IFSB WORKING PAPER SERIES

WP-04/10/2015

COMPARATIVE STUDY ON THE IMPLEMENTATION OF SELECTED IFSB STANDARDS

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Published by: Islamic Financial Services Board
Level 5, Sasana Kijang, Bank Negara Malaysia
2, Jalan Dato' Onn, 50480 Kuala Lumpur, Malaysia
Email: ifsb_sec@ifsb.org

ISBN 978-967-5687-47-1

ABOUT THE ISLAMIC FINANCIAL SERVICES BOARD (IFSB)

The IFSB is an international standard-setting organisation which was officially inaugurated on 3 November 2002 and started operations on 10 March 2003. The organisation promotes and enhances the soundness and stability of the Islamic financial services industry by issuing global prudential standards and guiding principles for the industry, broadly defined to include banking, capital markets and insurance sectors. The standards prepared by the IFSB follow a lengthy due process as outlined in its Guidelines and Procedures for the Preparation of Standards/Guidelines, which involves, among others, the issuance of exposure drafts, holding of workshops and, where necessary, public hearings. The IFSB also conducts research and coordinates initiatives on industry-related issues, as well as organises roundtables, seminars and conferences for regulators and industry stakeholders. Towards this end, the IFSB works closely with relevant international, regional and national organisations, research/educational institutions and market players.

For more information about the IFSB, please visit **www.ifsb.org**.

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ABBREVIATIONS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
ADB	Asian Development Bank
BCBS	Basel Committee on Banking Supervision
BCG	Basel Consultative Group
CBB	Central Bank of Bahrain
EMDEs	Emerging Markets and Developing Economies
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
GDP	Gross Domestic Product
GFC	Global Financial Crisis
G20	Group of Twenty
IAIS	International Association of Insurance Supervisors
IFRS	International Financial Reporting Standards
IFSB	Islamic Financial Services Board
IIFS	Institutions offering Islamic financial services
IMF	International Monetary Fund
RSAs	Regulatory and supervisory authorities
SPP	Strategic Performance Plan

ABSTRACT

This study[1] aims to identify factors that make for strong or weak patterns of implementation of Islamic Financial Services Board (IFSB) standards. It draws on the IFSB's annual standards implementation survey, on other publications, and on discussions and correspondence with regulatory and supervisory authorities (RSAs) in countries with different levels of standards implementation. It focuses, in particular, on four standards applicable to the banking sector that have been in existence for a sufficient period to offer reasonable experience of implementation. Research by conventional standard-setters indicates that the different stages of development of financial markets pose problems for all standard-setters. Ways need to be found for emerging and developing markets to "deconstruct" international standards and to prioritise implementation in accordance with local priorities. The implementation of technical standards often needs to be accompanied by institutional development. In Islamic finance, a significant minority of regulatory and supervisory authorities find greater difficulty in implementing IFSB standards than do their conventional counterparts. This paper examines reasons for this. Some reasons lie in the structure and drafting of the standards themselves, others in the structure and institutional capacity of the RSA, and still others in the general institutional climate in the jurisdiction. The factor most conducive to standards implementation is a prior presumption that international standards in general, and IFSB standards in particular, will be implemented. Few criticisms were made of either the IFSB standards or the standards process. However, in some areas there is a wish to see standards produced more quickly, mirroring more closely the coverage of conventional counterparts and that are more "implementation ready". There is a clear demand for greater support for implementation, and the IFSB does expect that its Strategic Performance Plan 2016–2018 will include expanded support for implementation. This may involve considering whether some standards can be deconstructed so that jurisdictions can implement them in phases as appropriate to their own needs. In areas other than capital standards, an approach based on the Core Principles for Islamic Finance Regulation may also have merits. Where the IFSB does provide implementation support to particular jurisdictions, this may need to go beyond those responsible for Islamic finance in the particular RSA and be tailored to different levels of knowledge and different requirements.

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1 The working paper greatly benefited from the feedback and coordination of a core team of the IFSB Secretariat, led by Assistant Secretary-General, Mr Zahid ur Rehman Khokher and including Mr Md. Salim Al Mamun, Mr Hamizi Hamzah and Mr Abozer Majzoub. Ms Nur Khairun Nissa Zawawi of the IFSB Secretariat provided support in survey distribution and setting up meetings with the representatives of various regulatory and supervisory authorities. Similarly, Mrs Siham Ismail and Ms Rosmawatie Abdul Halim provided assistance in the formatting and publication of the paper. I am also grateful to the banking regulatory and supervisory authorities, multilateral bodies, and other institutions that are members of the IFSB for their participation in the survey, interviews and useful comments on the draft paper.

EXECUTIVE SUMMARY

This study, funded by the Asian Development Bank (ADB), aims to identify factors that make for strong or weak patterns of implementation of Islamic Financial Services Board (IFSB) standards. It considers factors both within regulatory and supervisory authorities (RSAs) and in the standards themselves.

The study draws on the IFSB's annual standards implementation survey, as well as other publications. It also draws on discussions and correspondence with the RSAs of three countries that have been identified as possible recipients of ADB technical assistance, and of four countries with a strong record of implementation of IFSB standards. It focuses, in particular, on four standards applicable to the banking sector that have been in existence for a sufficient period to offer reasonable experience of implementation. These standards are of different types. One addresses the capital adequacy regime, two are concerned in a broad sense with business conduct, while a fourth is principally concerned with the activity of the supervisor. Three have conventional counterparts, in the three Pillars of the Basel regime; one, concerned with *Sharīʿah* governance, does not.

There is relatively little research available on the implementation of conventional standards, especially in emerging markets and developing economies (EMDEs). Furthermore, the climate has changed materially since the Global Financial Crisis (GFC), which began in 2007 and makes earlier research of limited relevance. There are, however, two post-GFC documents that give useful and relevant perspectives on the implementation of conventional standards.

In September 2013, the Financial Stability Board (FSB) published a study entitled "Monitoring the Effects of Agreed Regulatory Reforms on EMDEs". More recently, the Basel Consultative Group of the Basel Committee on Banking Supervision produced a Working Paper looking specifically at the implementation challenges of the Basel framework for a broadly similar set of countries. It is clear from these sources that the different stages of development of financial markets and their legal and regulatory infrastructure pose problems for all standard-setters. There is a growing recognition that ways need to be found for EMDEs in particular to "deconstruct" international standards and to prioritise implementation in accordance with local priorities. There is also a recognition that the implementation of technical standards often needs to be accompanied by institutional development – for example, in the area of supervisory powers. Islamic finance shares some of these tensions. It also has some specific features of its own, including growth and the constant presence of new entrants, whose infrastructure and experience will be centred in conventional finance.

Evidence from the IFSB's own implementation survey and from discussions with the relevant RSAs is presented in detail in subsequent chapters. It is clear that a significant minority of RSAs find greater difficulty in implementing IFSB standards than do their conventional counterparts. Some of the reasons for this lie in the standards themselves, including their structure, drafting, and relationship to conventional counterparts (where these exist). Other reasons lie in the structure and institutional capacity of the RSA, and yet others in the general institutional climate in the jurisdiction itself. The point that emerges most strongly is that the factor most conducive to standards implementation is a commitment to implement standards. The successful implementers start with the presumption that international standards in general, and IFSB standards in particular, will be implemented. In other jurisdictions, that presumption is much weaker. Also, in some instances the implementation of Islamic finance standards has lower priority than that of conventional standards.

There were few criticisms of either the IFSB standards or the standards process. However, where conventional standards have a high implementation priority, the obvious examples being the Basel capital and liquidity regimes, arguments were put forward that the IFSB counterparts should be developed more quickly, to allow jurisdictions with dual banking systems to implement both more-or-less simultaneously. For these standards, the presumption should also be that the IFSB standard should at least mirror the coverage of the conventional one, except where elements are clearly not relevant to Islamic finance.

All the sources used for this study suggest that there are some jurisdictions that want standards that are "implementation ready", with minimal further development or exercise of discretion. In some cases, particularly for quantitative standards, it may be possible to offer a "default option" which can be implemented without discretion, but from which more advanced jurisdictions can depart if they have evidence to support that departure. In other cases, it may be possible to state principles in such a way that they can readily be written into law or regulation to define a high-level regime, though this will work only where RSAs are able to supervise on the basis of principles rather than detailed rules. Implementation is also easier where the RSA has been involved in the development of the standard, though this will not be possible for all RSAs, notably those new to Islamic finance. There is a clear demand for greater support for implementation, and the IFSB does expect that its Strategic Performance Plan 2016–2018 will include expanded support for implementation. Some elements such as institutional capacity building fall more naturally to the multilateral agencies. In addition, standards implementation needs to be put into the context of a strategic approach to the Islamic finance sector. While the IFSB has worked with other institutions to provide a framework for such strategic decisions, it may be more appropriate for more jurisdiction-specific support to be given by institutions other than the IFSB.

