

# **CHALLENGES AND PROSPECTS OF ISLAMIC FINANCIAL SERVICES INDUSTRY (IFSI)**

## **Questions for the SCB Majlis**

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I would like to take this opportunity of the presence of such a galaxy of distinguished Shariah Scholars from various parts of the globe to guide us in the process of transition from conventional to Islamic finance by addressing the following ten questions:

1. Islamic Finance (IF) 's characteristics, Unique selling proposition (USP), resilience and a full range of global organizations serving the industry (annex I) provide strong anchors for global financial stability compared to the existing system of international finance which is prone to panics, shocks, and crises. Why there is underachievement? While ESG, Ethical finance and Impact finance are getting traction why IF isn't a choice asset class? Are we ghettoizing IF as faith based asset for Muslims only?
2. As banks redefine themselves as Technology companies and Digital banking and Fintechs provide cost effective solutions, AI drives client onboarding, biometric and other identity recognitions become verification tools, robotics process automation (RPA) for credit limits and applying Machine Learning for predicting credit default become the new SOPs are these in compliance with Shariah precepts or have to be modified for Islamic banks transiting to Digital banking and for Islamic Fintechs?
3. We have investors, issuers, instruments, infrastructure, indices, rating agencies, developed Shariah compliant standards and norms, guidelines –IFSB, AAOIFI-- , there is an overwhelming demand for IF products by public at large but we are still below the benchmarks for financial inclusion and the penetration rate of IFSI even in large Muslim populated countries Indonesia, Pakistan, Nigeria, India, Bangladesh,

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<sup>1</sup> Key note address delivered at the Standard Chartered Bank (SCB) Majlis held at Karachi on October 23, 2024

Turkie, Egypt is quite low. Why is it that Iran, Sudan, Saudi Arabia, Malaysia and GCC countries are moving ahead? Is it differences in the interpretation of Shariah compliance rulings in these jurisdictions or the Regulatory and Supervisory agencies taking the lead and playing a promotional role?

4. Most of the above countries are suffering from Poverty and inequalities. IF is a powerful means for bringing prosperity and equity. We find concentration of IF lending in big urban areas neglecting backward . remote , underdeveloped areas and minuscule lending to SMEs, Small farmers, Low cost housing, Consumer financing . In Pakistan, for example, these sectors receive only 11.5 percent of private sector lending much lower than that provided by conventional banks. Almost 1.7 billion people globally have no bank accounts ( 50 percent of them are in Muslim countries) and more than 200 million micro, small and medium sized businesses require banking assistance. . At the same time we have huge financing gap for meeting the SDG goals, adaptation and mitigation of climate risks, developing resilient infrastructure What incentives and policy measures you would recommend for changing the priorities of Islamic banks and their current lending practices to include the unbanked population and MSMEs?
5. Why is that we are all convinced that Social Finance ( Waqf, Sadaqah, Zakat, Qard e Hassan etc ) are powerful ingredients of a holistic approach to IF but why is that SF is not blended with Islamic banking to offer products and services for developing employable skills for the youth, financial aid and scholarships for education and health care to poor families, and invest in educational services and health care facilities? Zakat is being administered at individual or Government level but is missing ingredient of Blended finance at system wide level.
6. Why isn't it possible for the Shariah scholars from all major jurisdictions along with IB practitioners to develop off the shelf benchmark standards , eliminate overlapping or varied interpretations, agree on a common set of codes, laws, rules and procedures, dispute resolution mechanisms , contract enforcement that are Shariah compliant . How can these be then applied uniformly across various jurisdictions without specific references to multiple layers of Shariah boards at the entity level ,and central

regulator levels ? These references and determinations introduce uncertainty and add to the cost of transactions both in time and value perhaps discouraging potential borrowers to make the switch.

7. What are the most practicable means of to fill in the shortage of talent at all levels of IF and develop full fledged IF professionals who are both competent in modern banking and finance as well as in Shariah jurisprudence. How can we change the mindset of the staff of IFSI to develop a commitment towards a larger cause and purpose i.e. conversion to IB from Conventional banking. How can we fill in the gap between the supply and demand of Shariah scholars?
8. Are the main products being offered by the IBs at present reflecting the strong pillar of IF i.e. risk sharing rather than Risk transfer or Risk shifting as Debt like financing structures such as sales with mark up and deferred payments ( Murabaha), Purchases with deferred delivery of the products ( salam and Istisna), Leasing (Ijarah)are the main products and services ? Why are Musharakah and Mudarabah modes not so dominant in the product offering space? Won't the present debt like financing lead to greater concentration risks of commodities and real estate in future once the operations are scaled up.
9. IF institutions in many countries face constraints in liquidity management because of lack of Shariah compliant money market activities or lack of active Shariah compliant trading or Repo market, missing tools to mitigate and hedge risks , Regulatory agencies' limited ability for liquidity supply, absence of the lender of last resort , Securitization and different models of Liquidity Risk Management . What can this distinguished group of scholars do to suggest robust and sustainable Shariah compliant measures to overcome this critical constraint facing the Industry
10. As the IFSI spreads its tentacles it would need Shariah compliant Legal, Advisory, Brokerage, Investment Management, Accounting and Audit firms , Fintechs with the requisite numbers, competence and expertise to support the financial institutions . Is any one actually overseeing that these firms and expertise would become available and fully operational at the appropriate intervals of time?.

**ANNEX I List of Global Organizations serving Islamic Financial Services Industry**

1. Islamic Development Bank
2. Islamic Development Bank Institute IDBI
3. Islamic Research and Training Institute IRTI
4. Islamic Corporation for Insurance of Investments and Export Credit  
ICIEC
5. Islamic Corporation for the Development of the Private sector ICD
6. International Islamic Trade Finance Corporation ITFC
7. World Waqf Foundation WWF
8. Islamic Financial services Board IFSB
9. Accounting and Audit organization of Islamic Financial Institutions  
AAOIFI
10. International Islamic Financial Market IIFM
11. General Council for Islamic banks and Financial Institutions  
CIBAFI
12. International Islamic Liquidity Management Corporation IILM
13. International Center for Education in Islamic Finance INCEIF
14. International Shariah Research Academy for Islamic Finance ISRA
15. Islamic International Credit Rating Agency IIRA
16. Thomson Reuters Ideal ratings Islamic Indices