11th Islamic Financial Stability Forum

Comparative Study on the Implementation of the IFSB Standards: Cross-country Assessment

Jakarta, Indonesia

In conjunction with the 26th Meeting of the Council of the IFSB

Organised By: IFSB
Hosted By: BANK INDONESIA
11th IFSF : Speakers & Discussants

Speakers:
- Zahid ur Rehman Khokher, Assistant Secretary-General, Islamic Financial Services Board
- Peter Casey, Consultant, Islamic Financial Services Board

Discussants:
- H.E. Saeed Ahmad, Deputy Governor, State Bank of Pakistan
- Khalid Hamad Abdulrahman, Executive Director of Banking Supervision, Central Bank of Bahrain
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Comparative Study on the Implementation of the IFSB Standards: Cross-country Assessment

Presented at:
11th Islamic Financial Stability Forum
Jakarta, Indonesia 2 April 2015

Peter Casey
Zahid ur Rehman Khokher
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9TH STABILITY FORUM: STANDARDS IMPLEMENTATION INITIATIVES
While differences in market size and sophistication, all FSB members are deemed systemically important.

Sole Objective: Promoting safety and soundness.

Rigorous implementation monitoring including peer reviews and self-assessments

Members’ commitment to implement the global standards

Small but much more rapidly growing sector, with significant variations in market development across members

Promoting safety and soundness along with consistency in treatment across jurisdictions

IFSB members face implementation challenges that could be unique to each jurisdiction

Enhance capacity building and identify jurisdictions with large Islamic financial sectors
9TH STABILITY FORUM: STANDARDS IMPLEMENTATION INITIATIVES (2)

IFSB

- 16 Standards
- 5 Guidance Notes
- 1 Technical Note

Initiatives

- FIS Workshops for RSAs – build regulatory capabilities
- Knowledge dissemination initiatives – country & regional and speakers programmes
- Technical assistance
- E-learning modules

Implementation

Monitoring

- Implementation Survey 2013
- Status of implementation
- Key challenges faced by jurisdictions
- Mechanism for the TA
- Internal reorganisation of the Secretariat?
SURVEY RESPONDENTS INCLUDED MAJOR IFSB MEMBER JURISDICTIONS…

- 30 RSAs representing 22 countries.
- RSAs distributed geographically across a number of important regions.

Membership types

- Full Member: 21
- Associate Member: 7
- Observer Member: 2

Regional breakdown of respondent RSAs

- Asia (excluding GCC): 14
- GCC: 9
- North Africa: 5
- West Africa: 2
BANKING SECTOR: SIGNIFICANT TAKE UP OF RECENTLY ISSUED STANDARDS

One-third of RSAs implemented IFSB-1, IFSB-3, and IFSB-4.

IFSB-15 was already implemented by one-third (7 out of 21) of RSAs within one year of issuance.

More than one-fifth of RSAs implemented IFSB-13 and IFSB-16 and most of the RSAs were planning to implement those Standards.

<table>
<thead>
<tr>
<th>Standards</th>
<th>IFSB-1</th>
<th>IFSB-2</th>
<th>IFSB-3</th>
<th>IFSB-4</th>
<th>IFSB-5</th>
<th>IFSB-7</th>
<th>IFSB-12</th>
<th>IFSB-13</th>
<th>IFSB-15</th>
<th>IFSB-16</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base</td>
<td>22</td>
<td>10</td>
<td>22</td>
<td>22</td>
<td>9</td>
<td>7</td>
<td>22</td>
<td>22</td>
<td>21</td>
<td>20</td>
</tr>
</tbody>
</table>
The Survey found that 36% (four (4) of 11 RSAs) implemented IFSB-6

- Six (6) RSAs fully implemented the cross-sectoral standards, namely IFSB-9 and IFSB-10
IMPLEMENTATION STATUS IMPROVES SIGNIFICANTLY WITH MARKET SHARE

Standards implementation (minimum 1 IFSBS standard) - Comparison of Overall Results & Jurisdictions with More than 5% Market Share