Particularly for jurisdictions new to Islamic finance, a standard-by-standard approach to implementation may not be the best solution. It may be that some standards could be deconstructed so that jurisdictions can implement them in phases as appropriate to their own needs. In areas other than capital standards, an approach based on the Core Principles for Islamic Finance Regulation may also have merits. In addition to the fact that a Core Principles-based approach is capable of being broken into manageable but worthwhile elements, the Core Principles explicitly address some of the issues of supervisory capacity.

Where the IFSB does provide implementation support to particular jurisdictions, this may need to go beyond those responsible for Islamic finance in the particular RSA. There appear to be needs for communication with other RSA staff, and with local industry players about the relevance and the content of standards. This will be helped if the IFSB's workshops and e-learning modules are tailored to different levels of knowledge and different requirements.

SECTION 1: INTRODUCTION

1. This study, funded by the Asian Development Bank (ADB), aims to identify factors that make for strong or weak patterns of implementation of Islamic Financial Services Board (IFSB) standards. It considers factors both within regulatory and supervisory authorities (RSAs) and in the standards themselves, with the aim of improving the overall pattern of implementation.

2. The study draws on the IFSB's annual standards implementation survey, which in 2014 included questions specifically designed to address some of the issues discussed above. It also draws on discussions and correspondence with the RSAs of the three countries that have been identified as possible recipients of ADB technical assistance (Bangladesh, Indonesia and Pakistan) and four countries with a strong record of implementation of IFSB standards (Bahrain, Jordan, Malaysia and Sudan). The study is confined to standards applicable to the banking sector because of the importance of that sector to Islamic finance, but also because of the number of IFSB standards in the sector and the fact that it has, as a result, greater experience of implementation.

3. Four standards were chosen for particular focus:
   (a) IFSB-2: *Capital Adequacy Standard for Institutions (other than Insurance Institutions) offering only Islamic Financial Services (IIFS)*
   (b) IFSB 4: *Disclosures to Promote Transparency and Market Discipline for IIFS (excluding Islamic Insurance (Takāful) Institutions and Islamic Mutual Funds)*
   (c) IFSB-5: *Guidance on Key Elements in the Supervisory Review Process of IIFS (excluding Islamic Insurance (Takāful) Institutions and Islamic Mutual Funds)*
   (d) IFSB-10: *Guiding Principles on Sharīʿah Governance Systems for IIFS*

4. These four were chosen because:
   (a) They are well-established standards, so there is significant practical experience of implementation. Although IFSB-2 and IFSB-5 have now been superseded (by IFSB-15 and IFSB-16, respectively), the experience of implementing the earlier standards should be highly relevant to implementing their successors.
   (b) Three of the standards have conventional counterparts (the three pillars of the Basel capital framework), while one, IFSB-10, is unique to Islamic finance. This allows some comparison between ease of implementing

conventional and Islamic standards, and how far the existence of a related conventional standard assists or impedes implementation.

(c) They are of different types. One addresses the capital adequacy regime, two are concerned in a broad sense with business conduct, while the fourth is principally concerned with the activity of the supervisor. They should thus cast light on whether the type of standard is an important influence on implementation.

5. One caveat should be noted: essentially all the information on implementation in particular jurisdictions comes from the RSAs themselves. The resources made available for this study did not allow a wider range of informants to be targeted (though some publicly available information from other sources has been used). An International Monetary Fund (IMF) study in 2000 found that self-assessments of compliance with, in this case, Basel Core Principles found a substantially greater degree of compliance than assessments by the IMF and World Bank, and that this often reflected a defective understanding of the underlying purpose of the Principle.[2] It is thus likely that, on average, RSAs will be more optimistic about their own capabilities and about the status of implementation of standards than might be an external observer. However, some RSAs will be more rigorous than others and no conclusion can be drawn about a particular RSA.

2 See "Experience with Basel Core Principle Assessments", IMF, April 2000, notably paragraphs 31–35.

SECTION 2: GENERAL ISSUES IN THE IMPLEMENTATION OF STANDARDS

6. There is relatively little research available on the implementation of conventional standards, especially in emerging markets and developing economies (EMDEs). Furthermore, the climate has changed materially since the Global Financial Crisis (GFC), which began in 2007. That crisis led to changes to substantive standards, and to institutional reforms, but also to greatly increased international pressure for standards implementation.

7. The largest broadly comparable data set on implementation of any standards comes from the IMF/World Bank Financial Sector Assessment Program (FSAP). IMF and World Bank staff have analysed the outcomes of FSAPs to draw conclusions on the pattern of implementation and areas of particular difficulty.[3] This data set and the analyses derived from it are, however, of limited use for current purposes because:

   (a) Where they deal at all with the implementation of standards and codes, FSAPs do so only at the level of the Core Principles of the various standard-setters. It is difficult to extrapolate from this information, even where it is available in full detail, to the implementation of the detailed standards that sit below the Core Principles (e.g. from the Basel Core Principles to, say, Pillar 3 of the Basel capital regime).

   (b) The analyses deal with the pattern of compliance or non-compliance with Core Principles, but do not discuss the reasons. In addition, they predate the substantial changes that have taken place since the GFC.

   (c) For various reasons, fully detailed FSAPs have been focused primarily on the jurisdictions considered of most importance internationally. The post-GFC reforms expanded the membership of the Financial Stability Board (FSB) and effectively made an FSAP obligatory for members, but this has reduced the resources available for FSAPs in other jurisdictions.

   (d) As regards the countries considered in this study:

      ○ Bahrain and Pakistan have full FSAPs available, but dating from 2006 and 2004, respectively.

      ○ Bangladesh and Indonesia both have 2010 FSAPs, which contain a summary analysis of compliance with the Basel Core Principles. In

3 See, for example, "Implementation of the Basel Core Principles for Effective Banking Supervision, Experiences, Influences, and Perspectives", IMF/World Bank, September 2002. There are comparable documents on the implementation of the Core Principles of the International Association of Insurance Supervisors (IAIS) and the International Organization of Securities Commissions (IOSCO).

the case of Indonesia, there has subsequently been a major change to the institutional structure of regulation.

- Malaysia has a 2013 FSAP and a full analysis of the observance of Core Principles. In the banking sector, many of the recommendations addressed either powers of the supervisor, including many issues likely to have been addressed in new financial services laws passed subsequently, or supervisory practices.
- Jordan and Sudan have no FSAPs available.

FSAPs, and analyses based on them, are therefore less helpful than one might expect.

8. There are, however, two post-GFC documents that give useful and relevant perspectives on the implementation of conventional standards.

9. In September 2013, the FSB published a study entitled "Monitoring the Effects of Agreed Regulatory Reforms on EMDEs". This study updated an earlier one by the FSB, IMF and World Bank.[4] It looked at the implementation of several standards, including the Basel III capital framework, which is the most recent conventional analogue of IFSB-2, IFSB-4 and IFSB-5, and also at the Basel III liquidity framework, which might be expected to share some characteristics in implementation. More recently, the Basel Consultative Group (BCG) of the Basel Committee on Banking Supervision (BCBS) produced a Working Paper looking specifically at the implementation challenges of the Basel framework for a broadly similar set of countries, and covering broadly similar ground.[5] This paper benefited from substantial input from EMDEs and was, indeed, largely an expression of their concerns.

10. The FSB paper drew lessons for the implementation of Basel III, of which the following may also be relevant to the implementation of corresponding IFSB standards.

> **"The implementation of the Basel III framework is hampered by a variety of factors in some EMDEs, particularly adequate resources and capacity.** Evidence from IMF and World Bank diagnostic work, including findings from FSAP assessments, indicates that authorities in EMDEs are making significant efforts to align their supervisory and regulatory framework with the Basel standards. Important challenges remain in terms of the independence and powers of supervisors as well as the availability of adequate data, tools and methodologies. In

4 "Identifying the Effects of Regulatory Reforms on Emerging Market and Developing Economies: A Review of Potential Unintended Consequences", FSB, IMF and World Bank, June 2012.

5 "Impact and Implementation Challenges of the Basel Framework for Emerging Market, Developing and Small Economies", BCG, BCBS, November 2014.

that regard, the most important constraining factor cited by many of these authorities is the availability of adequate human resources in supervisors, both in terms of numbers and (more importantly) expertise. This concern has been a recurring issue and is becoming more critical as the Basel framework becomes more complex.

