

CHAPTER 12

Shari'a assurance process

12.1 Introduction

To understand the role of Shari'a boards that ensure Shari'a-compliance of products and services for IFIs, one needs to know the exact meaning of Shari'a-compliance, its importance in the Islamic banking industry and how non-compliance can jeopardize the integrity of this system. With this understanding, we will be able to suggest a suitable mechanism that could help Shari'a boards in playing this role effectively to overcome the challenges facing them in this regard. This chapter will focus on the following key issues:

- meaning of Shari'a-compliance
- importance of Shari'a-compliance
- Shari'a-compliance challenges and mechanism
- Shari'a board functions
- measures to help Shari'a boards play their roles effectively

12.2 Meaning of Shari'a-compliance

Shari'a-compliant, in the context of financial contracts, refers to what is permissible in the Shari'a. In other words, if a contract has not been prohibited in Shari'a, it is Shari'a-compliant in principle. Do we need a specific or explicit Shari'a permission? The answer is No, we do not need a specific Shari'a permission, as in the case of contracts, the Shari'a has given us broad principles and rules which draw the line between what is prohibited and what is permissible. As long as a contract falls within permissible parameters, it is considered to be permissible and there is no further need for a specific evidence for its permissibility. Should a dispute arise on the Shari'a-compliance of a certain contract, the onus of proof is on those who declare it Shari'a repugnant and not on those who consider it Shari'a-compliant.

There is a difference in this regard between *ibadat* (acts of worship) and *mu'amalat* (transactions). In the case of the former, unless there is specific evidence allowing, recommending or obligating an act, it would not be permissible to carry it out as an act of worship. In the latter case, an act is permissible in principle, unless there is Shari'a evidence prohibiting it. This difference is due to the fact that acts of worship are defined and limited. In Islam, Prophet Muhammad is considered the supreme authority in interpreting and disseminating God's instructions as to how to worship him, correctly. On the other hand, financial contracts facilitate the needs of people in different ages and times. These needs are not only unlimited, but also evolving with the passage of time through the emergence of new mediums of dealing with one another. Since Shari'a has come for the fulfilment of human needs in a just and fair manner, it has given mankind broad principles and rules to distinguish between a Shari'a-compliant contract and one that is Shari'a repugnant. The details of the structures and modalities are left for them to work out within those parameters and boundaries.

Some Muslim economists use the term Shari'a based to denote a higher and more desirable level of Shari'a-compliance which they feel cannot be expressed merely by the term Shari'a-compliant. For instance, they refer to *murabaha* and *ijara* as Shari'a-compliant contracts, while they consider *mudaraba* and *musharaka* as Shari'a based transactions. This difference is not based on any Shari'a evidence, as Shari'a only categorizes contracts as permissible or non-permissible with no further category of *fardh* (incumbent) or *wajib* (necessary) in financial contracts. Therefore, any contract which is Shari'a-compliant is also Shari'a based, meaning that the Shari'a has not disallowed it.

These economists argue that contracts like *mudaraba* and *musharaka*, being participatory in nature, serve the objectives of the Shari'a better through fair distribution of profit, and therefore, these contracts could be called Shari'a based, whilst the same is not true in case of those contracts which create a liability on the part of the customer such as the case in deferred payment sales.

One may agree with them to the extent that preference could be given to participatory modes of financing where equity participation is required or desired, but generalizing this as a policy to cover all areas of financing, and further relegating sale contracts to a secondary position is nothing but a gross misconception about the true nature and spirit of the Islamic financial system. An in-depth analysis will reveal that even in the case of *mudaraba* or *musharaka*, one party may be given a small share in profit, while in deferred *murabaha* or *ijara* they may get a fairer deal. Further, in many cases, financing may not be possible through *mudaraba* or *musharaka* such as the case of auto finance etc. where a *murabaha* or *ijara* contract may serve the objective of the Shari'a in a much better way than *mudaraba*, and thus, be more in line with the spirit of the Shari'a.

