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# THE ROLE OF STANDARDS WITHIN THE ISLAMIC ECONOMY



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دبي عاصمة الاقتصاد الإسلامي  
DUBAI THE CAPITAL OF ISLAMIC ECONOMY

A report commissioned by  
Dubai Islamic Economy  
Development Centre

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# About this report



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Dubai Islamic Economy Development Centre

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## The Islamic economy: expanding and creating connectivity

- With a young population and economic growth, the Muslim world offers significant potential for the growth of the Islamic economy.
- Perhaps even more importantly, opportunities exist to develop connections between Islamic economy sectors, spur innovation and tap into shared values and economic needs to expand into new markets.
- Key drivers of growth in the Islamic economy will be: population and economic growth; new markets beyond Muslim communities; and innovation and convergence between Islamic economy sectors.
- Prime markets for growth include sub-Saharan Africa, Iran, Central Asia, Indonesia, North America and Western Europe. Markets with potential - but which face particularly significant challenges - include Egypt and Pakistan, and possibly India and China.
- Kuala Lumpur, Dubai and London are best positioned to be future global hubs of the Islamic economy, though they will face competition from places such as Singapore, Istanbul, Riyadh and Luxembourg.
- Key challenges for growth in the Islamic economy include a need for more skilled and experienced labour, young industries that still lack maturity and depth, differing interpretations of Sharia, and lack of cross-border standards. However, the nature and extent of those standards must be carefully considered because promulgation may discourage innovation.
- Dubai is well positioned to serve as a global knowledge repository and centre for training and best practice adoption in standardisation efforts.

## THE ROLE OF STANDARDS IN SUPPORTING THE ISLAMIC ECONOMY

### The goal of this report

There has been a renewed focus on the vast untapped economic potential of sectors within the Islamic economy, largely driven by the Muslim population's desire to incorporate religious and cultural values into consumer and investor habits. While nascent Islamic industries are still expected to expand at high rates, significant differences in the interpretation of Sharia across different nations and cultures have complicated the growth picture for many sectors.

In this context, the goal of this thought leadership report is to examine the means by which the introduction of universal standards can help or hurt prospects for the Islamic economy. This report is intended to serve as a barometer of sentiment among experts in two significant components of the Islamic economy: the Islamic finance and halal foods industries. It is aimed at showcasing the efforts to establish a modicum of standardisation that experts identify as being critical to the continued development of the broader Islamic economy, and whether such efforts are on track, useful or necessary.

This report does not seek to measure empirically the economic impact of current standardisation efforts, nor is it a comprehensive survey of all global standards or efforts therein (although many are discussed at length). Rather, this report is a synthesis of leading expert thought on these subjects, and attempts to lay out the debate that is currently being held by practitioners who must contend with future scenarios.

There is broad agreement that increased harmonisation of standards in Islamic finance and the halal foods industry would support the growth of the Islamic economy by boosting consumer and investor confidence and by facilitating cross-border business. However, there is also a strong feeling that overly strict regulations and standards would damage innovation, which is also essential to development. In particular, there is concern among practitioners about the risk of new regulations, laws or standards that are imposed without a sound understanding of the potential impact on the market. As it is difficult to measure impact, the best route to standards development is through consensus building that aims to avoid contradiction.

One of the primary objectives of this report is to help inform policy design. To that effect, there are several recommendations, case studies and examples of comparative standardisation initiatives in peer sectors that experts identified as potentially useful benchmarks or reference points for future standardisation efforts. The primary recommendation this report makes is that Dubai is well-positioned to serve as a knowledge transfer base for best practices, contract development and training initiatives. Although the economy of Dubai and the wider United Arab Emirates is relatively small compared to the wider Islamic economy, its favourable geographical position, high level of connectivity with the world, large expatriate population and economic openness will greatly encourage greater cross-collaboration between standardisation stakeholders.

## DEFINING “STANDARDS”

It is critical to define the meaning of “standards” and distinguish between the types of standards discussed in this report and those left for future discussions. By “standards”, we mean a norm that can be used as a basis for comparison. In Islamic finance, for example, a standard could be a commonly accepted set of prescriptive steps for the issuance of a Sharia-compliant mortgage, by which future issuances can be compared. In halal products, a standard could be a Sharia-compliant ‘farm-to-table’ supply chain process by which other supply chain processes are evaluated. This report focuses primarily on the standards which can be used to evaluate whether a product or service is Sharia-compliant, and how to best define the meaning of Sharia compliance. Left for future discussion are standards that concern the organisational and administrative processes within Islamic institutions, which may help to promote efficiency and productivity.

### Standards in Islamic finance

- We found there to be no clear consensus on the need for greater standardisation in Islamic finance. Some interviewees expressed concern that increased standardisation would stifle the types of innovation that have been crucial to a nascent industry; others emphasised that a core set of standards, particularly those that increase transparency, lower costs and address investor concerns would greatly benefit the industry as a whole.
- Internationally, there is no single organisation which issues standards that are universally adopted by all jurisdictions. However, key organisations have led efforts to provide guidance for regulators and market participants. Interviewees generally agreed that future standardisation discussions must include organisations, which will function best as referees or consensus-builders between market participants and regulators.
- Major areas for increased standardisation include: the development of more secondary market master agreements; more authoritative rating agencies that focus on Islamic products; greater regulatory clarity, including the empowerment of a specific national or international Sharia board; better training and certification processes, particularly with respect to the legal aspects of Sharia-compliant transactions and cross-border comparative law; and steps to clarify the resolution of distressed sukuk.
- Many interviewees argued that as more jurisdictions pass standalone regulations for Islamic finance, the industry as a whole will benefit. Due to the dual ownership nature of many Sharia-compliant transactions, Islamic finance in many jurisdictions without such regulations is subject to onerous reporting and taxation requirements. Eliminating these obstacles through improving regulatory clarity would improve the global outlook for Islamic finance.
- Standards that integrate financial systems at a lower cost would be welcomed. Developing standards that help countries adopt better standalone macro-prudential regulation that integrates well with existing Islamic banking frameworks around the world ought to be a major goal of standardisation efforts.

## Standards in the halal foods industry

- There is widespread agreement that the halal foods industry needs much clearer and stronger standards. If developed through a global consultative process, clear standards would help the halal foods industry by reducing the cost and time for new companies to enter the market, reducing the costs to suppliers of selling to multiple countries, enhancing consumer confidence and ensuring supply chain integrity.
- In most cases, halal foods are regulated and certified by country-specific or local bodies. In some countries, a government agency or central authority reviews and accredits certification boards, but in others, there is a lack of clear accreditation authorities and processes, and many countries have several certification boards. This creates confusion and inefficiency and undermines the potential for cross-border trade.
- On the global level, there is no single, accepted body that issues standards or accreditation to certification bodies in the halal food industry. However, there are important institutions leading debate and research in this area. Moving forward, many in the halal foods industry want to develop globally accepted standards and to develop a global body and related regional bodies responsible for providing accreditation to certification boards.
- There is broad agreement that the halal foods industry would benefit from greater harmonisation of standards and a more credible accreditation system. However, there is vibrant debate over how this should work. Should there be a centralised, global system or a more diffuse, regional one? Should a long-term goal be the creation of a single, global halal brand and logo, or would that prove to be too limiting?
- Ideas that would promote such a harmonisation of standards include: liaising with experts in Islamic finance; creating a central warehouse of data on the global halal foods industry; identifying key points of contact and authorities in every country with a significant halal foods presence; ensuring that Sharia experts from around the world are involved in any discussion to create global standards and accreditation bodies; and, while aiming for global goals, also taking smaller steps, such as mutual recognition agreements to facilitate halal trade.
- Achieving the right balance in creating globally accepted standards and developing a more global (or at least regional) accreditation system would significantly contribute to the development of the global halal foods industry by creating greater consumer confidence and simplifying the processes of credible certification and reliable auditing for companies. It would also contribute to the broader Islamic economy by helping to break into new markets and facilitating interaction between halal foods and other Islamic economy sectors, such as Islamic finance and the hospitality industry.

## METHODOLOGY

Oxford Analytica interviewed 14 thought leaders in the Islamic finance and the halal foods industries. This expert panel included both academic scholars and practitioners. Representatives from the global financial services industry, law firms, academia, Sharia boards and standardisation institutes were interviewed.

The Oxford Analytica project team conducted first round interviews, guided by a questionnaire developed in conjunction with the Dubai Islamic Economy Development Centre. The goal of this round of interviews was to gain experts' insights into opportunities and challenges for growing the Islamic economy and the role that improved harmonisation of standards could play in fostering the development of both Islamic finance and halal foods.

After analysing the results of these interviews and conducting additional corroborating research, we held a second round of interviews to collect experts' feedback on our initial findings. Some members of our expert panel were interviewed in both rounds, and others in the first or second round only. Experts were interviewed under the condition of non-attribution, meaning that the findings discussed in this report cannot be linked to any individual interview.

Our Advisory project team drew on these interviews and additional research to produce the following report. In addition, the report was critiqued by Senior Advisor Afshin Molavi and an external expert in Islamic finance.



# The Islamic Economy

## EXPANDING AND BOOSTING CONNECTIVITY

With a young population and economic growth, the Muslim world offers significant potential for the growth of the Islamic economy. Perhaps even more importantly, opportunities exist to develop connections between Islamic economy sectors, spur innovation, and tap into shared values and economic needs to expand into new markets. To achieve the full potential in the Islamic economy, governments, businesses and institutions will need to work together.

The Islamic economy includes:

- Islamic finance
- Islamic fashion
- Halal food industry
- Family-friendly travel and recreation
- Halal pharmaceuticals and cosmetics
- Media, IT services and digital communication

While all these areas are important to an integrated vision of the Islamic economy, this report focuses on Islamic finance and the halal foods industry, as these two sectors are the biggest – Islamic finance is already a 1.5 trillion dollar industry and halal foods is estimated to be a 700 billion dollar business – and offer the most potential for deepening and expanding the Islamic economy.

## DRIVING GROWTH



Demographic and economic factors within Muslim-majority countries, potential to expand beyond Muslim communities, and opportunities to innovate and create connections between various sectors will allow significant space for the Islamic economy to grow and expand. Another important driver is government support from countries such as Malaysia and the United Arab Emirates (UAE), which have been instrumental in incubating industries.