While the Basel III framework has been developed to be applicable in various national contexts, several non-G20/FSB EMDEs are adopting a phased approach to its implementation. For these EMDEs, in the short term at least, implementing the Basel III framework competes with other priorities, such as enhancing loan classification systems, adopting consolidated supervision, or strengthening legal frameworks to undertake corrective and remedial measures. And since the Basel III framework is directed mainly at internationally active banks, not all of its elements are necessarily relevant for smaller domestic banks. As a result, a number of those EMDEs are adopting a phased approach that reflects their own national policy priorities and capacity constraints.

The IMF and World Bank are assisting EMDEs in this process via a variety of diagnostic, surveillance, policy guidance and capacity-building work.… Some of the lessons cited from this work include the need to 'deconstruct' the various elements of Basel III in order to help EMDEs prioritise areas that are most relevant (e.g. definition of regulatory capital or Pillar 2 risk assessments); integrate regulatory reform with enhancements to the supervisory framework; and engage with the industry to ensure effective implementation."

11. As already noted, the BCG document is more directly representative of the concerns of regulators in EMDEs. Those relating to the Basel capital and liquidity standards, and the BCG's responses to them, are summarised in the document as follows:

Background	Key recommendations by the BCG
Basel 2.5 led to increases in risk-weighted assets (RWAs) for trading exposures in the financial markets of EMDEs and small economies; while criteria for estimating RWA exposures is decided by parent banks and home-country supervisors.	Request for further BCBS guidance on the treatment, at the consolidated level, of subsidiaries' local sovereign exposures denominated and funded in local currency; and assess whether to re-evaluate consolidation practices.

Implementation of Basel III will generate a need for capital replenishment – in particular, the requirement that all Tier 1 and Tier 2 instruments have a "point of non-viability clause". If the clause is triggered, supervisors may face potential governance issues when conversion brings in shareholders that may not be fit and proper.	EMDEs and small economies should strengthen legal and institutional arrangements to enable issuance of capital instruments; define a priori criteria for the non-viability trigger; and ensure supervisory powers for case-by-case decisions.
When adopting Basel II and III, some banks may not reveal and recognise all potential risks associated with their balance sheets and could be tempted to put pressure on supervisors to approve internal risk-based (IRB) approaches/ internal models when both the bank and supervisor are not ready.	EMDEs and small economies should set priorities for ensuring the robustness, reliability and transparency in the adoption of Basel standards, including the Basel Core Principles; and communicate that: (i) decisions on the pace of implementation need to consider particular characteristics of banks and banking systems, as well as supervisory constraints; and (ii) Basel II and Basel III standards are designed primarily for large, internationally active banks in BCBS member jurisdictions.
The role of the supervisor is key to implementing the capital conservation and counter-cyclical buffers. Supervisory powers to restrict profit distributions in the event of non-compliance with these buffers and modalities to activate various triggers are still lacking in some EMDEs and small economies.	Adequate supervisory powers should be encouraged in EMDEs and small economies.
A mechanistic implementation of the counter-cyclical capital buffer (i.e. sole dependence on a credit-to-GDP ratio) could have negative consequences.	EMDEs and small economies should improve their understanding of credit cycles; and request for examples provided by the BCBS on the use of macroprudential tools (such as sector-specific counter-cyclical buffers), which can enhance banks' resilience to credit booms.
Implementation of the liquidity coverage ratio (LCR) will be challenging for many EMDEs and small economies.	Quantitative Impact Studies (QIS) for EMDEs and small economies; and creation of a dedicated unit in supervisory agency to facilitate LCR implementation.

Enhanced liquidity requirements are encouraging groups to hold liquid reserves at the parent level, but it is unclear when and how these reserves should be made available; deposits placed at a parent bank by foreign subsidiaries could become subject to bail-in arrangements; operations undertaken by banks in IFCs incur a higher liquidity charge; and banks may be "compartmentalising" their different operations, which may weaken the ownership chain and the availability of group liquidity and capital support.	BCBS Guidance and/or Best Practices requested to: (a) give greater encouragement to home supervisors to reach understanding with banks and host supervisors on how and when reserves can be made available; (b) allow greater flexibility for the treatment of non-retail deposits; and (c) encourage agreement on likely resolution scenarios in advance.

12. Some of these issues and responses have to do with relationships among supervisors in home-host and group supervision scenarios. Others have to do with supervisory capacity in a broad sense, including independence and other issues of capacity and powers. Few have directly to do with the process of translating international standards into national laws and regulations. There are, however, some points that are broadly concerned with the state of development of the industry in particular jurisdictions, and thus with the appropriateness and impact of applying the Basel standards in full. Some similar themes appeared in the FSB report, and there appears to be general acceptance of the principle that it may be appropriate for some jurisdictions to separate out elements of the standards and to apply them in an order and at times that reflect their relevance.

13. Although few issues were raised which bear directly on the process of translating international standards into national laws and regulations, there are some suggestions that EMDE regulators may be reluctant to exercise discretion, to some extent in making policy decisions as part of the implementation process,[6] but more so in applying the regime thereafter. The comments made about governance issues on conversion of contingent capital, approval of internal models and the use of buffers are all indicative of this. It may be in any particular case an issue of formal powers, of internal capacity to take the necessary decisions or, more subtly, of the political position of the supervisor and its ability to resist pressure from the firms it regulates. Whatever the reason, it is likely to manifest itself in a desire for the international standards to be as full and objective as possible, with minimal areas of discretion; this appeared to have some echoes in the work undertaken for the present study.

6 Examples would include the "national discretions" built into parts of the Basel regime, but also the challenges of adapting regulations intended for internationally active banks to the complexities, risks and peculiarities of their own banking systems.

14. So far as standards for Islamic finance are concerned, the IMF in 2014 published a study based on a survey of prudential frameworks governing Islamic banking conducted in 2011.[7] The study was largely descriptive of the regulatory frameworks, noting that a wide range of approaches has evolved. Eleven respondents indicated that a single integrated regulatory framework applied to all banks (with no reference to Islamic banking or Islamic banks); ten respondents indicated that a single integrated regulatory framework applied to all banks (with references identifying provisions applying specifically only to Islamic banking and banks); three respondents indicated two separate independent regulatory frameworks (i.e. one for Islamic banking and banks, and another for conventional banking and banks); and seven indicated the existence of a mixed approach (e.g. a similar regulatory framework is adopted for areas that are applicable to Islamic and conventional banks, but with separate guidelines and regulations for areas that are specific to Islamic banking). It is noteworthy that "successful implementers" as described in paragraph 2 were found in each of the last three categories.

15. The 2014 study and other IMF work[8] contributed to the very significant Staff Discussion Note issued by the IMF in April 2015.[9] In addition to the points made by the earlier authors, this paper noted the challenges faced by some banking supervisors in dealing with the special characteristics of Islamic finance – for example, the fund-like characteristics of profit-sharing investment accounts. In general, it noted the need for increased regulatory clarity – set in banking laws and regulations, and informed by enhanced dialogue between Islamic standard-setters and national regulators.

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7 Song & Oostuizen, "Islamic Banking Regulation and Supervision: Survey Results and Challenges", IMF Working Paper, December 2014.

8 For example, Lopez Mejia et al., "Regulation and Supervision of Islamic Banks", IMF Working Paper, December 2014.

9 Kammer et al., "Islamic Finance: Opportunities, Challenges, and Policy Options", IMF Staff Discussion Note, April 2015.

SECTION 3: EVIDENCE FROM THE IFSB IMPLEMENTATION SURVEY

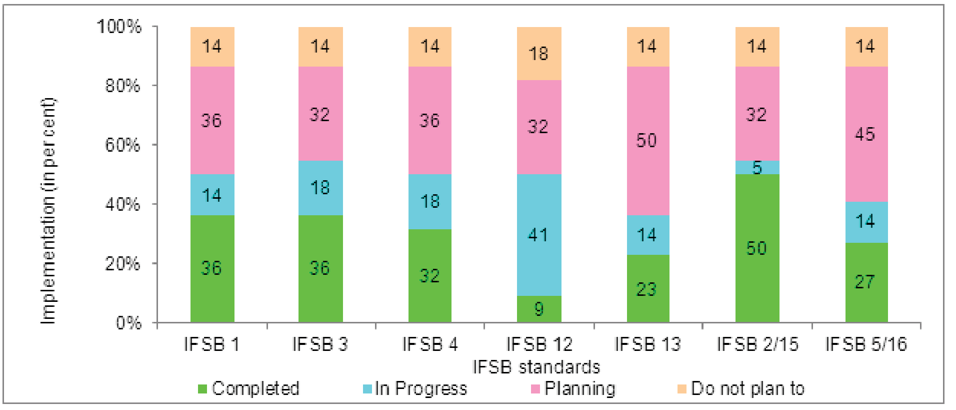
16. The IFSB Implementation Survey for 2014, reported fully elsewhere, asked several questions specific to the difficulties of IFSB standards implementation, and is very helpful in providing a broad view across many RSAs. (Thirty-six RSAs responded.) The results of the survey need to be approached with some caution. The sample size for standards in the capital markets and *Takāful* sectors is small (only five RSAs in each area). Issues in, for example, supervisory capacity are inevitably subject to the biases associated with self-reporting. In addition, the IFSB Secretariat has identified some inaccuracies in past surveys, perhaps resulting from limited knowledge of staff completing the return. While identified problems have been resolved by direct approaches to the respondents, their frequency suggests that there may be further, less obvious, inaccuracies.