There are quite a few fallacies regarding Shari'a-compliance of Islamic banking of which a few are noted below:

1. Some Muslim economists, for instance, argue that Islamic banking will not be Shari'a-compliant unless it serves certain financial visions and objectives that they feel constitute the touchstone that determines whether a contract is Shari'a-compliant or not. They have, unfortunately, developed these visions on the basis of their studies of western finance and personal, rather than academic, readings of Shari'a. In a recent conference on Islamic banking and finance, to the utter dismay of the participants, one such economist claimed that had Imam Abu Hanifa and Imam Shafi studied finance, they would not have allowed some of the financial contracts that have been declared Shari'a-compliant.

This gentleman overlooked the fact that Shari'a scholars have disallowed many contracts which were deemed as legal devices to achieve an unlawful end, on the basis of *itibar al maal* or *sadd al darie*. However, it must be noted that the decision about whether the end in question is lawful or unlawful, or the contract under question leads to this end or not can be pronounced only by qualified jurists of the highest order, who look at these issues from a purely Shari'a perspective based on the analysis of the entire body of *fiqh* literature and Shari'a texts relevant to the issue, in isolation of any alien discipline or system. This is not the task of an economist or any other expert for that matter, who might have developed his concepts and notions regarding the Islamic financial system under the influence of a western or conventional financial system.

2. Similarly, there are people who are judgemental of the Islamic finance industry based on their experience of some staff of IFIs not observing a proper Shari'a-compliant dress code. While there is no dispute that all IFIs should observe Shari'a principles in all areas including dress code or hijab, however non-compliance in such areas would not render their financial transac-

tions Shari'a repugnant provided these contracts fulfil the Shari'a requirements.

3. There are also those who consider some products of IFIs, as Shari'a repugnant, on the premise that these products apparently replicate interest-based transactions practised by conventional banking. Despite the fact that this claim of similarity is not correct in itself as it is impossible for a Shari'a-compliant contract to be identical to a loan with interest, if a Shari'a-compliant objective is achieved through a Shari'a-compliant contract, rather than through a loan with interest, with similar economic consequences, the similarity in result should not render the Shari'a-compliant contract, repugnant.

12.2.1 The broad parameters of Shari'a-compliance for financial contracts

The following are the broad parameters of Shari'a-compliance as far as financial contracts are concerned:

- The contract must be executed by legally qualified parties with their consent. The condition of consent on the part of the contracting parties requires knowledge of all details regarding the subject matter of the contract, its counter-value in case it is a sale contract, and its terms and conditions. Unless the contracting parties have prior knowledge of all these details, the contract would not be permissible in Shari'a.
- Compliance with the above parameter requires that transactions should be free from any kind of uncertainty that may lead to dispute between the contracting parties. This includes knowledge of the subject matter or other terms and conditions in a manner that would be satisfactory for giving consent. The term used for uncertainty in *fiqh* is *gharar*. The *gharar* which renders a commutative contract void is *gharar katheer* or *fahish*, which means excessive uncertainty, as excesses are not normally waived. However, if the uncertainty is not grave enough to lead to a dispute, or it is in a non-commutative contract, it does not lead to nullification of the contract.
- Since *riba* is strictly prohibited by Shari'a in all its forms, a Shari'a-compliant contract should be free from even the doubt of *riba*. If it is established that the contract results into, or contains, one or other forms of *riba*, then it is not permissible.
- *Al kharaj bid dhaman* is a Shari'a maxim that means any entitlement to profit in a financial contract is due to the risk undertaken by the relevant party; and hence a contract free of any risk would not be considered Shari'a-compliant. For instance, it is not permissible to get the profit gained from sale of an asset, unless the seller obtains the title and possession of the asset prior to its sale.
- A contract should not only be Shari'a-compliant, but it should also be used to lead to a Shari'a-compliant outcome. This is called *itibar al maal*. Based on this principle, the Shari'a disallows an apparently Shari'a-compliant contract if it is evident that it is being used as a legal device to work around a prohibited contract. *Bay ul ina* and organized *tawarruq* are examples of such transac-

tions, and hence have been prohibited by the majority of fuqaha.

