

CHAPTER 20

Islam, ethics & law

20.1 Introduction

It is probably a reasonable statement to say that Islamic finance as currently practiced is widely considered to be undertaken on an 'ethical' basis. The Islamic financial community certainly purports to differentiate itself from the practice of conventional banking by associating itself with the virtues inherent in the value system from which it is derived. However, is the reality behind this statement true? How do we benchmark actual performance in order to assess real world activity against a benchmark of good ethical behaviour? Is the avoidance of *riba* sufficient or should more be done?

The sort of activities that constitute 'ethical behaviour' can be a highly subjective area. Discussions on the topic can become philosophical and raise fundamental and complex questions that explore what ethics is and what sort of behaviour constitutes ethical behaviour? Discussants may find themselves contemplating whether ethics are the same thing as morals? They might ask whether simply observing the laws of the land constitutes ethical and/or moral behaviour, or is there more to ethics than this? If one then introduces *Shari'a* into the discussion, our discussants may have to think about what part of *Shari'a* is actually concerned with ethics or ethical behaviour and what would be enough to judge someone as an 'ethical' person? Is it just *fiqh al muamalat* involving financial matters or is it wider than that (i.e. is ethical behaviour imbued in all aspects of *Shari'a*)? This chapter does not attempt to explore the philosophical aspects of these questions; rather it asks whether or not we can assume that simply 'being' *Shari'a* compliant is enough for an entity to be considered an 'ethical' organisation? In the case of a financial institution, is it sufficient to conduct financial activity in a 'Shari'a compliant' fashion and thereby claim to be an ethical organisation? In addition, what steps can the organisation take to demonstrate to its customers and the world at large that it has actually

acted in an ethical manner and strives to do so?

Over and above these considerations, Allah (swt) knew that man was imperfect and contained flaws: hence the revelation of the Holy Qur'an to guide him to the right path. But in the modern, corporeal world, the temptation to stray is strong in all avenues of life, including financial dealings. The continuing impact of the global financial crisis is shining the spotlight of morality, integrity and ethics onto the activities and perceived misdemeanours of the global financial system. Although Islamic financial institutions are generally considered to have weathered the financial storm marginally better than many of their conventional peers, there have nevertheless been examples of behaviour that on the one hand, could be described as reckless and on the other hand, as ill-informed. A slightly more worrying category of behaviour is that which failed to observe the rationale and ethics generally thought to be embedded within the Islamic approach to finance, business and economic activity. It is this scenario that raises the most important question: how can ethical and/or moral behaviour be ensured in the context of Islamic financial activity? The answer to this question will, in part at least, include a consideration of the role law might play in helping solve this conundrum.

These questions are both fascinating and challenging. In a world where big business is increasingly expected to demonstrate Corporate Social Responsibility (CSR), the 'appearance' of ethical behaviour becomes an enticing unique selling proposition. However, corporate behaviour presented as being ethical needs to be assessed against objective standards if an increasingly sceptical public audience is to be convinced that the ethics being demonstrated are substantive and genuine. This is true irrespective of whether the corporation concerned is an oil company, a conventional bank or an Islamic financial

institution. Following the global financial crisis, it is almost trite to pronounce morality had all but disappeared from the conventional banking system but such a pronouncement is probably true. Many of the activities conducted in the name of conventional investment banking increased the wealth of traders and speculators but added negligible value to the underlying community. The benefits of so-called 'risk mitigation' through the deployment of securitisation techniques and derivative upon derivative brought the global financial system to its knees; and then it imploded. As a consequence, even where value had been added, it has been stripped away by the impact of consequences very few predicted. Many people are now asking: is there an alternative way to deliver financial intermediation that is ethical and responsible?

The message from the Islamic financial community to the world is that Islamic financial techniques offer an alternative, more sustainable, way to manage financial intermediation. The industry's stakeholders face major challenges as they seek to increase the scale and penetration of Islamic finance in various markets. They also face a less obvious but potentially life threatening challenge, which is to ensure that reputational risk, does not knock the industry off its growth trajectory. The virtues and merits of a belief system, or a particular method of working, will only ever be as virtuous or meritorious as the behaviour of those human beings working in the organisations seeking to act in accordance with such standards or methods. Whilst this chapter will not necessarily answer all of the questions mentioned above, it does seek to explore whether the 'Islamic financial system' is fundamentally achieving such ethical standards merely by 'being' Islamic or Shari'a compliant, or if there is a role to be played by external regulation or law to further compel the 'right' behaviour by individuals working in such a system?