Overall: 28 Jurisdictions

- Completed: 54%
- Planned: 14%
- In progress: 14%
- Do not plan: 18%

>5% market share: 17 Jurisdictions

- Completed: 65%
- Planned: 29%
- In progress: 6%
- Do not plan: 0%

Market share of Islamic finance

<table>
<thead>
<tr>
<th>Market share</th>
<th>Completed</th>
<th>In Progress</th>
<th>Planning</th>
<th>Do not plan to</th>
</tr>
</thead>
<tbody>
<tr>
<td>&gt;0%</td>
<td>36%</td>
<td>20%</td>
<td>27%</td>
<td>17%</td>
</tr>
<tr>
<td>≥5%</td>
<td>42%</td>
<td>19%</td>
<td>33%</td>
<td>7%</td>
</tr>
<tr>
<td>≥10%</td>
<td>41%</td>
<td>13%</td>
<td>38%</td>
<td>8%</td>
</tr>
<tr>
<td>≥15%</td>
<td>48%</td>
<td>7%</td>
<td>40%</td>
<td>6%</td>
</tr>
<tr>
<td>≥20%</td>
<td>53%</td>
<td>10%</td>
<td>33%</td>
<td>4%</td>
</tr>
<tr>
<td>≥25%</td>
<td>69%</td>
<td>12%</td>
<td>18%</td>
<td>1%</td>
</tr>
</tbody>
</table>
MEASURED PROGRESS IN IMPLEMENTATION OVER THE ONE-YEAR PERIOD

The implementation progress was seen particularly in IFSB-3, IFSB-4, IFSB-5, IFSB-6, IFSB-7 and IFSB-11 where they were each fully implemented by 5, 4, 3, and 3 RSAs in 2014, as compared to 4, 3, 2, and 2 RSAs in 2013.
implementing challenges broadly remained consistent over the years

<table>
<thead>
<tr>
<th>Challenges</th>
<th>Mean</th>
<th>Rank</th>
<th>Base</th>
<th>Mean</th>
<th>Rank</th>
<th>Base</th>
<th>Mean</th>
<th>Rank</th>
<th>Base</th>
</tr>
</thead>
<tbody>
<tr>
<td>Need to change legal framework</td>
<td>2.36</td>
<td>1</td>
<td>28</td>
<td>N/A</td>
<td></td>
<td></td>
<td>N/A</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Need to change regulatory and supervisory framework</td>
<td>2.52</td>
<td>2</td>
<td>28</td>
<td>2.4</td>
<td>1</td>
<td>29</td>
<td>2.7</td>
<td>1</td>
<td>25</td>
</tr>
<tr>
<td>Lack of personnel with relevant knowledge/experience/training</td>
<td>2.62</td>
<td>3</td>
<td>29</td>
<td>2.5</td>
<td>2</td>
<td>30</td>
<td>3.0</td>
<td>2</td>
<td>25</td>
</tr>
<tr>
<td>Cost of implementation</td>
<td>2.73</td>
<td>4</td>
<td>28</td>
<td>3.38</td>
<td>3</td>
<td>29</td>
<td>3.9</td>
<td>3</td>
<td>25</td>
</tr>
<tr>
<td>Lack/poor quality of data to support implementation of the Standards</td>
<td>2.79</td>
<td>5</td>
<td>28</td>
<td>3.6</td>
<td>5</td>
<td>30</td>
<td>4.1</td>
<td>4</td>
<td>25</td>
</tr>
<tr>
<td>Institution size and complexity</td>
<td>2.90</td>
<td>6</td>
<td>27</td>
<td>3.45</td>
<td>4</td>
<td>29</td>
<td>4.1</td>
<td>5</td>
<td>25</td>
</tr>
</tbody>
</table>

Most significant challenges faced by jurisdictions relate to ‘change in legal and regulatory framework’ and ‘lack of appropriate personnel’.
13 out of 30 (43%) RSAs preferred to organise more FIS workshops by IFSB as the most significant option for implementation of IFSB standards.

The direct TA was also ranked as most significant option by 10 out of 30 (33%) RSAs.
COMPARATIVE STUDY ON IMPLEMENTATION
OBJECTIVES OF STUDY

- To explore the extent of implementation of selected IFSB Standards in the IFSB member countries
- To identify factors that make for strong or weak patterns of implementation of IFSB standards
- To provide recommendations to the IFSB members on the areas that they should emphasise in strengthening resilience and stability

COMPARATIVE STUDY ON IMPLEMENTATION OF SELECTED IFSB STANDARDS
THE STUDY: JURISDICTIONS AND STANDARDS

Draws on:
- General evidence on standards implementation
- IFSB’s 2014 standards implementation survey
- Discussions and correspondence with selected RSAs in the following jurisdictions:
  - Bangladesh
  - Bahrain
  - Indonesia
  - Jordan
  - Pakistan
  - Malaysia
  - Sudan

Standards applicable to the banking sector were chosen:
- IFSB-2: Capital Adequacy Standard for IIFS
- IFSB 4: Disclosures to Promote Transparency and Market Discipline for IIFS
- IFSB-5: Guidance on key Elements in the Supervisory Review Process of IIFS
- IFSB-10: Guiding Principles on Sharîah Governance Systems for IIFS

Rationale
- They are well-established standards → significant practical experience of implementation
- Three of them have conventional counterparts (the three pillars of the Basel capital framework); one is unique to Islamic finance → allows for comparison
- They are of different types → whether the type of standard is an important influence
EVIDENCE: STUDIES AND SURVEY

