Arabia and Ufone (a subsidiary of Etisalat)
- ✓ Responsible for assisting the audit teams and clients across the Middle East region with **technical issues related to IFRS and Islamic finance**
- ✓ **Board Member** of the Accounting Board of the Accounting and Auditing Organization for Islamic Financial Institution (**AAOIFI**)
- ✓ **Member** of the Technical Accounting and Interpretation Committee (**TAIC**) at the AAOIFI



Mahesh Balasubramanian

Partner

Financial Services
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- ✓ **Over 20 years of professional experience** specializing in financial services including banking, Islamic finance, asset management, telecom, insurance and capital markets
- ✓ **Head of Department of Professional Practice and IFRS and AAOIFI** technical partner for KPMG in the region and part of KPMG Global International Standards Group topic team on Business Combinations and Consolidation.
- ✓ Responsible for assisting the audit teams and clients across the Middle East region with **technical issues related to IFRS and Islamic finance**
- ✓ **Member** of the Technical Accounting and Interpretation Committee (**TAIC**) at the AAOIFI
- ✓ **Project manager** leading the development of FAS 25 and FAS 26 for AAOIFI and part of team supporting industry standard Wakala contracts developed by IIFM.

2. Aim of AAOIFI standards

Accounting and auditing, governance and ethics

Accounting and Auditing standards

- ❑ Provide guidance on accounting treatment for specific Islamic finance products and mechanisms
- ❑ Provide guidance on presentation of financial statements for Islamic financial institutions (IFIs)
- ❑ Provide guidance on external auditing of IFIs

Governance standards

- ❑ Provide guidance on Shari'ah compliance and supervision framework and processes for IFIs

Ethics standards

- ❑ Provide code of ethics for accountants, auditors, and employees of IFIs

3. Perceived gaps in FAS

What are the perceived gaps in FAS compared to other global acceptable accounting practices?

One of the major challenges facing IFIs lies in the preparation of the financial statements under different accounting standards and which may lead to problems of comparability, reliability and compliance level measurement. This has resulted in a heated debate among scholars which has hitherto translated to the evolving existing literature surrounding the interpretation of the level of compliance with the Islamic accounting standards.

Development

- IFRS are developed and continuously being developed.
- Unfortunate fact that there is no significant effort on standardization of accounting principles in Islam. AAOIFI standards cater to the IFIs only, and not all the businesses in general.

Information Needs

Information needs of Muslim or Shari'ah compliant stakeholders differ significantly from a conventional stakeholder. This is due to its information needs for computation of Zakat, profit and loss distribution, screening of permissible investments and laws of inheritance.

Accounting Principles

Differences in accounting principles arising because of rejection of conventional financial system and its transactions by the Islamic economic system or rather the Islamic financial system, to be specific.

3. Perceived gaps in FAS (continued)

Objectives and focus

Conventional accounting

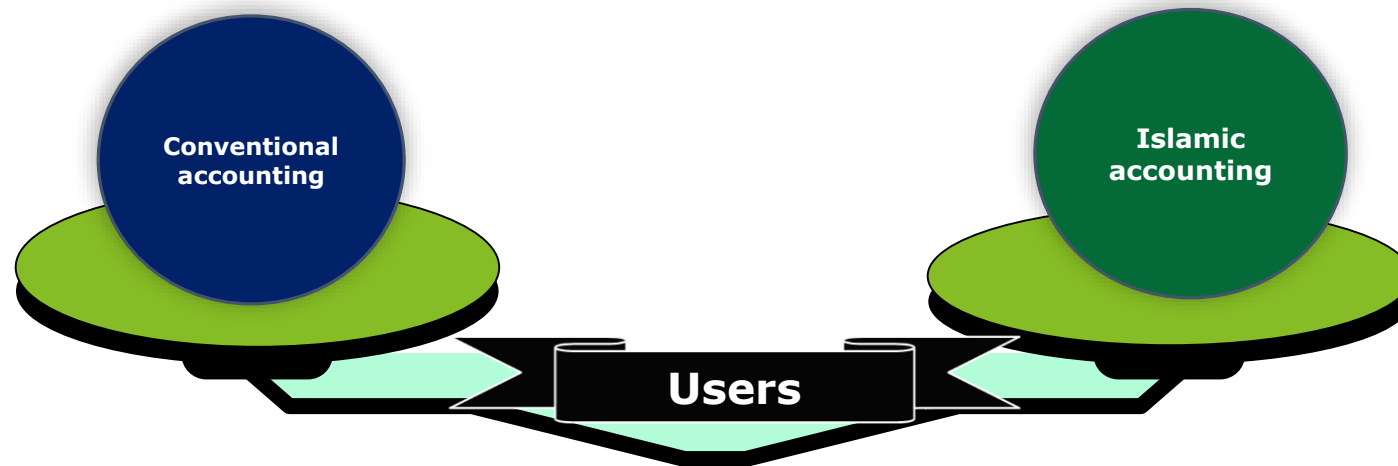
- Conventional accounting aims to permit informed decisions by information users, whose ultimate purpose is, to efficiently allocate scarce resources available to the best efficient and profitable manner.
- Conventional accounting concentrates on the information identifying economic activities and transactions.



Islamic accounting

- Islamic accounting abides by the principles of Shari'ah and rules in their dealings and to assess whether the objectives of the organization are being met.
- Islamic accounting also identifies and deals with certain socio-economic factors, religious activities and transactions.

3. Perceived gaps in FAS (continued)

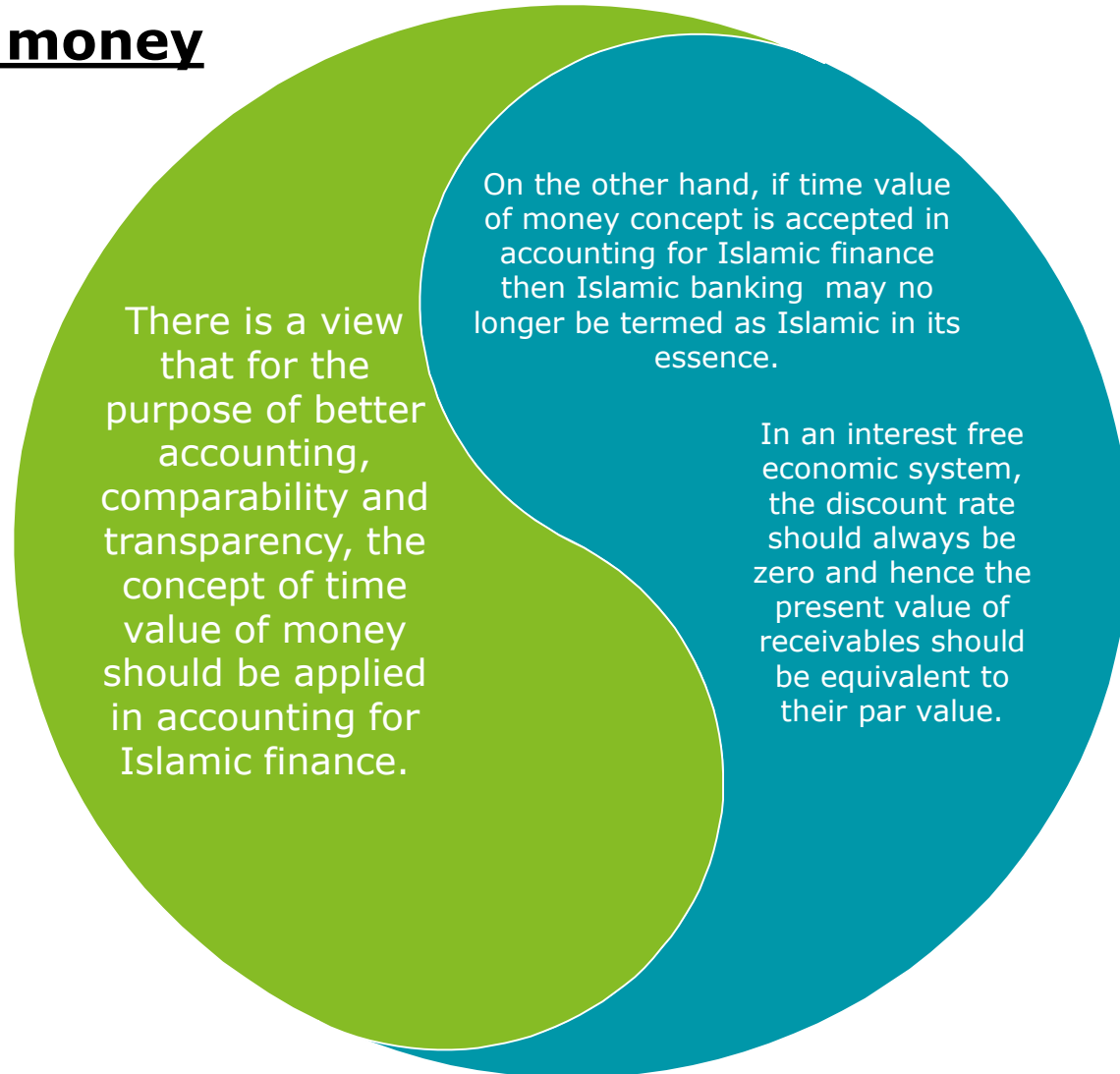


- ✓ Present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the public.

- ✓ Islamic accounting additionally aims to serve a wider range of stakeholders, in a wider array of information needs.

3. Perceived gaps in FAS (continued)

Time value of money



4. Known differences from IFRS

Major differences seen in practice

1

Equity of IAH and Attribution of profits and losses

3

Recycling and OCI

2

Linked contracts

4

Transition guidance

6

PER and IRR

5

Revenue recognition

7

Leasing and reserves (FAS 30)

9

Foreign Exchange accounting

8

Variability and consolidation

10

Investment property

11

Wakala (agency arrangements)

5. Emerging areas for new guidance (continued)

Emerging areas which require new guidance

1

Presentation and disclosures

3

Hedging and Derivatives

2

Sukuk

4

Takaful and Retakaful

6

Growing/ Diminishing Musharaka

5

Revenue recognition

7

Micro-finance

9

Foreign Exchange accounting

8

Tawaruq

10

Restructured contracts

11

Dealing in own equity investments

6. The case for separate characterization of Islamic finance transactions

- Accounting must reflect the transactions in their reality and in the right sequencing.
- The risk profiles of Islamic finance instruments:
 - are different from conventional transactions; and
 - change with the transaction sequencing.
- Most of the recognition and de-recognition principles for assets and liabilities are similar to those of IFRS.

- If a transaction is Shari'ah compliant it would be meeting most of the definitions and requirements of IFRS for accounting for assets and liabilities in different stages of a transaction.
- Adverse scenarios: most of the Islamic finance transactions would prove to be different from conventional in the adverse scenarios because of different risks and rewards structures on assets and investments. Accordingly, they need separate accounting.

Questions?





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Islamic Crowd Funding: Opportunities and Challenges

Faheem Ahmed

President–Strategic Planning and Global Relationships

Islamic International Rating Agency – Bahrain

November 3, 2019



Crowd Funding

- The concept of 'soliciting capital directly from the investors' is not new;
- Although remained unregulated till The Great Depression, the practice dates back to the 18th century;
- Regulatory Reforms of 1930s restricted P2P investments and lending;
- Crowd funding revived with the recent advancements in technology and enabling regulatory environment post Global Financial Crisis of 2008;
- Crowd funding reportedly achieving triple-digit growth in the last decade with UK, China and US in the lead;
- Most activity being witnessed in debt-financing to individuals and SMEs;

Top 5 Crowd funding Platforms

1. Kickstarter.
2. Indiegogo.
3. Patreon.
4. GoFundMe.
5. Crowdrise.



Crowd Funding

- With the presence of regulatory obstacles and inherent riskiness, equity-based crowd funding remains lackluster.

Alternative Finance in the UK, the EU and North America (NA), 2015 [in million]

Country/ region	Loan-based crowdfunding				Investment-based crowdfunding			Prepayment or reward based crowd funding	Donation based crowd funding	Total
	P2P business lending	P2P business lending (real estate)	P2P consumer lending	Invoice trading	Equity based crowd funding	Equity based crowd funding (real estate)	Debt based securities			
UK	£881	£609	£909	£325	£245	£87	£6	£42	£12	£3,116
[GBP]	28%	20%	29%	10%	8%	3%	0%	1%	0%	100%
EU	€1,182		€1,330	€349	€422		€103	€97	€25	€3,508
[EUR]	34%		38%	10%	12%		3%	3%	1%	100%
NA	\$2,620	\$783	\$25,750	\$33	\$598	\$484		\$658	\$216	\$31,132
[USD]	8%	3%	83%	0%	2%	2%		2%	1%	100%

Source: Islamic Financial Services Industry Stability Report, 2017 by IFSB

Shari'a Principles & Crowd Funding

- Direct P2P financial activity allows greater communication among parties and higher trust and transparency encouraged in Shari'a principles;
- Social solidarity dimension of crowd funding that enables regular and direct interaction between parties also contributes towards reduction in transaction cost;
- With regulatory initiatives by various Islamic countries like Malaysia, Turkey, Morocco, Bahrain etc. and formation of Islamic FinTech Alliance, Islamic crowd funding is gaining grounds;
- IFSB's research indicates that of 80 originating from OIC member states:
 - the number of non-charity based platforms that explicitly refer to Shari'a is very small;
 - A very small number of platforms could be termed as 'active'..



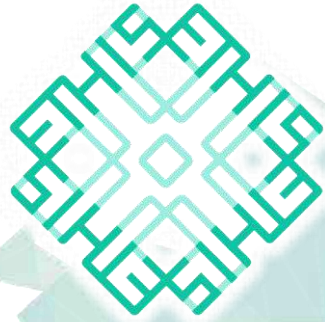
Regulating Islamic Crowd Funding Market

- Major areas of consideration while regulating Islamic crowd funding markets:
 - Shari'a compliance confirmation;
 - Risk assessment of investment seekers and the transaction;
 - Determination of risk profiles of funding providers & seekers,
 - Nature of contracts drawn with clear assumption of liabilities, guidelines on over-/ under-subscriptions and legal recourse;
 - Disclosure guidelines for local and cross-border seekers;
 - Mechanisms for post-investment surveillance throughout the life of the transaction;
 - Provisions for emergency exit and nature of compensations in cases of contractual breaches or technology failures;
 - In addition to determining obligations of CF platforms, considering engagement of qualified 3rd parties where required; Examples could be Governance, Social and Environmental Evaluators.



THANK YOU





ETHIS GLOBAL

Islamic Crowdfunding Opportunities

Q4 2019

The Crowdfunding (CF) Opportunity

An emerging fintech model - a marketplace for funds.

Platforms can raise funds from *almost any* source and match them to *almost any* project.

Funds flow directly to the real economy.



Investment CF



Peer to Peer (P2P) Financing

The crowd provides term financing to projects, companies or individuals, typically structured as debt-financing with interest.

Islamic structures earn income from profit-sharing, rental and trade.

Large growth in these verticals: SMEs, Property and Consumer loans.



Equity Crowdfunding

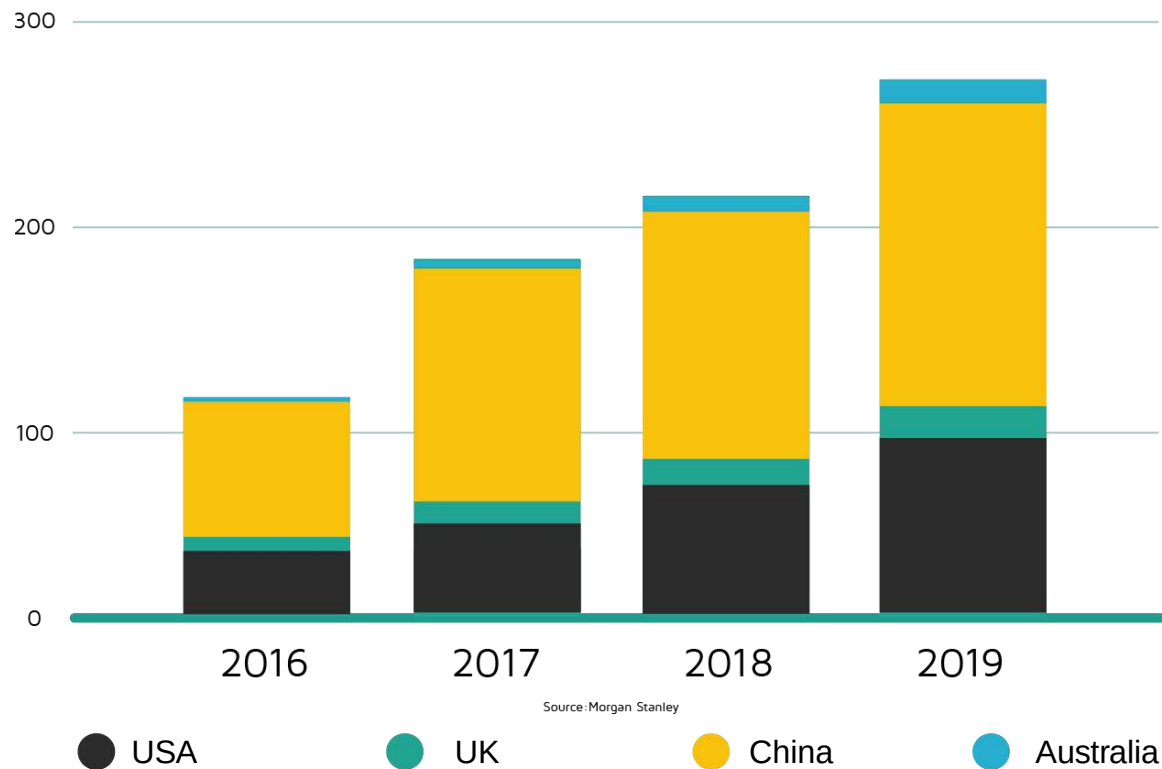
The crowd provides investment for equity in private companies and SPVs, typically ordinary or preference shares.

Shariah screening focuses on the issuer's business and internal finances.

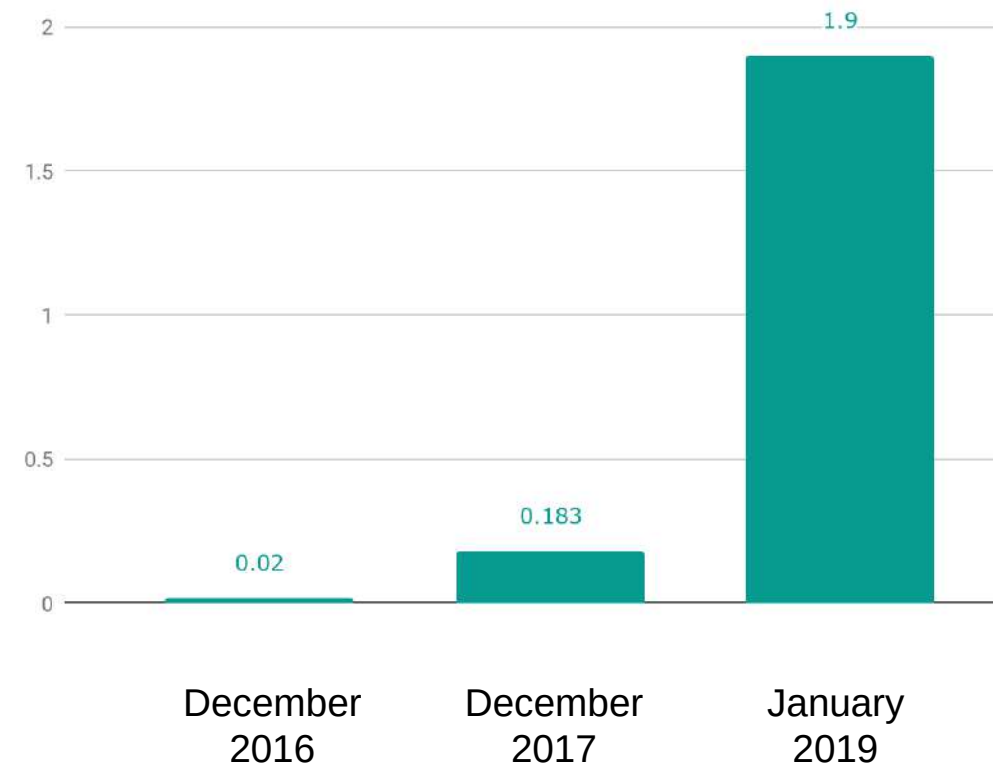
Large growth in these verticals: SMEs, Property and Startups.

