POLICY RECOMMENDATIONS OF THE 7th MEETING OF THE FINANCIAL COOPERATION WORKING GROUP

The COMCEC Financial Cooperation Working Group (FCWG) successfully held its 7th Meeting on October 20th, 2016 in Ankara / Turkey with the theme of “National and Global Islamic Financial Architecture: Problems and Possible Solutions for the OIC Member Countries”. During the Meeting, the participants discussed some crucial policy issues in light of the main findings of the research report prepared specifically for the Meeting and the responses of the Member Countries to the policy questions that were sent by the CCO in advance of the Meeting. Accordingly, the working group has come up with the policy advices below.

Policy Advice 1: Developing/ Supporting Legal Framework for Islamic Finance by Reviewing Islamic Financial Laws, Tax Regimes, Dispute Settlement Framework and Bankruptcy Law

Rationale: As financial sectors are bound by laws and regulations, it is vital to support legal infrastructure for different Islamic financial sectors. Various segments of the Islamic financial sector (banking, takaful and capital markets) would need enabling legal environment for their operations and reducing legal risks. Furthermore, there are tax implications for Islamic financial products as they are subject to real transactions such as sale, leasing and partnerships in projects. The tax laws related to income (profit, withholding), transactions (capital gains and stamp duties) and goods and services (value-added tax) need to be adjusted for tax neutrality. Furthermore, as civil courts in most OIC member countries use either the common law or civil laws to settle disputes, there is a need to address the dispute resolution framework for cases involving Islamic finance. Alternatively, arbitration centers can be used for disputes arising in the Islamic financial sector. Finally a bankruptcy legal framework that can deal with insolvencies and resolutions involving the Islamic financial sector is needed to mitigate legal risks.

Policy Advice 2: Developing Necessary Regulatory and Supervisory Institutional Framework for the Islamic Financial Services Industries (IFSI) through Adopting Standards Developed by Islamic Financial Architecture Institutions and Improving the National Framework

Rationale: As the introduction of Shariah principles changes the nature risks and return of Islamic financial transactions compared to their conventional counterparts, the regulatory treatment of the former would be different compared to the latter. As such, there is a need to come up with a sound regulatory framework for Islamic banking, takaful and capital markets. In this regard, the regulatory standards developed by Islamic finance standards setting bodies including IFSB and AAOIFI. In countries in which the Islamic financial sector becomes larger and systematically important, there should be separate regulatory departments/units to deal with the issues arising in the various Islamic financial sectors. To mitigate regulatory arbitrage, the licensing and regulatory requirements of conventional and Islamic financial institutions should be clearly defined and applied.

Policy Advice 3: Establishing a Sound Governance Framework by Introducing the Requirement of Shariah Governance at the Financial Institution Level in Islamic Financial Laws and in Regulations

Rationale: As Shariah compliance is the key distinguishing feature of Islamic finance, there is a need to have a Shariah governance framework to ensure that the products and operations of Islamic financial institutions do not contradict the principles of the Shariah. One of the key elements of ensuring a sound Shariah governance framework would be to make it a legal/regulatory requirement. This can be done by introducing the requirement of Shariah governance at the financial institution level in Islamic financial laws or in regulations. The regulators can come up with specific Shariah governance guidelines that banks are required to follow. Among others, this should include the requirement of Shariah audit to ensure that all the operations of financial institutions are in compliance with Shariah. Furthermore, existence of an independent national advisory body can help harmonize the Shariah rulings and minimize diversity of fatwas that introduces legal and reputational risks. The national advisory board can be established by the regulators. One of the roles of the national level advisory board is to come up with Shariah parameters or standards for different Islamic financial products. This will add to the harmonization of Islamic financial practices within the jurisdiction and also reduce the costs of Shariah governance at the organizational levels.

Policy Advice 4: Enhancing Consumer Protection and Financial Education through Ensuring Full Disclosure in Islamic Finance Contracts and Having Financial Education Programs to Increase Awareness and the Level of Understanding of Islamic Financial Transactions

Rationale: A robust consumer protection regime is necessary for the development of a sound financial system. There is a need to come up with specific guidelines that deal with protecting consumers of Islamic Financial Institutions. As Islamic financial products confer various rights and obligations to different parties of the contract, the laws and regulations must require that these specific rights are protected. Among others, information disclosure on the contracts used and their structures should be disclosed to consumers. As many consumers choose Islamic finance due to religious convictions, one of the key issues in protecting consumers of the Islamic financial sector would be to not only ensure Shariah compliance but its full disclosure. A related issue on the demand side is to have financial literacy programs to increase awareness and the level of understanding of Islamic financial transactions. Islamic financial products are new for consumer in most jurisdictions and there is a need to educate the consumers about the features of these products. Other than introducing the Islamic finance concepts in school and college curricula, different stakeholders such as regulators, financial institutions, and Islamic finance trade associations can use various methods to disseminate knowledge on Islamic financial products and services.

Policy Advice 5: Developing Liquidity Infrastructure for Islamic Financial Sector by Issuing Shariah Compliant Liquidity Instruments, Developing an Active Islamic Money Market and Ensuring Lender of the Last Resort to Offer Shariah Compliant Facilities

Rationale: Most financial institutions require liquidity facilities that they can tap into in cases of need. The liquidity infrastructure can be strengthened by providing Shariah compliant instruments, markets and the facilities for Islamic financial institutions. This would require developing and issuing Shariah compliant liquidity instruments that Islamic financial institutions can use either to place surplus funds or acquire funds when necessary. There may be a need to come up with Shariah compliant liquid instruments that satisfy conditions of High Quality Liquid Assets of the new Basel III liquidity requirements. These liquidity instruments can be issued either by the government or financial institutions. There is also a need to develop an active money market that would use some of these instruments to meet the short-term liquidity needs in an organized way. This platform can be established by the government in the countries where Islamic finance is in the initial stages of development. Finally, Shariah compliant lender of the last resort would be required so that Islamic financial institutions can benefit from the liquidity facility in case of emergencies.

Instruments to Realize the Policy Advices:

COMCEC Financial Cooperation Working Group: In its subsequent meetings, the Working Group may elaborate on the above-mentioned policy areas in a more detailed manner.

COMCEC Project Funding: Under the COMCEC Project Funding, the COMCEC Coordination Office calls for projects each year. With the COMCEC Project Funding, the member countries participating in the Working Groups can submit multilateral cooperation projects to be financed through grants by the COMCEC Coordination Office. For the above- mentioned policy areas, the member countries can utilize the COMCEC Project Funding and the COMCEC Coordination Office may finance the successful projects in this regard. These projects may include organization of seminars, training programs, study visits, exchange of experts, workshops and preparing of analytical studies, needs assessments and training materials/documents, etc.