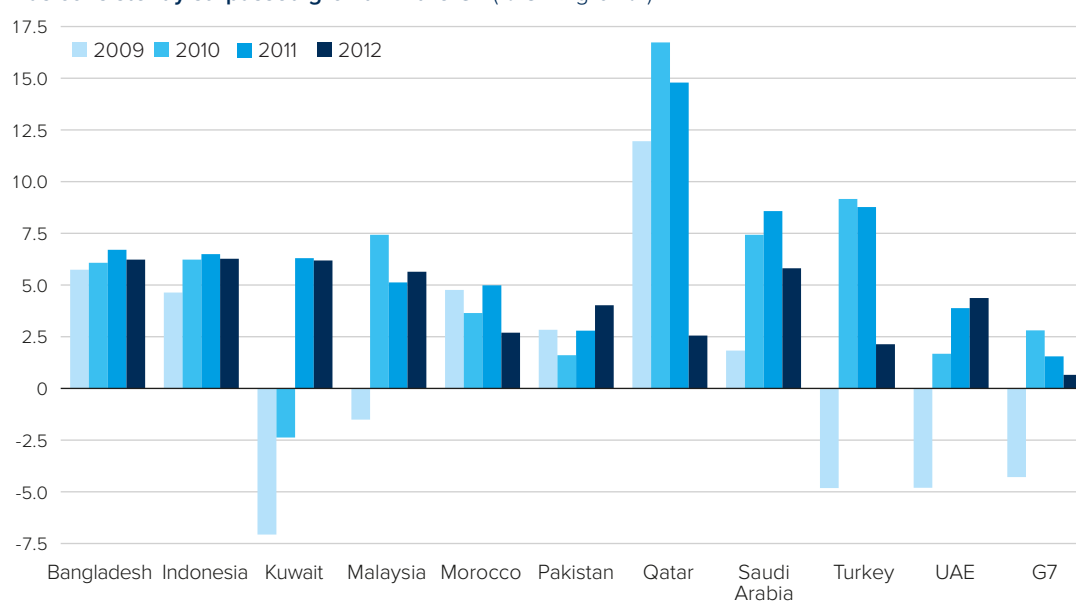
### Muslim-majority countries

Population growth through much of the Muslim world is a major driver of potential increased demand for Sharia-compliant products and services. Even though the rate of growth is slowing, the Pew Research Center has projected that the global Muslim population will increase by about 35% to the year 2030 – about double the growth rate for the rest of the world. By 2020, Muslims will make up about a quarter of the world's population.\* Furthermore, current populations in many Muslim countries are very young, creating a base of workers and consumers for decades to come.

\* Pew Research Center Forum on Religion and Public Life, "The Future of the Global Muslim Population," 27 January 2011.

In addition, many Muslim-majority countries are likely to experience economic growth rates higher than many developed countries. This is true for relatively wealthy countries in the Gulf Cooperation Council (GCC) but also for countries such as Indonesia, where per capita incomes are lower but room for potential economic growth is strong. Economic growth can drive demand for financial services as well as increased consumption of meat, which is particularly important to the halal food industry.

**Economic growth in current and future centres of the Islamic economy has consistently surpassed growth in the G7 (% GDP growth)**



Source: World Bank

With a growing population of Muslim consumers and higher incomes in many countries, there is strong potential for a larger future market for the Islamic economy. Furthermore, according to many of the experts interviewed for this report, there is also a sense of increasing interest within many Muslim communities in expressing one's faith through all aspects of life, which is driving a current wave of interest in Sharia-compliant products and services.

## Geographic expansion and crossing religious boundaries

Sharia-compliant businesses are already strong in several areas, including the GCC, Malaysia and some other parts of Southeast Asia, Muslim communities in Europe and elsewhere.

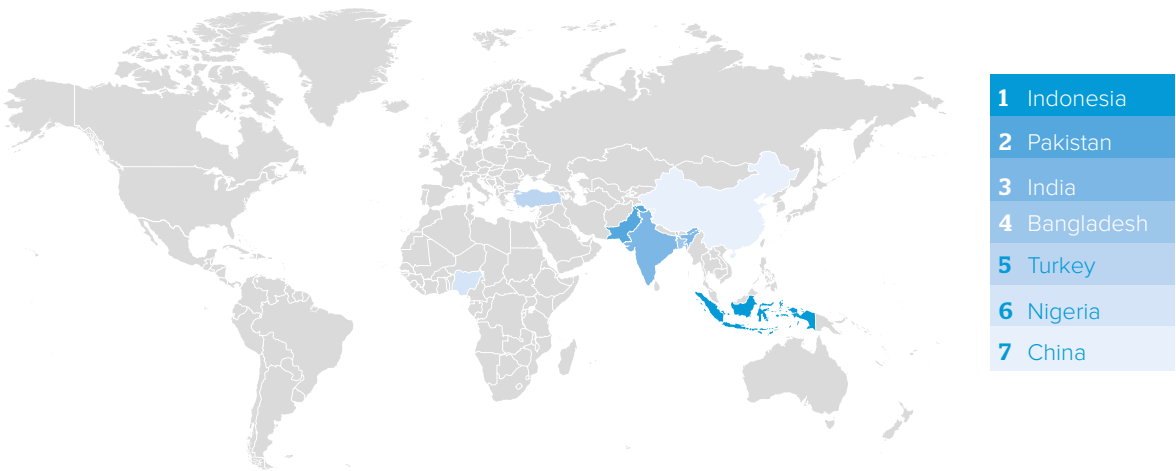
At the same time, there is significant room for geographic expansion to other Muslim-majority countries and to other areas. Markets for Sharia-compliant products already exist in non-Muslim-majority countries, in places ranging from India to Europe and North America where there are significant Muslim communities. There is significant potential to expand further, including beyond Muslim-focused markets.

### IDENTIFIED AREAS FOR EXPANSION

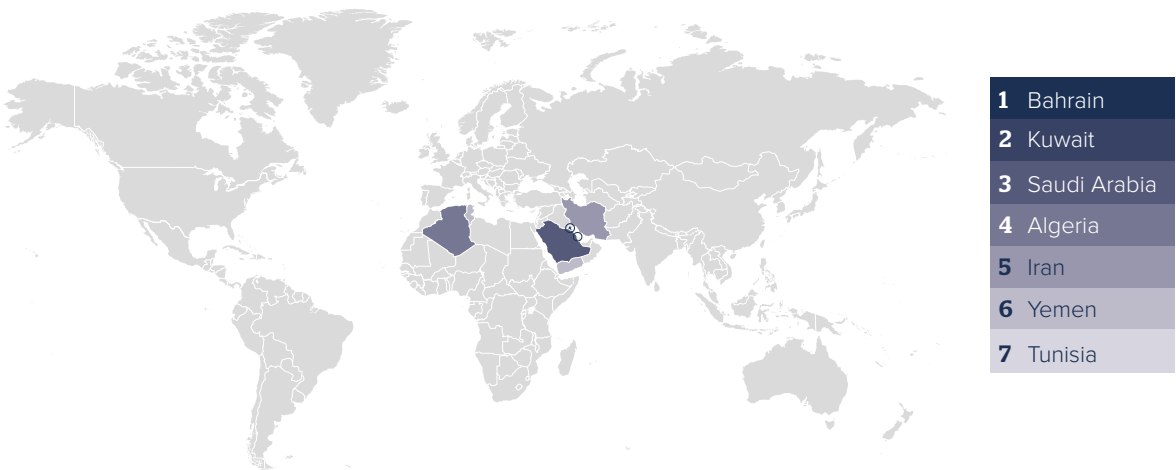
- **Sub-Saharan Africa:** Existing strong connections with the Gulf and a need to raise capital for large-scale infrastructure projects, as well as a high level of economic growth, could drive growth in Islamic finance. Several countries present major opportunities for the Islamic economy, including Nigeria, South Africa, Uganda and Zambia. Positive signs from central banks and legislators across the continent suggest that it could become an attractive market in the coming years.
- **Iran:** Though challenges exist, Iran represents a large Muslim economy, with an economically sophisticated and growing population. If sanctions are lifted following a potential diplomatic deal, it will offer significant new opportunities, especially if the country successfully implements banking sector reforms. Several experts said that Iran is likely to be a major player in Islamic finance in the future, if sanctions are lifted.
- **Central Asia:** With a large Muslim population and trade links to Turkey and Asia, Central Asia is a potential growth market. However, the region's has limited economic influence and lower levels of religious practice than other parts of the Muslim world. Low levels of practice is due to a variety of factors, including some that present challenges to growth prospects for the Islamic economy, such as the lingering effect of past secularisation efforts by regional governments. Nevertheless, experts noted that this is a potential market but one in which the Islamic economy is only starting to enter the conversation.
- **Indonesia:** With the world's largest Muslim population and average annual GDP growth of 6% in 2013, Indonesia is currently an underserved market in terms of Islamic finance, with much potential to grow. The Indonesian halal industry is large; extensive regulations surrounding the import and sale of halal products have contributed to a robust framework for certification. However, lower incomes in Indonesia will constrain potential growth in both Islamic finance and halal foods.
- **North America:** The United States is already one of the largest exporters of food/meat to Muslim-majority countries, with many companies already involved in the halal industry, both for domestic consumption and for export. There is still significant room for growth in its halal foods involvement. Members of our expert panel debated its potential as a growth market for Islamic finance. Given the size of the US financial market, if Islamic finance

The global Muslim population: size of potential consumer base (top seven countries)

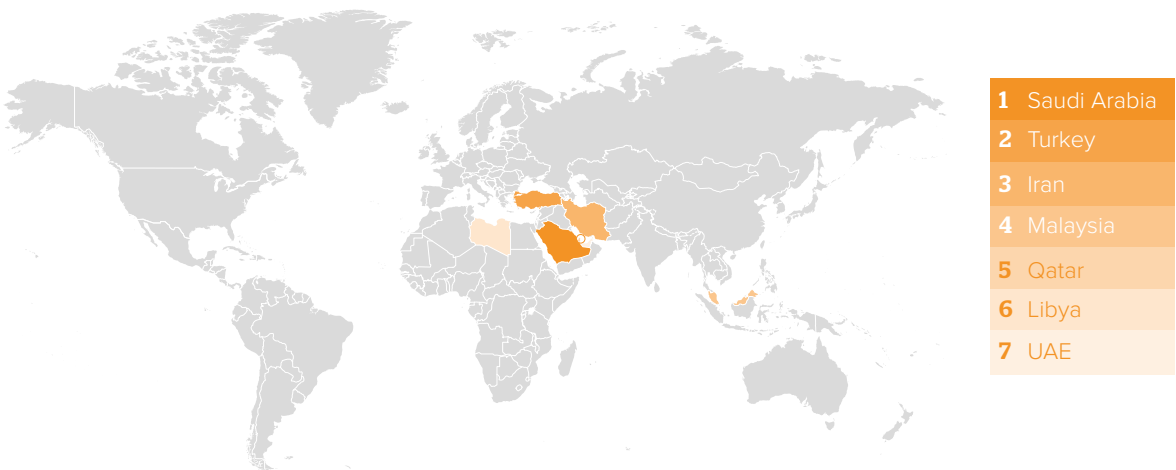
Largest Muslim population



Largest Muslim population as a percentage of total population



Highest purchasing power of Muslim population



Source: Government of Singapore

plays even a small but growing role, the potential is huge. Furthermore, the country will have large capital requirements to fund significant improvements in infrastructure over the next several years, as well as energy projects where there may be good opportunities for Islamic finance to build on the existing expertise of regional practitioners and diversify its assets. On the other hand, Islamic finance will face significant challenges in competing with conventional finance in the US market.