20.2 What is ethics?

To help answer this question, it may be helpful to have a clearer understanding of what is meant by 'ethics' and 'ethical behaviour'. If we can understand what ethics is

and how it determines a particular standard of behaviour, we can seek to objectively compare that standard against what is expected by an observant Islamic financial institution and those individuals who work for such firms. In his book 'Ethicability', corporate philosopher Roger Steare writes:

'Ethicability is about being good, doing right, and leaving the world a better place'

This sentence immediately suggests a symmetry with the Islamic notion of man's role as vicegerent (i.e. trustee or steward) of all the earth's resources in all its forms. At its simplest, man is duty bound to make sure that he does not unduly deplete such resources; he is obliged to preserve them and pass them down to those who succeed him.

To further help us clarify our understanding of what 'ethics' is, Steare proceeds to explain three moral philosophies. Briefly, they can be summarised as follows:

Principled conscience – helping us decide what is right by reference to principles such as fairness, courage and kindness.

Social conscience – helping us decide what is right by considering the consequences, both good and bad, of our actions on others.

Rule compliance – telling us what's right.

The following table illustrates these moral philosophies. Steare's analysis provides an interesting background to inform any discussion in today's corporate and business world about the value, role and purpose of ethics.

20.3 Ethics and religion

Although Islam prides itself on offering a holistic approach in the guidance it provides Muslims in how to live a good life, the ethical character of much that can be derived from Islam is not a monopoly of that par-

	Principled Conscience	Social Conscience	Rule Compliance
Philosophers call it...	Virtue ethics	Utilitarianism	Deontology
What's right is...	Guided by principles like courage and kindness; our integrity, our moral DNA	What benefits most people and harms the least; the end justifies the means	What's legal; our legal rights and duties; justice as fairness
We act as...	Moral grown-ups	Moral teenagers	Moral infants
As seen mostly within...	Personal, close relationship	Work and neighbourhood	Business and remote transactions
The weaknesses are...	Principles often conflict and doing the right thing requires courage	Minorities are marginalised; the end justifies the means; pleasure preferred over what's good	We stop thinking for ourselves; too many rules create more rule-breaking; too many rules stifles creativity

Table 1: Moral Philosophies compared²

¹ Ethicability, Roger Steare, ISBN 978-8-9552369-2-1

² Ibid, page 33.

ticular faith. Each of the Abrahamic religions will claim similar principles. The 2009 Encyclical Letter of His Holiness Benedict XVI³ contains an interesting exploration of rights, duty and moral responsibility in Chapter 4 (The Development of People, Rights and Duties, The Environment).

In paragraph 45, the Encyclical charts the growth of ethics in the economy, finance and business and refers explicitly to notions of 'ethical financing' but notes a concern that the adjective 'ethics' can be abused when used generically. Protecting the value inherent in the notion of ethics depends upon the 'underlying system of morality' and here Pope Benedict says the Church has a role to play. The crucial point he makes is perhaps best identified in the following passage:

"Efforts are needed - and it is essential to say this - not only to create "ethical" sectors or segments of the economy or the world of finance, but to ensure that the whole economy - the whole of finance - is ethical, not merely by virtue of an external label, but by its respect for requirements intrinsic to its very nature."

These words illustrate an interesting alignment of views and opinion between Christianity and Islam which need to be harnessed if such views are to have a material, beneficial impact upon the wider global financial community.

20.4 The development of ethical behaviour in the conventional business world

If we want to understand how the Islamic financial markets could (or should) institutionalise ethical behaviour⁴, it may be worth studying the sorts of development that have been taking place in the conventional business world. There is no reason why existing ethical practices should not be examined for Shari'a compatibility and adopted, where to do so would be the 'right' thing to do.

From a behavioural perspective, the development of an ethical mode of behaviour has to be inculcated by establishing a root and branch change in the corporate and cultural attitudes and activities of the individual firm. This approach has to start with the board of directors and flow throughout the business if it is to be implemented successfully.

Of course, it might not always be obvious to the board of directors why they should encourage such changes in behaviour, particularly if criticised activities have always been 'done that way in the past'. However, the reality is that human nature is such that rewards or punishments seem to be a critical element of changing behaviour. It is for this reason that the role of law and regulation becomes a critical factor in encouraging (and enforcing) changes in behaviour. A legitimate question to ask in Muslim-majority communities is whether or not it is realistic to suggest that the ultimate sanction of accountability to Allah (swt) in the Hereafter is enough to compel similarly desirable behavioural changes? Unfortu-

nately, most such communities still have 'rule-breakers' within the population.

When looking at recent legal activity in the area of business ethics, the US and the UK have been developing laws and regulation in this area. There has been a very strong focus on the subject of anti-corruption and bribery and there is a rapidly expanding library of materials that offers guidance on behaviour⁵.

