

## Strengthening the Islamic Capital Market: Welcome Measure of the SEC Pakistan

### Keywords

Islamic Capital Market  
Shari'ah Advisors Regulations  
Shari'ah Compliant Securities  
Shari'ah Opinion

*Ḥadīth*: Some desert Arabs clad in woollen clothes came to Allah's Messenger (*PBUH*). He saw them in sad plight as they had been hard pressed by need. The Holy Prophet (*PBUH*) exhorted people to give charity, but they showed some reluctance until (signs) of anger could be seen on his face. Then a person from the *Ansār* came with a purse containing silver. Then came another person and then other persons followed them in succession until signs of happiness could be seen on his (sacred) face. Thereupon Allah's Messenger said: He who introduced some good practice in Islam which was followed after him (by people), he would be assured of reward like one who followed it, without their rewards being diminished in any respect. And he who introduced some evil practice in Islam which had been followed subsequently (by others), he would be required to bear the burden like that of one who followed that practice without their's being diminished in any respect [*Ṣaḥīḥ* Muslim; Book 34, *Ḥadīth* 6466].

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### INTRODUCTION

The Securities and Exchange Commission of Pakistan (SECP, or the Commission) accomplished great jobs, overdue for many years, during 2017. Firstly, keeping in view the changes in the corporate business environment, impact of globalization and technology, and evolution of Islamic financial markets, it revised the Companies Ordinance, 1984 and promulgated the Companies Act, 2017 (the Act) on May 30, 2017. For the first time ever, the concept of Shari'ah-compliant companies and securities has been given in the Act. In addition to Shari'ah-compliant companies and securities, the Companies Act 2017 has provisions for Shari'ah compliance, Shari'ah advisory, and Shari'ah audit.

Secondly, the Commission notified the Shari'ah Advisors Regulations, 2017 (SAR, The Regulations) on 15th November, 2017. This notification is a recognition of Shari'ah Advisory function as a respectable profession, and Shari'ah Advisors (SA) as formal professionals by the leading Regulator of corporate sector and capital markets. SECP has set the

stage for the Sharī'ah Advisors who would now be easily approachable within and outside Pakistan by having their name on the website of the SECP. The Sharī'ah Professionals of Pakistan have been provided with this unique opportunity to highlight themselves across the globe through the platform provided by the capital market Regulator.

Main features of the new Act, *inter alia*, include facilitating the use of new information technology for faster communication between the stakeholders, passing resolutions through circulation, additional responsibilities of directors and auditors, added safeguards for the creditors and investors, and introducing the Section relating to "Sharī'ah-compliant Company" and "Sharī'ah-compliant security".

The most relevant section of the new Act for this editorial is the added Section 451, "Certification of Sharī'ah-compliant companies and Sharī'ah-compliant securities". It provides the concept of Sharī'ah-compliant business for companies and certification of Sharī'ah-compliant securities. In terms of the Act, no company shall be called Sharī'ah-compliant, and no listed or unlisted Security (investment instrument) could be claimed as Sharī'ah-compliant, unless it has been declared Sharī'ah-compliant through a process provided by the Commission.

As a second step to adding the Sec. 451 of the Act, and to provide a process of declaring any Company or any "Security" Sharī'ah-compliant, the Commission notified the SAR 2017. The Regulations were published for public consultation and eliciting comments vide a notification dated 18th September, 2017. Keeping in view the comments received and a series of consultation sessions held on the matter with the stakeholders (Sharī'ah Scholars, Islamic Finance professionals from financial sector such as Islamic banks, *muḍārabah* companies, *Takāful* companies, Asset Management Companies, ICAP, MUFAP, etc.), the SAR have been made effective from 1st December, 2017. The Commission shall maintain a register of SA out of which the companies could engage any of the SA, and inform the Commission within seven (7) days of appointment.

The Rules are applicable to every person providing Sharī'ah advisory services to a company or an entity registered, licensed, and/or regulated by the Commission, but are not applicable to the Insurance or *Takāful* Companies, Banking Companies or any other Companies regulated by the State Bank of Pakistan (SBP). Hence, all Islamic Banking Institutions (IBIs) operating in Pakistan are out of the ambit of the SAR. But, the non-banking finance companies like Investment Banks, Mutual Funds, *muḍārabah* Companies, Leasing Companies, and any Securities/instruments to be issued by them are subject to the SAR.