- **Europe:** Across the continent, there is renewed government support for Islamic finance. Although no country has yet to establish a standalone regulatory regime for Islamic finance, many countries have made notable efforts to recognise the sector. Luxembourg is in the process of issuing its first sukuk, which comes on the heels of the United Kingdom's first issuance in the summer of 2014. Efforts have been made to eliminate double taxation of ijara in several jurisdictions as well. Large Muslim communities with relatively high levels of spending power make many European cities attractive growth markets for the halal foods industry.

#### EXPERT VIEW

##### **Markets with potential but big challenges**

Experts noted that there are several markets with potential but that face major challenges likely to hinder development of Sharia-compliant products and services. For example, with a large economy and a large Muslim population, Egypt could be a natural market and even a leader in the Islamic economy, but its current government is wary of anything labelled as explicitly 'Islamic' and worries about perceived links between Islamic finance and the Muslim Brotherhood.

With a large Muslim population, Pakistan represents strong potential in Islamic finance and has huge potential as both a market for and supplier of halal food, but lower incomes, lack of infrastructure and political instability hinder this. There appears to be a renewed effort among policymakers in Pakistan to boost Islamic financial services in the country, and some cities are considering reforms to boost halal foods exports, but experts debated the impact that this might have. India has a large population and is already very important in terms of halal foods supply, but its strongly Hindu-affiliated government is not supportive of Islamic finance.

With huge needs for capital and a substantial Muslim minority, China is another place with potential, and the government has expressed some interest in Islamic finance; it represents a potential growth market but a limited one, and much of the potential business related to China is currently routed through Malaysia.

Another potential driver of growth is the opportunity to tap into shared values that transcend religious boundaries. With improved marketing and outreach, halal foods could tap into existing interest in organic foods and supply-chain integrity to expand beyond Muslim communities. Some experts interviewed for this report argued that Islamic finance will only reach its true potential when it is viewed not as “Islamic” but rather as an option alongside conventional finance. (Some experts also believe that Islamic finance could market itself as less risky than conventional finance – thus tapping into concerns beyond Muslim-specific interests – but other practitioners strongly disagree.)

#### EXPERT VIEW

##### **Can halal foods lead Islamic finance in non-Muslim markets?**

Some experts argue that the halal foods industry can and should lead the expansion of the Islamic economy into non-Muslim markets, because it is simpler to understand than Islamic finance and also because it more easily taps into shared values such as animal welfare and supply-chain transparency. If the halal foods industry successfully attracts more non-Muslim consumers and investors, it might pave the way for Islamic finance and other Islamic economy sectors. Key challenges include animal welfare concerns regarding a lack of stunning before ritual slaughter and broader perception problems; however, outreach and education regarding animal welfare and appropriate branding and marketing could overcome these challenges.

#### **Innovation and a more integrated Islamic economy**

The halal foods industry and particularly Islamic finance are comparably young industries with plenty of room for more innovation to create new and better products. There is a huge diversity of product offerings in Islamic finance, particularly in the retail banking sector, and halal as a brand has gained prominence among marketers around the world. Mobile and web technologies will increasingly drive innovation in these sectors, presenting unique opportunities and challenges to both industries.

Another key element of deepening and expanding the Islamic economy is to break down existing silos and exploit potential synergies between Islamic industries, particularly between Islamic finance and the halal foods industry. Currently, there are very few connections between these two; most Islamic finance funds and banks do not invest in or loan to halal foods companies. However, this is a natural area to develop new connections that would help to grow both sectors. For example, Islamic finance needs to diversify beyond real estate, and adding halal foods companies to its portfolios would help; at the same time, many halal foods companies need to raise capital. Furthermore, most producers of Sharia-compliant food products are using conventional finance; using Sharia-compliant investment and banking services would bolster their overall commitment to meeting consumers’ religious and ethical concerns.

## FUTURE LEADERS IN THE ISLAMIC ECONOMY

The most likely future hubs of the Islamic economy are



A thriving, global Islamic economy will likely have several key centres that lead and help drive growth. For example, there might be centres in Europe, the Middle East and Asia to serve various markets and time zones and connect different economic regions. Future leading centres might not be in the key growth markets but would help to serve them. They will be global or regional hubs with the resources and business culture primed to facilitate linkages across borders and sectors.

Our expert panel interviewed for this report listed a range of different potential leading centres of the Islamic economy, but those most often cited are:

- **Kuala Lumpur:** Often considered the longest-reigning leader in Islamic finance and a major leader in the halal foods industry, Kuala Lumpur will continue to be a key centre for the Islamic economy. It issues far more sukuk than any other centre and is a critical intellectual, regulatory and practical leader in Islamic finance. It hosts the Islamic Financial Services Board and other standard-setting bodies. It also plays an important role in creating standards for halal foods.
- **Dubai:** Sheikh Mohammed Bin Rashid Al Maktoum has identified supporting the expansion of an integrated Islamic economy as an important priority for Dubai. In addition to its leadership's focus, Dubai also offers other resources that could facilitate a role as a leader in the global Islamic economy. These include its existing role as a hub for global transportation and logistics, its top-tier business infrastructure, its positioning between European and Asian time zones, its current role as an important regional financial centre, and its cosmopolitan community with business connections that span the globe.
- **London:** London, along with Kuala Lumpur, is already an undisputed centre for Islamic finance, supported by its clear role as a global financial hub, UK government policy to support Islamic finance, and an active Muslim community with global links. Although its role in the halal foods industry is smaller, London also is an important centre for halal foods, given its

relatively large Muslim minority population and that community's global links. However, some experts argued that, despite playing a critical role in global Islamic finance with government support, the United Kingdom has not developed a comprehensive strategy to promote London as the centre of Islamic finance. The British government portrayed its June issuance of a sovereign sukuk – the first such sovereign sukuk issued by a non-Muslim country – as a key step that “cemented Britain's position as the western hub for Islamic finance”, but some expert panellists argued that this was a one-off gesture rather than a part of a comprehensive strategy. There are also political challenges for growing Islamic finance and halal foods in the United Kingdom, as recently demonstrated by Foreign Office minister Sayeeda Warsi's resignation in August 2014 over the UK's policy on Gaza, and by the 2014 controversy over Pizza Express's use of halal meat. However, Conservative Member of Parliament Sajid Javid remains in government and is a strong advocate for continued integration.

### Other candidates

Our expert panel was less clear on other potential future centres for the Islamic economy, but more than one expert mentioned the following candidates:

- **Singapore:** Singapore is an important global hub for conventional finance and has actively sought to enter the Islamic finance market, but its volumes and level of interest do not compare to Kuala Lumpur, and it is unclear whether Singapore will be a major centre for Islamic finance, and could be a hub for Islamic wealth management. Singapore is also important for halal foods; a certification from the Islamic Religious Council of Singapore (MUIS) is relatively widely recognised.
- **Hong Kong:** Hong Kong has expressed intentions to become an Islamic finance hub. However, most experts felt that Hong Kong is not really serious about taking the steps necessary to become a global centre for Islamic finance.
- **Riyadh:** Saudi Arabia as a country is and will remain a critical player in the Islamic economy, and several experts see Riyadh as an important regional hub. However, the focus is likely to be on the domestic Saudi market and the regional Gulf market and less on an integrated, global market. However, because of Hajj, Saudi Arabia has a significant share of the halal tourism market, which could generate future opportunities in the market for halal foods.
- **Manama:** Bahrain was previously the Gulf regional leader in Islamic finance, but internal politics combined with the rise of other regional centres have undermined its role. However, it is home to the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the International Islamic Financial Market (IIFM) and will continue to have a role in the development of Islamic finance.
- **Istanbul:** While it currently plays a small role, several experts mentioned Turkey as a potential leader in both Islamic finance and a broader Islamic economy. It has a large Muslim population, a growing economy and an advantageous position between Europe, the Middle East and central Asia. It is home to the Standards and Metrology Institute for Islamic Countries (SMIIC), a key global authority for developing halal foods standards, and to the recently launched World Bank Global Islamic Finance Development Center. Turkey has several major infrastructure



projects that make use of Islamic finance facilities to fund construction. It has huge potential in the halal foods industry, given its own population's religious composition and relative wealth, as well as its trade links with the Caucasus and Central Asia.

- **Luxembourg:** Luxembourg has developed a reputation for Islamic finance offerings, and authorities are considering pursuing a comprehensive strategy to become a key centre for Islamic finance. However, most experts on our panel see it as unlikely to seriously compete with London. It is more likely to be a centre for Islamic finance in Europe rather than on a global scale. It may also seek to cater to specific segments of Islamic finance, such as the Islamic fund industry.
- **United States:** Our expert panel debated the extent to which US cities might be centres for a future Islamic economy. The United States has a global financial hub in New York, and is already a major provider of meat and other food items to the Muslim world. It also has an environment that is conducive to international business and a significant Muslim community. However, notwithstanding several small – albeit successful – retail banks that conduct ijara and murabaha transactions, Islamic economy industries have not yet made major breakthroughs in the country, and what does exist is highly regional instead of consolidated in one hub. While the government appears open to Sharia-compliant products, it is not interested in pursuing a comprehensive strategy to become a hub. Arguably, there may be greater potential for the halal industry than Islamic finance in the United States, where there tends to be a cultural appreciation for respecting religious practices, as demonstrated in the recently passed Farm Bill that included increased access to kosher and halal foods as part of government emergency food programmes.