17. It is tempting to try to compare implementation survey data with corresponding data from other standard-setters. Unfortunately, this cannot be done in any meaningful way across the board, or for a comparable sample of countries. The best data available are from the BCBS,[10] but those data are confined to BCBS members, and the very different population involved means that no useful conclusions could be drawn from a detailed comparison. Thus the information presented is confined to IFSB standards.

18. Chart 3.1 shows the level of implementation of IFSB standards relevant to the banking sector. Because IFSB-2 and IFSB-5 have now been superseded, data from these have been combined with those for their successors (IFSB-15 and IFSB-16, respectively), and where RSAs have reported for both a standard and its successor, the more advanced implementation position has been reported. Implementation experience with the earlier standard will be highly relevant to the implementation of its successor, whether by the same or different RSAs. It will be seen from this that these standards are among the most fully implemented by IFSB members – which was one reason for choosing them for this study – and thus the comments on their implementation have as solid a basis of experience as can reasonably be hoped for.

10 See, for example, the progress report at www.bis.org/publ/bcbs290.pdf.

Chart 3.1: Implementation Status of IFSB Standards in the Banking Sector (22 RSAs)



19. Each of the three IFSB Implementation Surveys to date has asked respondents to assess on a scale of 1–4 the significance of various challenges in implementing IFSB standards. The form of the question changed slightly for the 2014 survey. The responses, for the three surveys conducted so far, are shown in Table 3.1. Note that, although the form of the question was changed between questionnaires, the answers have been put on a common basis, so that a low score implies that a challenge is more significant than one with a higher score, and the ranking is thus from the most to the least significant.

Table 3.1: The Significance of Various Challenges in Implementing IFSB Standards

Challenges	2014 Survey			2013 Survey			2011 Survey		
	Mean	Rank	Base	Mean	Rank	Base	Mean	Rank	Base
Need to change legal framework	2.37	1	28	N/A			N/A		
Need to change regulatory and supervisory framework	2.55	2	28	2.4	1	29	2.7	1	25
Lack of personnel with relevant knowledge/ experience/training	2.68	3	29	2.5	2	30	3	2	25
Cost of implementation	2.75	4	28	3.38	3	29	3.9	3	25
Lack/poor quality of data to support implementation of the standards	2.81	5	28	3.6	5	30	4.1	4	25
Institution size and complexity	2.94	6	27	3.45	4	29	4.1	5	25

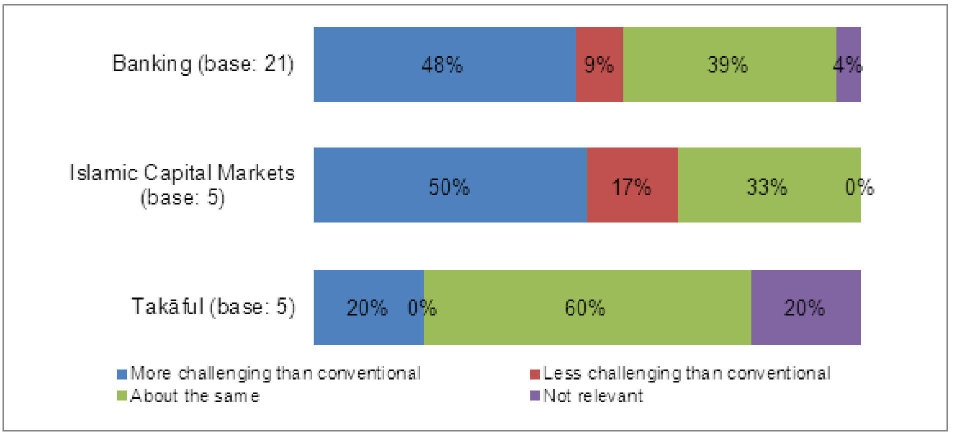
20. The change in the question in 2014 was intended to discover whether there was a material difference in difficulty between changes that could be made within the authority of the RSA (e.g. by changing regulations made by the RSA), as against changes that required the authority of others (e.g. approval by the legislature). The data suggest, as expected, that the need to seek external approval adds materially to the difficulty of implementation.

21. Another notable feature is that scores assigned to the final three factors (cost, data, and institution size and complexity) have changed significantly over the three surveys, implying that these factors are now perceived as sources of greater difficulty. It is likely that this reflects issues concerned with the implementation of Basel 2 and 3 and their Islamic counterparts. These are more complex than Basel 1, involve areas of national discretion, some of which should be data-driven, and in the case of Basel 3/IFSB-12 involve a new liquidity regime.

22. Because IFSB standards are normally based on corresponding conventional standards, the survey attempted to assess how far the difficulty of implementation of IFSB standards differed from that of conventional standards. This goes to, but does not directly answer, the question whether there is something in the form or process associated with the IFSB standards that may make them inherently more difficult to implement, or whether, at the other extreme, the RSAs that have difficulty implementing IFSB standards have similar difficulty in implementing conventional standards, in which case the issues may well be institutional. (Note, however, that IFSB standards could also be more difficult to implement for institutional reasons, such as a lack of capacity in Islamic finance specifically, or a lack of support at the political level for implementation, or for industry reasons – for example, IIFS being less capable than their conventional counterparts. These hypotheses need to be tested by other routes, and are partly discussed in later sections.)

23. The responses on the challenges are set out in Chart 3.2. While the data for *Takāful* and capital markets need to be approached with caution because of the small sample sizes, it is clear that in banking at least there is a significant minority that find IFSB standards more challenging than conventional ones. Furthermore, the RSAs that find them more challenging include several with substantial experience in Islamic finance and significant domestic Islamic banking sectors. It is therefore unlikely that the issues are solely institutional, or the result of Islamic banking sectors with more limited capacity to absorb new standards.

Chart 3.2: Comparison of Implementation Challenges between IFSB and Conventional Standards



24. A further question probed experience with each of the four standards considered as part of this study and attempted to identify specific factors that might lead to greater difficulty of implementation. Respondents were asked to rate on a scale of 1–5 how far certain statements were true of the standards in question. RSAs were asked to respond only if they had some experience of attempting to implement the standard in question. Partly as a result, respondent numbers were limited – around ten for each question – but some useful conclusions can be drawn. The basic results are set out in Charts 3.3(a)–(d).