Growth of P2P Crowdfunding

Global P2P financing issuance, USD (bil)



Indonesia total P2P financing issuance, USD (bil)



Source: OJK, Indonesian financial services authority

Our Problems

Direct investments and charity in emerging nations is broken.

- Incumbent financial institutions serve limited preferred segments, and have low social impact
- Local capital flows are poorly organised
- Global flows lack intelligence and facilitation



ETHIS believes that Crowdfunding
is the **FUTURE** of Islamic Finance.



The Difference

Money movement driven by the people.

Mechanisms to enforce transparency,
screening and accountability.

Increases efficiency of existing flows and
activates new flows.

Key Opportunities and Applications

Great potential for Zakat, Waqf and Sadaqah.

Funding for the underserved. An opportunity for everyone.

Current growth is in consumer, SME/ MSME, Property.

Crowd - Investors, Backers, Donors

Low minimums, wide variety

Transparent campaigns with updates

Ease of use and cross-border

Fundraisers

New, faster and more flexible avenue

Public awareness and market validation

Leverage on communities



Excellence

Transparency

Honesty

Integrity

Sincerity



Mission

Lead crowdfunding for impactful circulation of capital globally, based on universal ethical principles.

Vision

Create crowdfunding unicorns in the Ethis group by 2023.

PoC: Ethis Indonesia

Affordable housing project supported by a government program.

2015

Investment Club

Club Ethis Islamic Investment SMEs, Startups and Property

2016

Pivot

EthisCrowd.com Property CF Social Housing in Indonesia

2017

Pilots

Processing license in Malaysia
Piloted various models

2018

Tightening Dealflow

Fund one campaign at a time
Processing license in Indonesia

2019

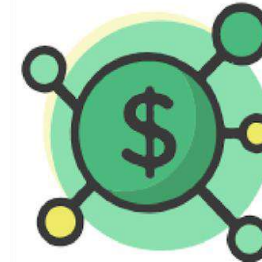
Scaling Up

Fund multiple campaigns
Licenses obtained

3,000
Investment
Transactions



\$43m
Projects
Value



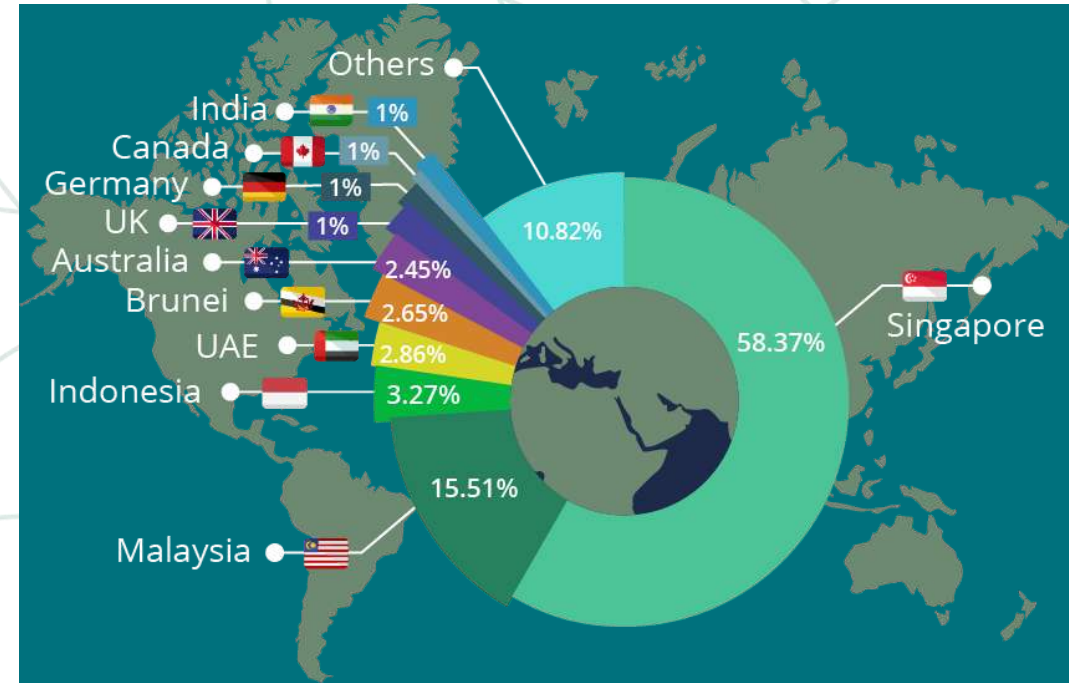
8,000
Affordable
Houses



Global Crowd-investors

The Ethis community includes

- ❖ Millenials and young professionals
- ❖ Islamic finance practitioners
- ❖ Foundations and community groups
- ❖ High-networth individuals
- ❖ Venture and early-stage investors
- ❖ Impact investors



Our crowd of **28,000** has made **1,300** investments.

98% are **first-time** investors in Indonesia

Global Expansion Pillars

1. Scale-up in large emerging markets

Indonesia is our main market. It is one of the most attractive emerging markets in the world and has a booming crowdfunding sector.

2. Branches in major Islamic finance hubs

We are licensed in Kuala Lumpur and obtained an approval in Dubai.

3. Enter new regions in the Muslim world

Obtain licenses to cover MENA and Central Asia.

Recent Licenses



ETHIS VENTURES RECEIVES MALAYSIA'S FIRST ISLAMIC ECF LICENSE

By Digital News Asia May 21, 2019

- ECF is a true Musharakah or Mudarabah relationship with shared risk and reward
- Plans to attract promising Islamic economy startups to setup and raise funds in Malaysia





المكتب الإعلامي
لحكومة دبي
GOVERNMENT OF DUBAI
MEDIA OFFICE



DLD launches 4 new investment products in Dubai's real estate market



Tuesday, July 02, 2019

Dubai Land Department (DLD) announce Estate Investment Opportunities (REIOs) conference held yesterday. The new initiative aims to attract investors from all economic sectors.

Before the launch of the project, a feasibility study and the most prominent international real estate practices were reviewed, and a committee was formed to follow up and develop the project. Several important investment products were launched, notably the collective real estate investment procedures to register units owned by a group, the lease-to-own system, and investment portfolio.

Ethis Group of Crowdfunding Platforms to Participate in Dubai Property Development

July 5, 2019 @ 6:49 am By JD Alois

Listen to this article
1:43



Awards & Accolades



GIFA Award for Best Islamic Crowdfunding Platform 2016



Islamic Economy Award 2016 from the Crown Prince of Dubai



World Islamic Fintech Awards 2018 for Best Islamic Peer to Peer Finance Platform (Ethis) & Best Social Impact Islamic Fintech Platform (Global Sadaqah)



Awards & Accolades



**Ethis won the coveted US\$100,000 'Innovation for Impact' grant
and will be featured in the Dubai Expo 2020**

Ethis Global Founders

Datuk Mohd Radzif Yunus, Founder/ Chairman

Datuk is a proven leader with a demonstrated track record of transforming large business groups and organisations to achieve successful turnarounds. A firm believer in 'Doing well to be able to do more good', Datuk sits on various boards of listed companies across healthcare, property and education. Datuk provides leadership to the dynamic founding duo of Umar and Ronald.



Umar Munshi, Founder/ CEO

A social entrepreneur since 18, with experiences in health-tech, Islamic finance and education that brought him from Singapore to Saudi, a long stint in Indonesia in a partnership with Ronald, and now Kuala Lumpur. Umar is well-connected to the fintech world, as the Chairman of the Islamic Fintech Alliance and a committee member of Fintech Association Malaysia.



Ronald Wijaya, Founder/ COO

A social entrepreneur since partnering with Umar a decade ago, Ronald has wide experiences as an entrepreneur and business consultant in various sectors across Indonesia including health-tech, trading, property and manufacturing. Ronald is the president of the Association of Shariah Fintech Indonesia (AFSI), the largest such group globally with >50 startup founders.



Shura - Advisors and Industry Leaders



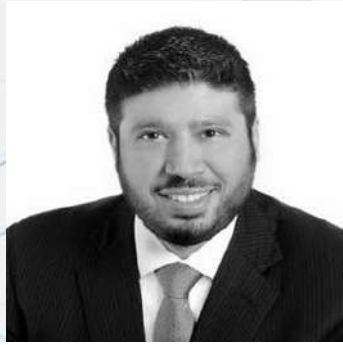
**Azizuddin @AJ
SEA, Europe**

Technopreneur, Venture Builder & Go-to-Guy. 21 yrs in tech, AJ has strong ecosystem knowledge and relationships.



**Md Raafi Hossain
MENA**

Founder of Finocracy, which develops fintech in partnership with corporates, governments and multilaterals.



**Rehan Noor Pathan
MENA**

Over 2 decades of experience building institutional sales businesses for global institutions and Family Office investors



**Daud (David) Vicary
Global**

Global Islamic Finance leader. Advisor to various corporates, governments and multilaterals.



**Dr Shamsiah A K
SEA, MENA**

Waqf and Zakat specialist, now an Islamic banker. A former regulator at the Singapore Islamic Religious Authority



**Ridzuan Aziz
SEA. Europe**

President of Fintech Malaysia. Former regulator turned consultant and entrepreneur with successful exits.

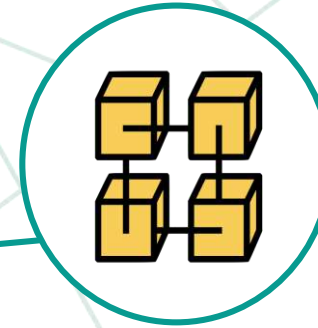
Tech Roadmap



Current Capability:
Web Platform
Web presence (SEO),
user-interface, clarity
of content



Version 2
API-based Web App
Robust, seamless and
automated internal
operations and
integration with external
vendors and partners



Version 3
**Smart Contracts and
Tokenised Securities**
Seamless global transfers,
secondary market, end-to-
end automation, robust
data capabilities and robo-
advisory



Ethis is Ethical Crowdfunding.
Let's change the world together.
Make a profit. Make a difference.

Our platforms feature exciting and sustainable campaigns. You are the ethical crowd funders. When good intentions converge, we inspire change in the world.
Impact investment. Participatory Project Financing. Effective Charity. We are **Ethis**.

[View our Platforms](#)

Invest, Donate or Raise Funds. Participate in our global movement for change



Charity Crowdfunding Around the World

Global platform for effective charity and Islamic social finance. Give Sadaqah, Zakat and Waqf online to credible charities and social enterprises alongside corporates and high-networth individuals.

[Visit Site](#)



Property Crowdfunding In Indonesia

Award-winning impact investment platform. Make healthy profits while building homes for low-income families. Investors from 65 countries have built more than 8,000 affordable houses since 2016. Property Crowdfunding in Indonesia

[Visit Site](#)



Property Crowdfunding In Dubai

Dubai's first and only investment platform in under-construction projects. Build a portfolio in the property capital of the Middle-east and make profits like a property developer with asset-backed investments.

[Coming Soon](#)



Equity Crowdfunding In Malaysia

Participate in equity project financing by investing directly into companies and SPVs. Almost anyone can now access institutional-grade private equity deals, fractional property investment and Waqf projects.

[Visit Site](#)



ETHIS

Umar Munshi

Co-Founder at Ethis Global

Kuala Lumpur, Kuala Lumpur, Malaysia · 500+ connections



Ethis Global



[Company Website](#) ↗

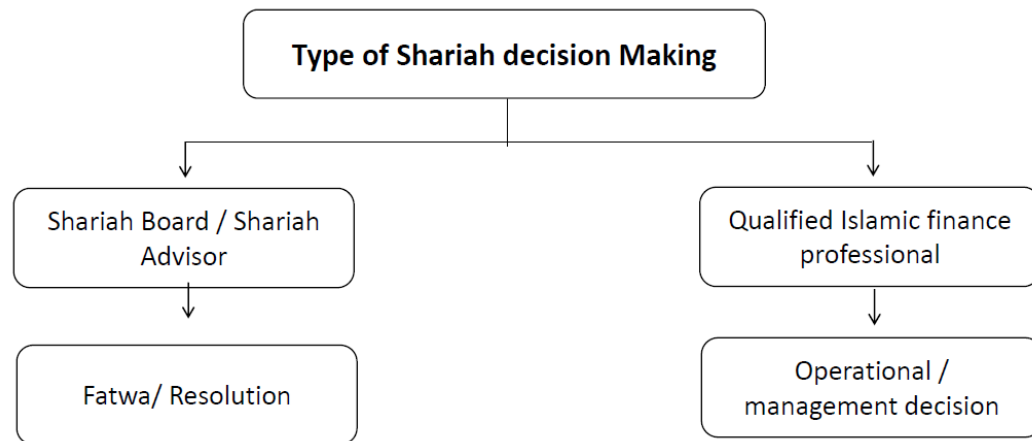
Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)

**14th AAOIFI – World Bank Annual Conference on Islamic Banking and Finance:
“The Revolution in the Global Islamic Finance Ecosystem: The Need for Governance, Standardization and Regulatory
Support”, Kingdom of Bahrain. 3-4 November 2019, Kingdom of Bahrain**

***SHARI’AH* DECISION MAKING PROCESS**

Dr Ahcene Lahsasna
CEO. Salihin Shariah Advisory (Malaysia)

Dimensions of *Shari'ah* decision making in Islamic finance



- *Shari'ah* decision making is a process/ an exercise undertaken by the Qualified Islamic finance scholars or professionals in order to provide a *Shari'ah* position that could be in a form of *Shari'ah* Ruling on operations matter or management decision to resolve a *Shari'ah* compliant matter and to provide a solution for existing or future issues faced by the IFI within the *Shari'ah* rules, values and principles.

The *Shari'ah* decision making of *Shari'ah* board and senior management in the IFI

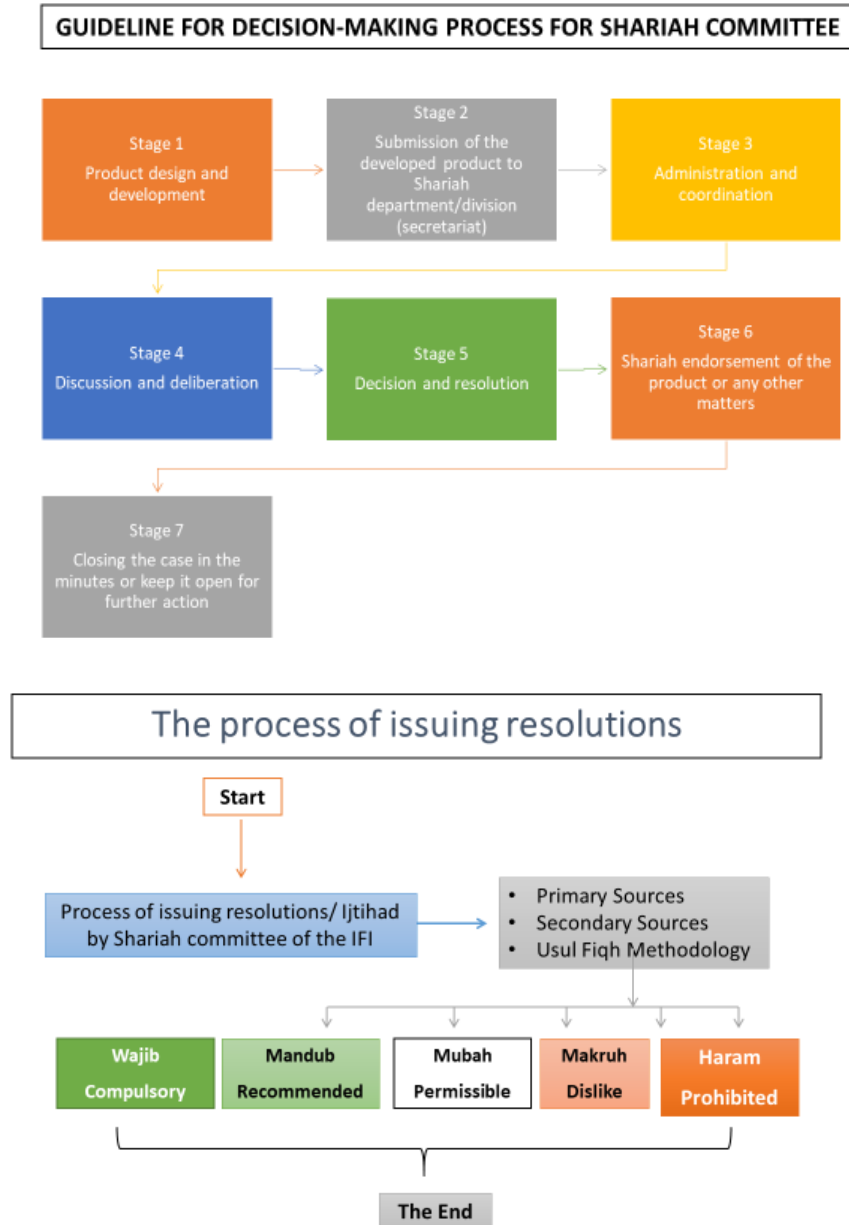
The difference between *Shari'ah* decision making of *Shari'ah* board and senior management in the IFI;

- The *Shari'ah* board will form a fatwa or *Shari'ah* ruling related to *Shari'ah* matters,
- The decision of the senior management would be in a form of resolution of decision that is operational and management in nature but has *Shari'ah* implications.
- Both decision have *Shari'ah* implications by end result
- *Shari'ah* board decision covers on *Shari'ah* matter
- Decision of senior management encompasses the operations and management matters.