## CHALLENGES



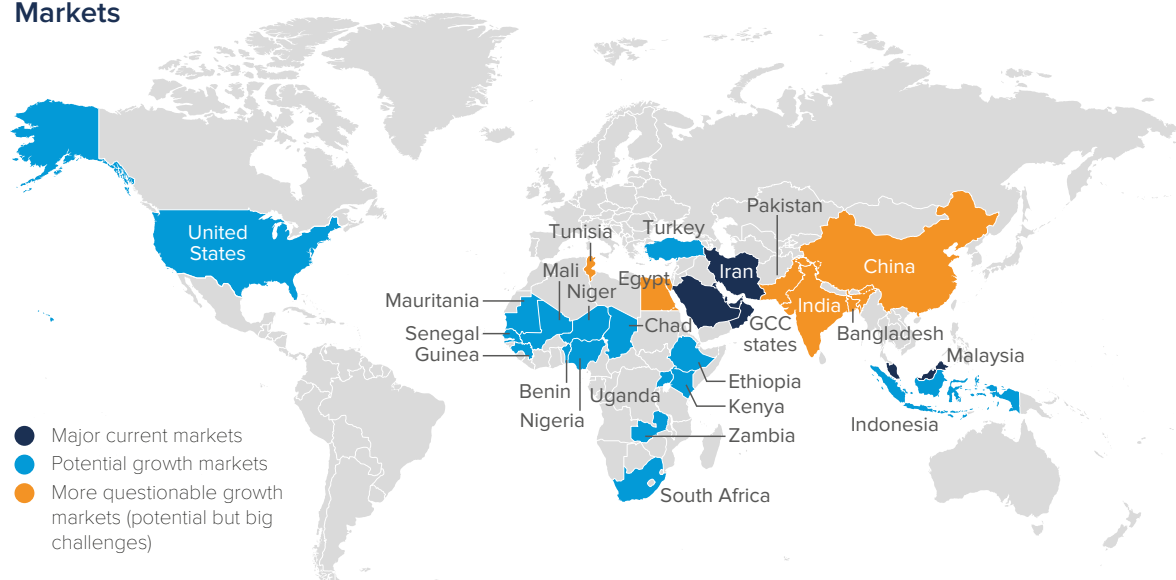
While there are very strong drivers to help the Islamic economy expand and grow, especially if players in the field proactively work to develop linkages across geographies and sectors, there are also important challenges to overcome.

### Developing the skills base, expertise and experience

Many studies and experts point to a lack of skills, expertise and experience among practitioners, regulators and scholars as a major factor holding back the innovation and expansion of Islamic finance and – to a lesser extent – the halal foods industry. This is part of a broader problem, at least in the GCC, related to a mismatch between education and private sector needs. In addition, the young nature of the industry and the fast recent growth of Islamic finance have led to a lack of supply in skilled labour, including accountants, advisors, managers and Sharia scholars. The Sharia boards often include ageing scholars who often serve on many Sharia boards simultaneously; new ones will be needed, both to replace them as they retire and to keep up with the expansion of the sector. Attracting new talent to the Islamic finance sector will also be critical to supporting the development of new product structures to meet needs in new markets.

## Leading Islamic economy markets and future growth areas

### Markets



### Hubs



### Young industries

Islamic finance remains a young industry, although it has developed significantly over the last two decades. In recent years, the industry has developed a wide range of services offerings and has survived the test of the global financial crisis. At the same time, it remains relatively young and must endure further tests that will create legal precedents. It also

remains overly dependent on real estate as the asset backing many structures and needs to diversify into other asset classes.

The halal foods industry is also a young industry. As it evolves, it will look to develop clearer structures for ensuring the credibility of certification boards and supply chains. It will also expand by developing new halal foods lines and by improving the marketing of its products. The growth in online shopping also presents significant opportunities and challenges for the halal foods industry.

### Perception problems

As the Islamic economy seeks to expand into non-Muslim markets, it will encounter, in several places, negative perceptions about Islamic finance and halal foods. There is often a misperception in North America and Europe – and even in parts of the Middle East and North Africa – that these industries help channel funds to violent Islamists. In Europe, these sectors have run up against broad concerns about the role of religion in society and business. Also in Europe, at various points, several states – including Denmark, Sweden, Poland and Norway – have banned halal and kosher ritual animal killing without first stunning the animal, in reaction to objections by animal welfare activists. Educational outreach, improved marketing and the development of a higher number of successful examples of Sharia-compliant businesses would help to address these problems.

### Diversity of Islamic practice

With more than 1.5 billion Muslims living around the world, Islam includes a vast array of practices and interpretations. While this enriches cultures in many ways, it also creates a challenge in determining exactly how finance and food products meet Sharia requirements, particularly when there is a wide range of interpretations of Sharia and its application. This has limited the ability of the Islamic economy to fully transcend borders and cultures. For example, several experts have cited anecdotes in which GCC consumers have been reluctant to accept Malaysian approval of financial or food products as Sharia-compliant, as they feel that Malaysia has a different standard for identifying something as complying with Islamic law.

### The question of standards

As presented in more detail later in this report, there is a vibrant debate over whether more universal standards in the Islamic finance and halal sectors would facilitate or hinder the growth of the Islamic economy. While there are disputes among the experts interviewed for this report, the overall sentiment is that greater standardisation in both Islamic finance and the halal industry would produce dividends that would benefit the Islamic economy as a whole. At the same time, experts cautioned that excessive standardisation would stifle innovation. The challenge for industry leaders, policymakers and investors will be to formulate standards that manage to both successfully reduce risks and generate increased interest in areas ranging from the secondary market for sukuk to a halal-certified supply chain that will be predictably certified and approved by an array of jurisdictions.

## KEY RISKS

### Key risks to the growth and expansion of the Islamic finance and halal industries

Key risks that could hinder the growth and expansion of the Islamic economy – or at least prevent it from achieving its potential – over the next one to five years include:

#### Economic

- There is a decline in consumer interest in Islamic finance and/or halal foods due to factors beyond the control of both industries, such as increasing secularisation or suitable alternative offerings developed by conventional banks.
- Growth of sukuk issuance in multiple markets reverses due to extenuating factors and Islamic finance becomes overly dependent on a single market or region, asset class transaction. Lack of diversification raises risks, as do persistent liquidity problems precipitated by insufficient short-term liquidity instruments.

#### Political

- There are high-profile cases in which halal labels are exposed as fraudulent (such as a case reported in China), or there are significant, public cases of failures in supply-chain integrity for halal foods (such as previous cases in which halal-labelled foods contained pork DNA).
- Political events – such as major terrorist attacks linked to extreme Islamist groups or backlashes against political Islam movements – could increase negative perceptions about or fears of association with sectors specifically labelled as 'Islamic', both within and without Muslim-majority states.

#### Organisational

- There is a failure to exploit opportunities to develop linkages between Islamic economy sectors, such as between Islamic finance and the halal foods sector.
- There is a failure to reach into new markets, and a failure to attract non-Muslim consumers (an inability to attract interest beyond Muslim communities might be driven by failures to brand and market Sharia-compliant products for non-Muslim consumers and investors, or by negative perceptions of Islam or of religiously affiliated products and services).

#### Regulatory

- Innovation in Islamic finance is held back by many factors, including overly burdensome universal standards, lack of skilled and experienced practitioners, and barriers to new entrants in the sector.
- Governments, institutions and businesses do not develop sufficient standards, transparency and/or regulatory structures to create consumer and investor confidence and facilitate the expansion of Islamic economy sectors across borders.



# **THE ROLE OF STANDARDS IN SUPPORTING THE ISLAMIC ECONOMY**



**It is critical to find the right balance between increased harmonisation of standards while allowing room for innovation and the realities of multiple legal jurisdictions.**

There is broad agreement that increased harmonisation of standards in Islamic finance and the halal foods industry would support the growth of the Islamic economy. It would both develop the confidence of both Muslim and non-Muslim consumers and investors, and facilitate cross-border business between different jurisdictions and cultures. However, there is also a strong feeling that overly strict regulations and standards would damage innovation, which is also essential to developing the Islamic economy. In particular, there is concern among practitioners about the risk of new regulations, laws or standards that are imposed without a good understanding of the potential impact on the market. This is especially so as Islamic industries tend to operate within conventional economic systems and are subject to their regulatory provisions and governance mechanisms; in other words, they have to comply with the stipulations of both Sharia and secular regulatory frameworks, such as capital adequacy rules or food safety regulations. Within these parameters, there is a very vibrant debate over every element of standardisation.

The following sections address standards in Islamic finance and the halal foods industry.