Chart 3.3 (a) Experience with the IFSB Standards: IFSB-2

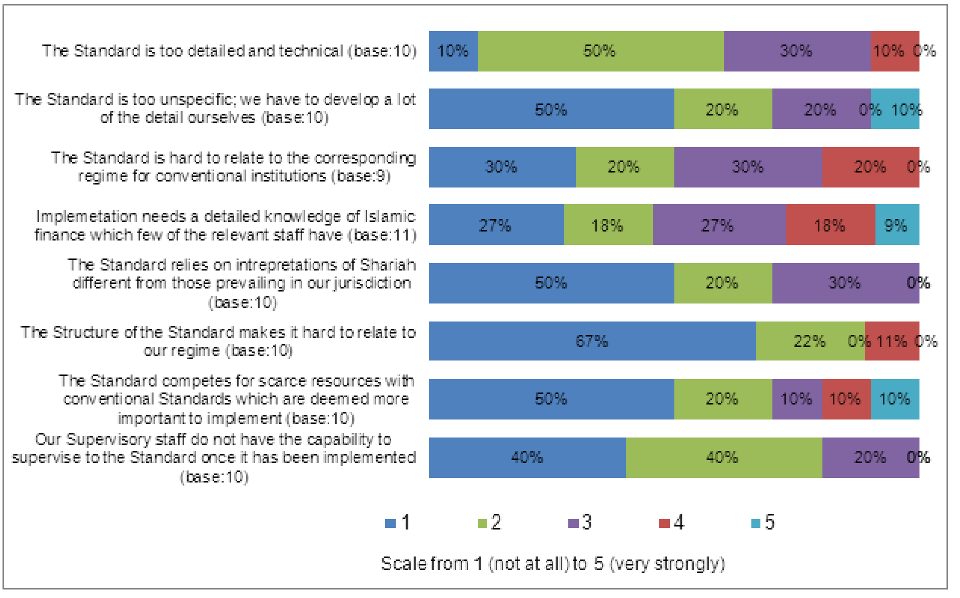


Chart 3.3 (b): Experience with the IFSB Standards: IFSB-4

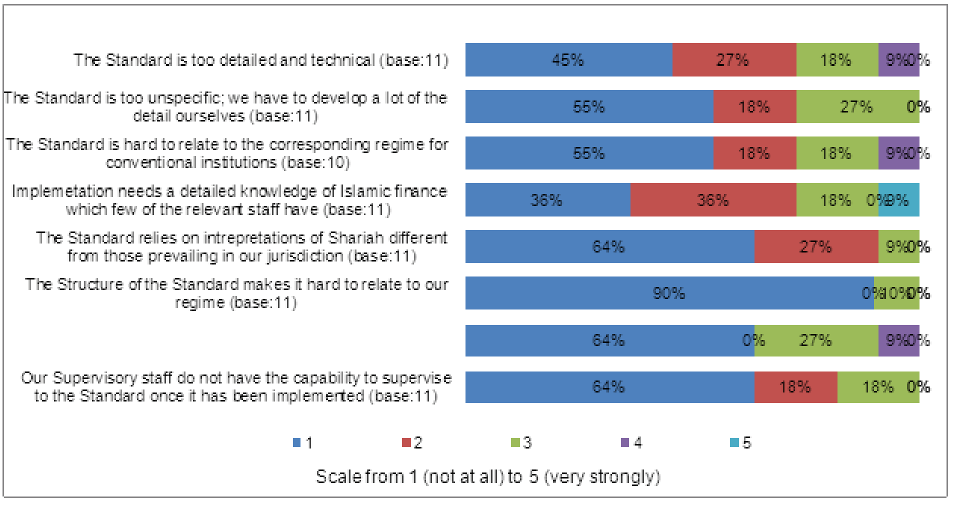


Chart 3.3 (c): Experience with the IFSB Standards: IFSB-5

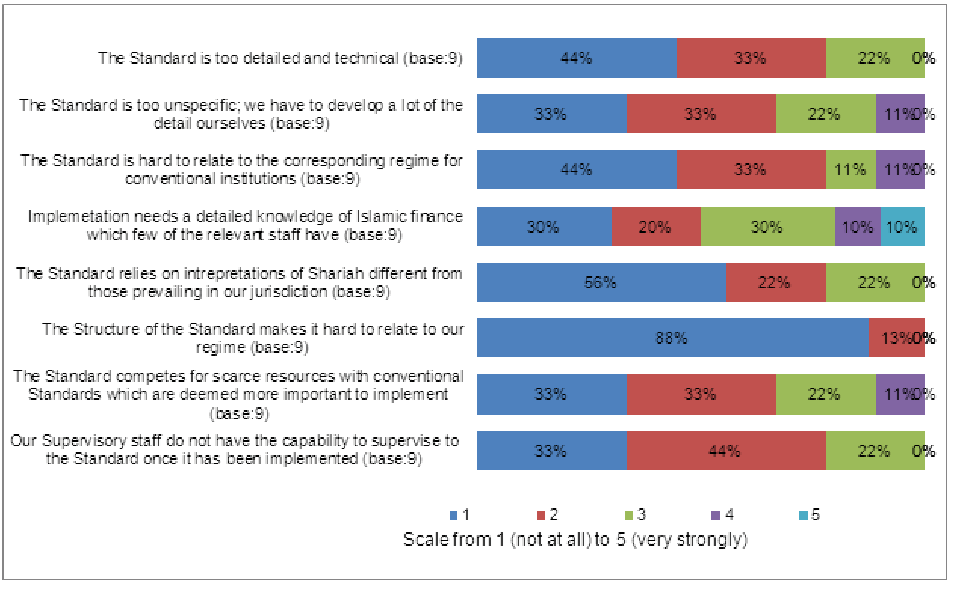
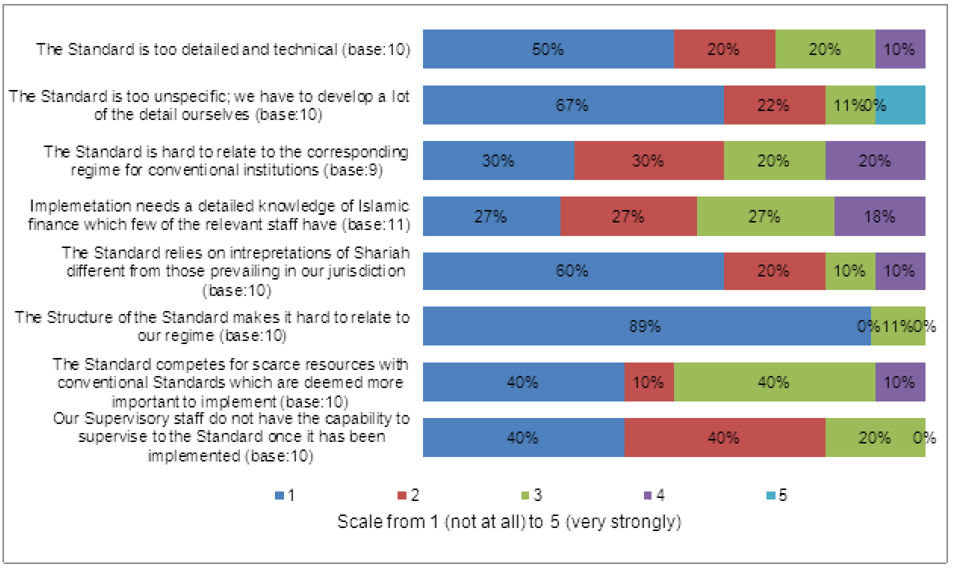


Chart 3.3 (d): Experience with the IFSB Standards: IFSB-10



25. Table 3.2 compares the average scores against each possible factor for each standard. It is intended to provide some understanding of common factors and also of whether there are material differences between standards of different types.

Table 3.2: The Average Scores against Each Possible Factor for Each Standard

	IFSB-2	IFSB-4	IFSB-5	IFSB-10
The standard is too detailed and technical	2.40	1.91	1.78	1.90
The standard is too unspecific; we have to develop a lot of the detail ourselves	2.00	1.73	2.11	1.80
The standard is hard to relate to the corresponding regime for conventional institutions	2.40	1.82	1.89	2.30
Implementation needs a detailed knowledge of Islamic finance which few of the relevant staff have	2.64	2.09	2.50	2.36
The standard relies on interpretations of *Sharīʿah* different from those prevailing in our jurisdiction	1.80	1.45	1.67	1.70
The structure of the standard makes it hard to relate to our regime	1.56	1.20	1.13	1.22
The standard competes for scarce resources with conventional standards which are deemed more important to implement	2.10	1.82	2.11	2.20
Our supervisory staff do not have the capability to supervise the standard once it has been implemented	1.80	1.55	1.89	1.80

26. Some differences are clearly observable. The *Sharīʿah* governance standard IFSB-10 stands to some extent on its own. The problems identified seem to relate to fitting the standard into a framework of largely conventional regulation. The fact that this standard is seen as competing for resources with conventional standards, which do not deal with this topic, suggests that the priority given to Islamic finance may be a key issue in some jurisdictions.