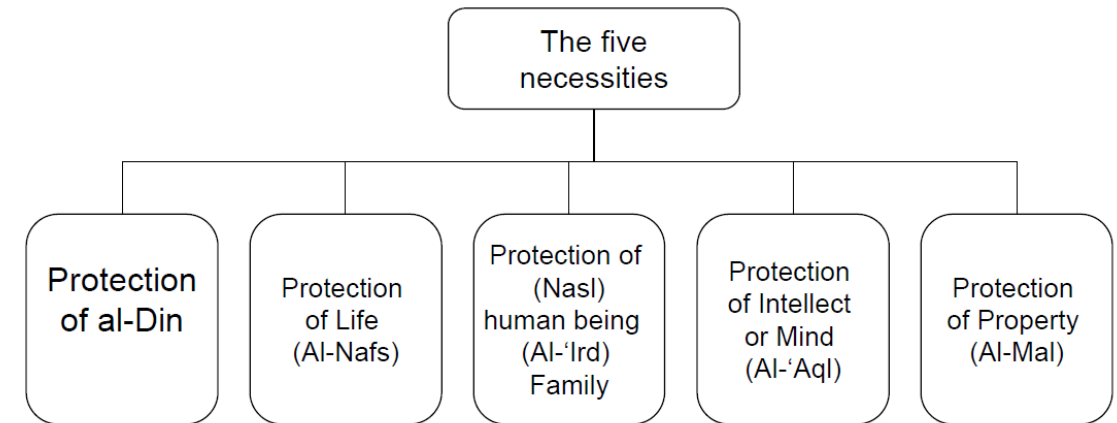
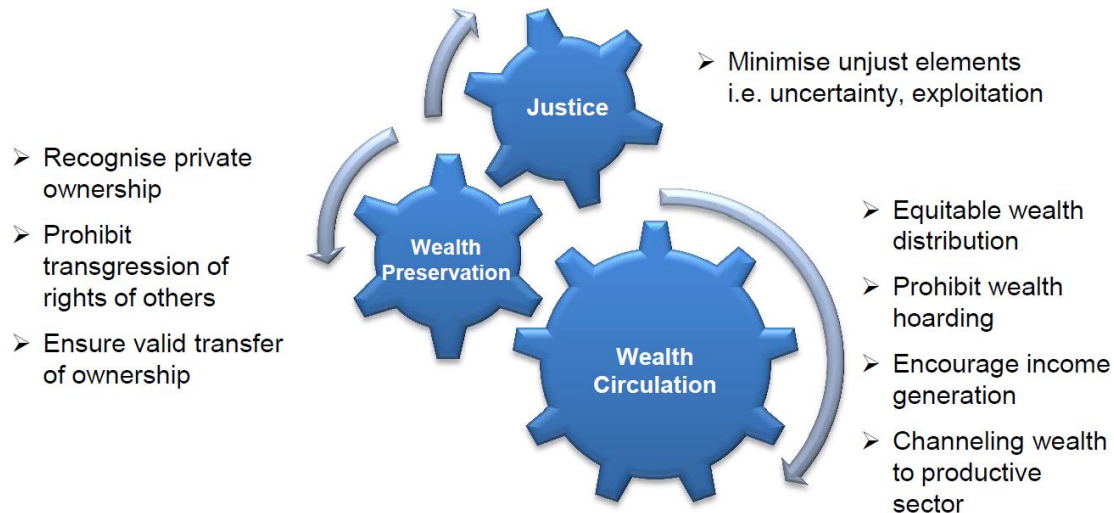
- 
- The key point here is that the management and board should not discount the importance of *Shari'ah* in their resolution, it should be integrated in their thinking and decision-making process.

The structured methodology & process of obtaining *Shari'ah* ruling/ resolutions in Islamic finance matters

- The *Shari'ah* board of the Islamic Financial Institutions in issuing resolutions or *Shari'ah* rules related to Islamic finance matters follow a sound structured and process to ensure consistency and robustness of the decision making; the methodology employed is briefly described as follows:



Shari'ah decision making and Consideration for Maqasid al *Shari'ah* in economics and finance



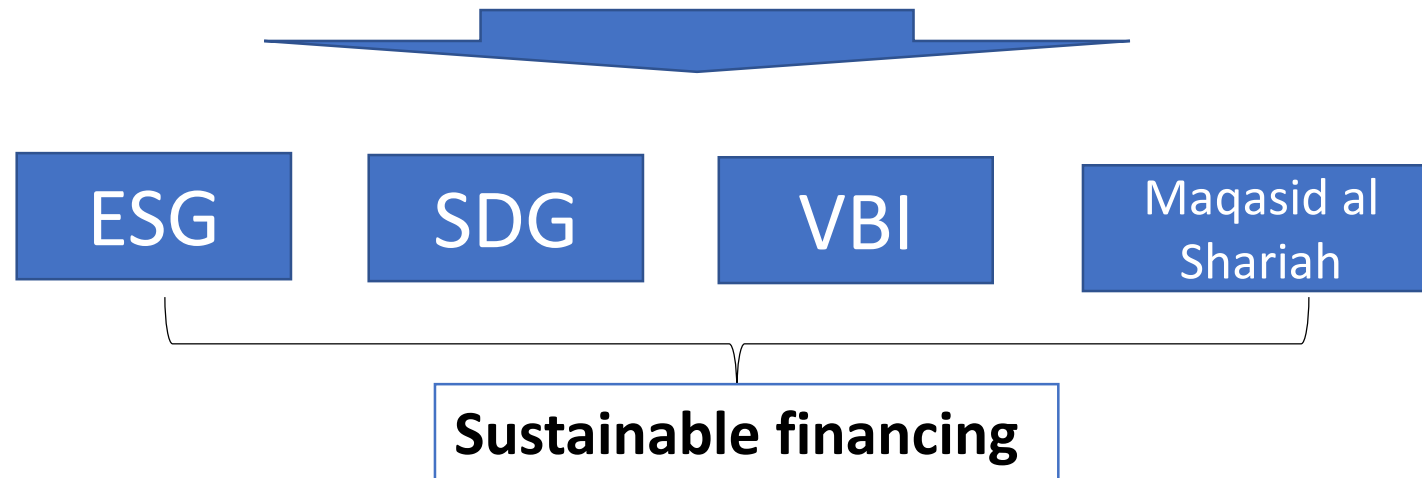
The *Shari'ah* decision making should reflect Maqasid al *Shari'ah*, where the outcome of the decision must be in accordance with the objective of *Shari'ah*.

***Shari'ah* decision making and Consideration for Sustainability**

Sustainability is one of the most significant trends in the current financial markets:

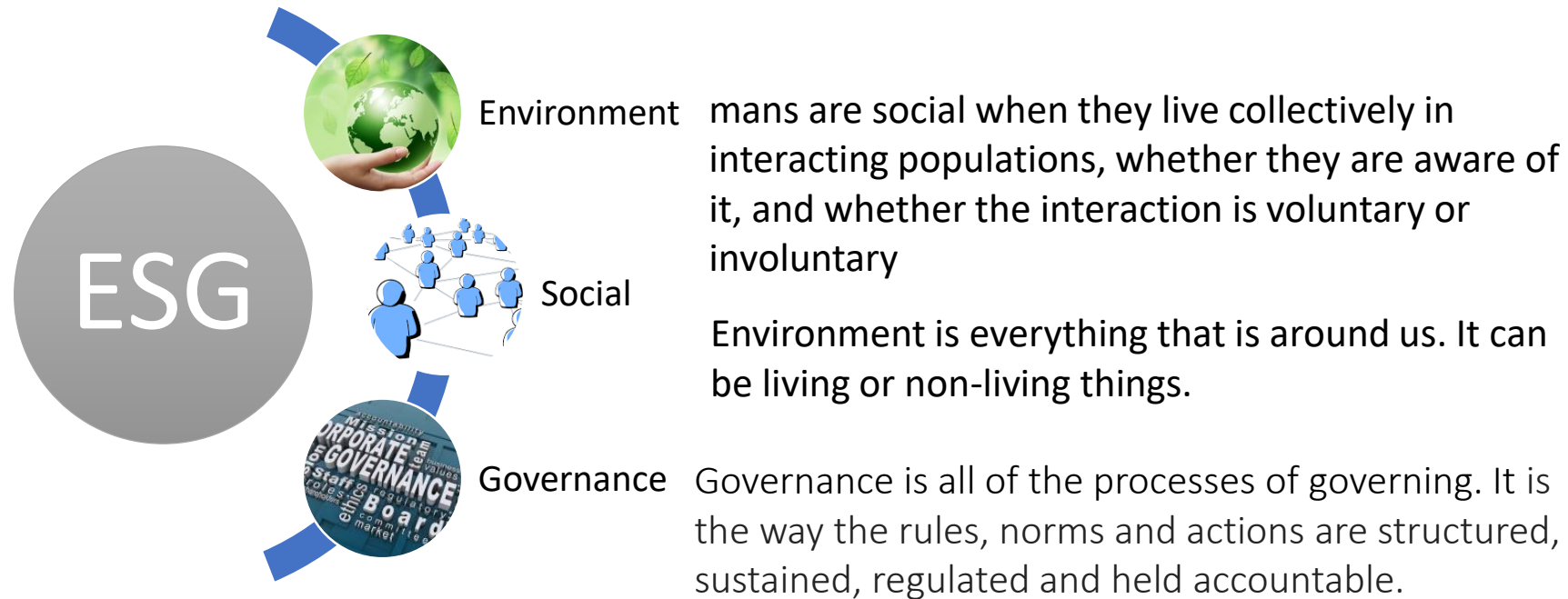
1. Whether in the form of investors' desire for sustainable responsible investing (SRI),
2. or corporate management's focus on corporate social responsibility (CSR),

The content, focusing on sustainability and ESG (environmental, social and governance) issues, is the same.



Sustainable finance

Sustainable finance refers to any form of financial service integrating environmental, social and governance (ESG) criteria into the business or investment decisions for the lasting benefit of both clients and society at large.



E**S****G****ENVIRONMENTAL ("E")****SOCIAL ("S")****GOVERNANCE ("G")**

Biodiversity/land use

Community relations

Accountability

Carbon emissions

Controversial business

Anti-takeover measures

Climate change risks

Customer relations/product

Board structure/size

Energy usage

Diversity issues

Bribery and corruption

Raw material sourcing

Employee relations

CEO duality

Regulatory/legal risks

Health and safety

Executive compensation schemes

Supply chain management

Human capital management

Ownership structure

Waste and recycling

Human rights

Shareholder rights

Water management

Responsible marketing and R&D

Transparency

Weather events

Union relationships

Voting procedures

S

D

G



Consideration of the criteria of green technology and sustainable development in offering products and services

Value Based Intermediation

An intermediation function that aims to deliver the intended outcomes of Shariah through practices, conduct and offerings that generate positive and sustainable impact to the economy, community and environment, without compromising the financial returns to shareholders

The benefit



Financial Industry

*Greater innovation,
enhanced efficiency
and effective
ecosystem*



Customer/Community

*Improved standard of
living, fair and
transparent treatment*



Government

*Realignment of
business focus with
national agenda*



Regulator

*Strengthened
financial stability*

Criteria of sustainability for financing decision making

1	2	3	4	5	6	7
CSR Policies, Procedures, Departments	Financial Inclusion, Micro and SME Finance	Non Profit Financing	Philanthropic and Social Programmes	Impact of the Environmental and Social Activities	Assessing, Screening of Environmental and Social Risks	Staff Competency and Customer Relations
✓	✓	✓	✓	✓	✓	✓

The above process is after

- Compliance with *Shari'ah* requirements
- Compliance with Legal requirement
- Compliance with other requirements where applicable (depending on each country)

Criteria of sustainability in investment decision making

Suggesting Green category for Shariah compliance investment

SC Methodology for
Shariah compliance stock
screening

Green Shariah compliance
category stock

ESG

SDG

VBI

Maqasid al Shariah

Examples

1	2	3	4	5	6	7
CSR Policies, Procedures, Departments	Financial Inclusion, Micro and SME Finance	Non Profit Financing	Philanthropic and Social Programmes	Impact of the Environmental and Social Activities	Assessing, Screening of Environmental and Social Risks	Other Elements of ESG, SDG & VBI
✓	✓	✓	✓	✓	✓	✓

Sustainable financing

Independence and conflict of interest issue

Conflict of interest could represent an issue if it is not well addressed in the context of *Shari'ah* decision making process, among the vital aspects that should be considered in the conflict of interest is as follows:

- Disclosure requirement of potential conflict of interest such as having relationship or interest in the subject matter of the decision.
- It could be the person who is making decision is a *Shari'ah* advisor of that particular company, he or she could be one of the shareholders of the company, he or she could have relatives working in the subject company.

Risks Mitigation in *Shari'ah* decision making

- *Shari'ah* non-compliance risk or otherwise, is part of the possible risks that could be associated with the *Shari'ah* decision making.
- *Shari'ah* non-compliance risk may have a significant impact and implication on the profitability of the IFI and its branding, image as well as reputation.
- Hence, *Shari'ah* non-compliance risk must be mitigated in *Shari'ah* decision making.

The role of good governance practices in avoiding hidden traps

- Governance aspect is a very important in *Shari'ah* decision making, it determine the appropriate process that should be followed, to determine the accountability, responsibility and scope of agreed upon duties to discharge the obligations.
- It should be clearly incorporated in the SOP and corporate governance framework of IFI.
- Proper illustration on the line of reporting
- Proper illustration on the delegation of power

The importance of critical *Shari'ah* analysis

- *Shari'ah* analysis is part and parcel of *Shari'ah* decision making
- An appropriate *Shari'ah* analysis must take place to ensure very effective and efficient decision and resolutions.
- Brief descriptions of the different dimensions of the *Shari'ah* analysis are as follows:

Cont.



A. Fundamental Aspects of *Shari'ah* analysis in *Shari'ah* decision making

- Understanding the composition of Islamic finance industry
- *Understanding Shari'ah* principles and values in Islamic economics and finance
- Connecting the dots between the *Shari'ah* contracts and the enhanced *Shari'ah* contracts
- Appreciate the enhanced of *Shari'ah* concepts and terms in Islamic finance

B. Framework of *Shari'ah* analysis in *Shari'ah* decision making

- Product descriptions and features
- Legal and Regulatory requirements
- *Shari'ah* compatibility

D. Parties involved in *Shari'ah* decision making at approval stage

- Owner of the product
- *Shari'ah* department
- Legal department
- Risk management
- *Shari'ah* board
- Risk management

C. Practical and technical knowledge in *Shari'ah* analysis in *Shari'ah* decision making. Understand:

- The nature of Islamic finance business model
- Islamic finance versus conventional finance
- Prohibited elements and activities in Islamic financial system
- Business ethics, values, principles and norms of Islamic Finance
- The different Islamic finance portfolios
- Understanding the scope of the proposed product and its niche market
- Selection and mapping of the *Shari'ah* contracts
- Differentiate exchange contracts and voluntary contracts
- Ensure the compliance of the *Shari'ah* contracts
- Careful design of the combination of contracts
- Observation of the sequence of the execution of contracts

THANK YOU

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**AAOIFI's Governance Standard on Shari'ah
Compliance & Fiduciary Rating for IFIs
&
Islamic International Rating Agency ("IIRA") Rating
Methodology**

- IIRA was set up as an infrastructure institution for Islamic Finance in 2002
- Islamic Development Bank was the founder shareholder
- Two key objectives were and are relevant
 - Growth of national and international sukuk markets through ratings in Islamic countries where rating culture is not well developed
 - Providing a value added service to Islamic investing by formalizing a view on Shari'ah compliance

IIRA Ratings – Niche

- **IIRA provides ratings for all types of issuers and issues**
 - Shari'ah Compliance and Fiduciary Rating
 - Sovereign Ratings
 - Issuer Ratings
 - Sukuk Ratings
 - Takaful Financial Strength and Fiduciary Ratings
 - Participation Banks Fiduciary Ratings
 - Governance Ratings
 - Waqf Assessment (Development in progress)
 - Collective Investment Scheme (CIS) Ratings
- Financial Data Portal (available through Subscription)
- Rating and training workshops

GCC

- Bahrain
- Kingdom of Saudi Arabia
- United Arab Emirates
- Oman

Levant

- Egypt
- Jordan
- Lebanon
- Syria
- Turkey

Africa

- Sudan
- Tunisia
- South Africa
- Algeria
- Nigeria

South & South East Asia

- Malaysia
- Pakistan

IIRA's Presence in Islamic Markets

Be an alternate voice in international ratings

Customized approach to rating Islamic Financial Institutions

Facilitate Development of Sukuk markets through National Scale Ratings

Facilitating Cross-border Transactions

Form local base in key OIC member economies

Wide coverage of Sovereign Ratings in OIC Countries

IIRA – Primary Objectives

- IIRA provides ratings for all types of issuers and issues through a value added methodology that incorporates the element of Shari'ah governance in all of its ratings through its “Fiduciary Ratings”
- IIRA's Fiduciary Ratings appeal to the diverse needs of investors, with greater information regarding institutional financial strength, in addition to governance infrastructure, while giving specific coverage to Shari'ah governance

IIRA's Fiduciary Ratings

- How are Fiduciary Ratings differentiated from conventional ratings?
 - Two-dimensional assessment – recognizes the mutually dependent nature of credit & Fiduciary risks in an IFI
 - ❖ Poorly governed institutions – may be more susceptible to the risk of credit failure
 - ❖ Credit event could be triggered by perception regarding Shari'ah Governance
 - Credit ratings may be faced with downward pressure on account of developments in terms of fiduciary capacity

- Market participants recognize the need of investors to discern the level of compliance with generally accepted standards
- Hence a standard focused on providing such information
- Encapsulates all areas of coverage laid out in GSIFI 10 to be finalized shortly
- Comprehensive guidance for best practices, resulting in a continuously evolving framework of governance for Islamic financial institutions.

IIRA' Shari'a Rating Standard Objective

- The Standard and methodology envisages the institutionalization of a system of review of IFIs' adherence to Shari'ah related guidance and standards.
- Issues an independent opinion
- The final output in the form of an Alpha-numeric symbol is indicative of the rank order classification of a financial institution in terms of compliance of and fulfillment of the Fiduciary responsibilities of Shari'ah based investing.

**Rating
Outcome**

- The fundamental objective of ratings is to evaluate the process of compliance to a pronouncement, as put in place, more than evaluate the ‘correctness’ of the underlying structure itself.
- IIRA further evaluates Islamic financial services or products of an institution against a ‘hierarchy of standards of Compliance’, being ‘international’, ‘local’ or ‘institution’ level
 - International best practices
 - Country level guidance
 - institutional approvals or guidance

Hierarchy of Compliance

Scope

- Best practices remain universal; ratings will be benchmarked to international best practices (save in areas where regulations or commercial law bars an institution from instituting such practices).
- In terms of product structure and design, where permitted practices are notably weaker than internationally relevant guidance, ratings may be relatively lower rating than those of an institution which follows international best practices.
- Rating evaluation is conducted annually to capture both positive and adverse developments on a timely basis

- Reflects a combined assessment of an IFI's relative state of compliance, duly reflected on a rating scale, with standards, regulations and best practices (collectively called benchmarked practices) with regard to
 - (A) Compliance with Shari'ah principles and rules
 - (B) Shari'ah Governance Framework
 - (C) Corporate Governance Practices
 - (D) Transparency and Disclosures
 - (E) Ethics and Values
 - (F) Fiduciary Responsibility and Performance.

Key Parameters of Assessment

Compliance with Shari'ah principles and rules-

- A.1 Compliance with Shari'ah principles and rules in terms of product structure,
- A.2 Adherence to approved structures and policies as also evidenced in the generation of non-halal income as a consequence of inconsistent implementation of A.1 above,
- A.3 Asset Manager Quality, i.e. quality of business generated and avoidance of unnecessary risk backed by a sound, business screening process, reflected in risks and return characteristics vis-à-vis peers.

Shari'ah Governance Framework

- B.1 Empowerment, Independence, Competence and Integrity of Providers of Shari'ah Guidance through Shari'ah Supervisory Board and Management engaged in the enabling of Shari'ah compliant finance,
- B.2 Organization wide acceptance and respect for faith based finance,
- B.3 System of checks and balances through internal and external audit, enabling the roll out of Shari'ah principles in business.

**Key Pillars
described**

Corporate Governance framework

- C.1 Empowerment, Independence, Competence and Integrity of Leadership to enable a system for protection of rights of stakeholders including unrepresented shareholders, and most significantly investment account holders
- C.2 System of Internal Control enabling A.3 and C.1 above

Transparency and disclosure

- D.1 Disclosure of practices and performance through published and web based media,
- D.2 Investor engagement and in particular communication with takaful participants in Takaful firms and investment account holders in Islamic banks, by recognizing the difference in nature of claim of investment account holders in IFIs vis-à-vis that of depositors in conventional banks.