But bribery and corruption are not the whole story. Ethical issues arise in connection with many more facets of corporate life and we are seeing a trend amongst non-financial (in particular) institutions and corporations who are starting to address this in widely disseminated firm 'ethics policies' or 'codes of ethical conduct' that are broadly framed. Pointedly, in the financial context, developments in the continuing global financial crisis during the second half of 2011 resulted in several prominent financiers stating that international finance needs to become more ethical⁶. In the United Kingdom, pressure from the established church continued as the Archbishop of Canterbury in particular increased his rhetoric about the need for greater morality in international finance. This has been brought into sharper focus by the 'Occupy' movements that spread across from the US to the UK and enveloped St Paul's Cathedral in London and, arguably the heart of capitalism, Wall Street in New York. To a certain extent, we can therefore expect to see these policies and ideas becoming enshrined as core values for more institutions in the future; whether they are strictly observed or are only paid lip service will be a test for the future.

20.5 What is the Islamic financial industry doing to promote ethical behaviour?

Against the background of growing disenchantment with the banking and financial community as a whole, is the Islamic financial community doing enough to differentiate itself from the conventional financial community? One aspect of this question concerns how the industry is communicating its message to its potential client base (i.e. the population at large, particularly in Muslim-majority countries). It is necessary to explore the unique selling proposition (USP) potential of an ethics-based approach to financial intermediation. Expanding further, one needs to consider what steps the industry can (or should) be taking to achieve two critical goals: first to further embed ethical behaviour in the day to day activities of every Islamic financial institution and secondly, to embed a deeper awareness of the industry's USP in the consciousness of its target audience. Achieving these goals will help to establish behaviour patterns that ensure Islamic financial institutions do not make the same sorts of mistakes that led to the global financial crisis.

Over the years, a number of initiatives have been undertaken to develop the ethical foundation of the industry. This chapter discusses a few of them.

³ See http://www.vatican.va/holy_father/benedict_xvi/encyclicals/documents/hf_ben-xvi_enc_20090629_caritas-in-veritate_en.html

⁴ Of course, this statement may be contentious if one is of the view that the Islamic financial markets by definition already achieve this?

⁵ See for example, The Serious Fraud Office (SFO) Guidance on self-reporting (2009); the International Corporate Governance Network (ICGN) Statement and Guidance on Anti-Corruption Practices (2009); the Halliburton Department of Justice Opinion Procedure Release 08-02; the FSA Review of Insurance broker's Anti-bribery and corruption controls - Interim findings (2009); Transparency International Business Principles for Countering Bribery (2009); US Sentencing Guidelines: Chapter 8, Effective Ethics and Compliance programme.

⁶ See for example: Lord Levine, Sunday Telegraph, 6 November 2011

20.6 AAOIFI

In many respects, the AAOIFI can be credited as the first institution that recognised there was a need to 'regulate' ethical practices in Islamic financial institutions, with the production of its 'Code of Ethics for Accountants and Auditors of IFI's' (the Accountants Code of Ethics) in June 1998 and its 'Code of Ethics for the Employees of Islamic Financial Institutions' (the Employee Code of Ethics) (together the Codes) in January 2003.

The AAOIFI makes some valuable observations about the basis for the Employee Code of Ethics when talking about the difference between what Steare would recognise as Rule Compliance (i.e. laws and regulations) and ethics derived from religious sources, or in Steare's terminology, Principled Conscience. The AAOIFI talks about Shari'a rules and principles having a 'self-obligating' force and implicit within this is the notion that the individual is compelled to act in the appropriate manner. However, the effective enforcement of any code of ethics cannot rely on self-motivated behaviour alone because there will always be individuals who fail to live up to the standards expected of them. Again, if the threat of sanction in the Hereafter is insufficient, what can be done today?

This is the fulcrum that requires law to intervene and where the notions of Rule Compliance have a role to play. The AAOIFI recognised this in paragraph 7 of the Employee Code of Ethics, where the Code advises Islamic financial institutions to enforce the Employee Code of Ethics through '... disciplinary actions, ... laid down by the relevant bodies'. This is discussed further below.

Another interesting facet of the AAOIFI Codes is that neither of them is predicated from the perspective of the Islamic financial institution itself. The Accountants Code of Ethics is telling accountants how they should behave whilst performing their audit function; similarly, the Employee Code of Ethics is very much about telling the employee, as an individual, how he should behave, with a detailed section on how the employee should behave toward his seniors, the shareholders and fellow employees.

What is patently missing from the AAOIFI Codes is any guidance to the IFI and its board of directors as to how they should shape the behaviour pattern of the organisation itself. Certainly, the directors are employees too but the language of the Employee Code of Ethics is clearly couched in terms of telling employees to observe the directives and instructions issued by the 'institution's management'⁷. It seems unduly onerous to place the burden of ethical performance on the employee without similarly making it a corporate obligation too.