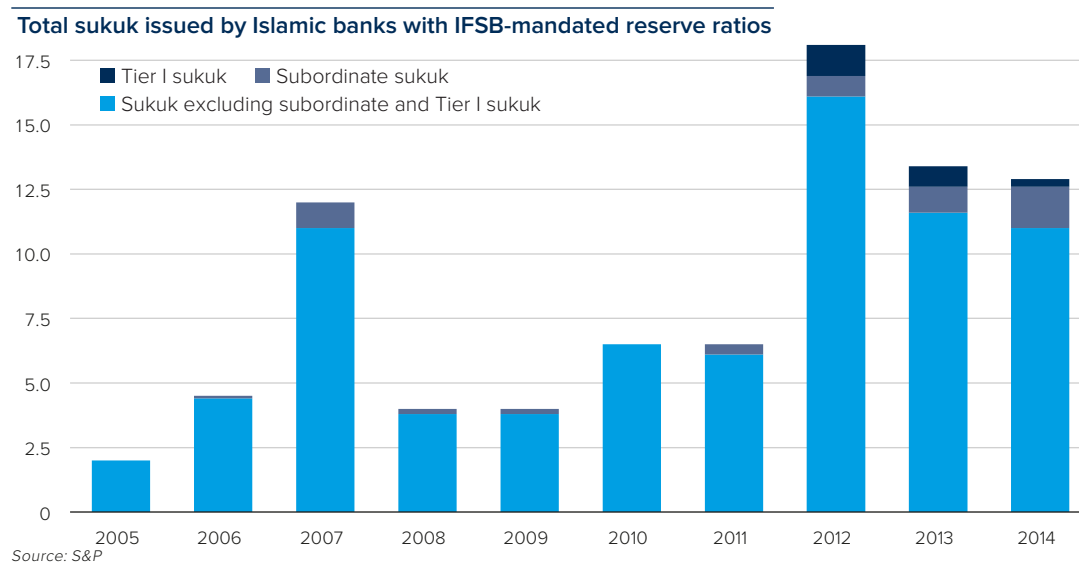
# Standards in Islamic finance

## WHERE DO STANDARDISATION EFFORTS STAND TODAY?

In our interviews, we found that experts broadly agreed that the Islamic Financial Services Board (IFSB), the International Islamic Financial Market (IIFM), the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), the Islamic Development Bank (IDB) and the Organisation of the Islamic Conference (OIC) are all key players in the global standardisation effort. While each of these organisations have slightly different mandates and disparate strengths, interviewees suggested that they lack credible enforcement mechanisms and would benefit from increased communication, coordination and enforcement power.

Our interviewees identified the IFSB as the most recognised international standard-setting body for Islamic finance. The IFSB leads efforts in drafting new standards and developing guidance notes for the Islamic banking industry, Takaful (insurance) and Islamic capital markets, with a primary focus on developing capital adequacy rules for Islamic financial institutions. Following the issuance of its guidance notes, it is common for many domestic supervisory authorities to adopt and implement its recommendations. In this, the IFSB is – like conventional setters of transnational financial standards such as the Basel Committee for Banking Supervision – reliant on domestic regulators for the implementation and supervisory enforcement of its rules. IFSB has also prioritised finding resources and developing partnerships to address emerging issues in the global Islamic finance industry.

The IFSB has been active in interpreting voluntary Basel III standards to determine appropriate leverage ratios for Islamic banks.



Since the inception of the IFSB in 2002-2003, Islamic finance has grown considerably, and the IFSB has worked to address, guide and accommodate divergent trends seen in Islamic finance across multiple jurisdictions. Furthermore, the IFSB has played a key role in standardising calculations and conversions between conventional and Islamic finance. For example, on the heels of the Basel III accord, which introduced a consistent voluntary leverage ratio measure for banks and is in the process of being implemented by jurisdictions around the world, the IFSB introduced IFSB-15, which outlined how Basel III ratios ought to be applied to Islamic banks, which are typically less leveraged than conventional banks.

AAOIFI is in many respects a sister standard-setting organisation to IFSB. AAOIFI is not necessarily aiming to replace or supplant International Financial Reporting Standards (IFRS) or generally accepted accounting principles (GAAP) in the Islamic world; AAOIFI's aim is to standardise the method of booking Islamic financial products and harmonise them with existing IFRS or GAAP guidelines. This is particularly essential as Islamic financial products tend to co-locate risk, assets, liabilities and future cash flow as part of the terms of transaction.

The IIFM and the OIC – and specifically the International Islamic Fiqh Academy within the OIC – are comparatively small organisations that have both worked to bring about greater standardisation within Islamic finance and the broader Islamic economy. Certain issuances are universally lauded; fatwas announced by the Islamic Fiqh Academy are internationally recognised. They tend to influence the development of standards at a national level and inform Sharia scholars.

The International Islamic Rating Agency (IIRA) is also recognised by multiple jurisdictions, but has so far issued a limited number of ratings.

Many other such organisations also exist, and the sheer number of organisations in the field is one of the key challenges to the promotion of more effective standardisation. Other standardisation efforts, particularly more technical ones, are less coherent across sectoral and geographic lines. For example, the IIFM is working towards an ijara sukuk template and aims to release one by the end of 2014. This standard follows the creation of a tahawwut master agreement that IIFM released in conjunction with the International Swaps and Derivatives Association (ISDA) in 2010, one of five such master agreements the IIFM has authored. Although the legal permissibility of these agreements has come into question in several countries, the IIFM has been widely recognised for its efforts, which should ultimately lead to reduced costs for companies that wish to opt for Islamic financial facilities to reduce their risk profile.



### Major standard setting bodies

Organisation (headquarters)	Areas of standardisation	Standards, guidance notes, etc issued
<b>AAOIFI (Bahrain)</b>	Sharia accounting, auditing, ethics and corporate governance	46 Sharia standards 26 accounting standards 5 auditing standards 2 codes of ethics 7 governance standards
<b>IFSB (Malaysia)</b>	Capital adequacy, prudential and regulatory matters	3 standards and guiding principles 5 guidance notes 1 technical note
<b>IIFM (Bahrain)</b>	Capital and money market product documentation	5 documentation agreements; first standard forthcoming
<b>IIRA (Bahrain)</b>	Ratings	3 governance ratings 3 credit ratings 2 sovereign 2 Sharia quality, and 7 fiduciary ratings in 2012-2013

Source: EY

Multiple other organisations have attempted to develop or have developed similar templates as a means of promoting a particular capital market. As a result, national-level standards have yielded significantly lower transaction costs for sukuk issuance, thereby making it easier to finance smaller projects. In most countries, these efforts have reduced transaction costs to a point where they are broadly competitive with issuing a conventional bond. Still, there is wide discrepancy between what ‘legally permissible’ sukuk documentation entails. This reduces the appetite for sukuk issuance for financing needs that have a more multinational component. The International Islamic Liquidity Management Corporation (IILM) has tried to increase the market for such transactions by facilitating cross-border liquidity management through Sharia-compliant short-term instruments. The IDB has also issued bonds which are eligible for the liquidity management purposes of Islamic banks in many jurisdictions, including the United Kingdom.

Many of our interviewees stressed that, although it appears that there are many bodies involved in setting standards, they are more complementary than contradictory. Emphasising the niche roles organisations play – the IILM, for example, only addresses short-term commercial paper, while the IFSB is focused on capital markets – the interviewees suggested that what is needed is a greater effort to harmonise and empower these efforts. Some suggested that AAOIFI is well-suited to perform such a role, as its accounting and auditing standards are increasingly used as a comparative benchmark across countries.

Two experts identified a comparatively ‘easy’ standardisation effort that AAOIFI could undertake as a means of testing a greater harmonisation protocol. This would be to work with IIFM and ISDA to tailor ISDA documentation to achieve Sharia compliance, and to then develop accounting standards around these tailored agreements.

However, others cautioned against such an approach, arguing that both AAOIFI and IFSB are too small to serve as meaningful intermediaries without significant input from legal, regulatory and industry representatives. Furthermore, both organisations lack the necessary enforcement mechanisms to back up guidance notes as they are reliant on domestic regulators for the implementation and enforcement of their standards.

#### **WHAT COUNTRIES HAVE THE MOST ADVANCED STANDARDISATION REGIMES?**

Our interviewees generally agreed that Malaysia's standardisation regime is the most advanced. Malaysia has worked to provide a large degree of legal certainty and transparency to the Malaysian Islamic economy. Collectively, Bank Negara Malaysia (the country's central bank), Securities Commission Malaysia and its two ratings agencies are close partners in developing and implementing applicable rules for Islamic finance transactions. This linkage has removed redundancies and dramatically increased the efficiency of conducting such transactions. A range of industry associations and ancillary services providers complement these efforts. Malaysian Islamic banking assets totalled about 20% of global assets in 2012, whereas the UAE held about 17% that year. Additionally, Malaysia easily leads in both volume and number of sukuk issuances.

Malaysia is also home to the most comprehensive regulatory framework; the Islamic Financial Services Act (IFSA) of 2013 provides the most regulatory clarity surrounding the development and enforcement of standards. For example, the law empowers Bank Negara Malaysia with supervisory oversight powers and codifies the role of the Bank's Sharia council as the primary determinant of Sharia compliance and governance in the Islamic financial sector. It also ensures, through a comprehensive legal framework, that every aspect of regulation and supervision is Sharia-compliant for all stages of a company's lifecycle.

Malaysia has also invested in growing its domestic talent base in order to meet forecasted demand for Islamic financial professionals. This is key in many ways: it supports innovation; helps meet the demand for labour; and ensures that practitioners and Sharia scholars have the knowledge necessary to develop and apply standards.

The UAE has in place a standalone regulatory regime that governs Islamic financial transactions, but the country does not have a centralised Sharia board of scholars or uniform guidelines for Sharia boards. Many interviewees argued that the upshot of a more decentralised compliance environment is that it allows for greater diversity of offerings. However, since an in-house Sharia board supports each financial institution in the UAE, these boards interpret each transaction individually. This leads to fundamental discrepancies, such as different levels of permissibility for identical structures. The Dubai International Financial Centre has in the past developed contract templates to help mitigate some of this uncertainty. The UAE, and Dubai specifically, was also recognised by interviewees for its efforts to extend finance to small and medium-sized enterprises.

## HOW CAN INCREASED STANDARDS IMPROVE THE OUTLOOK FOR ISLAMIC FINANCE?

Interviewers singled out enhanced domestic regulatory clarity, more enforceability and a larger talent pool – particularly legal talent – as being the core standardisation areas that would improve the outlook for Islamic finance. Standards surrounding these areas should be adopted, with existing supervisory bodies facilitating harmonisation across borders.

– **Regulatory clarity and enforceability.** Technical regulations or schemes are essential to developing nascent financial industries around the world. Islamic finance will similarly benefit from regulation that clarifies business processes and establishes rules around transparency and disclosure. For example, when legislatures and banks take an active role in establishing Sharia boards at a central bank level, the standardisation process will accelerate, boosting predictability and lowering costs. This will eliminate business behaviour that reduces credibility of Islamic finance as a practice, such as ‘fatwa shopping’ to obtain favourable rulings on a potential issuance. If regulators develop domestic guidelines that are clear, simple and flexible, international organisations such as AAOIFI can referee developments, guide future regulatory efforts and identify best practices without requiring these organisations to significantly change their size or mission.