**Key Pillars
described**

Ethics and Values

- E.1 A code of ethics and values should be adopted at all levels within the organization,
- E.2 An appreciation of environmental and social ecosystems as a tenet of faith based investing should be incorporated in investment screening processes,
- E.3 Entity level adoption of practices that respect the environment and social causes.

Fiduciary Responsibility and Performance

- F.1 Methods employed for distributing returns,
- F.2 Comparison of returns or losses transferred to investors.

**Key Pillars
described**

AAA (SCFR) –conforms to the highest level of standards in terms of fulfilling fiduciary obligations of Shari’ah compliant Finance AA (SCFR)

AA (SCFR) - Conforms to very high level of standards in terms of fulfilling fiduciary obligations of Shari’ah compliant Finance

A (SCFR)–conforms to high level of standards in terms of fulfilling fiduciary obligations of Shari’ah compliant Finance

BBB (SCFR) –conforms moderately to standards in terms of fulfilling fiduciary obligations of Shari’ah compliant Finance and has few weaknesses in some areas of Shari’ah compliant Finance

BB (SCFR) –conforms to satisfactory level of standards of Shari’ah requirements and has notable weaknesses in some areas of Shari’ah compliant Finance.

B (SCFR)– Does not conform adequately toS hari’ah requirements and has notable weaknesses in several areas of Shari’ah compliant Finance

Rating Definitions

- On the panel of approved rating agencies of IDB
- Recognized as an External Credit Assessment Institution (ECAI) by:
 - Central Bank of Bahrain (CBB)
 - Central Bank of Jordan (CBJ)
 - Banking Regulation & Supervisory Agency (BRSA), Turkey
 - Central Bank of Sudan (CBoS)
- Recognized as an External Credit Rating Agency (ECRA)
 - Astana Financial Services Authority (AFSA), Kazakhstan
 - The Securities and Exchange Commission of Pakistan (SECP)
- IIRA is also an approved rating agency by the National Insurance Regulatory Authority, Sudan
- IIRA is also licensed to operate as a rating agency in Sultanate of Oman

Regulatory Recognition

- Rating Committee consists of
 - Core members
 - Shari'a experts.

All members are completely independent with no conflict of interest

- IIRA's website www.iirating.com makes full disclosure regarding its ownership, management, rating methodology for all its services and rating scales and definitions

**IIRA's
Competitive
Edge –
(Cont'd.....)**

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YOU**



NATIONAL RESEARCH
UNIVERSITY



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HSE – Skolkovo Institute
for Law and Development

Boosting Russian
agricultural exports
and securing food supply
to Islamic countries through
Islamic finance mechanisms

PROJECT BACKGROUND



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Challenges

- Oligopolistic structure of the global food market
- Important role of speculative forces
High dependence on stock exchange trade controlled by speculative capital
- Lack (high cost) of long-term investment and lending for small and mid-sized farmers in Russia
- Legal complexities of obtaining a loan for small and mid-sized farmers in Russia
- Decreasing marginality of Russia's agricultural sector
- Underdeveloped export infrastructure in Russia
- No link between producer and exporter
- Segments which are the most capital intensive and most volatile get smallest profits, and vice versa

Boosting Russian
agricultural exports
and securing food
supply to
Muslim countries

Opportunities

- High demand for food security in Islamic countries
- Availability of uncommitted financial resources in Islamic countries, esp. from conservative investors (e.g., family offices)
- Demand for more stable and less speculative relations with food suppliers, based on the principles and values of Islamic law
- Demand for cheaper grain by eliminating unnecessary middlemen
- Expansion of grain production in Russia subject to stable funding
- Conformity of Russian grain with the quality standards set for Muslim countries' social programmes
- Opportunity to develop new logistic routes to Muslim countries (a range of alternative solutions, including the North-South international transport corridor)

PROJECT GOAL AND OBJECTIVES

Goal

Establish long-term sustainable partnership mechanisms for the supply of Russian agricultural produce to Muslim countries using partnership financial instruments based on the principles of Islamic law



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Objectives

- Lay the groundwork for long-term sustainable financing of Russia's agricultural production and exports
- Contribute to Islamic countries' food security
- Build up food reserves jointly controlled by project participants, which can serve as a collateral for the securities to be issued as part of the project
- Implement partnership financial instruments on the world agricultural market
- Establish new pricing mechanisms in the global food trade
- Build long-term relations Islamic investors
- Develop cross-border logistics infrastructure in Russia and in food importing countries, jointly owned and controlled by project participants

GLOBAL PROBLEMS OF THE AGRIFOOD MARKET. HUNGER



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Agriculture is affected by climate change.

+

According to FAO, with demand for grain reaching 2.7 bn tonnes in 2030, grain production will only be as low as 2.1 bn tonnes.*

=

FAO’s forecast for combating global hunger is overly optimistic.



Tightening competition



Higher demand

In the near future, the global food system will be under an unprecedented pressure:

- 01 Tightening competition for land, water and energy.
- 02 Population growth to more than 9 bn people by 2050; according to World Bank, global demand for food is projected to increase by around 70% with estimated extra investments of \$80 bn/year needed to meet it. **

||

We are concerned that, after many years of decline, global hunger increased in 2016 and now affects 815 million of the world population, and that about 2 billion people suffer from micronutrient deficiencies.

*2018 Declaration of the G20 Meeting of Agriculture Ministers**

People suffering from hunger in the world (FAO), mln people

Region	2000	2010	2020
South Asia	180	240	300
East Asia	360	400	420
MENA	70	40	40
Latin America	70	60	50
Africa	170	160	50

||

This is the third consecutive year that progress in ending hunger has stalled and now hunger has actually increased (in 2015, 2016 and 2017).

*FAO Director General
José Graziano da Silva*

*[FAO, 2018]. ** [Maram Ahmed].

OLIGOPOLISTIC STRUCTURE OF THE GLOBAL FOOD MARKET



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A few companies (ADM, Bunge, Cargill, Louis-Dreyfus, Glencore, etc.)

- dominate the global food market
- have departed from the original business model of buying and selling food and have come to resemble 'value chain managers' involved in food production, processing, distribution, financing and investment*
- operate within an oligopolistic global grain market and exert major influence on the world food system, posing a risk to the welfare of consumers**
- traders' vertical and financial integration is tightening with horizontal integration expanding (entering new markets)***
- Russia being #1 exporter globally and having 10% of world's arable land, there are no major Russian players in this circle



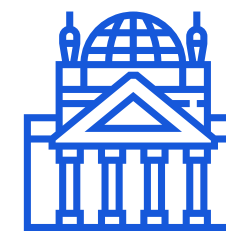
This may have contributed to the
'Arab Spring' events****



imposing prices
and terms on smaller
producers



affecting
people's access
to food****



unstable political
and social environment
in food importing countries



LDC.
Louis Dreyfus Company

BUNGE

Cargill™

GLENCORE

* Clapp J. (2015). ABCD and Beyond: From Grain Merchants to Agricultural Value Chain Managers // Canadian Food Studies — Special Issue: Mapping the Global Food Landscape. 2015. Vol. 2. No. 2, p. 129.

** Park H.-I., Kang H.-C., Kim H.-N., Lim S.-H., Moon W.-S. (2011). New Food Security Strategies in the Age of Global Food Crises // Samsung Economic Research Institute Monthly Focus. 2011. No. 4, p. 5.

*** Clapp, 2015, p. 129–130.

**** Clapp, 2015, p. 130–131.

***** Lybbert T.J., Morgan H.R. (2013). Lessons from the Arab Spring: Food Security and Stability in the Middle East and North Africa // Barrett C.B. (ed.). Food Security and Sociopolitical Stability. Oxford University Press, 2013, p. 366.

SPECULATIVE PRICING



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Commodity prices are increasingly influenced by factors that have nothing to do with physical reserves, while there is at least a short-term impact on food prices as a result of increased financial speculation.*



Increasing financialization of commodity production with hedge funds, private equity funds and others investing directly in land and agricultural production.**



Wheat price and supply volatility (driven by, e.g., financialization, consolidation of TNCs trading wheat, etc.) negatively affect importing MENA countries, which have to work with traders to offset short domestic food supply with imports.***



Most banks finance grain from the moment it is on board of a vessel in an export port, while its domestic production and storage is not or insufficiently financed, giving even more leverage to a small range of trading companies

* Murphy S., Burch D., Clapp J. (2012). Cereal Secrets: The World's Largest Grain Traders and Global Agriculture // Oxfam Research Report. 2012, p. 27–29.

** Ibid., p. 36.

*** Ahmed G., Hamrick D., Gereffi G. (2014). Shifting Governance Structures in the Wheat Value Chain: Implications for Food Security in the Middle East and North Africa // Center on Globalization, Governance and Competitiveness at the Social Science Research Institute. 2014, p. 22.

SPECULATIVE PRICING



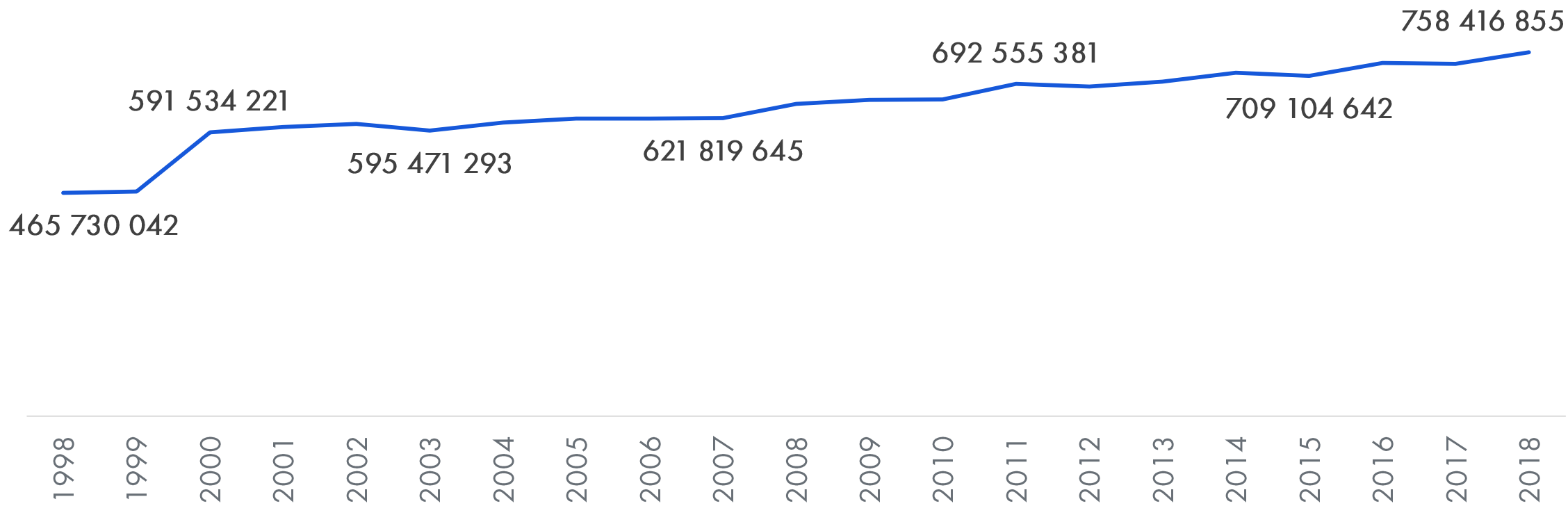
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World wheat prices, 1998-2018



World wheat consumption, 1998-2018



Data on wheat price (wheat, No.1 Hard Red Winter, ordinary protein, Kansas City): IMF Primary Commodity Prices
Data on wheat consumption: OECD-FAO Agricultural Outlook 2018-2027

GRAIN PRODUCTION IN RUSSIA. EXPORT POTENTIAL



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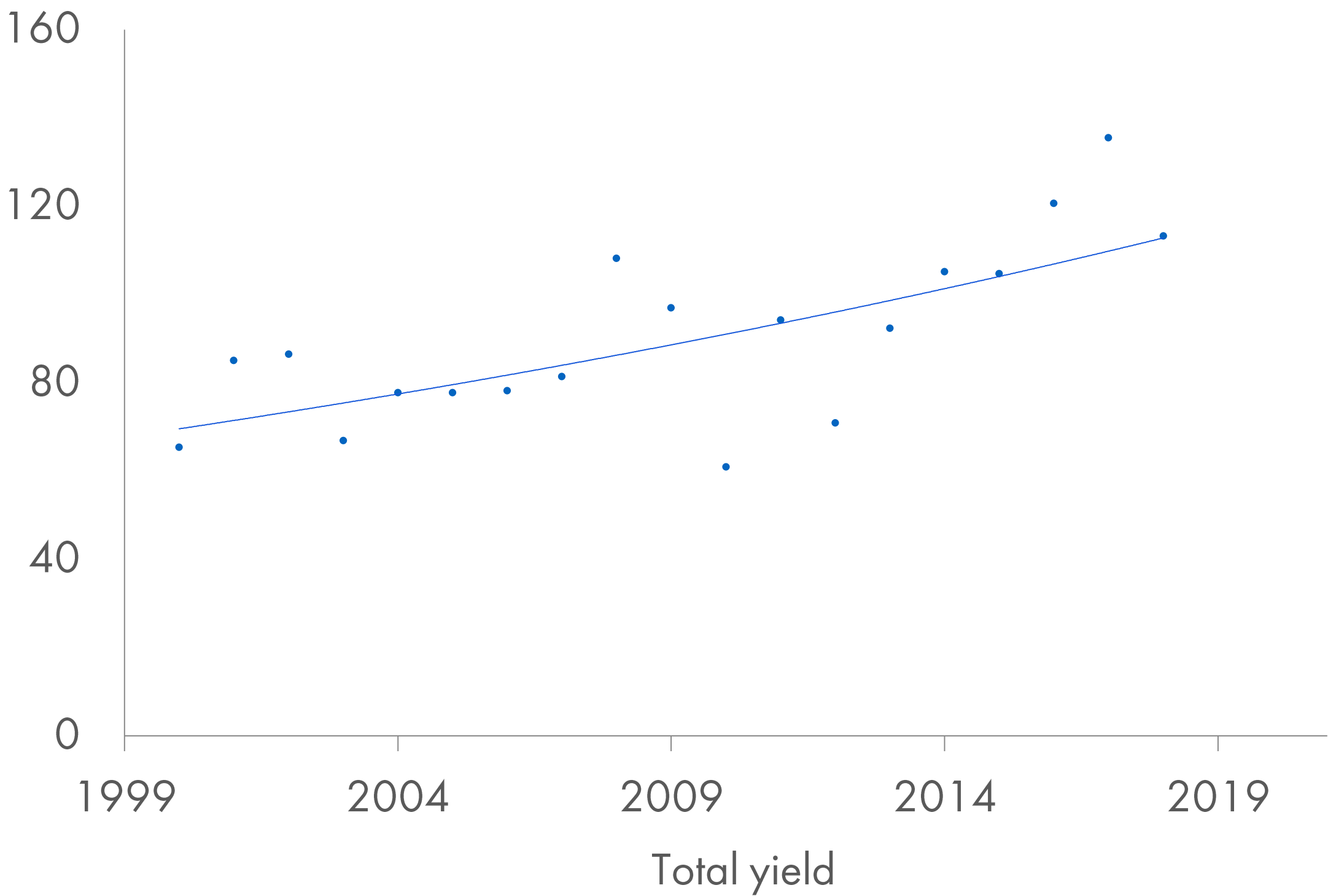


President Putin’s May 2018 Decree:
Agricultural exports to reach \$45 bln in 2024
(from \$24 bln in 2018)

With its vast expanses of arable land in areas where climate is conducive to crop farming, Russia is well positioned to be a key supplier of grains to the world markets. Over the last 20 years, the country has achieved a two-fold increase in grain production (from 65.4 mln tonnes in 2000 to 135.3 mln tonnes in 2017) and has converted from a net importer to a net exporter of grain.

Today, Russia’s potential for both intensive and extensive growth in this area is far from being exhausted.

Total yield of grains and pulses, mln tonnes



GRAIN PRODUCTION IN RUSSIA. EXPORT POTENTIAL

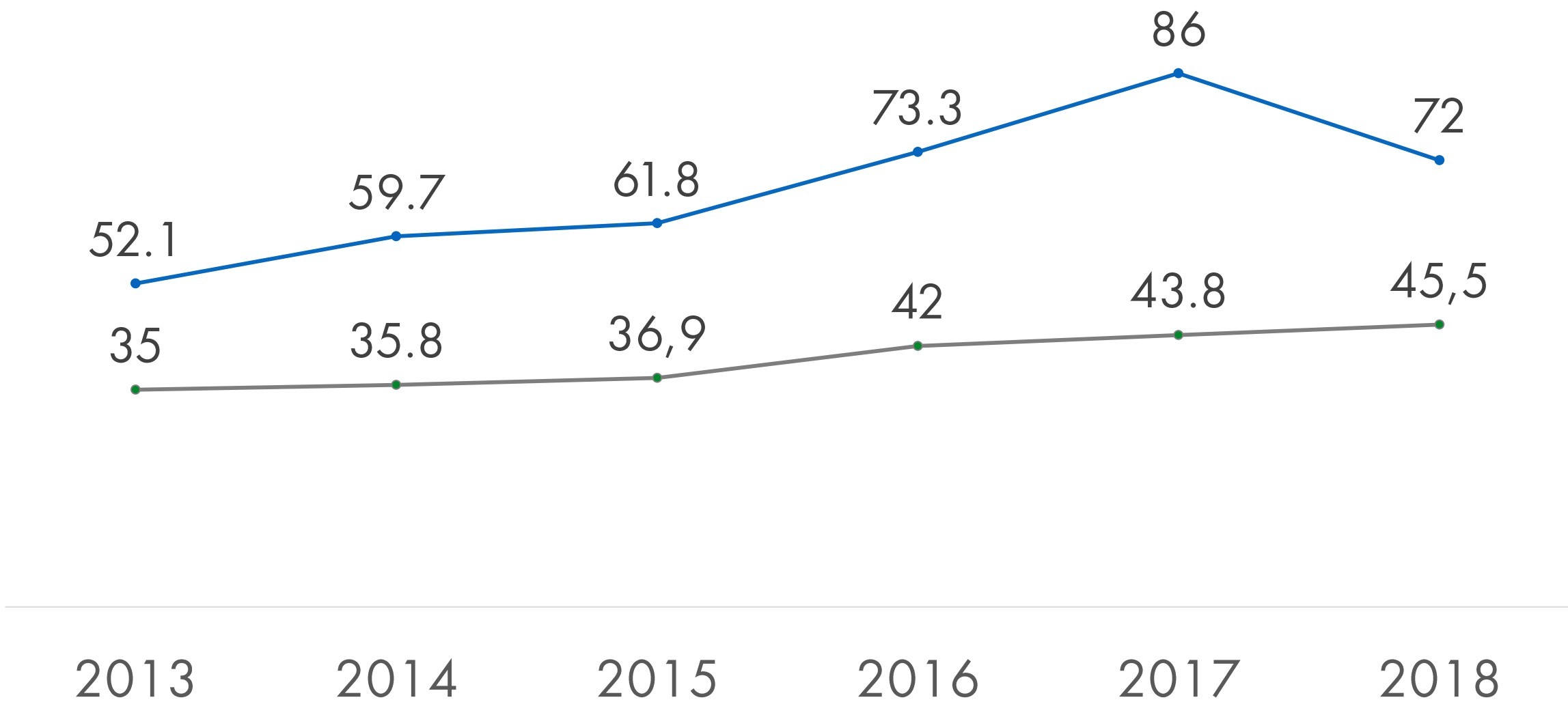


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According to some expert estimates, Russia’s grain sector has the potential to produce up to 100 mln tonnes of grain in excess of domestic consumption and to establish itself on the world market as a leading supplier of grain.