### Eligibility Criteria

As per the SAR, the 'Fit & Proper' criteria [Clause 3 (1)] for a person to be enlisted as approved SA with the SECP include *Shahādat al-ālamīyah* degree from any approved *Wafāq al-Madāris*, B.A. with minimum 2nd Class, and at least four years' experience of giving Sharī'ah rulings in *fiqh al-mu'āmalāt*, including the period of *takhaṣṣuṣ fī al-iftā'*.

Any post graduate from Kulyah Sharī'ah/*Kulīyah Uṣūl al-Dīn*/L.L.M. (Sharī'ah)/MS Sharī'ah with GPA of 2.5 or equivalent from any recognized institution is also entitled to apply to be enlisted as SA. Such applicants must have at least 5 years' experience in teach-

ing or research or training in Islamic financial services; or 5 years' working experience in relevant departments of any institution offering Islamic financial services, or in the relevant department of the SBP, or the SECP (a combination of eligible work experience shall be acceptable).

The candidates also need to have adequate understanding of relevant financial and legal concepts and command over English language to comprehend legal documents pertaining to financial transactions. The Regulations also provide for registration of a Sharī'ah Advisory firm, LLP or a company.

However, notwithstanding anything contained in clause [3 (1)], an individual, partner, director or chief executive of a firm, LLP or company shall be deemed eligible if s/he, in the opinion of the Commission, is a person who has adequate understanding of and experience in Sharī'ah, legal, and financial issues pertaining to Islamic financial services (Clause 3 (2)). We expect that approval of any such person would be subjected to the approval by the Sharī'ah Board of the Commission (it should not be the Commission's Management decision only).

Regarding the eligibility criteria as given above, the issue is: how to ensure/judge that any person has knowledge of finance, banking, and capital market and is capable of understanding English-the technical language used in the formats and processes of the instruments/products and prospectus of instruments like *ṣukūk* or securities. The concern becomes more serious when we keep in view the curricula of the *madāris* issuing degree of *Shahādat al-'ālamīyah*. The *madrasah* graduates may hardly be able to suitably understand the nitty gritty of highly complicated conventional investment products enabling them to make decision on Sharī'ah compliance. For this, the SECP may need to arrange an examination covering both fundamental and structured financial products for selecting the really capable SA. It's not a too difficult job to be undertaken for the sake of preparing a sound team for Sharī'ah clearance and supervision. Any third party consultancy/advisory entity like EYFRSH, National Institute of Banking & Finance (NIBAF), the training arm of the SBP, and the Institute of Bankers, Pakistan (IBP) can perform this job once a year for the SECP.

### **Enlistment and Appointment**

Any eligible person will apply to the Commission for registration as SA/Sharī'ah advisory firm as per the Forms given in Annexures to the SAR, and bank challan of payment of Rs.5000 for individual SA, and Rs.10,000 for any Company, Firm, or LLP, as initial non-refundable application fee (Annexure II-Schedule of Fees). The SA or Advisory Firms would also need to pay fees with Renewal application (half of the initial amount of fee), and for annual reporting (Rs.500 for individuals and Rs.2000 for any Company, firm, or LLP).

In our view, the individual SA should not be charged any fee for registration/inclusion of name in the 'SA List'. It may lead to the impression that Sharī'ah advisory is a lucrative/competitive business to get highest possible fees/pay and perks by the SAR and, thus compromises on even the essential Sharī'ah principles using far-fetched '*hīlah*'. Further, taking it as a noble function, any SA may like to provide Sharī'ah opinion regarding any Instrument of any Company free of any fee. Such sentiment has to be respected and encour-

aged, and charging registration and renewal fee from such persons may not be justifiable.

The Board of Directors (the Board) of any company shall appoint or remove a SA from the Commission's List, and the Board or its Committee shall meet the SA upon appointment, removal, and resignation. The Board or its Committee shall also meet the SA at least twice a year to review the matters related to Shari'ah compliance. Similarly, no person shall act as a SA for a company or entity unless registered with the Commission.

The Commission may require an applicant to appear for an interview before any of its officials or its Shari'ah Board, and if satisfied, may register a person for a period of three years, unless cancelled earlier by the Commission. The registration could be renewed after every three years. The Commission can remove the name of any person from its list in case any SA fails to comply with any provision of the Rules, and may impose penalty as per law. Disciplinary actions have also been provided if any SA or the appointing company fails to comply with any provision of the SAR. It may also impose such conditions as it deems appropriate. Any SA, if removed, shall report the same to the Commission within 14 days.