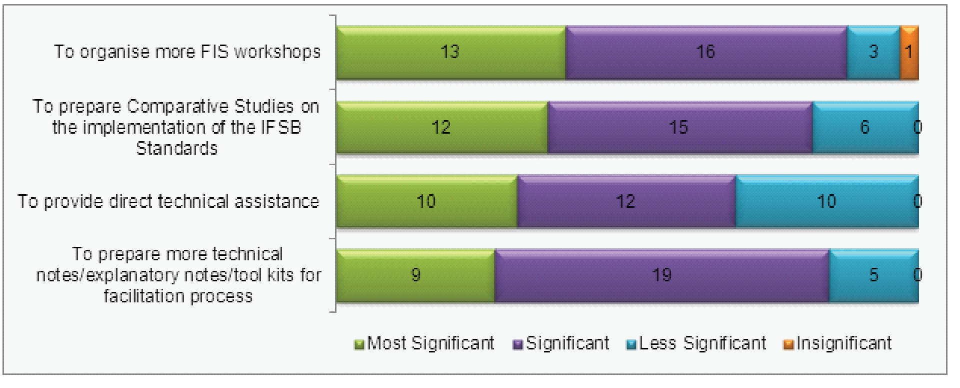
27. The capital adequacy standard IFSB-2 emerges as more demanding than the others, as might be expected given its complexity. Interestingly, it scores highest both as “too detailed and technical” and as “too unspecific”. The latter comment emerged also in the interviews and seems to relate to topics

not covered (such as approval of internal models), to national discretions, including setting the level of α in the capital adequacy model, and possibly in one case to the treatment of Islamic windows. The former comment did not emerge in the same way, but may reflect corresponding difficulties with the underlying BCBS standard.

28. Technical knowledge of Islamic finance among staff emerges as a significant factor at the implementation stage, but staff capability for supervision appears much less significant. These results are a little difficult to reconcile, but it may be a signal that turning a standard into rules requires a level of ability not required to supervise thereafter, especially if the rules are written in terms that require limited judgment from supervisors.

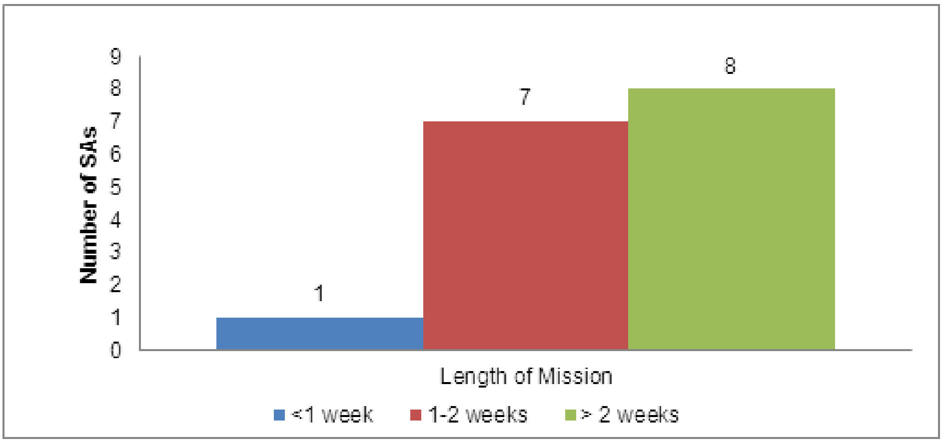
29. Survey respondents were also asked about strategies the IFSB might adopt to assist implementation. Responses are summarised in Chart 3.4. Comparisons with the 2013 survey are difficult because of changes in the form of the question, but it appears that RSAs may be attaching slightly less priority to direct technical assistance than in the past, though there is no evidence on possible reasons for this.

Chart 3.4: Technical Assistance Options for RSAs



30. Those who did consider provision of direct technical assistance either "significant" or "most significant" were also asked for how long they would want the IFSB to conduct it. Chart 3.5 shows the responses, for the banking sector only. Responses from the capital markets and *Takāful* sectors are too few in number to be statistically significant, but both sectors show a peak in the "1–2 weeks" category. In so far as any weight can be attached to this limited data, it supports the evidence above that RSAs are finding the new generation of banking standards, whether Basel or IFSB, relatively difficult to implement (and more difficult than standards in the capital markets and insurance sectors).

Chart 3.5: Approximate Time Frame for Technical Assistance – Banking Sector



SECTION 4: EVIDENCE FROM DISCUSSIONS WITH REGULATORY AND SUPERVISORY AUTHORITIES

31. Meetings have been held, either face-to-face or by teleconference, with the banking supervisory authorities of six of the seven jurisdictions named.[11] In some cases, additional information was provided in written form. In the remaining case, limited information has been made available by email. The discussions with the three ADB target countries were in part aimed at focusing future technical assistance, and responses may have been influenced by this. As with the survey discussed above, the information is self-reported by the RSAs, and it has not been possible with the resources available to verify it from other sources, such as the industry in the relevant jurisdiction. Existing knowledge of the jurisdiction has, however, been used where relevant.

32. It is not possible to report the study in any sensible form without mentioning jurisdictions by name. This paper does so, however, only where it is essential to the analysis. Thus, for example, it does not give a full jurisdiction-by-jurisdiction account of implementation processes, but does bring out key differences that appeared material to standards implementation.

33. Although four standards of somewhat different type were considered, and jurisdictions were asked explicitly whether they found significant differences in ease of implementation between them, most of the comments made were generic and very few specific differences were identified. Those which appeared material are mentioned below. In this respect, this part of the study contrasts with the survey report, though this may reflect the fact that discussions were often with relatively high-level staff who may not have been familiar with all the details of implementation.

4.1 Implementation Processes

34. In general, there are standard elements to an implementation process. A decision to implement a standard is taken, either by senior line management or by a committee, whether an internal policy committee or a board. A project team (referred to in some jurisdictions as a committee) is assembled. It develops the detail of implementation, including both the secondary policy options (e.g. the "national discretions" provided within both the BCBS and the IFSB regimes), and oversees the translation of the standard into the legislative form appropriate to the jurisdiction. There is consultation with the

11 Indonesia has seen a recent change in responsibility for banking supervision from the central bank to the Financial Services Authority (OJK). Both organisations contributed to the discussion, but the organisational change means that past experience may not wholly translate to the future. It is also clear that the change, in which some relevant staff elected not to transfer to OJK, as well as subsequent staff moves, have led to a significant loss of accumulated expertise on IFSB standards.

industry about the implementation; this may be a fully public process or a largely private one. A final version of the legislative instrument is prepared and is signed off, usually by the authority that made the original decision to implement.

35. All these standard elements can be found in all seven jurisdictions studied. The sequencing may vary somewhat. For example, some work on the secondary policy options may be undertaken before a decision to implement. Some elements of the process may be repeated. For example, an internal policy committee may sign off on the secondary policy options before industry consultation. Most of these variations, however, did not appear material to success in implementation. That is, there was not a clear systematic difference between successful and unsuccessful implementers, and the repeated elements in general (with one important exception) were not seen as material obstacles to success in implementation. This exception concerns industry consultation.

36. As already noted, all jurisdictions have some form of industry consultation or market study, but there are differences between successful and less successful implementers as to how this takes place, and the context. In Bahrain, when the IFSB issues an exposure draft, the Central Bank of Bahrain (CBB) alerts the industry, urges them to participate in the consultation process, and warns that the CBB may not consult again when the decision to implement is made unless it has identified major issues, or they have been identified but remain unaddressed. Once draft rules have been prepared, the relevant executive director circulates them to the industry for comments and impact analysis. When the rules are finalised, each relevant licensee will be asked to submit a detailed gap analysis on the new rules and the actions required to implement them. Based on the gap analysis received, the relevant supervision directorate would then follow up with the licensees on the implementation. Malaysia, Jordan and Sudan have less complex processes for industry consultation, but all three do so in the context of a decision to implement that has already been made. By contrast, in Indonesia, industry experts may be involved in the project team. Once a full proposal has been developed, a meeting is held with industry to examine it, and at this stage academics will normally be involved in presenting the proposal. The proposal is then presented to the board at an informal seminar. It goes to a subsequent board meeting for approval in principle, and is then exposed for public consultation. During that period, industry events, including focus groups, may be held. The involvement of industry is thus far more substantial, and it is clear from the discussions that a key issue (for both IFSB and conventional standards) is *whether* the standard should be

implemented, not simply how.[12] In Bangladesh, once a decision has been made to go ahead with a project, there is a market study survey, which, though formally optional, is regarded as a critical phase. A road map for implementation is prepared and disseminated to those involved, including market participants, and once the final guidelines have been published there is a programme of training, workshops, seminars and dialogue between Bangladesh Bank and the market participants. In Pakistan, external agencies may be consulted either before or after the key decision to implement. (The Pakistan Banks' Association has consultative committees, including one specifically for Islamic banking, which are well geared to commenting on regulatory proposals.) Subsequent internal development may well involve informal consultation with the industry, and in general the issues encountered in the implementation of IFSB standards have been mainly concerned with the state of development of the Islamic banking industry in Pakistan. On some occasions the standards have been judged to represent too great a regulatory burden for relatively small institutions, and implementation has been deferred until the industry has grown to the point where it can support it.