Gross yield and domestic consumption of wheat, mln tonnes



Gross yield (Rosstat)
Domestic consumption (IKAR, ProZerno (for 2018))

NEW MARKETS



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- Afrika – 7,2 mln t
- Vietnam – 2,6 mln t
- Bangladesh – 1,8 mln t
- Indonesia – 1,4 mln t
- Philippines – 1,1 mln t



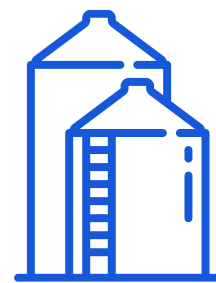
AGROFINMOST PROJECT CONCEPT



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Create a **grain security fund** in one of the Gulf countries

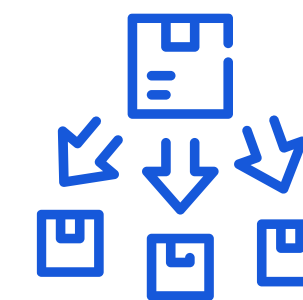


Raise capital using the fund as the underlying asset.



Invest the proceeds in the Russian agricultural sector by **advancing working capital to Russian grain producers** and engaging in other income-generating activities:

- Management of grain reserves outside Russia;
- Management of other assets;
- Grain trading on spot basis;
- Grain trading on deferred payment basis.



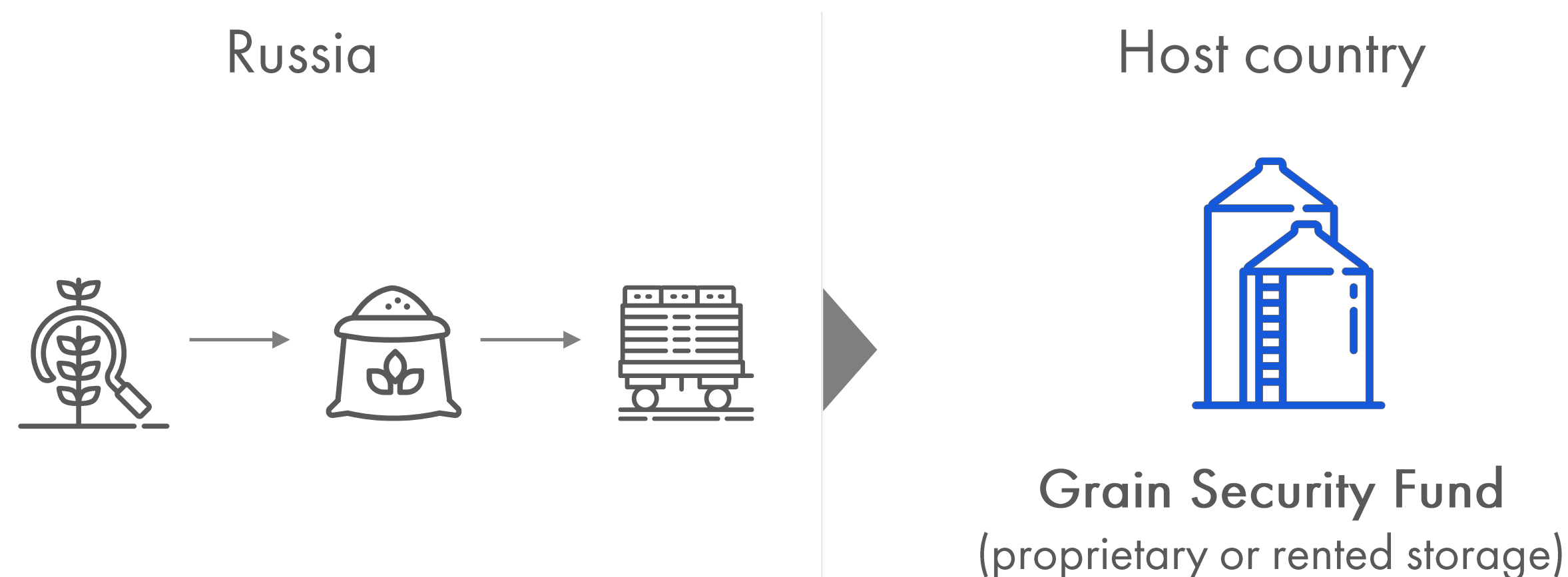
Incorporate the grain security fund in the supply chain of a food processing cluster outside of Russia.



GRAIN SECURITY FUND OUTSIDE OF RUSSIA

The main function of the fund is to **secure grain supplies to the consumers** of the region:

1. When a trigger event arises (disruption of grain supplies, shortage of grain, price exceeding a threshold level, etc.), the fund is used to ensure an uninterrupted supply of grain to the public of the host country and a broader region.
2. At other times, the fund is in constant circulation: it may be sold for processing, etc. Grain that has been disposed of is replaced with new supplies.
3. In any event, a pre-determined minimum stock level is maintained at all times.
4. This minimum stock defines the value of the fund, against which financial instruments may be issued.

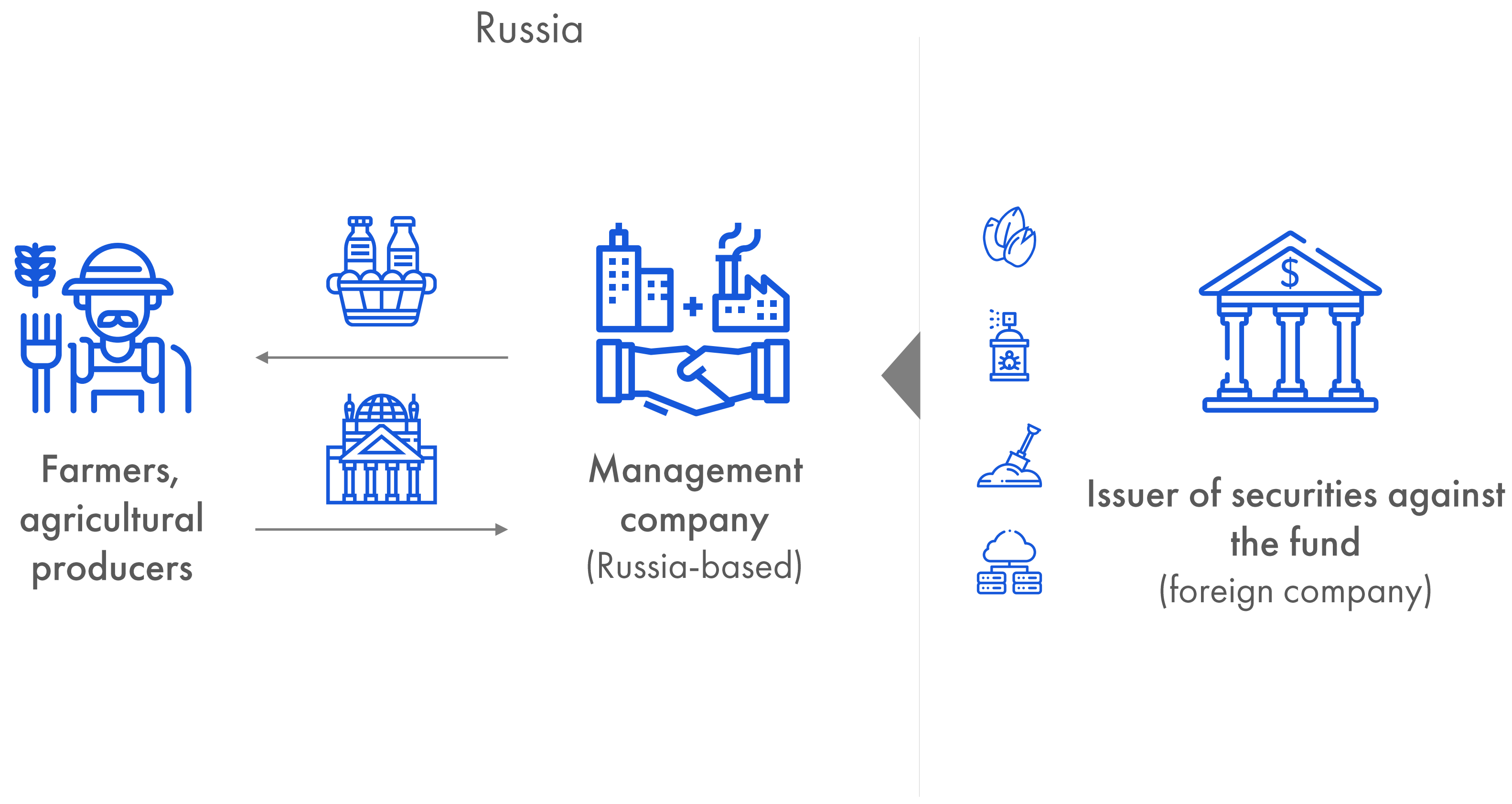


Setting up the fund in a location outside of Russia:

1. Improves grain **availability** for the consumers in the region: the grain from the fund can be shipped for consumption within a short period of time.
2. Increases the value of the grain and transforms it into an **asset** against which capital can be raised.
3. Levels out the export cycle by **smoothing peak loads** on the transport and logistics infrastructure.



ADVANCING WORKING CAPITAL TO FARMERS



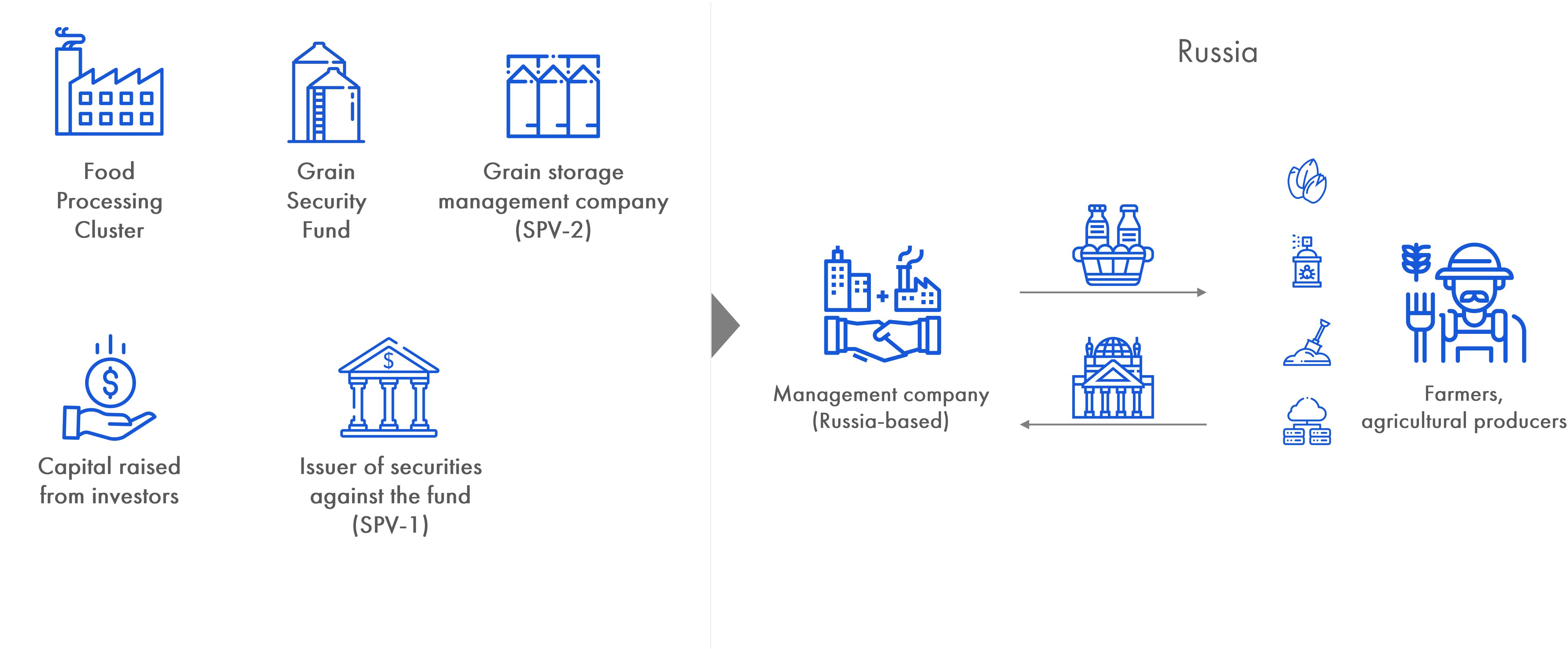
The capital raised against the fund is used to **advance working capital to Russian ag grain producers:**

1. The foreign issuer of securities transmits the capital to the Russian management company as advance payment for future grain
2. The management company advances to grain producers (under a deferred delivery contract):
 - High-yield grains
 - Agrochemicals
 - Fuels
 - Fertilizers (blends)
 - Digital services
3. On maturity, the grain producers supply grain of stipulated quality to the management company

GENERAL PROJECT CHART



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AGROFINMOST PROJECT CONCEPT (1/2)



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■ Stage 0

Preliminary agreements with potential project partners,
investors and contractors.
Legal formalities

■ Stage 1

Grain Security Fund

Implementation:

1. Purchase ca. 0.5 mln t (~\$100 mln worth) of wheat on the spot market and place it in a storage facility outside of Russia
2. Establish a grain security fund, define its rules of operation, including:
 - The minimum stock level;
 - The stock rotation method (FIFO);
 - A contract for physical protection of the stock with an independent security services provider.
3. Potential host countries: Egypt, Turkey, Lebanon, UAE, Iran



AGROFINMOST PROJECT TIMELINE (2/2)

- **Stage 2** Capital raising outside Russia (SPV-1)
The grain security fund to serve as the underlying asset of the issue.
Pilot issue size: from \$200 to \$500 mln.

Income generating activities:

- Advancing of working capital to Russian grain producers
- Spot purchases of Russian grain and its sale in importing markets
- Grain storage and processing plants in importing countries (Egypt being the first target country)

Potential guarantees for investors :

- Minimum balance of grain security fund
- Government guarantees
- Personal guarantees of producers
- Producers' land
- Joint responsibility and common assets of cooperatives

- **Stage 3** Further project expansion



Income generating activities for SPV-2

ISLAMIC FINANCE: POTENTIAL ROLE IN BOOSTING GRAIN EXPORTS (1/2)



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Benefits of Islamic financial instruments

- 

Countries of the Islamic world are among the key importers of Russian agricultural produce
- 

Islamic investors are interested in humanitarian supplies of food to the region to secure social peace
- 

Opportunity to attract a wide range of investors from destination countries, including the most conservative ones
- 

Broader range of investors, including Islamic and conventional ones
- 

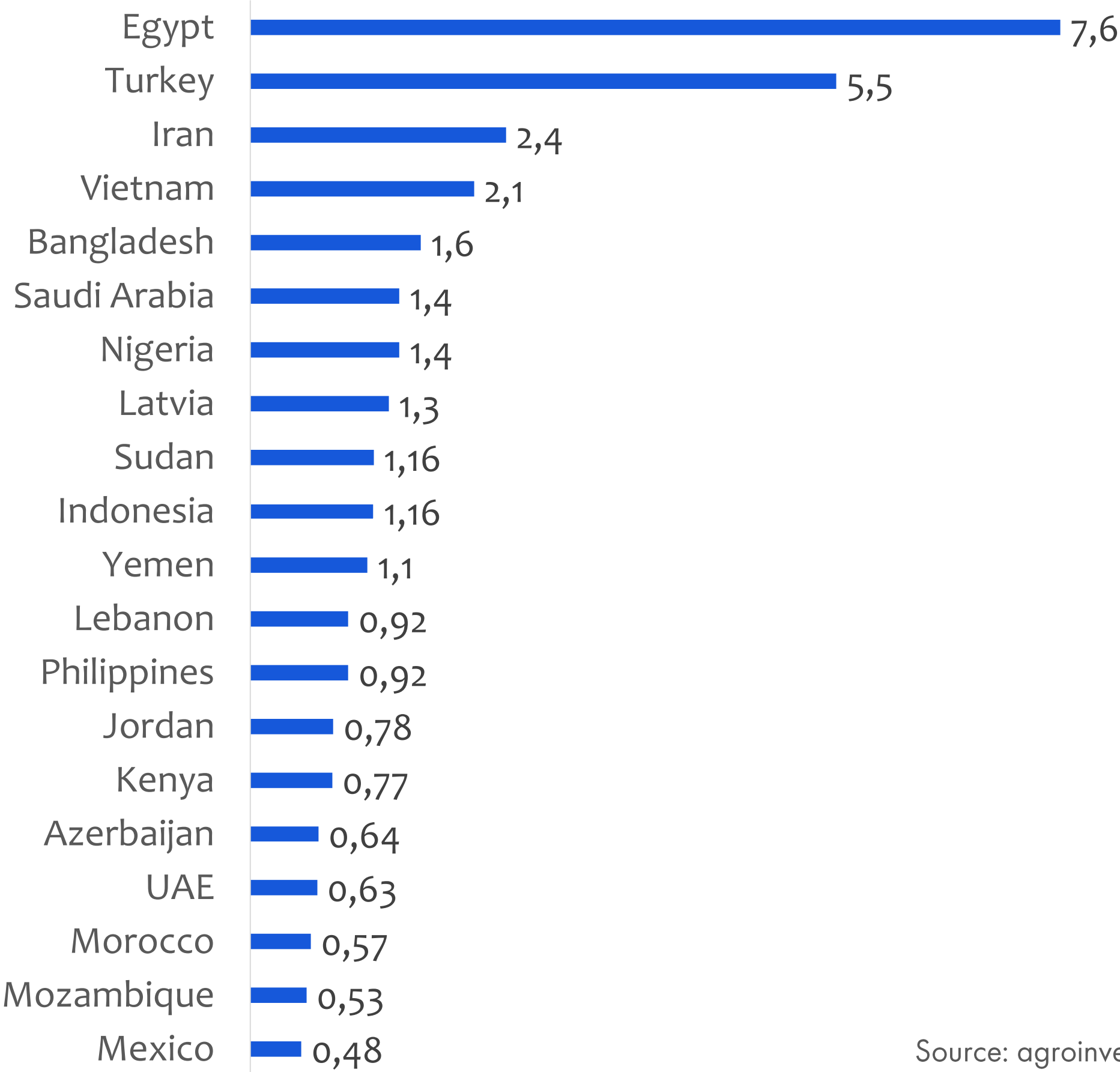
Broad spectrum of instruments that can be used depending on transaction objectives

II

The main export destinations are Middle East countries (including Egypt, Saudi Arabia, Iran, Lybia, etc.)

from a presentation of Novorossiysk Grain Products Company (Russia)

TOP 20 importers of Russian grain (mln tonnes, 2018/2019 season)



Source: agroinvestor.ru

ISLAMIC FINANCE: PARTNERSHIP AND REAL ASSETS



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Universal human values at the core



Prohibition
on interest



Prohibition
on speculation
and speculative instruments



Prohibition on excessive
uncertainty in transactions
(including derivatives)



Real asset-based
contracts



Principles common
to all world religions
and universal human morals

SOME FORBIDDEN AND DISLIKED ELEMENTS IN CURRENT COMMODITY TRADING



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PHENOMENON & ARABIC TERM

Riba (ربا) Usury

- Interest based financing
- Repo transactions

Gharar (غرر) Uncertainty with regards to one of the contract pillars:

- sale of unidentified and non-quantified goods
- sale with voidable condition
- sale without stipulating certain price
- other types of gharar (see below)

Short selling (بيع قبل القبض) and other types of unsecured transactions:

- sale of goods before possessing it
- sale of good before they appear
- future and forward selling

Maysir (ميسر) Gambling

Approaching the sellers (producers) before they enter the city (market)
(تلقى الجلب) (makrooh)

Najash (نجش) Use of the information asymmetry in order to speculate with the price (makrooh)

Ihtikar (إحتكار)

Buying out and retaining products that results in raising prices

CONSEQUENCE IN COMMODITY TRADING

Companies use commodity repo transaction in order to get short term financing

High level of uncertainty related to price and terms of delivery of food commodities.