### **Capping the Appointments**

One person may be appointed as SA subject to the limit of maximum four concurrent appointments applicable with effect from July 1, 2018. However, appointment as a SA in any banking company, regulated by the SBP, is not included in this limit. It implies that one Shari'ah scholar (other than Resident Shari'ah Board Member of the banks) is eligible to be on the panel of 3 banks (under SGF, 2015) and 4 non-banking companies (under SAR, 2017). Appointment by one Non-Banking Financial Company (NBFC) for its different investment schemes, pension funds, discretionary and non-discretionary portfolios shall be considered a single appointment. It is quite demanding and the Shari'ah scholars having up to seven engagements with banks and the NBFC will have to ensure that sufficient time is given to each and every matter put up before them for Shari'ah opinion.

Any company may appoint one SA, or constitute a Shari'ah Board with at least 3 Shari'ah scholars and technical/professional members (criteria for them also given), if it wishes. However, the opinion of majority of the SA only shall prevail.

The SAR seem to have implemented the Islamic Financial Services Board (IFSB) standards as well, as the SA have been required to adhere and uphold the Shari'ah and observe the principles of professional behaviour including integrity, objectivity, due diligence and responsibility, care, and conscientiousness. One has to uphold fairness and truthfulness, be straightforward and honest in professional relationships, and shall maintain independence without any financial or non-financial conflicts of interest. By introducing such norms of professional behaviour, SECP has endorsed the IFSB principles for the professionals in Islamic financial sector of Pakistan.

The companies employing SA(s) have been required to disclose in their financial statements the details of any compensation paid to them for Shari'ah advisory and any other ancillary professional services like education and training.

### Giving Sharī'ah Opinion

It's the most crucial area of the Sharī'ah advisory function. As per the Regulations, SA are required to thoroughly understand and analyse the relevant issues before giving decision. The Sharī'ah opinion regarding any product, instrument or an activity must provide the underlying reasoning and references in detail covering: i) the extent to which the arrangement, structure, and the contract(s) are consistent with Sharī'ah principles; ii) how they are free from *ribā*; iii) how *gharar* involvement (if any), has been addressed; iv) extent to which how they are consistent or inconsistent with the relevant Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI's) Sharī'ah standards; v) exceptions, reservations, qualifications regarding compliance, if any; and vi) any other needed details.

The part of this Clause, "*whether and to what extent the financing arrangement is consistent or inconsistent with the relevant Sharī'ah Standards of AAOIFI*" leaves some ambiguity whether AAOIFI Standards are mandatory or optional. We understand that the Commission may issue a clarification to the effect that the AAOIFI's Sharī'ah Standards would be the basis and benchmark for giving Sharī'ah-related opinions on any instruments, products or investment activities. It is necessary to regulate the flexibility in the Sharī'ah rulings, to avoid market distortions and to bring harmony in the national market. So far, any institutional arrangement for regulated use of flexibility in Sharī'ah rules is missing. It could harm the integrity of Islamic finance and become a constraining factor in its growth.

We would like to suggest that Sharī'ah approvals of the instruments by any individual SA may first be vetted by the SECP's own Sharī'ah Board. It is because central Sharī'ah board's authentication would be helpful in creating harmony in the national capital market and endorse greater confidence amongst the public concerning the Sharī'ah validity of ICM products (Muzahid & Sadat, 2016).

Any SA may amend or revoke his own Sharī'ah opinion based on new facts, findings, or research after giving the related company or entity adequate notice to consider and act upon the same. Any dispute or difference of opinion regarding a Sharī'ah opinion shall be referred to SECP, which may refer it to any relevant forum including its Sharī'ah Board.

### Dissemination of the Sharī'ah Opinion

The company obtaining opinion shall have to disseminate the Sharī'ah opinion through website and other means to make it readily and publicly accessible without any hindrance or fee. Any Sharī'ah opinions (*fatwā*), both in English and Urdu, have to be signed by the SA and made available with details to the public on the website, and published in any Company's publication. SA, and the company or entity that solicits a Sharī'ah opinion, shall maintain record of all Sharī'ah opinions for ten (10) years.