20.7 IFSB

Since its establishment the IFSB has also issued a number of documents that have some bearing on the questions of ethical behaviour and ethical governance:

- IFSB 3 - Guiding Principles on Corporate Governance for Institutions Offering only Islamic Financial Services (Excluding Islamic Insurance (Takaful) Institutions and

Islamic Mutual Funds) (2006);

- IFSB 6 - Guiding Principles on Governance for Islamic Collective Investment Schemes (2008);
- IFSB 8 - Guiding Principles on Governance for Takaful Operations (2009).

These three sets of Guiding Principles focus on specific segments of the Islamic financial service industry.

- IFSB 9 - Guiding Principles on Conduct of Business
- IFSB 10 - Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (2009).

IFSB 10 was designed to provide a framework for the roles and functions of Shari'a boards themselves, none of which had been addressed in previous publications. This standard contains a lot of valuable guidance that perhaps crystallises and codifies much of what has been developed and utilised in recent years. In the course of helping numerous institutions establish Shari'a Supervisory Boards and engage independent scholars in the process, much of what IFSB 10 discusses is already found in the various appointment agreements and operating procedures that many lawyers and Shari'a scholars will already be familiar with.

However, there are several statements of particular interest, particularly from a legal perspective. First, in seeking to define what a "Shari'a Governance System" is, the statement in footnote 8 on page 2 of IFSB 10 acknowledges that whilst a Shari'a pronouncement is intended to have 'full legal effect and bind the IFS' this may be contingent on relevant national laws. The reality is that the legal effectiveness of fatawa is best secured by embedding the rulings into the documentation being used to facilitate Islamic financial transactions. It is the creation of legally valid, binding and enforceable obligations in contracts that gives the fatawa real world credibility. This is a clear realisation that secular legal sanction has a role to play in ensuring good, Shari'a compliant, ethical behaviour.

Further, paragraph 25⁸ IFSB 10 also notes that there is no internationally recognised code of ethics and conduct for the members of Shari'a boards. It recommends to IFIs that they create their own 'appropriate code[s] of ethical conduct' and these should be embedded in the terms of appointment of the scholars to the Shari'a board. This chapter will come back to this later on when exploring what is happening in the commercial world to effectively embed ethical modes of behaviour in corporations.

20.8 What are IFIs themselves doing about this?

Research⁹ on annual financial reports of Islamic financial institutions suggests, aside from a few honourable exceptions, that a limited number of Islamic financial institutions published significant information about their corporate social responsibility activities before 2009.

⁷ See para 6/2/3 of the Employee Code of Ethics.

⁸ IFSB 10

⁹ The original preparation for this chapter was undertaken in late 2009/early 2010. It included a relatively un-scientific search of the websites of a variety of Islamic financial institutions based in the GCC and Malaysia (when year-end 2009 and earlier years of annual financial reports were available). That exercise was repeated at the start of 2012 (when year-end 2010 annual financial reports were available but reports for financial year 2011 were still to be published).

Since the end of 2010, it is noticeable that an increasing number of Islamic financial institutions started to include a page or two in their annual financial reports that specifically address issues of ethics and corporate social responsibility. A handful of firms also publish separate CSR reports to accompany their annual financial reports. These materials primarily seem to confirm what we already know, namely, that many Islamic financial institutions do make ad hoc donations to charity, undertake a range of community-based activities and pay zakat (particularly where legally obliged to do so). The statements made about social responsibility and the descriptions of their related activities are generally quite brief. Far too many banks do not appear to address these issues at all (or at least nothing was revealed on their websites). There is limited information to indicate whether or not steps along the lines described in the case study (see further below) and later on in this chapter are being undertaken to embed notions of ethical behaviour across the firm that might, for example, support an 'adequate procedures' defence (see paragraph 5 of the case study). Similarly, information on corporate governance is not easy to find; and when found, invariably, does not specifically address issues of ethical governance and behaviour.

Interestingly, in January 2010 AAOFI supported Dinar-Standard and Dar al Istithmar in the production of a report - 'Social Responsibility Trends at Islamic Financial Institutions'¹⁰ - which examined trends towards CSR in IFIs. One of the conclusions in the report was that: "... IFIs do have a good start on most aspects of social responsibility, contrary to criticisms levelled at the industry. However, this varies widely between institutions".

This is quite an interesting conclusion that may not be well reflected in the public material produced by IFIs. This could be due to Islamic injunctions about "conducting good or socially responsible activities with modesty". If this is the case, are Islamic financial institutions failing to identify and promote one of their main USPs?