37. The key point of this exposition is that the successful implementers have a working presumption that IFSB standards will be implemented, and their dialogue with industry takes place in that context. In the case of the other three countries, that presumption is less strong. In Indonesia, it is clear that industry has a very significant voice and needs to be convinced of the case for implementation; indeed, it appears that this is frequently the case for conventional standards, too, despite Indonesia's membership of the G20. Although the situation in Pakistan and Bangladesh is less clear, it appears that the industry may be able to resist implementation at least for some time, on the grounds that it is not yet ready.

38. Some jurisdictions reported additional elements in the process:

    (a) One jurisdiction (Indonesia) reported that the final instrument needed to be submitted to a government department (in this case, the Ministry of Law) for final approval and gazetting. (It is known that some RSAs outside this study have similar requirements.) This was not perceived as a substantial area of difficulty, and is consistent with what may be inferred from the survey.

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12 The procedure described is for the principal implementing instrument, referred to as a regulation. This is typically a framework document, the details being specified subsequently in instruments referred to as circulars. The procedure for these is less onerous, and consultation takes place against the background that the principle of implementation has already been accepted.

(b) Pakistan and Indonesia have requirements to consult *Sharīʿah* boards when implementing Islamic finance standards. In the case of Indonesia, this is a national *Sharīʿah* board with wider responsibilities than Islamic finance. In the case of Pakistan, a further complication is that *Sharīʿah* issues can be (and in practice have been) taken before the Federal *Sharīʿah* Court. In the other four jurisdictions, there is no requirement to consult *Sharīʿah* scholars, and regulators will do so, usually on an informal basis, though sometimes formally, only if they consider that the standard may raise *Sharīʿah* issues. In general the presumption in those jurisdictions is that an IFSB standard will already have been through *Sharīʿah* scrutiny, so such issues are unlikely.

4.2 Other Jurisdictional Issues

39. The study identified other issues that favoured or hindered standards implementation in particular jurisdictions.

40. For those jurisdictions that have both conventional and Islamic banking, there appears to be some, though not a conclusive, advantage in having a top-level legal framework that covers both. Typically this allows the many common elements between the two sets of standards to be translated into regulation only once. However, the IMF survey evidence already cited suggests that this is by no means decisive.

41. Institutional capacity is clearly an issue in some jurisdictions. The discontinuity in knowledge caused by organisational change in Indonesia has already been mentioned. Indonesia also reported, with particular reference to IFSB-2, that at the stage of industry discussion there was a shortage of experts who could convey the issue to the industry. In addition, the number and quality of supervisors was a potential issue, and there was a need for a parallel education process during the implementation phase. One other jurisdiction is also known to have had particular problems in developing and sustaining experience within its Islamic banking team. Staff have moved rapidly, and as a result the collective memory is weak. This jurisdiction also reported that the key obstacle to implementation of IFSB standards was gaining the approval of its top management to do so, suggesting that Islamic finance is not given a high priority within that regulatory system.

42. One jurisdiction also noted, again with particular reference to IFSB-2, that while in general the difficulty of implementation was similar to that for the standard's conventional counterpart, the smaller industry base meant that there were limited industry resources available to make inputs during the process. It is thus clear that issues of capacity are not necessarily confined to the RSA itself.

43. The presence of a separate policy team for Islamic banking avoids competition for resources between Islamic and conventional standards. However, only larger jurisdictions with a very substantial Islamic finance presence are likely to be able to justify this. (Whether policy resources are located centrally or dispersed into supervisory divisions is a matter on which RSAs differ somewhat. Globally, however, most agree on a need for some identifiable policy resources if standards implementation is not to be in constant competition with day-to-day supervisory work.) It is also noteworthy that the RSA which has the clearest issues of institutional capacity, and which reported particular difficulties in getting approval to implement, has a separate Islamic banking team but one whose influence within the organisation may be limited.

44. One factor put forward on several occasions as assisting implementation was involvement in the standards creation process. One advantage of this is in planning. Malaysia, in particular, said that their knowledge of emerging IFSB standards and their timetable allowed implementation of these standards to be built into their rolling three-year business plan. But there is a still greater advantage for the process of implementation, since a deeper knowledge of the underlying thinking is a great help when considering how to translate a standard into national regulations. (The implications of this point for the IFSB are discussed below.)

45. Pakistan noted a particular point in the structure of its Islamic banking industry. This is substantially dependent on windows, and windows remain an important part of the government's strategy because of the much wider distribution that can be achieved by using the branch networks of existing conventional banks. IFSB standards in general say little about how they should be applied to windows, and this is a significant issue in translating them. The results of the implementation survey, which asked about the institutions supervised, suggest that this may be an issue in several other jurisdictions. It is hard to be certain, however, since the data do not distinguish between branches (of fully Islamic banks headquartered elsewhere) and windows (i.e. Islamic operations of conventional banks, without separate legal personality).[13]

46. Pakistan also noted a particular issue in the implementation of IFSB-4 (on transparency and disclosure), because most of the disclosures specified in that standard would normally be made as part of a bank's normal financial reporting. That reporting in Pakistan is based on International Financial Reporting Standards (IFRS), whereas IFSB-4 is in some respects closer to the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) standards. Although the Institute of Chartered Accountants

13 Similarly, some data published at the national level do not distinguish between windows as defined above and legally incorporated subsidiaries of conventional banks.

of Pakistan does have a group studying the AAOIFI standards, it was nevertheless considered problematic to implement a standard diverging from IFRS. IFSB-4 is, however, reported as fully implemented by Jordan and Malaysia, both of which also adopted IFRS and have not adopted AAOIFI accounting standards for Islamic institutions. Malaysia commented that the IFRS do not in general prohibit additional disclosures, and that Bank Negara has been able to mandate such disclosures using its regulatory powers. The issues may thus be more institutional than technical.

4.3 Standards Issues

47. One important aim of the research was to understand whether there were issues in the way standards were prepared, in their content, or in their drafting, that made them more difficult to implement.

48. In general, respondents had very few criticisms of the IFSB standards, even when pressed on this point. Furthermore, even where points were reported, it was usually by one jurisdiction only, and the comments that follow should be read in that context.

49. One jurisdiction commented that standards were sometimes not sufficiently detailed, and left the regulator with too many gaps to fill in. It was clear in discussion that this was primarily a comment about the capital adequacy standards (IFSB-2 and, subsequently, IFSB-15), and the context was that the IFSB had not covered all the topics covered in the BCBS equivalents (e.g. use of internal models). This meant that to implement a full regulatory regime for Islamic banks the gaps had to be filled in, usually by analogy with the corresponding conventional standard.

50. The same jurisdiction also said that there was sometimes too long a period between the emergence of a conventional standard and its Islamic counterpart. It was difficult to implement a standard for conventional banks without also implementing it in some form for Islamic banks, but this created the risk that the implementation for Islamic banks would be different from that in the final IFSB standard when it emerged. (It appeared that this, too, was primarily a comment about elements of the Basel regime.)

51. Another jurisdiction said that IFSB standards did not always use language consistently, so that similar concepts might be expressed in different words at different points within the same standard. This gave rise to a problem in translating the standard into national regulations, since it required staff to work out whether or not real differences were intended in each case. This was, however, said to have been less of a problem with recent IFSB standards than with earlier ones. In addition, definitions were not always consistent between one standard and another.

52. Finally, one jurisdiction flagged two areas in which it would welcome future work by the IFSB. One, arguably outside standards development as such, was guidance on producing a strategic plan for the implementation of Islamic finance in a jurisdiction. The second area concerned the quantification of *Sharīʿah* non-compliance risk, a subject which is in fact already the subject of a joint IFSB/International *Sharīʿah* Research Academy (ISRA) research project.

SECTION 5: CONCLUSIONS AND WAYS FORWARD

53. The principal objective of this section is neither an academic analysis of standards implementation nor a detailed prescription for technical assistance to the target countries concerned. The latter will of course be done separately as part of the work funded by the ADB. Rather, it aims to suggest directions for the IFSB to develop its work, particularly in standards development and in support for implementation. The IFSB will consider these possible directions in developing its Strategic Performance Plan 2016–2018 (SPP).