- A Shari'a-compliant contract must not contain any condition which runs against its nature. For instance, a sale contract would be void if it is stipulated in the agreement that the seller does not transfer the Shari'a title of the asset to the buyer, or that he would be under no obligation to deliver the asset to him. Similarly, an ijara contract would be declared Shari'a repugnant if risks associated with the ownership of the asset are transferred to the lessee.

- A Shari'a repugnant contract which has been disallowed by all the established fiqhi schools, hanafi, shafi, maliki and hambali, cannot subsequently be declared as compliant. In other words, if there is a consensus of jurist scholars on the prohibition of a contract, it will remain so, and no new ijihad is allowed in this regard. However, if there is a difference of opinion regarding the permissibility of a specific contract, IFIs may follow the opinion of that fiqhi school which has the predominant number of followers in the area of its operation. If a case is made for standardisation and global acceptability of Islamic banking products, IFIs would be better off selecting, through collective deliberation and discussion amongst Shari'a scholars, such opinions that serve the Shari'a objectives in a better way and are supported by stronger evidence. In this regard, IFIs should avoid basing their products on opinions regarded as weak, or on opinions cherry picked from different schools of fiqh in a manner that the composite structure would not be acceptable to any one school.

12.3 Importance of Shari'a-compliance

Since Islamic banking means banking in line with Shari'a principles and based on Shari'a-compliant contracts and structures, it is imperative for the regulators and the management of these IFIs to ensure Shari'a-compliance, not only as a corporate governance requirement, but also as a religious duty.

The importance of Shari'a-compliance can be gauged from the impact that it has in disseminating the message of Islamic banking, especially in such countries and areas where the masses are still sceptical about the genuineness of Islamic banking as a whole, or have apprehensions regarding certain products and practices. Any Shari'a-compliance breach can result in crippling reputational risk that does not remain confined to the erring institution only, but rather engulfs the whole entire industry or at the very least, those institutions that operate in the same geographical location. Therefore, all the stakeholders (the regulators as well as the institutions individually and collectively), must make concerted efforts to ensure Shari'a-compliance, not only at their own levels, but should also keep a vigilant eye on the violators in the market.

Since Islamic banks are bound by their bylaws, the rules and regulations as well as the contracts they sign with their fund providers to comply with the principles of

Shari'a in all of their transactions and activities, they have to ensure that the profit they earn for their shareholders and depositors is halal. To that end, and in order to segregate tainted income and purify the profit of the IFI, Shari'a audit of the transactions is conducted regularly. In case the Shari'a audit finds that the Shari'a-compliance requirements of any transaction have not been fulfilled, the profit of such a transaction is declared Shari'a repugnant and directed to a charity fund. This shows that Shari'a-compliance is not only a religious and regulatory duty of an IFI, but also plays an important part in ensuring profitability of the institution.

12.4 Shari'a-compliance: challenges and mechanism for enforcement

One of the toughest challenges in the area of Shari'a-compliance is that while the industry has witnessed phenomenal growth in recent years, the academic institutions and the industry itself have not been able to produce trained and qualified people capable of running these institutions in line with the rules and objectives of Shari'a. This has made the task of ensuring Shari'a-compliance and proper monitoring of transactions and activities increasingly difficult; a task that requires immediate attention and remedy. Similarly, a lack of Islamic banking laws and appropriate rules and regulations to facilitate Islamic banking, especially in the area of Shari'a-compliance, combined with laxity on the part of the management of some institutions in putting in place an effective Shari'a-compliance system, pose serious challenges to the industry, with the potential of irreparably damaging the message of Islamic banking and impeding its growth and expansion to new horizons.

It is not strange to come across scattered examples of violations of Shari'a rules and principles by some institutions which adversaries use to tarnish the entire industry. It must be acknowledged that such instances of non-compliance could occur under any system due to error in human judgment in understanding the situation or application of the rules, or even as a direct result of misconduct or negligence. However, the remedy lies in a well defined compliance system and the commitment to abide by it, and there should be no complacency on this front. It is in this context, that we have recently witnessed a conscious effort by many IFIs and regulatory authorities to improve the Shari'a-compliance system.