20.8.1 Transparency

Participants in the Islamic finance industry will often claim that Islamic financial transactions are more transparent than contemporary conventional financial transactions. The claim is based on the notion that a typical Islamic financial transaction should be linked to a genuine commercial venture or a real asset. So-called derivative transactions (in the widest sense of the expression) are not favoured and combined with the rule that prohibits selling or dealing in assets one does not own, effectively prohibits financial dealings that bet against the market. From an ethical perspective, this is helpful but an ethicist will also be concerned about how an Islamic financial institution deals with its customers and counterparties. In this regard, there is always room for improvement and we now consider several areas where the industry could do more to bolster its ethical credentials.

- Mudaraba based unrestricted investment accounts are commonly used by Islamic banks for deposit raising. Unless the account holder is also a shareholder (in which case they will be entitled to receive the annual financial statements), the level of information

made available to this class of investor (depositor) is limited. This is regardless of the fact that, unlike a conventional bank, a depositor with an Islamic bank is actually liable to bear any loss arising on investments made by the bank. The question that therefore arises is what level of disclosure would be appropriate for the Islamic financial institution to make to its customers? Although practical constraints might not allow the institution to make detailed disclosures about all of the parties with which it has invested the depositors' money, this does not justify the other end of the spectrum (i.e. a negligible provision of information). It should be possible to determine some practical thresholds in this regard.

- The fatawa issued by Shari'a scholars should form the foundation upon which the institution conducts its business. However, the fatawa are invariably treated confidential and are not shared with the general public. While there is some merit in the claim that fatawa constitute proprietary information, the fact remains that a fatwa is a religious pronouncement and that scholars may make mistakes on occasion. There is also a much wider public policy issue that the industry continues to debate and is partially addressing as different jurisdictions establish central Shari'a Advisory Boards. Who should be charged with the formalisation of Shari'a as enshrined in fatawa, a procedure that might be considered quasi-legislative in character? The fatawa issue is also particularly relevant given the fact that, in addition to Shari'a, the structure of a transaction is influenced by various other factors, such as, legal, regulatory accounting and taxation, to name a few. These added complexities mean there is always the risk of things falling through the cracks. A good example is the much quoted statement of Sheikh Mufti Taqi Usmani against certain sukuk structures that were being approved by some Shari'a scholars. A significantly more transparent approach to fatawa publication could lead to a healthy debate about the way the industry should evolve based on full information and knowledge. This may help prevent similar situations from arising in the future, where the credibility of a particular modus operandi is challenged, globally, notwithstanding that it has been established through a consistent course of previously approved actions.

Another concern is that bank personnel may not always act strictly in accordance with the fatawa. From an ethical perspective, and as mentioned at the start of this chapter, an institution that purports to be managed along ethical lines must be able to test its procedures against its guiding principles. It is unfortunate that in many cases the issuance of a fatwa is, for practical purposes, taken to be the end of the Shari'a process in relation to the actual launch of a product. The better view is that the grant of Shari'a approval should be treated as the start of the Shari'a process in relation to the product that has been approved. Once that has happened, it becomes the responsibility of the Islamic financial institution's senior management to ensure that products are delivered and administered in precisely the same way in which these were explained to, and approved by, the Shari'a scholars during the approval process. A violation of Shari'a matters may render income

¹⁰ January 2010, see <http://www.dinarstandard.com/maqasid>

generated non-compliant for Shari'a purposes, besides other ramifications for all stakeholders. While the regulators in most countries are yet to issue a framework to ensure compliance with Shari'a matters as set out in a fatwa, there are many Islamic financial institutions that have also failed to take any initiative in this regard. There is a growing argument that firms offering Islamic financial products and services should take steps to have their business processes independently reviewed to determine the level of compliance with Shari'a as outlined in the relevant fatawa. The objective of such independent 'process' reviews would be to engender confidence in the public.

20.8.2 Self-regulation

In the real world, we have to acknowledge that self-interest drives many human beings. In the financial market place, self-interest can often times manifest itself as "greed". Greed undoubtedly had its part to play in the activities that precipitated the ongoing global financial crisis. Much of this chapter is exploring what can be done by Islamic financial institutions to establish systems and frameworks whereby investment activity that is driven purely by greed or speculation is checked. We reach some conclusions about the need for Codes of Ethics but the issue hinted at by the discussion regarding self-regulation, has the potential to raise a much more fundamental issue that could affect the very fabric of the Islamic financial industry's philosophy. A very simple example serves the purpose. If an Islamic bank is approached with a request to enter into a diminishing musharaka financing by someone who only wants to invest in property and is not looking at buying a principal home or do some business, where should the Islamic financial institution draw the line when deciding whether or not to fund? This is perhaps one of the simplest questions that could have been framed but if Shari'a, as a general principle, has abhorrence towards debt, when should the institution refuse to fund such a transaction on the basis that it constitutes needless borrowing? A truly ethical organisation (applying a Shari'a benchmark) might conclude that it should refuse that transaction much earlier than many such deals witnessed in the past five years would suggest. Although apparently innocuous, questions similar to this could be framed that would cut across many other lines of business; and perhaps the truly ethical Islamic answers to such questions would result in some very different business models to those being pursued by many Islamic financial institutions today.