Selling of grain before possessing it is a popular transaction on the market

Traders are speculating on price on commodity exchanges resulting in price violation, including the use of derivatives

Huge difference in ex-works and FOB price, the food producers are unable to take part in commodity food trading at large markets

Sometimes small producers are unaware of real market price of the products

Some traders buy out and hold food commodities during the upward price trend that results in raising prices

FORBIDDEN

DISLIKED (SINFUL)

RUSSIA ON THE ISLAMIC FINANCE MARKET



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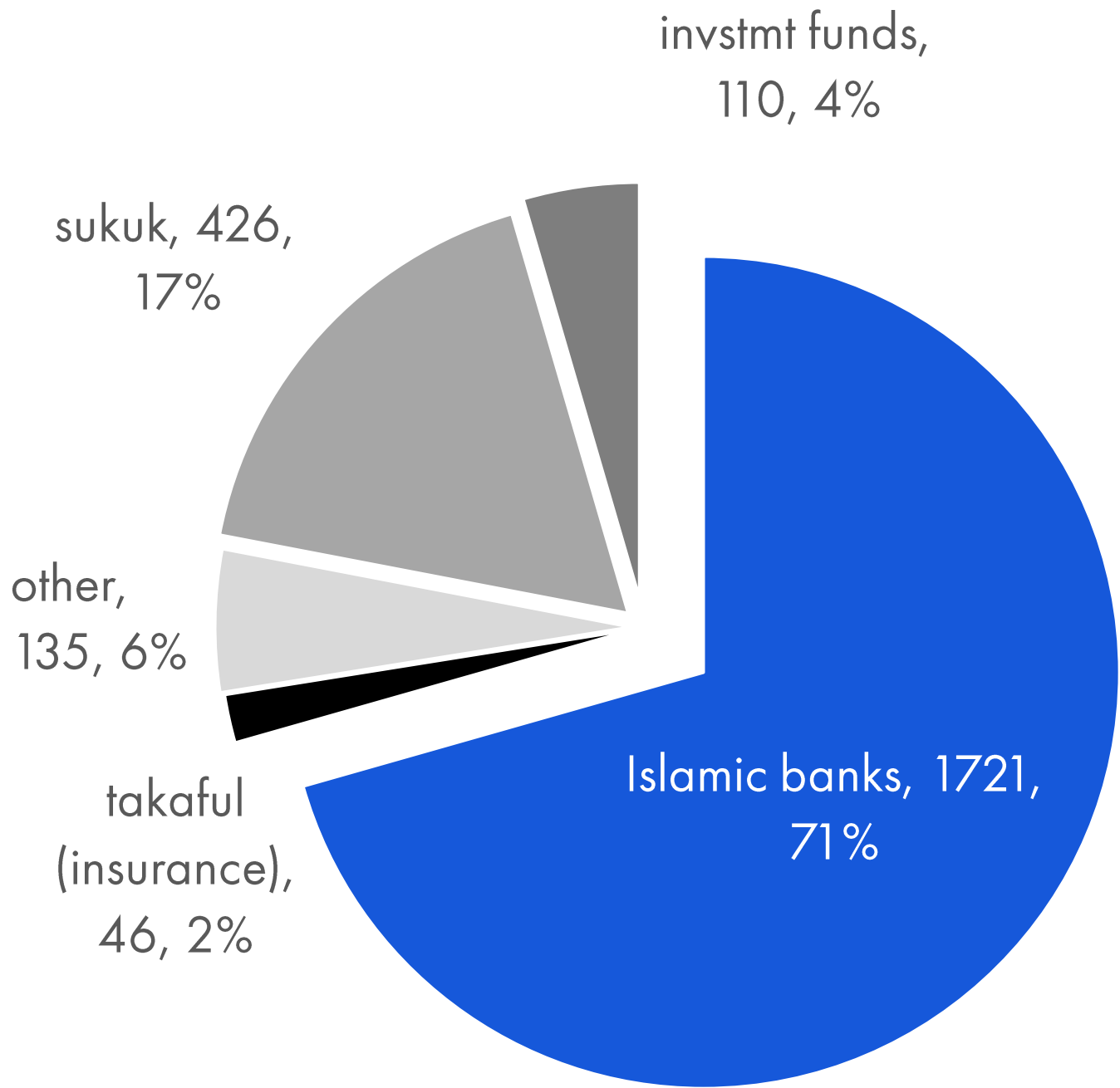


Islamic finance in the world

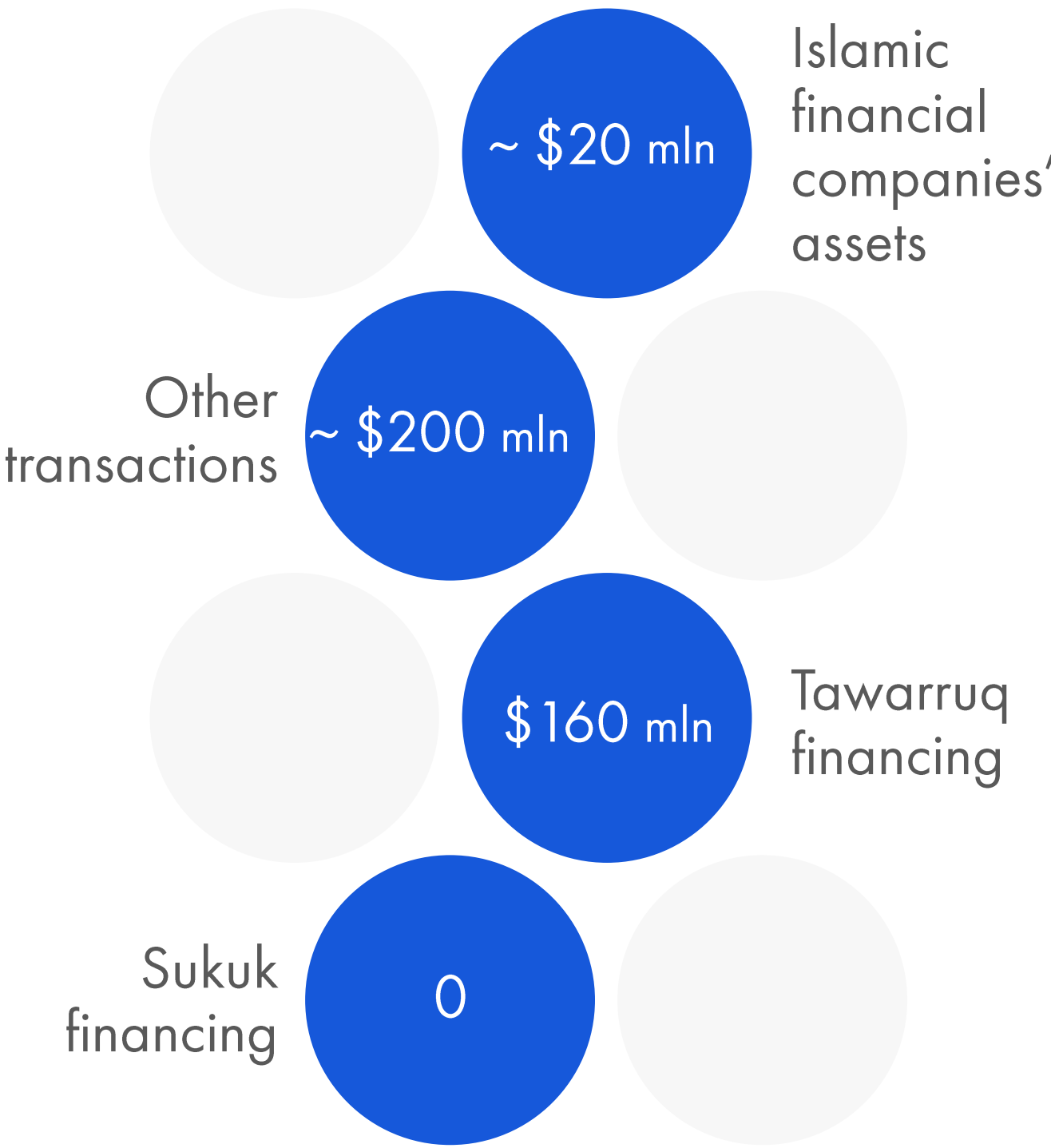
Parameter	World
Assets of Islamic banks	\$1,765 bn
Nr of Islamic financial companies	1,407
Total worth of sukuk	\$426 bn
Nr of sukuk outstanding	2,590
Total worth of funds managed	\$110.1 bn
Nr of Islamic funds	1,410
Regulation of Islamic finance	-
Nr of Sharia scholars	1,162
Rating as per published reports	33.11
Educational programmes	688
Research works	2,542

Source: HSE, based on zawya.com 2017 data

Islamic finance assets, \$bn (world)



Russian market: untapped potential?



Source: HSE, based on RAEIF 2017 data

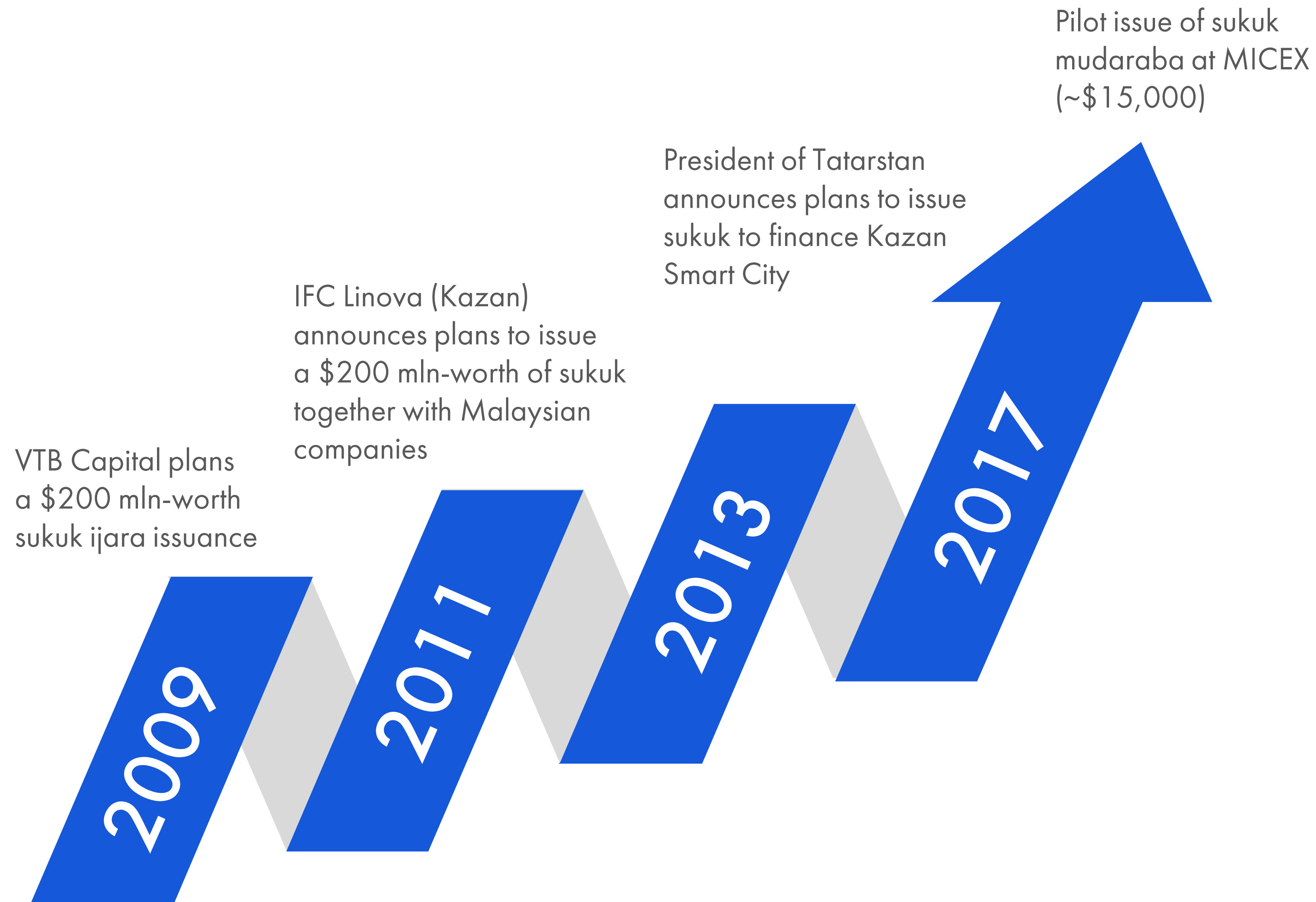
SUKUK IN RUSSIA: LACK OF SUSSESSFUL STORIES



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SUKUK IN RUSSIA: MARKET OVERVIEW

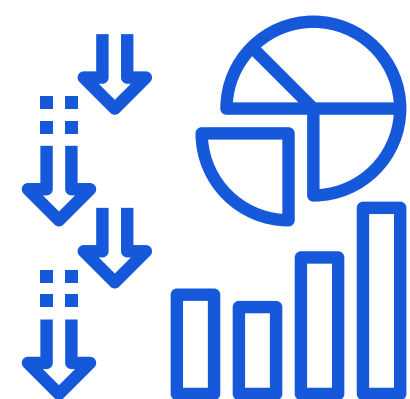


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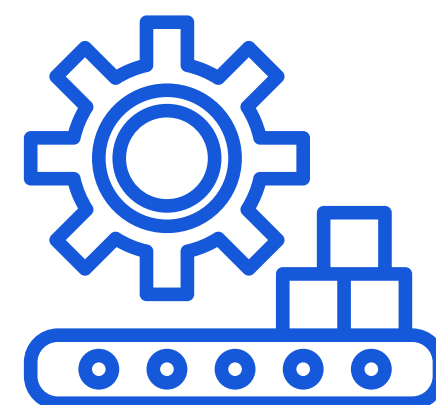


page 36

Why Russia lacks positive experience on the sukuk market



General decline
in investor activity due
to 2007-2008 crisis



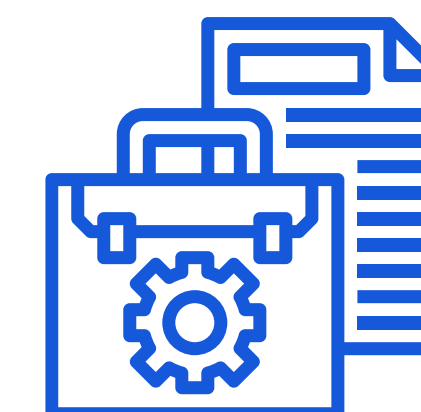
The sukuk structures
were not mature
enough until recently



Lack of stable cross-cultural
communication between
Russia and the Islamic world.
Deficit of trust



Lack of positive history
of interaction with conservative
Islamic investors



Scarcity of projects
strategically interesting
to investors



SELECTION OF SUKUK STRUCTURE

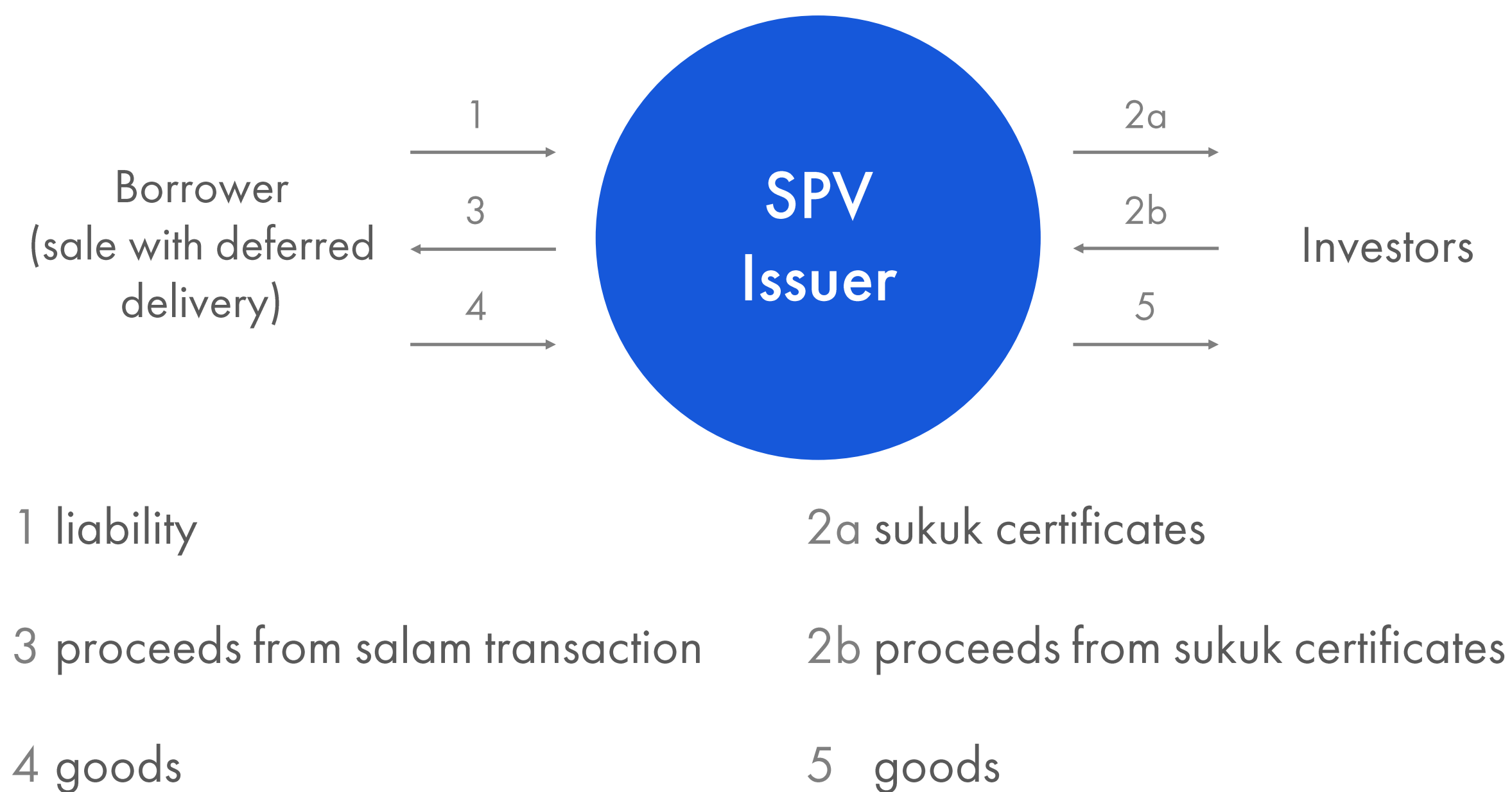
Structure	Type of income	Tradable
Sukuk Salam	fixed	no
Sukuk Murabahah	fixed	no
Sukuk Musharakah	not fixed	yes, if no less than 33% of sukuk assets are illiquid assets
Sukuk Mudarabah	not fixed	yes, if no less than 33% of sukuk assets are illiquid assets
Sukuk Istisna	pre-determined pricing formula	yes, after the asset has been produced
Sukuk Wakalah al-Istithmar	pre-determined pricing formula	yes, if no less than 33% of sukuk assets are illiquid assets

Source: AAOIFI (2017), Standard No. 17 ‘Investment Sukuk’

FINANCIAL AND INVESTMENT TOOLS: SUKUK SALAM*

The issuer of such certificates ('food bonds' or 'agribonds') sells goods to buyers, i.e. sukuk subscribers, on deferred delivery terms; the proceeds from subscription constitute the purchase price (**salam** capital) of the goods.