It is the responsibility of the management to run the affairs of an IFI in a Shari'a-compliant manner. This task cannot properly be discharged unless a comprehensive Shari'a-compliance mechanism is put in place. This mechanism should be supervised and guided by a qualified Shari'a supervisory board. In the following section, the main functions and duties that should be assigned to the Shari'a board will be discussed. This will be followed by a discussion on the measures and tools necessary to enable the Shari'a board to discharge its functions in a befitting manner.

12.5 Broad scope of the Shari'a boards' duties and functions

The following should constitute the main functions of the Shari'a board of an IFI:

- a. Reviewing transaction proposals, answering queries, recommending appropriate solutions and issuing pronouncements and instructions for Shari'a-compliance.
- b. Developing product manuals, along with sample documentation, process flows etc. to simplify the execution process of the transactions for the staff of the IFI.
- c. Organizing and supervising training of the staff to ensure Shari'a-compliance in implementation of the transactions.
- d. Supervising Shari'a audit of the executed transactions to ensure that the transactions have been implemented in line with the instructions of the Shari'a board, and to segregate any Shari'a repugnant income that the IFI may have realized through transactions not fulfilling the basic requirements of Shari'a-compliance.
- e. Reviewing and approving Shari'a-related aspects in the bylaws, rules and regulations, all manuals and policies adopted by the IFI.
- f. Ensuring that the profit and loss is calculated according to the rules of Shari'a under the terms of the agreements with the depositors and the approved policies.
- g. Examining and approving the financial statements and annual accounts of the IFIs and issuing Shari'a-compliance reports, at least annually, expressing the extent of adherence of the management to the pronouncements, instructions and advice issued by the Shari'a board.
- h. Examining all activities conducted in the IFI, whether directly linked to banking or of an ancillary or allied nature, including those activities that are only of operational or procedural nature, on the touchstone of Shari'a principles and advising the management accordingly.

Can a single Shari'a advisor handle all these responsibilities? Is it appropriate to assign all these duties and functions to a single person, or is there a need for establishing a full-fledged Shari'a board for this purpose? In this regard, different IFIs, in line with their bylaws and in the light of their declared objectives of Shari'a-compliance, have adopted different strategies and mechanisms. While some are functioning under the guidance of a single Shari'a advisor, others have established Shari'a boards which collectively share the burden of guiding and advising these IFIs. However, due to the diversity and vast scope of the duties and functions that are related to Shari'a in an IFI, and the need for collective ijti-had on the new issues and products that arise from time to time, a single Shari'a advisor will not be able to carry out these duties in a befitting manner. Therefore, the regulatory authorities should make it obligatory on the IFIs to constitute full-fledged Shari'a boards for fatwa and

supervision of their activities from Shari'a perspective.

Some may argue that since many urgent issues and transactions cannot be delayed for a long period till a meeting of the Shari'a board could be called, and the IFIs require constant Shari'a guidance for smooth and timely management of their affairs, there is always a need for establishing a mechanism which would ensure provision of timely Shari'a guidance and involvement, and as such the model with a single dedicated Shari'a advisor would serve the purpose better. While there is a need for such a mechanism, one must not lose sight of the fact that it would not be an alternative for, nor a valid counter argument to the need for existence of, a full-fledged Shari'a board. To address this issue, many esteemed IFIs have constituted executive committees, or appointed executive members of their Shari'a boards to provide this kind of immediate guidance and pronouncements, but the ultimate authority of Shari'a supervision, guidance and compliance vests in the Shari'a boards, and thus all the decisions of the executive committees or members have to be submitted for review and ratification by the Shari'a boards.

12.6 Measures to make Shari'a boards more effective

To empower Shari'a boards to play their roles effectively and discharge the heavy burden of the duties and functions assigned to them in a desirable manner, the regulators and the managements of IFIs, should take a number of very important measures, as highlighted below:

12.6.1 Regulatory requirement of Shari'a-compliance:

To enable Shari'a boards to discharge their duties as per the requirements of Shari'a, the regulatory authorities should ensure that IFIs are bound by the Shari'a pronouncements, opinions and guidance given by their respective Shari'a boards and the national Shari'a board, if any. Through reviews and inspection from time to time, the authorities should make sure that these institutions implement the Shari'a pronouncements and instructions in a timely manner and in both letter and spirit. The regulators should also penalize the erring IFIs to ensure that Shari'a-compliance stays at the top of their list of priorities.