20.9 A note on micro-finance

The other topic that always seems to raise its head when contemplating what Islamic financial institutions could do to demonstrate their ethical credentials is micro-finance. However, supporting or contributing to a micro-finance scheme will not be enough on its own to imbue an organisation with a wider-reaching ethical credibility. At the moment, the delivery of Shari'a compliant micro-finance schemes is quite difficult, labour intensive and seems predominantly to involve the mobilisation of waqf funds in support of third party charitable endeav-

ours, rather than large scale commercial enterprises. It is also worth noting that much large scale micro-finance is currently conducted on a non-Islamic basis and, very often, at rates of interest that might appear usurious.

20.10 Current legal developments

This chapter establishes the premise that even where Shari'a principles underpin the business proposition of an Islamic financial institution, there is still a realisation amongst those charged with regulating and guiding the industry in governance matters¹¹ that additional sanctions – in the form of legally enforceable commitments – are required. With that in mind, it is worthwhile looking in some detail at one of the recent developments that has taken place in the legal arena and demonstrates a parallel understanding of these issues. The box contains a case study that looks at the recent introduction of the Bribery Act in the United Kingdom.

20.11 How can law, ethics and Islam reach an accord as to what constitutes ethical behaviour in financial markets?

It is undeniable that the topic of 'ethics' is becoming more topical, relevant and powerful as a driver of business activities across the world in all markets whether developed, emerging or frontier. Even the 'Complete Idiot's Guide...' series of publications has a book on the subject¹², which is indicative of a far wider interest in the topic than many may have imagined. Islamic financial institutions should be encouraged to take a much more holistic approach to ensuring that their activities are, in all respects, ethical and in compliance with Shari'a. This will enhance their unique selling point.

From the perspective of a CEO running an Islamic financial institution, the active promotion of good 'ethical' behaviour across the firm represents a further opportunity to demonstrate the Shari'a credentials of the institution to the world at large. Doing so has the potential to achieve several laudable goals:

Strategy alignment - it helps to align the strategy of the firm with developing international best practice in this area; and

Reputational integrity – by comparing Shari'a principles of good business behaviour to a typical code of ethics, it further enhances the reputation of Islamic finance as a medium for delivering financial services with integrity because of the embedded character of those principles.

It is likely that in any discussion about the introduction of ethical standards and behaviour in the Islamic financial industry, IFIs will have to contemplate a methodology

¹¹ For example, the AAOIFI and the IFSB.

¹² See 'The Complete Idiot's Guide to Understanding Ethics' (2nd Edition) by David Ingram and Jennifer Parks.

for encouraging observance not just in the hereafter but in today's world too. AAOIFI and IFSB have, in many respects, led the charge to-date but the guidance published by these bodies is not universally adopted by IFIs globally and they seem to focus rather more attention on the behaviour of the employees, auditors and the independent Shari'a supervisory boards of IFIs, rather than on the corporate entity and its board of directors. It is the latter body which is ultimately responsible for the day to day management of the business. Alongside this formal material, there is a growing body of literature that seek to encourage IFIs to adopt a far broader approach to ethics than merely paying zakat or sponsoring ad hoc community events. There is insufficient evidence that these principles have been deeply embedded in Islamic financial institutions and form part of the day to day mindset of all personnel.

Ultimately, an ethical approach to business requires a holistic approach that permeates the entire firm. All of the stakeholders have to 'buy into' the new approach and live it each day in all that they do. However, in a modern corporation, it should be the senior management that are obliged to inculcate the change and demonstrate its observance by their own behaviour. If management does not have the willingness to do this

independently, then they may need to be encouraged by external movers. How might this happen? For some, it may be as simple as re-reading their Qur'an and thinking more deeply about what motivates them, whether as human beings and/or as Muslims (NB: although it should not be forgotten that not all senior management in IFIs are Muslims so this cannot be taken for granted). In some firms, it may require their Shari'a Scholars to assert a broader ethical narrative. In all cases, the final sanction would see law-makers and financial institution regulators taking steps to introduce measures designed to compel certain modes of behaviour.