The provision regarding dissemination of the Sharī'ah opinions is crucial, and the Commission needs appreciation for mandating it. Opinion/pronouncement about any securities/instruments like *ṣukūk*, PTCs, TFCs along with their trading (in secondary market) rules, and the structured products must be publicised in all details to the general public also bearing the signature and names of the Sharī'ah Scholar who approved. It would enhance the credibility of Islamic finance products among the public.

Once a Sharī‘ah opinion on Sharī‘ah compliance of any company, entity, security or product is given, no other SA shall publicly issue a Sharī‘ah opinion declaring the company or entity or its security, non-Sharī‘ah-compliant. However, any Sharī‘ah scholar, if solicited, acting in good faith, may privately issue a Sharī‘ah opinion about investing in or divesting from the subject company, entity, or its security.

If an entity obtains a Sharī‘ah opinion on any issue from more than one SA, it shall make a disclosure of the reasons for obtaining more than one Sharī‘ah opinion to each SA, as well as, in the prospectus, financial statements, and any other relevant document.

### **Implementation and Effectiveness of the Rules**

The Commission has done a strategic job in mandating all aspects pertaining to giving Sharī‘ah opinion about any investment/financing instruments. Its effectiveness in ensuring Sharī‘ah compliance in letter and spirit hinges primarily on the responsibility shown by the SA themselves. Islamic principles of finance and investment offer a better alternative against conventional practices in financial markets, and the Sharī‘ah scholars should play their role to make this a reality. While the management of the companies and the shareholders are there to take care of their business interests and profitability, SA need to take care of the Sharī‘ah aspect only. They may stick to the Sharī‘ah tenets and principles and not succumb to the practitioners or management’s pressure, or any other conflicts of interests, just for the sake of maximising the profits.

In the capital market, the SA would be mainly concerned with the instruments of perpetual equity (Stocks), redeemable equity (*ṣukūk*, *muḍārabah* certificates, *mushārah* certificates/TFCs) or *ijārah ṣukūk*. There is a huge potential in issuing such instruments at macro and micro levels in general, and Open and Closed Mutual Funds, Venture capital funds, and Islamic Real Estate Trusts (REITs) that could be based on the principle of *waqf* as well, industry, and the EXIM sectors, in particular. The first Islamic REIT, Al-Aqar KPJ REIT, established in 2006 in Malaysia invested in 6 hospitals and the market value of the properties was estimated at US\$138 million in the very first year.

SA need to discourage and avoid all doubtful products based on sale of debts, short selling, and the financial derivatives. Different equity-based investments, *ṣukūk*, and mutual fund certificates have to be used to fund projects in both public and private sectors, including those of infrastructure, such as roads, bridges, ports, airports, etc. where large amounts of financing are required, particularly in CPEC perspective.

It is satisfactory to note that so far the so-called Islamic derivatives, non-Sharī‘ah-compliant as per the resolutions of Islamic *Fiqh* Council and the AAOIFI’s standards, are not being used in Pakistan. Sharī‘ah scholars, while allowing such products on the basis of any ruses, may keep in view the saying of the Prophet (PBUH), quoted below the Heading, that whoever initiates or introduces any evil or prohibited practice or activity which is followed subsequently (by others), he would be required to bear the burden like that of one who followed that practice without their’s being diminished in any respect. [*Ṣahīḥ* Muslim; Book 34, *ḥadīth* 6466]. It is what Qur’ān (5:30-32) declared with regard to murder of Habel by Qabeel, “For that cause, We ordained for the Children of Israel that whosoever killed one

human being, unless for murder (*qiṣāṣ*), or for creating *fasād* (chaos) in the land, it shall be as if he had killed all mankind...”

The liberalization of trade and investment regulations at global level and adoption of information technology have permitted the development of ever new sophisticated debt derivatives and hedging instruments. It resulted in endemic volatility in the financial system as exemplified by the recent global financial crisis. Sharī‘ah-compliant instruments, *ṣukūk* and certificates, not based on debt, have to provide a strong basis for corporate financing, asset and fund management, Islamic fund and portfolio management, and even inter-bank liquidity management.

Islamic capital instruments must avoid *ribā* and *gharar* and be linked to any underlying assets or established receivables that may give profits. Sharī‘ah prohibitions should be taken as guarantees of ethical and value-added market practices that aim to ensure fairness, justice, transparency, and disclosure. This way, the Sharī‘ah seeks to prevent individuals from taking advantage of each other and societies from becoming crippled by interest and speculation.

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