12.6.2 The status, expertise and composition of the Shari'a board

The Shari'a board of an IFI should be an independent board appointed by the general assembly of shareholders of the IFI. The Shari'a board should be an apex body, with its decisions in relation to all the financial matters of the IFI binding on the management, and as such, it should not, and cannot, be made subservient to the board of directors in the IFI. This is the position of the Shari'a boards of the leading Islamic banks in the Middle East and other regions, although in some countries they are appointed by and report to the boards of directors, which is not an ideal situation.

The appointment and dismissal of Shari'a boards should be through a transparent procedure with the consent of the regulators to guarantee that the independence and impartiality of these boards are not compromised. Also, it is important that the most qualified available scholars in the field are appointed to the Shari'a board. The Prophet Muhammad (peace be upon him) is reported to have said, "If an authority appoints someone in a public position and there is someone else more qualified for the job amongst the Muslims, then he has cheated Allah, the Messenger and the Muslim community."

While this is true for every public post or position of authority, it is more so for membership of Shari'a boards of IFIs, whose decisions and pronouncements are issued in the name of Shari'a and as such bear the ultimate authority.

A Shari'a board should include at least one or more experienced Shari'a scholars with the capability to issue correct pronouncements on new issues in the light of Qur'an and sunnah and the fiqhi literature. It is also important that the Shari'a board should have the required technical knowhow on banking operations and commercial practices that would allow them to properly understand the issues and queries and enable them to give Shari'a-compliant solutions. This is because a Mufti issues a Shari'a ruling in relation to a query or issue after examining the case thoroughly, and therefore he has to have the capacity to understand all the dimensions of the case subject of the query.

12.6.3 Specialized training to Shari'a staff

The Shari'a board of an IFI would not be able to discharge its responsibilities in a proper manner unless a full-fledged Shari'a department manned by qualified staff is established within the IFI to assist the Shari'a board in all areas of their responsibilities and functions. This Shari'a department should have at least the following units:

- Product development, structuring and documentation
- Shari'a audit and compliance
- Shari'a training

Due to the unique nature and diversity of the tasks assigned to their Shari'a departments in particular, the staff of the department must have adequate knowledge of Shari'a as well as banking, as without a fine blend of expertise in these two areas, they will not be able to carry out their assignments in an appropriate manner.

Given the shortage of such qualified staff, the IFIs, as a short term remedy, have to be content with the best that the work market can offer and conduct on the job training, enhancing the capabilities of their staff, with the hope that in the long run the market will produce such manpower once the need for them is realized. Any proposed training programmes for the Shari'a staff should encompass both areas in a way that a staff with Shari'a background should be given specialized training in banking while the staff with banking and financial knowhow should undergo specialized Shari'a training.

12.6.4 Shari'a-compliance manual:

A Shari'a board will not be able to discharge its duties and functions unless the IFI develops a Shari'a-compliance manual which should determine the duties and functions of the Shari'a board and the responsibilities of the management vis-à-vis the Shari'a board. Experience has proven that one of the main factors behind success or failure of a Shari'a board in discharging its functions is the extent of the cooperation that it receives from the management of the IFI.

The following details the steps and measures that have to be taken by the management to ensure that the Shari'a board plays its role in an effective manner:

i. The management should get all products, policies, manuals, documents and advertising material approved from the Shari'a board. The profit distributions and annual accounts should be submitted for endorsement by the Shari'a board before their announcement. For effective product development, the management should provide the Shari'a board with all the information that will help the Shari'a board in arriving at Shari'a-compliant decisions regarding the proposed products.

ii. The management should get prior approval of the Shari'a board for any structured transaction and give adequate time to the Shari'a board for review of the transaction structure and documentation. It must submit to the Shari'a board all new contracts and samples that the IFI may be planning to use in future for review and approval by the Shari'a board before their execution.

