Accountability & Ethical Values in Financial Practices: A Case Study of Islamic Finance

Dr Jikon Lai
University of Melbourne
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Dr Jikon Lai
School of Social and Political Sciences
The University of Melbourne
• Can financial practitioners be held more accountable for the impact of their actions on the wider society?

• How can we embed more desirable ethical values into financial practices?
• In this paper:

  – Analyse the regulatory and supervisory structures in Malaysia to govern compliance with Islamic system of ethics
• Ethical form of financing
• Growing exponentially
  – about 10-15% a year since 2000
  – but still a small market
• Not just limited to Muslims
  – Belgium, Ireland
  – UK government has ambitions for London to be a global Islamic finance hub
  • UK government plans to issue £200 million sukuk
What is Islamic Finance?

- A financial system that seeks to offer equity and fairness in financial transactions/relationships

- Against usury (riba) – exploitative transactions
  - Risk (profit and loss) sharing

- Avoid uncertainty (gharar)
  - Importance of materiality and explicit link with the ‘real’ economy

- Avoid speculation (maisir), as opposed to risk-taking

- Certain prohibited activities (haram) (e.g. alcohol, gambling etc)

- Sources: Quran + hadith + sunnah + fatwa = syariah (shari’ah, sharia)
• Two main approaches
  – Decentralised (Middle East)
  – Centralised (Malaysia)
• Two national-level shariah advisory councils
  – Central bank (Bank Negara Malaysia)
  – Securities Commission
  – Ultimate authority on shariah aspects of Islamic finance

• Firm-level shariah advisors/committees
  – Preliminary advice
  – Help enforce national rules
• Shariah governance framework 2010
  – Prescribed frequency of shariah committee meetings
  – Prescribed decision making process (two-thirds majority)
  – Tension
    • Responsibility of members of shariah committee to arrive at conclusions on matters of shariah (but no measures to censure)
    • Board of Directors ultimately accountable and responsible for the institution’s compliance
• Islamic Financial Services Act 2013
  – Religious experts
    • now legally liable for advice provided
    • Statutory protection for breach of confidentiality and defamations
  – Financial institutions required to seek prior written approval from central bank before terminating appointment of religious advisors
  – Central bank has enhanced powers to issue binding standards
Governance Structure in Malaysia

- High centralized and institutionalized
- Minimizes emergence of competing views
- Engenders market confidence
• Limits diversity of interpretations
• Risks of capture
  – At the national policy making level
  – At the level of the firm
    • Limits to knowledge of shariah experts
    • Conflict of interest between firm and shariah experts
• Who is the ultimate arbiter of the interpretive work done by religious experts?