The first step management could take in many cases would be to draft and publish a code of ethics for their firm. In looking at examples in Western financial institutions, a bank well known in the Middle East, Standard Chartered Bank¹³, demonstrates how this can be done. Such a document is far wider than merely bribery and corruption and extends to general behaviour that includes avoiding conflicts of interest; avoiding insider dealing; treating people with respect; and general notions of responsible behaviour within the community. All of these are attributes that the CEO of any Islamic financial institution would (and should) expect his staff to adhere to.

¹³ See Standard Chartered Bank, Group Code of Conduct, Leading by Example (July 2008).

CASE STUDY: THE UK BRIBERY ACT¹⁴

In recent times, several providers of legal and business advisory services have developed 'corporate integrity campaigns' to help them explain to their clients the implications of legal changes that effectively start to 'criminalise' behaviour that may previously have been considered 'unethical' but was not necessarily illegal. The next few paragraphs discuss certain characteristics of the new Bribery Act in the United Kingdom to demonstrate how thinking has developed in this area. Lawyers in both government and private practice have formed the view that this was a key agenda item for corporate boards, financial service regulators and national legislators because:

- it has become part of the international regulatory response to the credit crisis;
- it has been expressed as being part of sound corporate governance;
- corruption investigations/prosecutions are on the increase;
- developing economies have a diminished tolerance for corruption; and
- it forms a major part of modern corporate risk analysis: namely non financial (reputation) risk.

Although the role and importance of ethics in business is wider than dealing with issues of bribery and corruption, the way in which the law is dealing with this particular issue illustrates an almost symbiotic relationship between law and ethics.

The coming into force of the UK Bribery Act on 1st July 2011 was the culmination of pressure that had been mounting over the preceding eleven years since the Law Commission concluded in 1998 that the then current law was 'obscure, complex, inconsistent and insufficiently comprehensive'. This chapter need not explore the background to these developments however, what is interesting for present purposes, is the way in which the offences have been crafted and what will have to be done by companies in order to defend against prosecution.

The four principal (categories of) offences are¹⁵:

Offence of bribing another person

Offence (1) is concerned with the conduct of the payer. The payer must be shown, directly or through a third party, to have given, offered or promised an advantage to the recipient with the intention to induce the recipient to perform a relevant function or activity improperly or to reward the recipient for such conduct. It matters not whether the person to whom the advantage is offered is the same person who it is intended will perform the function improperly.

¹⁴ This Case Study is derived from materials produced by Norton Rose partner Sam Eastwood and the work of Feras Al Amro Law Firm in association with KPMG, Saudi Arabia.

¹⁵ See Norton Rose Group Briefing Paper, 20 November 2009: 'The Bribery Bill' (Sam Eastwood and Chris Campbell-Holt) and subsequent publications.

Offences relating to being bribed

Offence (2) is concerned with the conduct of the recipient. The recipient must be shown to have requested, agreed to receive, or accepted an advantage intending that, in consequence, a relevant function or activity should be performed improperly. It does not matter whether the recipient receives or accepts the advantage directly or through a third party or whether it is for the recipient's benefit or that of another.

Bribery of a Foreign Public Official (FPO)

Offence (3) comprises a new offence if it can be proved that an advantage was offered, promised or given to an FPO with the intention:

- of influencing the FPO acting as an official; and
- of obtaining or retaining business, where the FPO was neither permitted nor required by written law to be so influenced.

The new corporate offence: failure to prevent bribery

A commercial organisation (a corporate or a partnership) could be guilty where:

- a bribe has been made by a person performing services for or on behalf of the commercial organisation;
- with the intention to obtain or retain business or other business advantage for the commercial organisation.

The offence is punishable by a fine. The offence creates a form of strict liability in order to deter companies from giving direct or indirect support to a culture of bribery on the part of those with whom they do business.

The adequate procedures defence

It is a defence for the organisation to show that there were 'adequate procedures' in place designed to prevent employees or agents committing bribery (see further below). The availability of this defence is an important limitation on liability for the offence and demonstrates that the key cause for concern is companies that fail to make continuing and systematic efforts to ensure that active bribery is not committed on their behalf.

The penalties on conviction would be the same as for fraud including, in the most serious cases, a sentence of up to ten years' imprisonment following conviction on indictment.

In parallel with these developments and whilst the Bribery Act was at the Bill stage, the Serious Fraud Office (SFO) in the UK published guidance on the benefits for corporations of voluntarily disclosing overseas corruption¹⁶. The key message that permeates through the guidance is that this new US-style system of self-reporting, under which "effective and proportionate sanctions" will be crafted as appropriate, will help produce "a new corporate culture". The SFO advance several key benefits of self-reporting under this new regime, among them (i) the prospect of a civil rather than a criminal outcome, (ii) the opportunity to manage the issues proactively, (iii) meeting stakeholder expectations in term of good corporate citizenship and (iv) assuming a negotiated settlement is achieved, avoiding the debarment provisions of the EU Public Procurement Directive.