iii. The Shari'a board members and Shari'a auditors should be provided unhindered access to all the books, records and documents of the IFI. The IFI should also submit proper explanation required by the Shari'a board especially in relation to those transactions which have been executed, in the opinion of the Shari'a board, in a Shari'a repugnant manner. In the event the management fails to implement the pronouncements and decisions of the Shari'a board or denies it access to the records and documents of the IFI, or does not furnish the required information, the Shari'a board should raise the matter with the BoD of the IFI. In case the BoD fails to address the issue, the Shari'a board should report all such irregularities in its periodic Shari'a-compliance report.

iv. The IFIs should have effective mechanisms to reward their departments and officers for Shari'a-compliance and penalize them for breach of Shari'a instructions.

v. As mentioned above the management should establish a full-fledged Shari'a department which should act as a link between the IFI's management and the Shari'a board. This would not only ensure involvement of Shari'a in the day-to-day affairs of the IFI, but would also help reduce the chances of errors in matters of Shari'a-compliance.

vi. Further, the Shari'a board should be provided with technical support of financial and legal experts at its request, especially when new products are developed or sample documentation is prepared.

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12.6.5 Involvement of Shari'a board in product development, audit and training

It has been observed that in some IFIs, there is no involvement of Shari'a board/department in some important activities that are left to the management of the IFI. The issues to be raised to the Shari'a board are selected by the management at its own will, and the meetings of the Shari'a board are convened whenever the management desires; product development, documentation and manuals preparation are carried out by the management with very little involvement of the Shari'a board or staff, and Shari'a audit is either outsourced or conducted irregularly, covering only a small percentage of the transactions.

Such a state of affairs is not acceptable at all, as Shari'a-compliance in any IFI is more important than compliance with regulations, and while there are always compliance units or divisions to ensure compliance with regulations and rules of the regulatory authorities, how can an IFI eliminate or minimize instances of non-compliance with Shari'a rules and principles without having a robust Shari'a-compliance function which should be involved in the day-to-day functions of the IFI?

Some people may think that the duty of a Shari'a board is limited to giving Shari'a opinion and issuing of pronouncements regarding the queries raised or proposals and products submitted by the management, and oversight of the Shari'a audit to be conducted after the transactions. In fact, nothing could be more misleading or confusing about the duties of a Shari'a board. The Shari'a board of an IFI is the highest authority that is responsible for overall Shari'a-compliance of the IFI and for everything that is related to Shari'a.

Therefore, the tasks of product development, structuring of new transactions and documentation cannot be left to the management alone. Similarly, the Shari'a board should be directly involved in Shari'a audit and training of the staff on the products and services provided by the IFI.

Product development, structuring and legal documentation unit

When a product proposal is submitted for approval of the Shari'a board, it will not only issue the fatwa regarding the product, but would also ensure that it is executed in a fully Shari'a-compliant way. Therefore, the tasks of product development, complete with all the steps of preparing a product manual, which should detail the process flow of the transaction and the accounting entries, and the legal documentation to ensure that the terms and conditions of the contracts are in line with the principles and rules of Shari'a, have to be carried out by trained staff under the direct supervision and guidance of the Shari'a board.

The Shari'a boards should take a proactive role in this regard by guiding the IFIs to diversify their product suits, avoid dubious products and improve upon features of

their services. The IFIs should try to address taxation and legal issues that at times force them to adopt not-so-desirable products and march onwards to create new instruments and products that should be different from their conventional counterparts in both form and substance.

The Shari'a board would be assisted in this task by the Shari'a department of IFI, which should have a unit specializing in the area of product development, structuring of corporate deals and documentation.

Shari'a audit under the supervision of the Shari'a board

The Shari'a audit should aim to ensure complete Shari'a-compliance in all the activities of the IFI, point out cases of Shari'a repugnancy, if any, and ensure transfer of any Shari'a repugnant income of the IFI as per the charity policy of the IFI. A strict and comprehensive Shari'a audit should be conducted in line with an audit plan to be approved by the Shari'a board. All activities of the IFI fall within the purview of the Shari'a audit, and as such all financing and transaction agreements, product documents, forms, brochures, agreements, services provided by the IFI and all the policies and manuals should be subject to Shari'a audit.