The goal of regulatory standards should be to address risks and convince investors. For example, national-level regulations that standardise disclosure rules for securitised products would address risks and boost liquidity. Incentivising the development of regional ratings agencies to augment S&P/Moody’s/Fitch ratings with a more transparent process centred on Islamic finance – including subjecting sukuk issuances to a scoring system – would help to convince investors of the safety of Islamic financial products.

– **Talent.** A common refrain in media reports and studies on the state of the Islamic finance industry is that it suffers from a talent shortage. While this can be addressed through certifications and degree programmes, many interviewees suggested that a wide array of institutions are already dedicated to increasing the number of financial professionals, lawyers and Sharia scholars. Emerging centres of Islamic finance – including Dubai and Kuala Lumpur, but also in areas primed for increased activity in Islamic financial markets, such as sub-Saharan Africa – should work to identify key talent shortages and address those needs first.

One potential area identified by interviewees was developing a legal certification in comparative standalone regulatory regimes. In Malaysia, for example, the Financial Accreditation Agency is in the process of developing standards for Islamic finance education programmes; there is also scope for self-regulating professional associations of Sharia scholars such as the Association of Sharia Scholars in Islamic Finance (ASSIF).

## EXPERT VIEW

### Practical training

Our panel had many ideas to develop talent. A popular suggestion was for governments or key institutions to establish educational centres to provide accredited degrees in fields relevant to Islamic finance, and that businesses need to develop career paths to attract and retain talented people in the Islamic finance field. While many institutions already do this, panellists expressed the view that extant institutions ought to work more closely with the banking and legal sector to identify skills shortages.

Another idea suggested by one of our expert panellists was the development of a course or seminar for practitioners that would provide lessons learned from case studies. Topics covered could include how previous sukuk were structured, whether they were tested and what happened to distressed sukuk in a variety of jurisdictions. He emphasised the importance of learning from mistakes and accepting a level of risk, rather than seeking to avoid failure.

Standardisation has a value to markets because it will mean that prospective consumers of financial products can compare them more readily, evaluate products irrespective of jurisdiction and reduce legal costs. Standards that answer major questions (What are investor rights? What happens if a transaction ends up in court?) are most valuable.

However, several experts emphasised that it is critical to avoid over-standardisation. Too many standards developed by the wrong bodies or in a way that is not inclusive of all parties would be ineffective and would encourage firms to develop their own templates to address in-house concerns. Furthermore, overly cumbersome standards or regulations could kill the innovation that is critical to the growth of Islamic finance.

Furthermore, others cautioned against placing too much faith in standards, arguing that what matters most are the domestic legal tests and regulatory reviews that structures and transactions must undertake.

## HOW CAN IMPROVEMENTS IN STANDARDS SUPPORT THE WIDER ISLAMIC ECONOMY?

Our interviewees felt that the Islamic economy as a whole would benefit from improved standardisation in the Islamic finance industry if those standards led to a larger secondary market for sukuk and more options for raising short-term capital, an industry-wide acceptance of internal legal requirements, and contingencies for resolution of instruments. For example, international standards surrounding cross-border insolvency, amendments to existing agreements, external crises mitigation and response plans would all be welcomed, as would a set of templates for basic transactions that are universally recognised, legal and enforceable. The continued development of instruments that reduce risk, such as standardised Sharia-compliant repurchase agreements with rules that govern their use, should also be a priority. This is because the assets under management at Islamic banks are growing at an extremely rapid rate, but there remains a dearth of tools to manage short-term liquidity.

One major improvement that such standards would bring to the wider Islamic economy would be to help successfully integrate financial systems at a lower cost. For example, if a diplomatic deal is reached that removes sanctions on Iran, the country will require access to capital markets; this is a major opportunity for the global Islamic financial industry. Helping a state such as Iran adopt better standalone macro-prudential regulation that integrates well with existing Islamic banking frameworks around the world would reduce risk and increase opportunities for the Islamic economy as a whole.

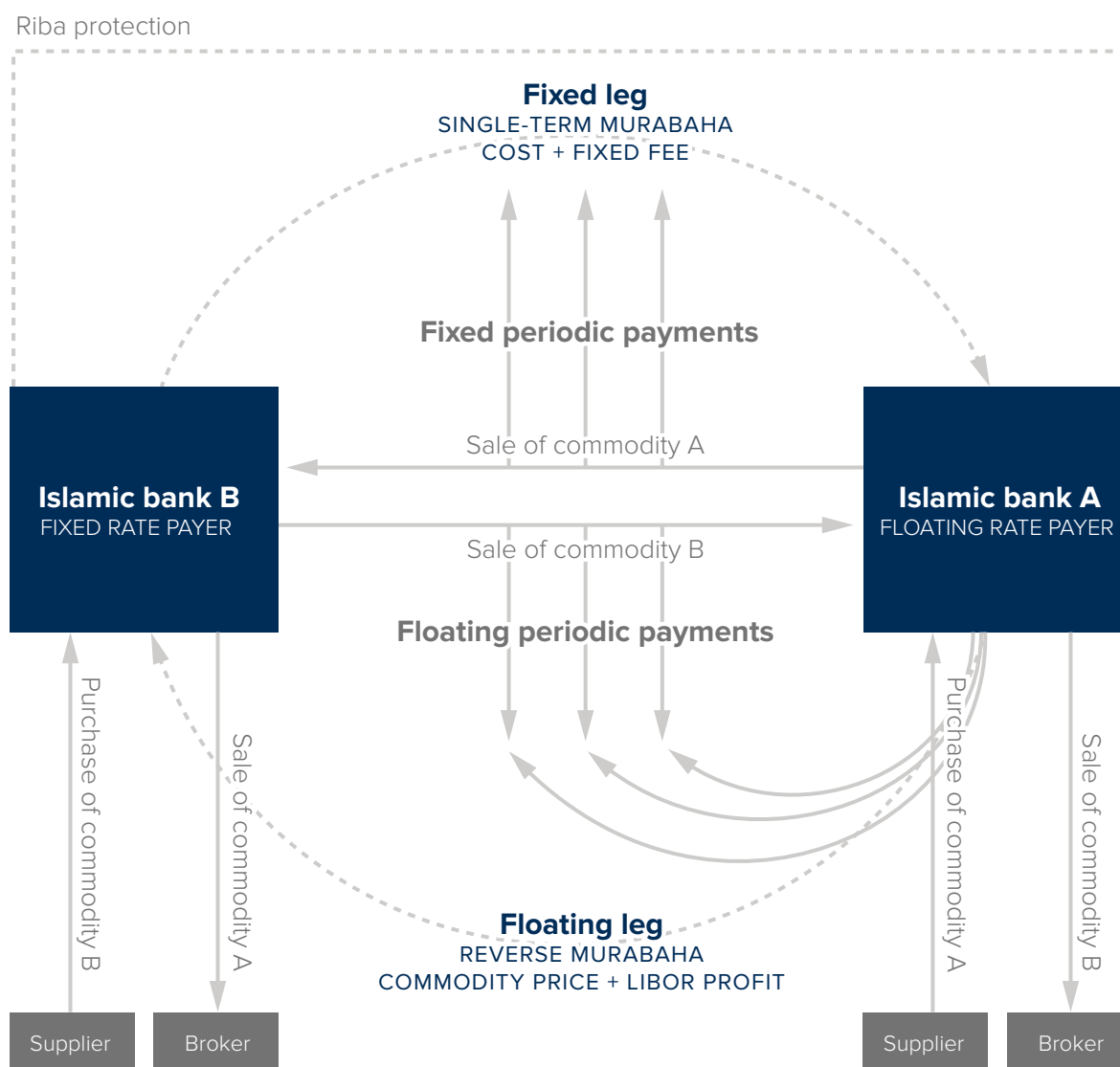
### ANALOGY

#### **The role of international organisations in guiding regulatory standardisation and industry growth**

The TriBar Opinion Committee in the Greater New York area is an organisation comprised of representatives from a variety of legal fields. The committee regularly releases reports on transactions that take place within its jurisdiction. Specifically, TriBar reports explain to its members how legal opinions should be formed after the conclusion of a transaction. Therefore, whenever TriBar releases a report, all legal practitioners in the New York area know exactly how to frame legal opinions surrounding similar transactions to which they are a counselling party.

The Islamic finance industry could adopt something similar, where AAOIFI and IFSB, in conjunction with industry representation, regularly releases reports on transactions and forms opinions around emerging and commonly accepted best practices. This would inform deliberations in emerging regulatory schemes, help shape existing guidelines and could eventually include opinion on more robust standards for cross-border Islamic finance. The key is to find a balance between industry-led and regulatory expertise. Too much of a regulatory bias may lead to the criticism that standardisation efforts lack sufficient industry expertise, while too much industry-led bias may mean the efforts lack regulatory credibility.

## The Tahawwut Master Agreement



The Tahawwut Master Agreement constitutes a framework agreement for bilateral Sharia-compliant derivatives transactions and lays the groundwork for Sharia-compliant hedging across multiple jurisdictions through the use of a variation of commodity murabaha, a favourite tool of Islamic finance practitioners seeking to raise short-term capital.

One challenge of this master agreement is the potential for brokers to collude in a fashion that negates the need for the transaction to be truly asset-backed. Although the permissibility of this standard is still debated by scholars and regulators, the intent of such derivatives is to allow businesses to reduce commodity risk in a Sharia-compliant fashion.

Source: Delphi Risk Management.

Many respondents argued that greater standardisation would encourage diversification out of the traditional sectors in which Islamic finance is most popular, such as real estate. More robust standards – especially across borders – should contribute to an ongoing revitalisation in intra-Islamic trade finance, secondary sukuk markets and investment funds markets.

One potential area to produce an effective standard would be to implement a unified legal framework for Islamic funds – a passporting system akin to the EU passport for investment funds, the Undertakings for the Collective Investment in Transferable Securities (UCITS) directive, in which Islamic funds could be distributed across jurisdictions without requiring local permission beyond an initial notification.

The GCC is currently considering a GCC-specific passport for investment funds; the UAE and Malaysia are also in talks to develop a bilateral passport. A strong Islamic funds passport recognised by multiple countries could serve as a brand for the Islamic finance industry as a whole and encourage greater institutional participation in the secondary market for Islamic funds, many of which have a high transparency threshold.