The holders of **sukuk (investors)** are the owners of the goods and are entitled to the sale price of the goods.



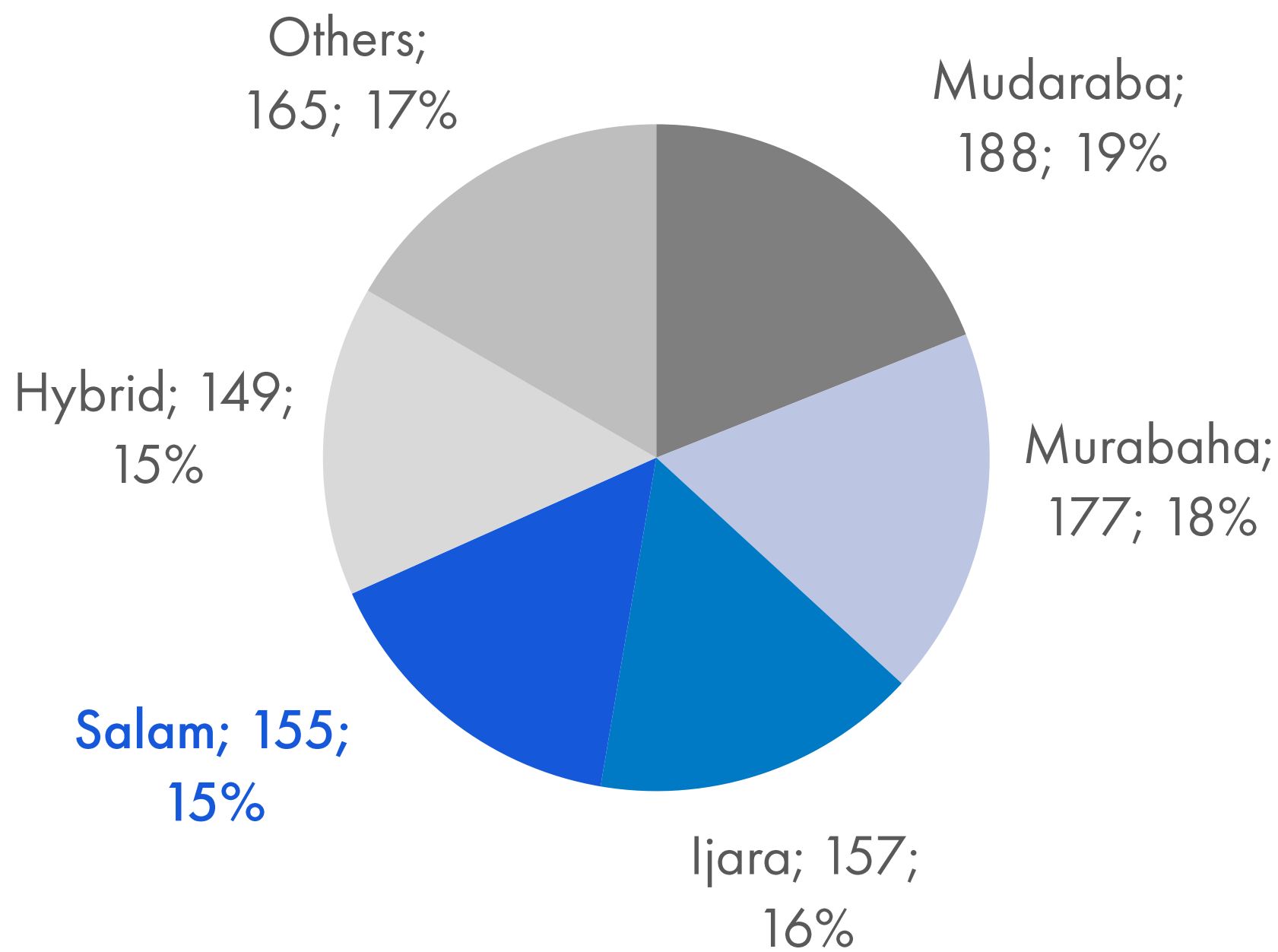
Source: AAOIFI Sharia standards



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Types of sukuk, nr of issues, 2017



Source: Thomson Reuters

* This is but one example of a sukuk transaction structuring. In practice, sukuk may as well be based on other contracts, including hybrid ones.

FINANCIAL AND INVESTMENT TOOLS: SUKUK MUSHARAKA*

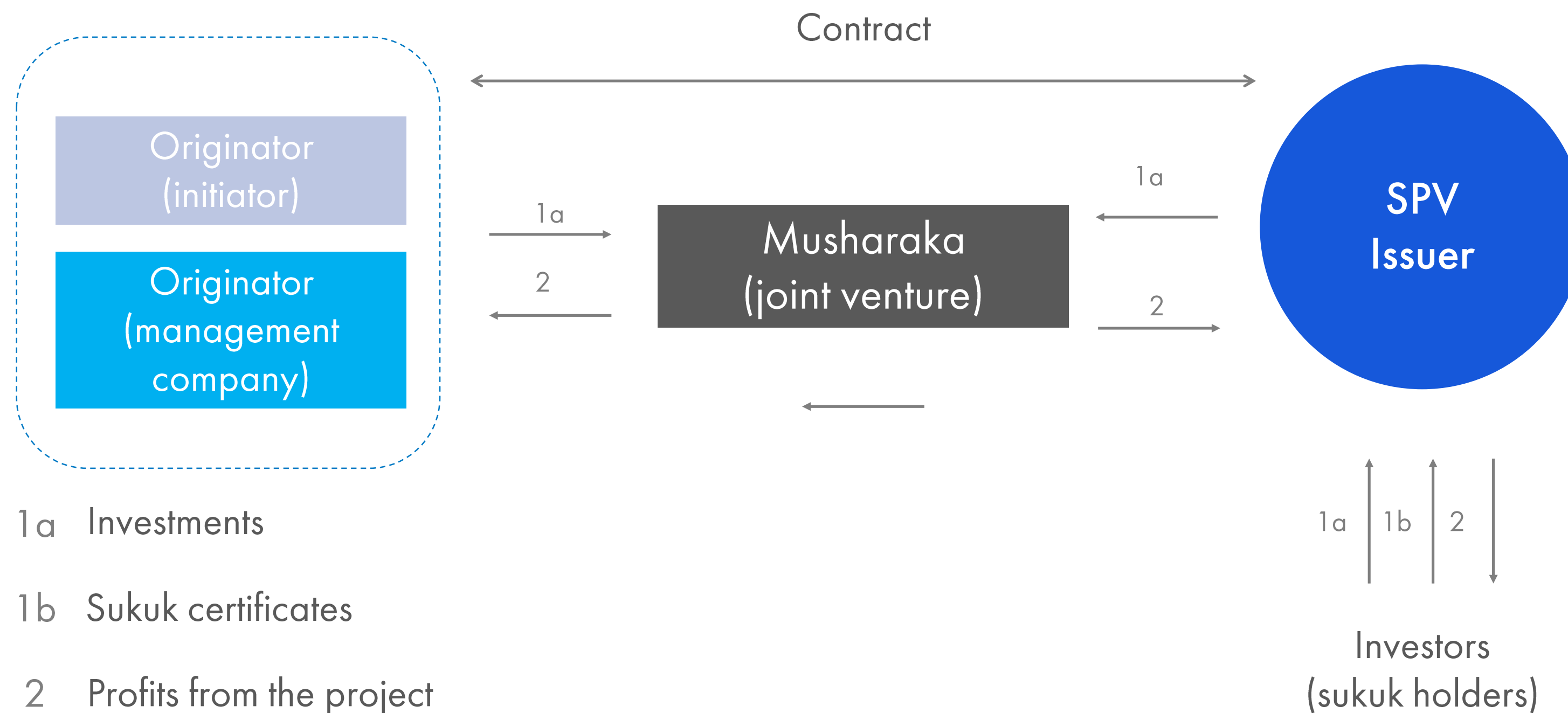


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Equal value certificates, issued for using the funds received to establish a new or develop an existing project on the basis of any of the partnership contracts. The certificate holders become the owners of the project or of the assets of the activity as per their respective shares. The musharaka certificates are structured on the basis of participation, or fiduciary management, or an investment agency.



Benefits of sukuk musharaka structure

- Sukuk musharaka certificates **can be traded** on the secondary market (unlike, e.g., sukuk salam)
- **Moderate risks** for the investors
- **More options for deal** structuring depending on contract and project specifics

FINANCIAL AND INVESTMENT TOOLS: SUKUK WAKALA BIL ISTITHMAR



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Participation certificates managed on the basis of investment agency

The issuer of these sukuk is an investment agent, the subscribers are the principals and the realised funds are the subject matter of investment under an agency agreement. The holders of sukuk own the assets represented by the certificates with its benefits and risks and are entitled to profits from the partnership, if any

Share of Sukuk al Wakala in different issuances by issue size, 2018 (international issues)

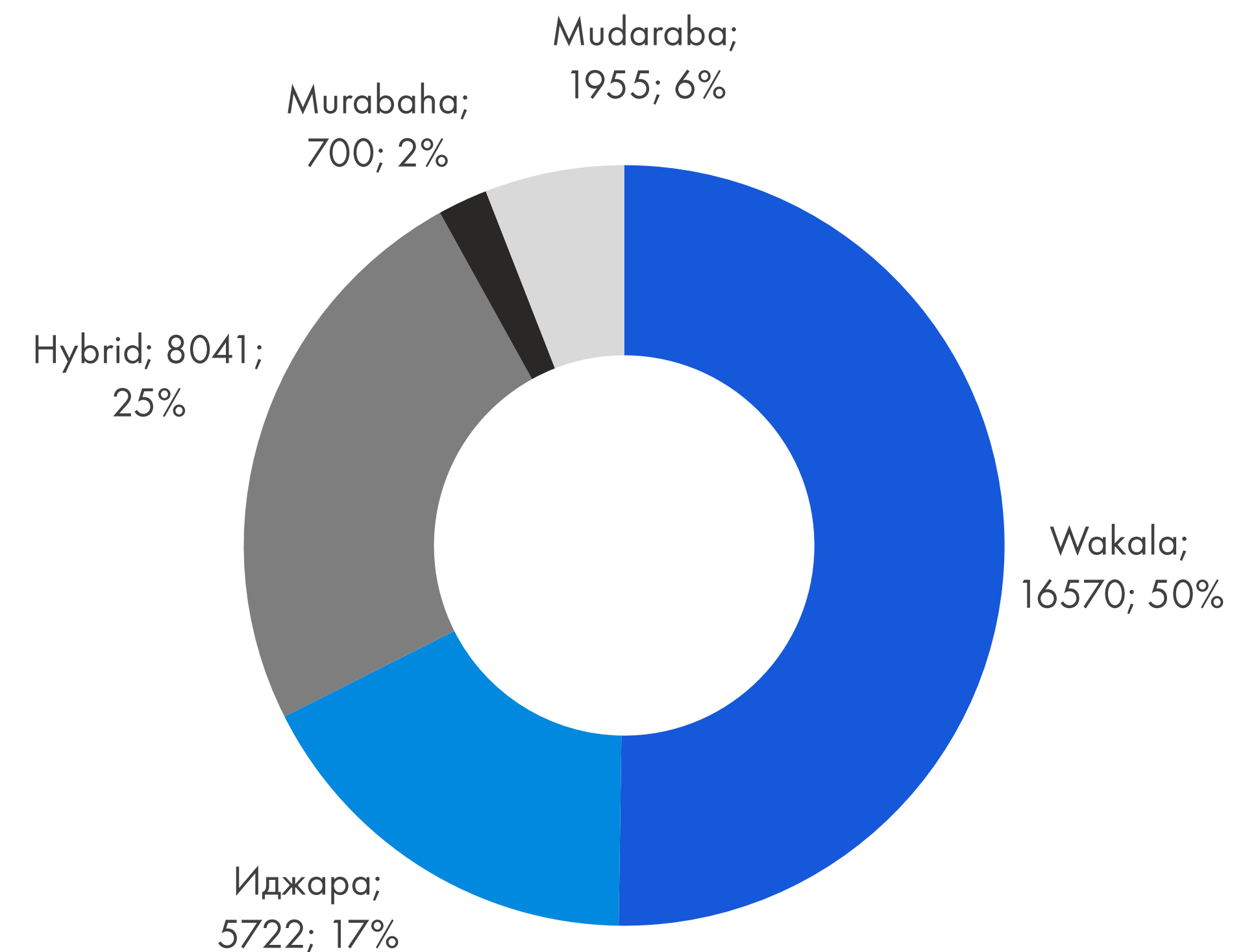
- Sovereign issuances – 34% (top 1)
- Quasi-Sovereign issuances – 92% (top 1)
- Corporate issuances – 31% (top 2)2
- Islamic financial companies' issuances – 25% (top 1)

Sukuk wakala issuances in 2018 (individual landmark issuances):

- IDB (3 issuances)
- Central Bank of Qatar (4 issuances)
- First Abu Dhabi Bank (1 issuance for 650 mkn USD)
- Noor Bank, Dubai (1 issuance for 500 mln USD)
- Medco Power, Indonesia (1 issuance for 426 mln USD)
- .

Source: IIFM, 2019

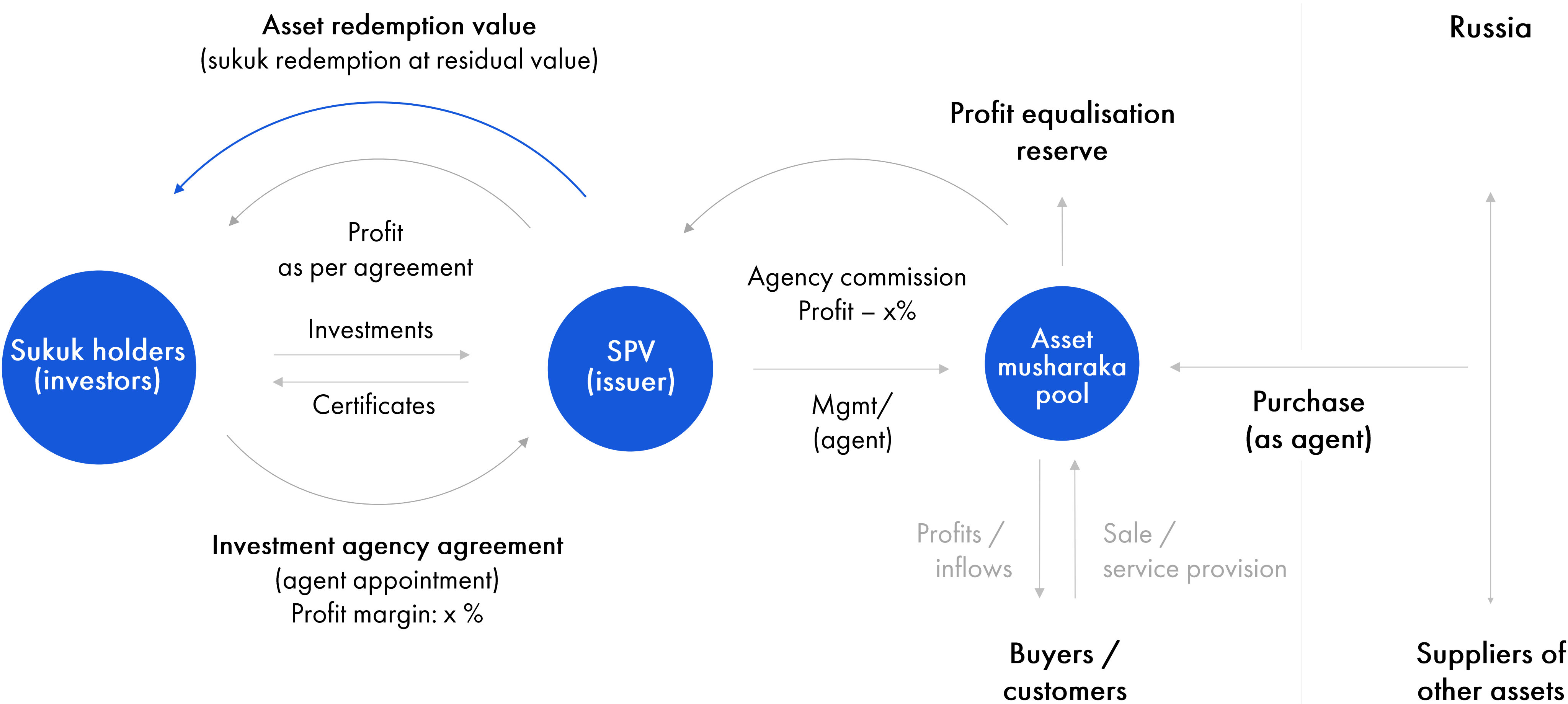
International sukuk issuances, mln USD, 2018



SUKUK STRUCTURE FOR AGROFINMOST (WAKALA BIL ISTITHMAR)



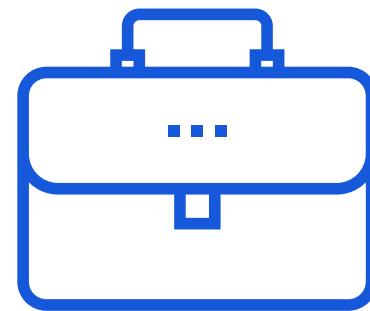
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NOTES ON SUKUK STRUCTURE (1/3)

Investment agency agreement



Sukuk holders appoint a management company as an agent to set up and manage the investment portfolio (asset pool). The contract must specify the nature of the assets, e.g.:

- Real estate
- Property to lease out
- Goods for sale (e.g., grain)



The investment agent must ensure that the asset time ratio is maintained: illiquid assets must be above 33% of the portfolio. (All cash and receivables are liquid assets)



The income generated by each asset type in the portfolio is divided between investors and the management company.

The management company:

- is entitled to all the profits in excess of the pre-determined rate stipulated in the contract;
- receives a fixed agency fee.

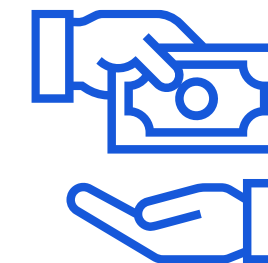


NOTES ON SUKUK STRUCTURE (2/3)

Lease asset management



Such assets, together with other illiquid assets, are purchased under an Asset Purchase Agreement. They must represent 33% or more of the portfolio value (for sukuk to be tradeable on the secondary market: AAOIFI Standard 21, item 3.19)



Upon maturity of sukuk, the assets are bought out from sukuk holders at residual value under an **Undertaking to Purchase (UTP)**



After purchase, such assets are leased out under a **Lease Agreement**. The size of lease payments must meet a pre-define criterion



If the assets were purchased from the issuer (the borrower) and then leased back to the issuer, at the end of the lease the issuer repurchases it, then minimum period of lease must be 1 year (as per AAOIFI standards)

NOTES ON SUKUK STRUCTURE (3/3)



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Current asset management (grain)

The proceeds of the sukuk issue are invested in grain trading contracts (no more than 67% of contract price).