Studies cover standards implementation in emerging markets and developing economies

- Common issues of capacity, independence and powers
- Particular issue around ability to exercise discretion
- May be appropriate to “deconstruct” standards for implementation

Challenges in implementing IFSB-2, 4, 5 and 10

- For IFSB-10 main issue seems to be fitting Shari’ah governance into frameworks designed around conventional regulation.
- IFSB-2 clearly more difficult than IFSB-4 or IFSB-5.
- Scores highly on both “too detailed and technical” and “too unspecific”
- Technical knowledge of Islamic finance among staff seen as a significant problem at implementation stage

Technical assistance

Priority may be lower, but sought for substantial periods

IFSB vs conventional standards for banking

Banking (base: 21)

- 48% More challenging than conventional
- 9% Less challenging than conventional
- 39% About the same
- 4% Not relevant
## Implementation process

- The successful implementers have a working presumption that IFSB standards will be implemented, and their dialogue with industry takes place in that context.
- Others may have more difficulty gaining consensus on need to implement.
- Some also need to convince local Shari’ah boards.

## Other issues

### Jurisdictional

- In dual systems, a single top-level legal framework may be an advantage.
- Some RSAs have problems of institutional capacity.
- So does industry in contributing to discussion.
- Implementation benefits from:
  - Identifiable policy resources for Islamic finance
  - Involvement in the standards creation process.

### Standards

- In general, few criticisms of IFSB standards.
- Some jurisdictions want more complete standards, covering same issues as conventional counterparts.
- Too long a period between the emergence of a conventional standard and its Islamic counterpart.
- The standards did not always use language consistently.
- Possible areas for future work: strategic planning, Islamic windows.
MAIN OVERALL CONCLUSIONS

• The factor most conducive to successful implementation is a commitment to implement standards

Commitment

• IFSB needs to create and support a presumption for implementation

Presumption

• As with conventional standards, jurisdictions have different needs: simplicity vs completeness

Simplicity vs. completeness

Standards development

Faster, more complete response to conventional standards?

“Implementation ready” standards

Consistent definitions and terminology

Involvement in the process gives real value
IMPLEMENTATION

- Need to support members with implementation strategy?
- Full implementation standard by standard will not always be right
- Are there advantages to a “deconstruction” approach for more complex standards?
- Core Principles are particularly suited to this; do they offer an alternative approach to implementation strategy, especially for jurisdictions new to Islamic finance
- Communication may need to go beyond technical staff, and beyond the RSA

Members’ requests

- More comparative studies
- Longer/ more sustained TA

- But what is envisaged here?
- May involve working with other agencies
MOVING FORWARD
GOING FORWARD: MULTI-PRONGED STRATEGY FOR SUPPORTING IMPLEMENTATION (1)

BROADER CONSIDERATIONS FOR STANDARDS IMPLEMENTATION PROCESS

- Adoption of conventional standards - how frequent?
- Additional aspects: specific Islamic finance issues, building blocks etc.
- More coverage for some areas e.g. windows

The IFSB Standards Agenda

- Faster, more complete response to conventional standards?
- Involvement of RSAs in standards preparation supports implementation
- Consistent definitions and terminology

Standards Development: Process and Content

- IFSB to work with other agencies for greater impact
- "Deconstruction" of standards for implementation
- Implementation approach based on Core Principles
- Communication with local industry as well as RSAs

Implementation Support
GOING FORWARD: MULTI-PRONGED STRATEGY FOR SUPPORTING IMPLEMENTATION (2)

**Technical Assistance:**
- Need to significantly ramp up the IFSB’s capabilities in direct TA programmes for a closer engagement with the members for a longer period
- Staff missions of limited short duration to facilitate groundwork of implementing standards

**FIS Workshops:**
Need to have more frequent workshops and in more jurisdictions

**E-Learning:**
These modules will help reach out to member RSAs and market players and address the issue of capacity constraint

**Comparative Studies**
Working with Partners
The Secretariat will submit a detailed strategy to the Council in December 2015 as a part of new Strategic Performance Plan 2016-2018

<table>
<thead>
<tr>
<th>Component</th>
<th>Issues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Staffing</td>
<td>• Additional intellectual resources to address capacity and capability constraints</td>
</tr>
<tr>
<td>Financial resources</td>
<td>• Additional financial resources to help support implementation initiatives</td>
</tr>
<tr>
<td>Organisational priorities</td>
<td>• Changes in organisational structure of the Secretariat</td>
</tr>
<tr>
<td></td>
<td>• Possible significant implications for SPP 2016-2018</td>
</tr>
</tbody>
</table>
THANK YOU FOR YOUR ATTENTION