Finally, respondents widely concurred that anything that reduces the cost of capital will increase opportunities for small- and medium-sized enterprises (SMEs) to finance investment. This includes standardisation regimes that lower transaction costs and facilitate global trade. These are key for fostering growth of the halal industry, in which SMEs play a very important role.

## WHERE DO STANDARDISATION EFFORTS STAND TODAY?

While there is much debate within Islamic finance over whether more standards are needed and to what extent, there is widespread agreement that the halal foods industry needs much clearer and stronger standards. If developed through a global consultative process, clear standards – backed by a strong system of accreditation and certification bodies – would help the halal foods industry in several ways, without sacrificing much in the way of innovation:

- **Reduce confusion and the cost and time required for new companies to enter the halal foods market:** Currently, in many countries, determining which certification body to go to and which ones are credible can be confusing. Additionally, the costs of acquiring certification (and ongoing auditing) and the time required to do so can deter entrepreneurs.
- **Reduce costs to suppliers selling to multiple countries:** Suppliers, such as multinational corporations like Nestle, spend time and money ensuring that their products meet a range of national halal requirements. A global standard would enhance significantly efficiencies in selling to a range of markets.
- **Enhance consumer confidence:** Currently, consumers – especially outside of Muslim-majority countries – are easily confused over whether foods are truly halal and find it difficult to know who to trust. This is especially true when buying halal products online. Providing a higher level of confidence for Muslim and non-Muslim consumers interested in halal products is essential to the industry's future growth.
- **Ensure supply chain integrity:** Previous cases in which there were failures in supply chain integrity – such as allowing pork DNA into halal products – damage the industry's credibility. Better standards and auditing processes would help to improve this critical area of the industry.

## CASE STUDY

### Cadbury controversy

In 2014, initial reports from Malaysia's Ministry of Health that pig DNA was found in Cadbury chocolates sparked a multinational uproar that was damaging to Cadbury and the global halal industry. In the end, Malaysia's halal authority – the Department of Islamic Development Malaysia (JAKIM) – concluded that, after conducting its own testing, Cadbury chocolates were in fact halal. The incident demonstrated the critical importance of ensuring supply chain integrity, the potential problems caused when different authorities are competing or fail to communicate, and the role that respected halal foods authorities can play in preventing and responding to concerns.



## HOW HAVE COUNTRIES ESTABLISHED CERTIFICATION BODIES?

In most cases, halal foods are regulated and certified by country-specific or local bodies. Nearly every country with a Muslim population – including those with minority Muslim populations – has at least one certification body, and often there are several (Australia, for example, has gone from 11 to more than 20, according to varied reports). Estimates of the number of certification bodies around the world range from 75 to 300.

In some countries, such as Malaysia and the UAE, governments play a strong role in establishing and supporting bodies to create and enforce standards. In other places, religious institutions play a major role, such as the Grand Mosque of Paris, which works with Carrefour.

In other countries, the private sector itself has set up a range of certification boards and relevant organisations; for example, in the United States, the non-profit Islamic Food and Nutrition Council of America (IFANCA) is the country's most important organisation for certifying halal products, though it is not the only certification body in the country. Nestle – a major and early leader in halal foods products – created its own internal standards and auditing processes, as well as working with regional bodies. Australia, which is a major exporter of meat products to Muslim countries, requires that certification boards are approved by the government.

There are some benefits to multiple certification boards in a single country: the competition might help keep fees lower and certification faster in ways that help meet private sector needs. However, multiple boards also create confusion, and as some tend to be lower quality than others, the situation undermines confidence in halal certification.

In some cases, since they compete with each other, different certification boards openly criticise others, which creates confusion for consumers and for businesses seeking certification. Centralised, government-funded certification councils such as the Indonesian Ulema Council (MUI) and JAKIM in Malaysia are probably the most robust in terms of enforceability and scope.

For countries with multiple certification boards, developing a respected body responsible for accrediting the certification bodies would help to build confidence.

## CASE STUDY

### Japan seeks to attract Muslim tourists

The government of Japan and several local authorities have actively developed halal food lines in an effort to attract Muslim tourists. The Osaka Chamber of Commerce distributed 5,000 leaflets to raise awareness of foods that can and cannot be consumed according to halal principles, while various private companies, such as All Nippon Airways, have started offering Sharia-compliant options.

However, standards and regulations for halal certification remain nascent. The Japan Halal Association, established in 2010, is an associate member of the World Halal Council and is one of only two recognised certification bodies in the country. Despite its very recent entry on the halal foods scene, providing halal foods remains crucial to Japan's tourism strategy, which aims to attract 20 million foreign visitors before hosting the Olympic Games in 2020. Central to this goal is the effort to boost tourism from Muslim-majority countries in the region.

Country-specific or local halal foods standards may provide comfort to local populations and facilitate business within the country, but they create major challenges for cross-border trade, which is where the majority of halal foods growth potential lies. Furthermore, many halal food products are supplied and produced outside of Muslim-majority countries; future global standards would need to consider the impact on producers in non-Muslim-majority countries such as the United States, Brazil, European countries and Australia.

### Global authorities

On the global level, there is no single, accepted body that issues standards or accreditation to certification bodies in the halal food industry. This leaves the halal industry with a wide range of certification boards but without clear authorities to provide accreditation to them.

The situation also creates conflicts of interest, as certification boards are often left to regulate themselves, and there is much room for such boards to essentially 'sell' certification for a price as a business rather than playing a more objective role in certifying and auditing halal processes.

However, there are important institutions leading debate and research in this area, as well as working to establish global standards and to create a global accreditation structure. The International Halal Integrity Alliance (established in 2007) and the annual World Halal Forum (which began annual meetings in 2006) collectively provide the most developed international standardisation effort. Another key global organisation is the Standards and Metrology Institute for Islamic Countries (SMIIC), which is based in Turkey and plays a key role in leading OIC efforts to develop standards for halal food products.

There are also several bodies that started as specific to a particular country that could play a global role. The Emirates Authority for Standardisation and Metrology (ESMA), which was established in 2001 to develop and ensure quality of halal products and ascertain whether a product ought to be certified as halal – whether produced locally or imported – is now playing a leading role in OIC efforts to develop OIC-wide standards for halal cosmetics and foods. Given Dubai's focus on becoming a major centre for the Islamic economy, ESMA could play a growing global role in halal standardisation. Malaysia has also long been a leader in halal standards domestically, and given its weight within the global Islamic economy, it will also be important to a successful establishment of global standards and bodies.

Moving forward, many in the halal foods industry want to develop globally accepted standards and to develop a global body and related regional bodies responsible for providing accreditation to certification boards. Enforceability of standards is also a key issue for practitioners and scholars working in the halal foods industry – and is of greater importance than for most Islamic finance practitioners.

#### HOW TO DEVELOP STANDARDS AND AUTHORITIES IN THE HALAL FOODS INDUSTRY?

There is broad agreement that the halal foods industry would benefit from greater harmonisation of standards and a more credible accreditation system. However, there is still vibrant debate over how to do this.

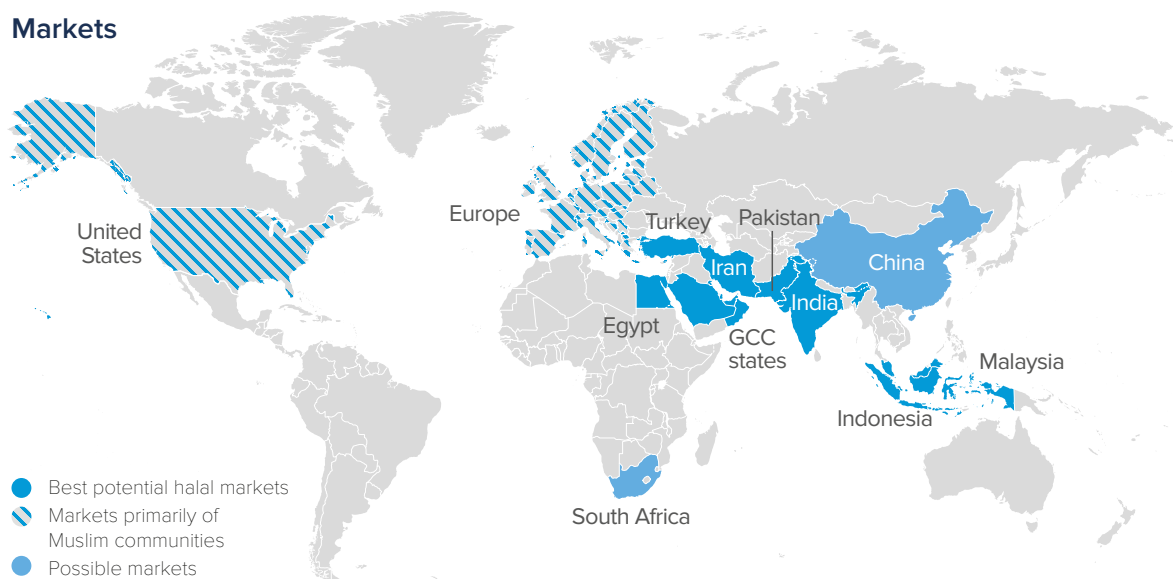
##### A centralised global system or a more diffuse, regional one?

Should there be a single global body responsible for setting standards to which everyone agrees, with responsibility to enforce standards by revoking certification to companies that fail to abide by standards (or by revoking accreditation to certification boards that do not uphold the body's standards)?