- The management company seeks to achieve the pre-determined profit margin stipulated in the business plan and agreement. If the actual profits exceed the pre-determined margin, the company may keep the excess profits (fixed agency fee plus incentive).
- Every six or four months (depending on the documentation), the management company makes distribution of profit to investors. After financial statements are out, the disbursements are reassessed. Reserves can be created to adjust any variation at the end of the year.

SUKUK ISSUE DOCUMENTATION



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Investment agency agreement
(between Investment Agent
and Participants)



Lease agreement
(between Investment Agent and
Sukuk Issuer)



Agency agreement
(between Investment Agent
and Sukuk Issuer)



Undertaking to Purchase
(by Sukuk Issuer)



Asset purchase agreement
(between Investment Agent
and Sukuk Issuer)



**Security documents,
guarantees**

CONTACTS



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مؤتمر أيوفي - البنك الدولي السنوي الرابع عشر

التحولات الجذرية في منظومة المالية الإسلامية الدولية

الحاجة إلى الحوكمة والمعييرة والدعم الرقابي

3-4 نوفمبر 2019

عملية اتخاذ القرارات الشرعية

د. عبدالباري مشعل

الشريك المدير - شركة رقابة (أمريكا)

مقدمة

تتناول هذه الورقة إضاءة مختصرة للمسودة الأولية غير المعتمدة من معيار الحوكمة رقم 12 بشأن عملية

اتخاذ القرارات الشرعية والدراسة الأولية للمعيار وبعض الدراسات الأخرى ذات الصلة.

وقد هدف المعيار إلى صياغة إطار عمل لعملية اتخاذ القرارات الشرعية في المؤسسات المالية الإسلامية

بغرض تنميط الممارسات حول العالم. هناك جانبان في هذه العملية، الأول: إصدار الفتوى وهو الذي تمت

تغطيته بالمعيار الشرعي رقم 29 بشأن ضوابط وأخلاقيات الفتوى، والثاني: ضوابط الحوكمة الخاصة بالحصول

على الفتوى وتطبيقها، وهي موضوع معيار الحوكمة رقم 12.

والدافع لهذا الموضوع أن عملية اتخاذ القرارات الشرعية تنطوي على مخاطر متعددة، ولذا فإن هذا المعيار يتضمن توجيهات تفصيلية بشأن تحسين العلاقة بين هيئة الرقابة الشرعية وإدارة المؤسسة المالية الإسلامية وتعزيز التعاون بينهما في هذا الشأن.

ويشمل نطاق المعيار؛ المجالات التي تصدر بشأنها القرارات الشرعية، الاعتبارات الجوهرية التي يجب مراعاتها في اتخاذ القرارات الشرعية، عملية تطوير المنتجات، دور ومسؤولية أجهزة الحوكمة المختلفة المتدخلة في هذه العملية، آليات تطبيق وتبليغ إطار العمل المقدم في هذا المعيار.

1. مجالات القرارات الشرعية:

1.1. اعتماد المنتجات: يفرق المعيار بين نوعين من المنتجات:

1.1.1. المنتجات النمطية الخاصة بالمؤسسة نفسها، وهذا تتطلب النظر الشرعي في الآتي كحد أدنى:

مذكرة عرض معد من القسم الشرعي الداخلي، مراجعة شرعية للاتفاقيات المعتمدة من الإدارة القانونية بالمؤسسة، مراجعة شرعية للجوانب المالية، مراجعة شرعية لنظام المعلومات الآلي، ومواد التسويق، ومراجعة شرعية لأدلة العمل ذات العلاقة.

1.1.2. المنتجات غير النمطية المعتمدة من من هيئات شرعية أخرى، مثل الصكوك والتمويل الجماعي

ومشروعات الاستثمار، وغيرها، وهذه تتطلب النظر الشرعي في الآتي: مراجعة الهيكل والمستندات ذات العلاقة، أو المصادقة على الفتوى المصدرة الهيئة الشرعية الأخرى.

1.2. الاستفسارات: يفرق المعيار بين نوعين من الاستفسارات:

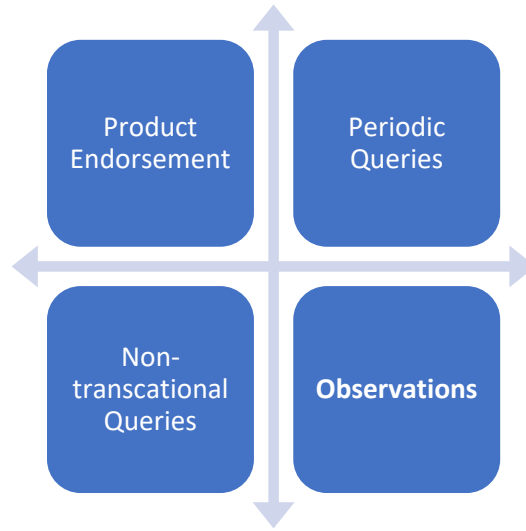
1.2.1. استفسارات خاصة بالمعاملات.

1.2.2. استفسارات لا علاقة لها بالمعاملات:

- استفسارات مالية، مثل تطبيقات المحاسبة، سياسة المخصصات، حساب الزكاة، التصرف في حساب الخيارات، تعديل مبلغ الضرائب، وغيرها.

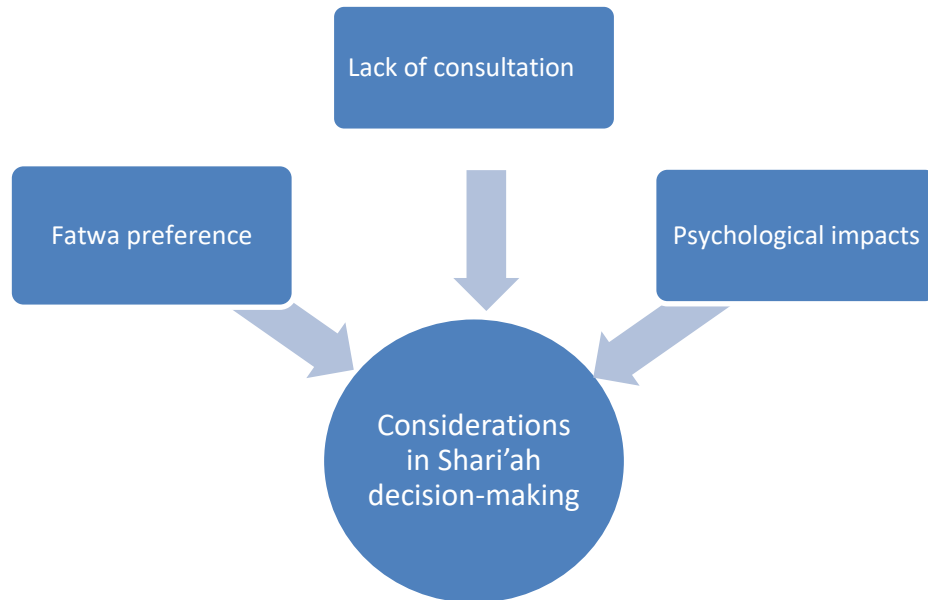
- استفسارات غير مالية، مثل مواد التسويق، الموارد البشرية، أنشطة العلاقات العامة.

1.3. التحفظات الشرعية: الهيئة الشرعية تنظر في هذه التحفظات للتوجيه بتصحيحها ومعالجتها، وعلى الهيئة الشرعية أن توجه المؤسسة لتبني منهجية، أو إجراءات خاصة لتجنب مخالفة الشريعة.



2. الاعتبارات الجوهرية في اتخاذ القرارات الشرعية:

يجب على هيئة الرقابة الشرعية أن تأخذ في الاعتبار العوامل التي تؤدي إلى إمكانية اتخاذ قرارات غير مرغوب فيها يمكن أن تؤثر على مخرجات القرارات الشرعية وقد تؤثر سلباً على أهداف المؤسسة بصفة عامة. وتشمل هذا الاعتبارات التي ينبغي تجنبها:



2.1. Fatwa preference: البحث عن فتوى محددة مسبقاً والانتقاء من الجزئيات والفروع الفقهية ما

يتلاءم مع الفتوى المرغوبة (the arbitrage should be avoided)،

2.2. Lak of consultation: وجوة فجوة معلومات بين الأطراف ذات العلاقة بسبب ضعف الاتصال

الفعال الأمر الذي قد إلى مخاطر رفض الفتوى (fatwa rejection) من قبل المؤسسة. ولتجنب هذه

المخاطر يجب تجنب الآتي:

2.2.1. الآراء الضعيفة والشاذة.

2.2.2. عدم تضمين الفتوى التفاصيل المطلوبة للمستثمرين.

2.2.3. فشل الهيئة الشرعية للمستثمر (مؤسسة أخرى) في الإحاطة بالعمليات أو الهياكل الموصوفة

في الفتوى لغياب الشرح الملائم أو تضمين مفاهيم واعتبارات غير مقبولة.

2.2.4. عدم أخذ الاعتبارات الدينية والقانونية والعملية بشكل كاف، وظهور الفتوى بأن تصورات نظرية

لا علاقة بواقع الأسواق.

2.3. Psychological Impacts:

2.3.1. على الهيئة الشرعية أن تتجنب التأثيرات النفسية التي يمكن أن تؤدي إلى التحيز في اتخاذ

القرارات الشرعية المختلفة على مستوى المنتجات والاستفسارات والملاحظات. وتعد هذه التأثيرات

بمثابة مصادد خفية (hidden traps) لمتخذ القرار الشرعي. وتعالج هذه المخاطر الخفية

ينبغي تطوير مهارات التحليل الشرعي النقدي (skills of critical Shari'ah analysis).

2.3.2.



2.3.3. وتعد هذه التأثيرات بمثابة مصائد خفية (hidden traps) لمتخذ القرار الشرعي. وتعالج هذه

المخاطر الخفية ينبغي تطوير مهارات التحليل الشرعي النقدي (skills of critical Shari'ah

analysis). ووفقاً للتحليل النقدي ينبغي للهيئة الشرعية مراعاة الاتي:

- تجنب قبول التصور الأولي، وبذل الجهد في التصور الصحيح من خلال تحقيق المناط في المسألة المعروضة،

- تقييم وتحليل كل الخيارات المتاحة وعدم التخوف من الاجتهاد ومخالفة التطبيقات السائدة، وتجنب الركون للوضع القائم.

- عدم الاقتصار على المعلومات الأولية وطلب بحوث إضافية من أمانة الهيئة أو إدارة الالتزام الشرعي،

- ولا بد من مراجعة الفتاوى المبكرة التي صدرت في ضوء حقائق وظروف طرأ عليها التغيير،

- وعدم تتبع الأقوال بغرض تأييد رأي محدد مسبقاً،

- وعدم الخضوع لتخويف الإدارة بحدوث الخسائر أو فقدان الأرباح،

- وأخيراً يجب على الإدارة عدم ربط قرار الهيئة مهما كان نوعه بأي أحداث مصاحبة وإبرازه كسبب له.

- ويساند في تخفيف هذه المخاطر تحقق الاستقلالية وتجنب تعارض المصالح في كل وظائف

الحوكمة، ومنهجية تطوير المنتجات ومدى مراعاة مقاصد الشريعة وأهداف التنمية المستدامة،

وسياتي بيان ذلك.

3. تطوير المنتجات

3.1. عملية تطوير المنتجات (PDP) Product development process

3.2. بعض المخاطر التي تؤثر على القرارات الشرعية تعود إلى غياب عملية تطوير منتجات في

المؤسسة. لتخفيض المخاطر يجب أن تعتمد نموذج شامل لتطوير المنتجات: من توليد الأفكار -

التصميم - الموافقة الشرعية - الاختبارات - التسويق - التنفيذ - التغذية الراجعة.

3.3. اعتبارات التنمية المستدامة من خلال مقاصد الشريعة Consideration of SDGs through

Maqāṣid Al-Shari'ah

ينبغي تشجيع المؤسسات المالية الإسلامية على مراعاة الأهداف 17 للتنمية المستدامة الصادرة عن

الأمم المتحدة، هذه الأهداف تشمل تطوير الأبعاد الاجتماعية والاقتصادية والبيئية وغيرها، وهي تتفق

مع أهداف ومبادئ الشريعة الإسلامية. ومن الملائم وضع إطار لدمج هذه الأهداف ضمن مقاصد

الشريعة التي تحكم عمليات المؤسسات المالية الإسلامية.

4. دور ومسؤوليات أجهزة الحوكمة المتدخلة في اتخاذ القرارات الشرعية

4.1. هيئة الرقابة الشرعية:

4.1.1. ينبغي اتباع منهج التحليل الشرعي النقدي لتخفيف المخاطر، والمصائد الخفية، التي من شأنها

أن تؤثر سلبًا على عملية اتخاذ القرارات الشرعية، كما سبق بيانها من قبل.

4.1.2. ويضاف إلى ذلك تحقق الاستقلالية وعدم تعارض المصالح في جميع أعضاء هيئة الرقابة

الشرعية بمن فيهم العضو التنفيذي، وعلى سبيل المثال تجنب ما يأتي: تقديم الاستشارات الشرعية، التدريب، الحصول على تمويل بمزايا تفضيلية، علاقة القرابة من الدرجة مع كبار المسؤولين أو المدراء التنفيذيين، وتجنب مشاركة العضو في التصويت أو حضور الاجتماع في موضوع يهدد الاستقلالية الخاصة بذلك العضو. ويمنع أن يكون أياً من أعضاء الهيئة موظفين أو مدراء تنفيذيين في المؤسسة، كما يمنع أن يشاركوا في أي قرارات تنفيذية.

4.1.3. يجب أن تتضمن الفتوى في الحد الأدنى ما يأتي: هيكل المنتج مع الشرح المفصل، وملخص

لتدفق العمليات، المستندات ذات العلاقة بالعقود الأساسية، الاستفسار الأصلي أو التحفظات المرفوعة للهيئة، ملخص الأحكام الشرعية والشروط التجارية، الضوابط الرقابية الخاصة بمخاطر عدم الالتزام الشرعي المحتملة، الأساس الشرعي للفتوى المصدرة، التحفظ والمخالفة للرأي إن وجد مع ذكر السبب، وذكر اسم وتوقيع كل عضو.

4.2. أمانة هيئة الرقابة الشرعية:

4.2.1. تستعين الهيئة بجهاز الأمانة أو إدارة الالتزام الشرعي في حال غياب جهاز الأمانة، في

تحضير الدراسات الخاصة بالأعمال المعروضة على الهيئة،

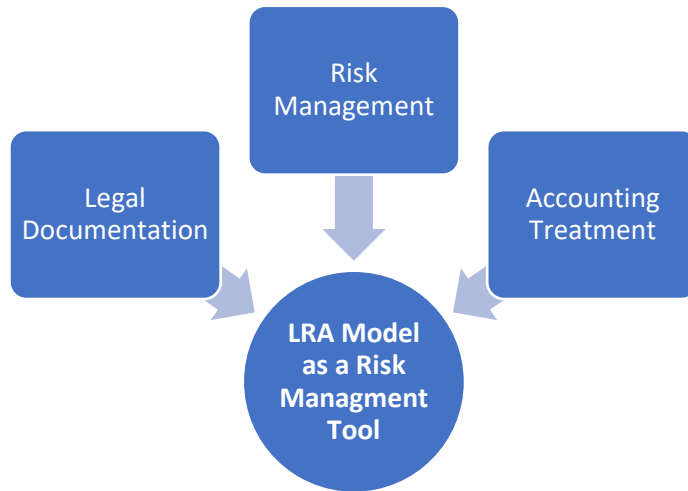
4.2.2. ولتقديم دراسات ملائم لهيئة الرقابة الشرعية يجب على الجهاز المساند تطبيق تقنية إل آر آي

(LRA technique) - (Legal documentation, Risk management and)

(Accounting treatment) لضمان أن القرار الشرعي لم يغفل الجوانب القانونية، المحاسبية،

عملية اتخاذ القرارات الشرعية -د. عبدالباري مشعل

وإدارة المخاطر المتعلقة بعمليات الشركة وسمعتها. ويذكر في الدراسة المقدمة أي تعليمات للبنك المركزي أو للمعايير الشرعية تتعلق بالموضوع محل العرض.



4.2.3. بعد صدور القرار يعود إلى الإدارة القانونية، والمحاسبة، وإدارة المخاطر لفحص وتقييم تأثيره على عمليات المؤسسة، وعلى مستوى التطبيق يجب تبليغ الهيئة بتطبيق القرار أو عدم تطبيقه كلياً أو جزئياً مع بيان الأسباب.

4.3. الإدارة:

4.3.1. لضمان دقة القرار الشرعي، يجب على الإدارة تقديم معلومات صحيحة، وكاملة، وتجنب تقديم

تفسيرات أو إيضاحات حسب تقدير الإدارة ودون الرجوع للجهات المختصة بشأن الموضوع محل

العرض.

4.3.2. توفير التدريب والتوجيه المناسب للأجهزة ذات العلاقة باتخاذ القرار الشرعي،

4.3.3. ولا ينبغي أن تتحيز الإدارة ضد أي مقترح جديد يتحدى التطبيقات السائدة،

4.3.4. تجنب الطلب بإلحاح من الهيئة الشرعية أن توافق على المنتجات والخدمات بسبب أنها أجازت

من علماء وزملاء أو مدارس فقهية أخرى مخالفة، أو مؤسسات منافسة.

4.3.5. تجنب الضغط باتجاه الفتوى المحددة مسبقاً.

4.3.6. وإجمالاً يجب عرض جميع الأعمال على الهيئة.

تم بحمد الله في مطار هانيدا-طوكيو في الطريق إلى كولالمبور.

د. عبدالباري مشعل

2019/10/30



HSE-SKOLKOVO
INSTITUTE FOR
LAW AND DEVELOPMENT



Agrofinmost



Special event

‘Islamic Finance for Food Security: Connecting Russia and Muslim Countries’

held by HSE-Skolovo Institute for Law and Development

chaired by Sheikh Muhammad Taqi Usmani,

with contributions by Shari’ah scholars and Islamic finance industry experts

supported by AAOIFI and in association with Usmani and Co during the

14th AAOIFI — World Bank Conference

‘Revolutionary Changes in Global Islamic Finance Ecosystem: Need for Governance, Standardization and Regulatory Support’

RESOLUTION

Participants of the special event ‘Islamic Finance for Food Security: Connecting Russia and Muslim Countries,’

Taking into account the keynote speech delivered by Sheikh Muhammad Taqi Usmani and the presentation of the Agrofinmost project made by the HSE-Skolovo Institute for Law and Development;

In view of the opinions expressed by and contributions made by attendees;

Having regard to the discussions held as part of the event,

have agreed that:

1. Food security is an urgent concern requiring innovative solutions.
2. The contemporary food trade model is unsustainable, characterized by monopolisation and speculation, and is in conflict with the basic principles of fair trade, incapable of delivering food to all people, as a public good and not as an object of speculation.
3. Alternative models of farmer financing are required that would meet the needs of market participants.
4. Islamic finance instruments, in particular sukuk, may be a viable alternative to industry-distorting instruments, such as speculative futures, and will attract a wider base of investors, including those who focus on ethical investments.
5. The Agrofinmost project and the solutions it proposes have the potential to improve food security of the Muslim countries dependent on food imports.
6. The project proposes a fairer and more equitable model of food trade based on the principles of Islamic financing while safeguarding the interests of food producers and consumers alike.
7. The project has the potential to reduce the cost of food to combat hunger, give the underprivileged rural population broader access to food resources and bring peace to society.
8. The project will set up sustainable trade corridors between Russia, its neighbouring countries and the Muslim world for the benefit of the wider community.
9. Islamic businesses, institutions and governments are encouraged participate in the Agrofinmost project for their own benefit and for that of the Muslim community at large.