The Shari'a audit team should also interact with the staff during audit exercise to gauge the knowledge of the staff relating to their products. The observations of the Shari'a audit should be conveyed to those who are responsible for designing the training material and conducting the sessions for improving upon the features of the training programme.

Shari'a related training of the IFI staff:

It is obligatory on each and every Muslim to acquire the relevant body of Shari'a knowledge to perform his obligatory duties. Based on this principle, there is no doubt that acquiring knowledge of basic financial contracts is obligatory on each and every Muslim, as they have to enter into such transactions in their daily life.

However, an Islamic banker, in addition to the general knowledge for basic financial contracts whose acquisition is obligatory on every Muslim, has to acquire the knowledge of the products and services that he is responsible for, in order to be able to offer the same in a Shari'a-compliant manner. It is reported that Umar, the second caliph of Islam used to visit the markets of Madina, and ask the traders about the rules of Islamic financial contracts, and whenever he would find anyone lacking the required level of knowledge, he would order him to leave the market place and go to the scholars to seek the required knowledge.

This is not only a religious duty of an IFI staff, but also a requirement of corporate governance and a tool to mitigate reputational and operational risk for IFIs, which can lead to losses due to segregation of tainted income. Compliance with Shari'a principles and rules would not be achieved unless the employees of the IFIs are properly trained on the Shari'a-compliance requirements of their products and services.

It is imperative for Shari'a boards and departments of IFIs to take the following steps to address the issue of lack of proper training of IFIs' staff.

To enable IFIs to recruit staff suitable for Islamic banking, the Shari'a board should lay down parameters and general guidelines for selection of IFI staff. However, since it might not be possible to find trained staff with the right aptitude and Shari'a inclination in the market, it would be the responsibility of the IFI to train the recruited staff adequately on all the products offered by it.

A proper training programme should be devised in a manner that it should start with basic and compulsory training sessions relating to the economic philosophy of Islam and concepts of Islamic banking and then move on progressively to specialized courses. The basic courses should be compulsory for all employees, irrespective of their job and the departments that they are working in, while the specialized courses on various products should be compulsory only for those employees who are directly dealing with such products. However, all staff should be encouraged to attend specialized sessions once they have been through their basic training.

The training material should be prepared by qualified Shari'a scholars cum trainers in very simple language, and the reading material should be given to the participants before the training session so that they get an idea about the subject, before the training starts. This will raise their level of comprehension and ensure that the training session would be lively and interactive.

The trainers, who should be qualified Shari'a scholars, or certified Shari'a trainers, should prepare effective power point presentations, but should avoid reading the presentation material. It must be noted that an effective training is always based on a two-way interactive communication with participants. The trainers should also address the operational issues related to their topic and give live examples.

The participants should be given tests so that the level of their comprehension and attention is gauged. The results of the tests should be communicated to the line managers as well as to the human resource departments.

Emphasis should be on training of both the junior and senior staff, as with more knowledge about the Shari'a aspects of the products, a senior staff would be in a much better position to guide his subordinate staff properly and ensure greater Shari'a-compliance.

Special training sessions should be offered to educate serious customers, or those customers who act as IFI agents in various stages of execution of their transactions, about the basics of Islamic banking and their responsibilities when they act as the IFIs' agents. Similarly, they can attend the courses offered under the Shari'a training programme for the staff.

that the Shari'a board of an IFI should play in this regard. Cognizant of the challenges and issues that have so far hampered the efforts in this regard, the chapter has highlighted some of those challenges and took them into consideration while suggesting remedial measures. In a nutshell, an attempt has been made to prove that an IFI cannot be fully Shari'a-compliant unless it is supervised and guided by a qualified and fully empowered Shari'a board which should be assisted in all areas of its responsibilities by a full-fledged Shari'a department, manned by competent resources especially in areas of product development, structuring, documentation, Shari'a audit and training.

12.7 Conclusion

This chapter has tried to define the term Shari'a-compliance, highlight its importance and discuss the role