54. First, it is clear from other sources that the different stages of development of financial markets and their legal and regulatory infrastructure pose problems for all standard-setters. While the most advanced markets demand standards capable of dealing with large, highly sophisticated, firms using innovative technology and transaction structures, other markets struggle with the complex standards that result, which also often assume an infrastructure that these markets lack. There is a growing recognition, noted above in the work of the BCG, that ways need to be found for such markets to "deconstruct" international standards and to implement them in accordance with local priorities. There is also a recognition that the implementation of technical standards often needs to be accompanied by institutional development – for example, in the area of supervisory powers. Despite such recognition, however, the global standards organisations are in general placing increasing weight on implementation as the post-GFC needs for standards development are gradually met.[14]

55. Islamic finance shares some of these tensions. It also has some specific features of its own. One is growth and the constant presence of new entrants – that is, jurisdictions becoming active in Islamic finance for the first time. Whether their conventional financial markets are sophisticated or very simple, they are likely to be implementing Islamic finance without a full supporting infrastructure, and also using standards established before they had the capacity to be seriously involved in standards development.[15]

56. It is clear that authorities in the banking sector in particular are increasingly focused on implementation of the BCBS's quantitative standards, on both capital and liquidity, and their Islamic counterparts. These are complex and highly technical standards, in comparison with many standards elsewhere (e.g. most of those in the securities area, and even some other BCBS standards such as that on corporate governance). Even where RSAs were

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14 The IAIS is perhaps something of an exception, as it remains under pressure to produce a global capital standard for insurance, and this requires major technical effort.

15 There may be some parallel here with former Communist countries seeking accession to the European Union and taking on its accumulated body of legislation.

asked to comment on other standards, it is likely that their responses will have been shaped by their current focus on the quantitative standards. Conclusions may therefore not be fully transferable to other sectors.

5.1 Commitment to Implement Standards

57. The point which emerges most strongly from this work is that the factor most conducive to standards implementation is a commitment to implement standards. The successful implementers start with the presumption that international standards in general, and IFSB standards in particular, will be implemented. In other jurisdictions, that presumption is much weaker. One factor in this may be that some jurisdictions have been relatively isolated from the international community and from the peer pressure to implement standards in general. Another appears to be a relative political weakness of the regulator in relation to the industry it regulates, requiring it to seek consensus for even the principle of standards implementation. More specifically, in some instances the implementation of Islamic finance standards appears to sit behind that of conventional standards in priority, to the point that in some jurisdictions the need for separate standards is not regarded as given. In some cases also, the industry lacks the understanding and intellectual capacity to engage coherently on standards issues.

58. The principle of adherence to international standards generally is, in most cases, better driven by bodies other than the IFSB. However, the IFSB could:
    (a) continue its efforts to ensure that its standards are among those implemented; and
    (b) seek ways to communicate the need for and content of its standards to the regulated community, as well as to RSAs.

5.2 The Standards Agenda

59. There are a relatively few international standards which are likely to be adopted around the world within a short time of their appearance, or the appearance of a revision. Obvious examples are the Basel capital and liquidity regimes and, in another sector, possibly the capital regime from the IAIS. For such standards there is merit in the argument made that the IFSB should be in a position to respond to them quickly. Not to do so increases the risk that the conventional standards will simply be applied across the board. This suggests that the IFSB standards agenda should be planned in the light of the agendas of the conventional standard-setters; in general, these will be known to the IFSB through public statements and through its own contacts, including the participation of its members in those organisations. For critical standards, it may even be worthwhile beginning work before the standard is finally published, drawing on such papers as the conventional

standard-setter is willing to release and the knowledge of those members who are participating in the development process. For these standards, the presumption should be that the IFSB standard should at least mirror the coverage of the conventional one, except where elements are clearly not relevant to Islamic finance.

60. Some discernment is necessary, however. Most conventional standards do not demand an instant response. Conversely, the IFSB's agenda cannot simply be driven by that of the conventional standard-setters, partly because there are large areas of existing standards that it has not considered – for example, in capital markets – and partly because it also has to consider some areas that are unique to Islamic finance – for example, *Sharī'ah* governance.

61. The discussions with RSAs identified some areas where certain RSAs would welcome more coverage. Two of these are identified in paragraph 52. A third may be Islamic windows, depending on how far other jurisdictions share the issues identified in Pakistan. These suggestions will need to be considered alongside others (including those from sectors other than banking) in the SPP process.

5.3 Standards Development: Process and Content

62. The most important point which emerges in this context is the benefit that a jurisdiction's active involvement in the standards development process brings when the standard comes to be implemented. This suggests that the IFSB should continue to allow participation in its working groups to jurisdictions that will use them primarily for learning, but learning with an eye to implementation. There will be limits to how far this can be done without making the working groups unwieldy, and there must also be other ways of making standards practically accessible to those who did not participate in their development.

63. As regards content, the literature review, the comparative study and the survey results all suggest that there are some jurisdictions that want standards that are "implementation ready", with minimal further development or exercise of discretion. The evidence suggests that this may be because of limited organisational capability or, more subtly, because of a political position (in the widest sense) which makes them subject to undue pressure in the exercise of discretion. If it is thought desirable to deliver this, the approach may differ from area to area. In some cases, particularly for quantitative standards, there may be a "default option", or a standard regime that can be implemented without discretion, but from which more advanced jurisdictions can depart if they have evidence to support that departure (e.g. evidence to support a particular value for the displaced commercial risk parameter, α). In

other cases, the aim could be to state principles in such a way that they can readily be written into law or regulation to define a high-level regime. There are, however, problems with this, since there is no point in implementing a standard that cannot be supervised, and in general the supervision of a high-level regime requires greater institutional capacity than supervision of a more detailed one.

64. The request for language to be used consistently and precisely is a reasonable one, of which the IFSB Secretariat and consultants will take due note.

5.4 Supporting Implementation

65. This is not the appropriate context in which to discuss the IFSB's entire programme of support for implementation, including workshops and the development of e-learning modules. Rather, the aim is to bring out a few points that may guide future developments, in the context of what is expected to be an expanded programme of implementation support during the period 2016–2018.

66. First, it is clear that there are some problems on which the IFSB alone can make only a limited impact. Some issues are relatively fundamental, and in a jurisdiction with a mixed regime typically affect both conventional and Islamic finance. These include, for example, some of the institutional weaknesses identified in the work of the FSB and implicit in some of the BCBS comments. While the IFSB may be able to fill knowledge gaps, especially where these are specific to Islamic finance, it cannot on its own address issues such as regulatory independence or staff turnover, which fall more naturally to the multilateral agencies such as the ADB and the Islamic Development Bank (IDB). This means that the IFSB will need to work with other agencies, often as part of a programme for the development of the jurisdiction's financial sector more generally. In Islamic finance, also, while the structure of *Sharīʿah* governance is commonly a matter of some national sensitivity, there seems to be a need in some jurisdictions to integrate local *Sharīʿah* scholars more into the international community so that, even where differences are unavoidable, they at least understand how the interpretations that underlie the standard have been arrived at.

67. Some jurisdictions are building an Islamic finance regime essentially from scratch; others have been developing over a period of time, but still do not have a complete regime in place. Standards implementation needs to be put into a strategic context, and standards will sometimes assume that parts of the infrastructure are available. The request for assistance with creating strategies for the development of the Islamic finance sector has been heard

in contexts outside this study. The IFSB has worked with other institutions to provide a framework for such strategic decisions;[16] it may be more appropriate for more jurisdiction-specific support to be given by institutions other than the IFSB. Nevertheless, some thought will be given in the SPP context to how jurisdictions can be helped to create these broad strategies.

68. Particularly for jurisdictions new to Islamic finance, a standard-by-standard approach which assumes that one standard will be implemented in full before moving to the next may not be the best one. It may be, as the BCBS has suggested in relation to the Basel regime, that some standards could be deconstructed so that jurisdictions can implement them in phases as appropriate to their own needs. In areas other than capital standards, in particular, an approach based on the Core Principles for Islamic Finance Regulation may also have merits. In addition to the fact that a Core Principles-based approach is capable of being broken into manageable but worthwhile elements, the Core Principles document (IFSB-17) explicitly addresses issues of supervisory capacity, and articulates as prerequisites of successful implementation certain strategic elements such as macroeconomic policies, public infrastructure, and recovery and resolution frameworks.

69. Where the IFSB does provide implementation support to particular jurisdictions, this may need to go beyond those responsible for Islamic finance in the particular RSA. There appears to be a need in some cases for communication with other RSA staff. There is an even more clearly identified need for communication with the local industry about both the relevance and the content of the standards being implemented. This may need to be considered in the more general context of the IFSB's relationships with its Observer Members, though it is likely that communication may need to go more widely than that group. Communication of this kind will be helped if workshops and e-learning modules are tailored to different levels of knowledge and different requirements, reflecting the fact that some recipients will need more detailed knowledge of the standards than others.

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16 For example, in the report *Islamic Finance and Global Financial Stability*, published with the IDB and the Islamic Research and Training Institute in 2010.

ISBN 9789675687471

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