At the same time, the SFO sought to convey the message that there will be consequences for corporations that choose not to self report, warning that it "expects to conduct more criminal investigations and prosecutions in the future". Under the new Bribery Act, a commercial organisation ("**C**") will be guilty of an offence if: "(a) a person ("**A**") performing services for or on behalf of C bribes another person; (b) the bribe was in connection with C's business and (C) a responsible person ... was negligent in failing to prevent the bribe"¹⁷.

And, just as the Bribery Act provides for a defence of the corporate having "adequate procedures" in place to prevent bribery, the SFO has indicated that it will be looking for evidence of such procedures "to assess how successful the corporate has been in mitigating risk". The SFO gave the following examples as indications of a compliant culture:

- A clear statement of an anti-corruption culture fully and visibly supported at the highest levels in the corporate.
- A Code of Ethics (NB: emphasis added).
- Principles that are applicable regardless of local laws or culture.
- Individual accountability.

¹⁶ See Norton Rose Group Briefing Paper dated 27 July 2009: 'A culture change among corporates: SFO publishes guidance on self-reporting' (Sam Eastwood and Holly Howarth)

¹⁷ See 'The Bribery Act 2010: Commercial Organisations Beware!' Feras Al Amro Law Firm in association with KPMG for further detailed case studies illustrating potential offence situations.

- A policy on gifts and hospitality and facilitation payments;
- A policy on outside advisers/third parties including vetting and due diligence and appropriate risk assessments.
- A policy concerning political contributions and lobbying activities.
- Training to ensure dissemination of the anti-corruption culture to all staff at all levels.
- Regular checks and auditing in a proportionate manner.
- A helpline within the corporate which enables employees to report concerns;
- A commitment to making it explicit that the anti-bribery code applies to business partners.
- Appropriate and consistent disciplinary processes.
- Whether there have been previous cases of corruption within the corporate and, if so, the effect of any remedial action.

Pursuant to section 9 of the Bribery Act, the Ministry of Justice issues further guidance in March 2011 comprising six principles that will guide compliance with the Bribery Act. The guidance is not prescriptive and is not intended to constitute a 'one size fit all' solution. Companies should implement procedures guided by the following¹⁸:

- **Principle 1: Risk assessment** – The procedures should follow an internal and external corruption risk assessment – this analysis should be periodic, informed and documented;
- **Principle 2: Top level commitment** – The procedures should form part of a visible and unambiguous support of the company's top level management, which must forbid any form of corruption - this must be reflected in the values, the communication and strategy of the company;
- **Principle 3: Due diligence** – Organisations should undertake audits and due diligence procedures relating to the persons who perform services for, or on behalf of the organisation, in order to mitigate identified bribery risks;
- **Principle 4: Clear, practical and accessible policies and procedures** – The procedures should be well communicated and understood both internally and externally, in particular through effective training;
- **Principle 5: Effective implementation** - They should be proportionate (i) to the risk faced by the company and (ii) to the nature scale and complexity of the company, embedded throughout the organisation and implemented through appropriate communication and training;
- **Principle 6: Monitoring and review** – they should form part of a periodic control and review programme.

Although the above discussion focuses on bribery and corruption what it is really indicative of, is the desire within government to promote behavioural change within corporations. Such change will be achieved by using a combination of carrot and stick measures. This type of legislation is not unique to the United Kingdom other than the United States. Within the past year or so strengthened anti-corruption legislation has been promulgated in countries as diverse as India, Russia China and Spain.

Similar Middle Eastern legislation

In case any Islamic financial institution in the Middle East and/or the Muslim-majority world thinks this legislative approach will pass them by, the desire for change in these areas is not limited to Western countries and companies.

Bahrain - For example, at the end of 2009, the Government of Bahrain announced its intention to establish an authority to combat corruption in the public and private sectors in the Kingdom. In October 2010 Bahrain ratified the United Nations Convention Against Corruption.

United Arab Emirates - In the UAE, Sheikh Mohammed bin Rashid Al Maktoum, the Ruler of Dubai, introduced new laws on corruption in late 2009 (Law No. 37 of 2009).

Saudi Arabia - In May 2011 the Kingdom of Saudi Arabia also established the Anti-corruption National Commission whose mandate is aimed at protecting integrity, promoting the principle of transparency, and fighting against financial and administrative corruption.

¹⁸ Ibid 16.