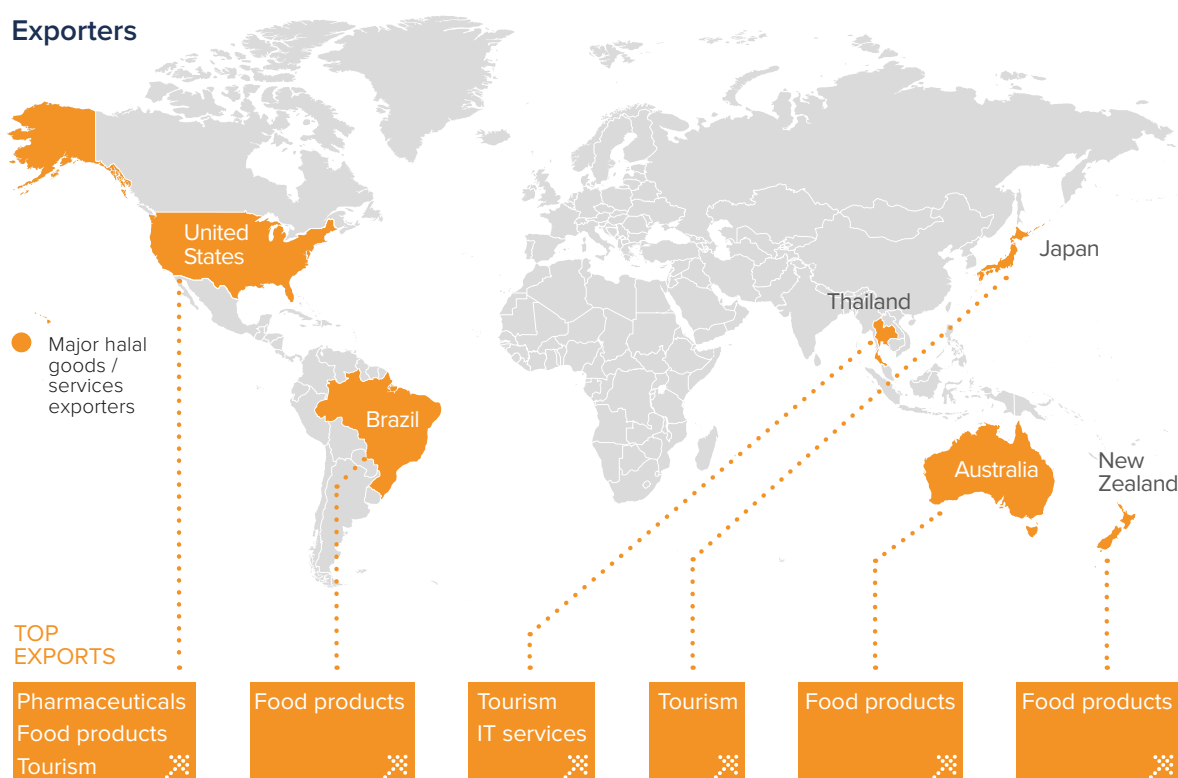
Some argue that such a global body would greatly simplify halal foods processes. It would create an easy-to-understand system for consumers, which would build trust and interest in halal foods products. It would facilitate cross-border trade; there would be no concern about whether products imported from the United States or approved in Malaysia or anywhere else would be acceptable to consumers in Saudi Arabia, for example, because everyone accredited and certified under the global system would have agreed to the same standards. It could also simplify the process that companies go through to gain certification; it would erase confusion over which certification boards are credible, for example, as all would be accredited by bodies that are approved by a single global body.

## Major halal markets, exporters and potential growth areas

### Markets



### Exporters



Source: Expert interviews, Thomson Reuters

However, some would object to the centralisation of halal standards in one global body. One concern is that it would privilege certain interpretations of Sharia in a way that would be divisive rather than unifying, and not every country may opt in. There are also some concerns – though less so than in Islamic finance – that centralising the accreditation and standards process might hinder innovation in the industry. Some experts and practitioners would prefer smaller but still valuable steps, such as creating an information warehouse for halal foods companies and creating regional accreditation bodies that allow for a greater diversity of practices while still providing more control than the current system. Some would also prefer the development of general principles that companies and certification boards could voluntarily accept to help create a more flexible but still more organised system, though others argue that this would lack the necessary ‘teeth’ of enforcement.

### CREATING A SINGLE, GLOBAL HALAL BRAND AND LOGO

Some practitioners and policymakers would like to eventually develop a global halal brand with an approved logo managed by a global body. Advantages might include a more informed, unified marketing strategy that could help to break into new markets, including non-Muslim ones. It would also make choices easier for consumers, who could always know when something is approved as ‘halal’ by respected authorities.

However, others argue that this is impractical and undesirable. Some experts believe that halal products should look to achieve more than just being ‘not haram’. In other words, some propose a spectrum in which halal foods, at a minimum, would be ‘not haram’ and could go up to higher levels, such as also including health and broader ethical concerns. Some experts also worry that working to achieve a single accepted brand and logo would be a divisive process, given the variance in cultures and in interpretations of Sharia.

### ANALOGY

#### The International Organization for Standardization (ISO)

The ISO is an international standard setting body that is composed of representatives from national standards organisations around the world. It is tasked with promoting commercial standards that are then recognised by all member states. It is a consensus-based organisation that establishes standards based on market demand, with input from a multiplicity of stakeholders.

The ISO has developed several standards relating to food preparation and safety, including ISO 9001 (quality management of food products) and ISO 22000 (risk management systems for food processing). A halal-oriented counterparty could adapt these standards to ensure halal compliance along the supply chain, using the same consensus-based, multi-stakeholder approach, replete with a certification regime that publishes guidelines for member states to adopt.

## IDEAS GOING FORWARD

There are many expert bodies developing proposed standards, which is not the purpose of this report. Rather, based on expert interviews and research, some guiding principles for efforts to increase harmonisation in the halal foods industry include:

- **Liaise with experts in Islamic finance** and draw on lessons from how that sector has been working on and debating greater harmonisation of standards. Some leaders in the halal industry are already doing this.
- **Consider the need for creating a central, virtual warehouse of data** to enhance understanding of the practical landscape of the halal foods industry before trying to complete proposed standards. Such a warehouse – which should provide information to industry companies, Sharia scholars, regulators and consumers – should include information on certification boards in every country, suppliers and buyers in every country, import regulations and so forth. This could greatly help to inform discussion of standards and to ensure that those involved in developing standards fully understand the potential impact on the industry. It would also provide much value to companies, especially SMEs, involved in or wanting to enter the halal foods space. Malaysia's halal repository is a good example of a nascent effort.
- **Identify key points of contact** in every country that plays a significant role in providing or consuming halal foods. Points of contact should include the relevant authorities – governmental or non-governmental – who have formal or informal responsibility for ensuring the application of halal standards and the integrity and safety of halal products. This information would be extremely useful to efforts to facilitate cross-border dialogue on standards and accreditation and would also be a useful addition to the above-mentioned information warehouse.
- **Ensure that Sharia experts from around the world are involved** in any discussion to create global standards and accreditation bodies. The halal foods industry is very global, with major thought leaders from Malaysia to the Gulf to Turkey to Europe and North America, and with companies and consumers around the world. Any successful effort to develop global standards and processes must address the diversity in practices and interpretations and must include voices from all regions with major roles in the industry. While the OIC might be the best forum for starting this process, it will eventually also need to include voices from outside the OIC, given the locations of key supply chains.
- **Aim high but take smaller steps too.** While the goal of a global body and global standards has value – arguably, as noted above – the pursuit of lofty goals should not exclude smaller steps that can add a lot of value and learning experiences. For example, the UAE is working to create mutual recognition agreements to facilitate intra-OIC halal trade.

## HOW CAN IMPROVEMENTS IN STANDARDS SUPPORT THE WIDER ISLAMIC ECONOMY?

Achieving the right balance in creating globally accepted standards and developing a more global (or at least regional) accreditation system – and including a greater level of enforceability – would significantly contribute to the development of the global halal foods industry by creating greater consumer confidence and simplifying the processes of credible certification and reliable auditing for companies.

As halal foods is a key pillar of the Islamic economy, improved standards and accreditation processes would be a boon to the wider Islamic economy as well. In addition, some specific benefits might include:

- **Developing standards and review processes** for halal foods is complementary to developing standards and processes for other halal sectors, such as pharmaceuticals and cosmetics.
- **Developing greater confidence in the halal industry** could help attract Islamic finance investment and facilitate greater linkages between these two industries.
- **Clearer, trustworthy certifications** – and even possibly a future global halal ‘logo’ – might help to attract interest from non-Muslim consumers and investors, which could boost the overall attractiveness of the Islamic economy in the eyes of a broader population base.
- **Improved clarity** in the halal foods sector would also benefit the hospitality sector of the Islamic economy, as providing halal food options for tourists and business travellers is a key part of providing Muslim-friendly lodging, entertainment and conference facilities.
- **Better safety in emerging markets**, where government mechanisms to ensure food and product safety are often insufficient or untrusted, could contribute to improved public health and well-being. It would also allow local firms to demonstrate trustworthiness and compliance with internationally accepted best practices.

Overall, harmonising the halal foods certification process would help to create a more common language that could facilitate interactions with other sectors of the Islamic economy.

## SUPPORT FOR THE ISLAMIC ECONOMY

Based on the outcome of our interview panel, there are many ideas for steps that governments, businesses and institutions could take to develop the Islamic economy. This report includes a few of these suggestions:

### Develop talent, expertise and career paths

- A critical area of support is the development of human capital to encourage further growth of the Islamic economy. This includes training Sharia scholars who understand the basics of the industry they are evaluating – such as capital markets or banking – and practitioners who understand the basics of relevant Sharia principles.
- Governments and institutions could establish educational centres that offer degrees and support research in relevant fields, such as accounting, jurisprudence, comparative law for Islamic finance, supply chain management and certification processes for halal foods. Such centres should engage with universities, institutions, businesses and Islamic scholars. Developing credible curricula and requirements for achieving degrees would be essential. These educational centres could also develop contacts and understanding between professionals in the various sectors of the Islamic economy, thereby facilitating longer-term convergence between these sectors. Developing educational certifications in a variety of skill functions central is one way standards can improve the outlook for the Islamic economy.

### Facilitate convergence of Islamic economy sectors

- Governments, institutions and businesses can facilitate linkages across Islamic economy industries. One major way to benefit the Islamic economy is to work collectively to develop basic regulatory frameworks that invite new market entrants and assure them against uncertainty. These efforts are already underway at many levels, but more can be done to assure that substantive goals are met. Dubai is well positioned to serve as an intermediary and skills repository for these efforts. In doing this, it is critical to ensure that contradictions among previously established standards adopted by disparate Sharia committees are addressed.
- Islamic finance can contribute to the convergence process through the creation of standards that promote new short-term liquidity instruments, such as a Sharia-compliant repo market. Additionally, developing a method to better publicise legal opinion on resolution proceedings, and continued efforts to promote passporting, such as the efforts underway in the GCC, were strongly encouraged by our panel.

As one of the primary gateways to the Islamic economy, Dubai plays a critical role in the consultative process for the development of such contract standards.

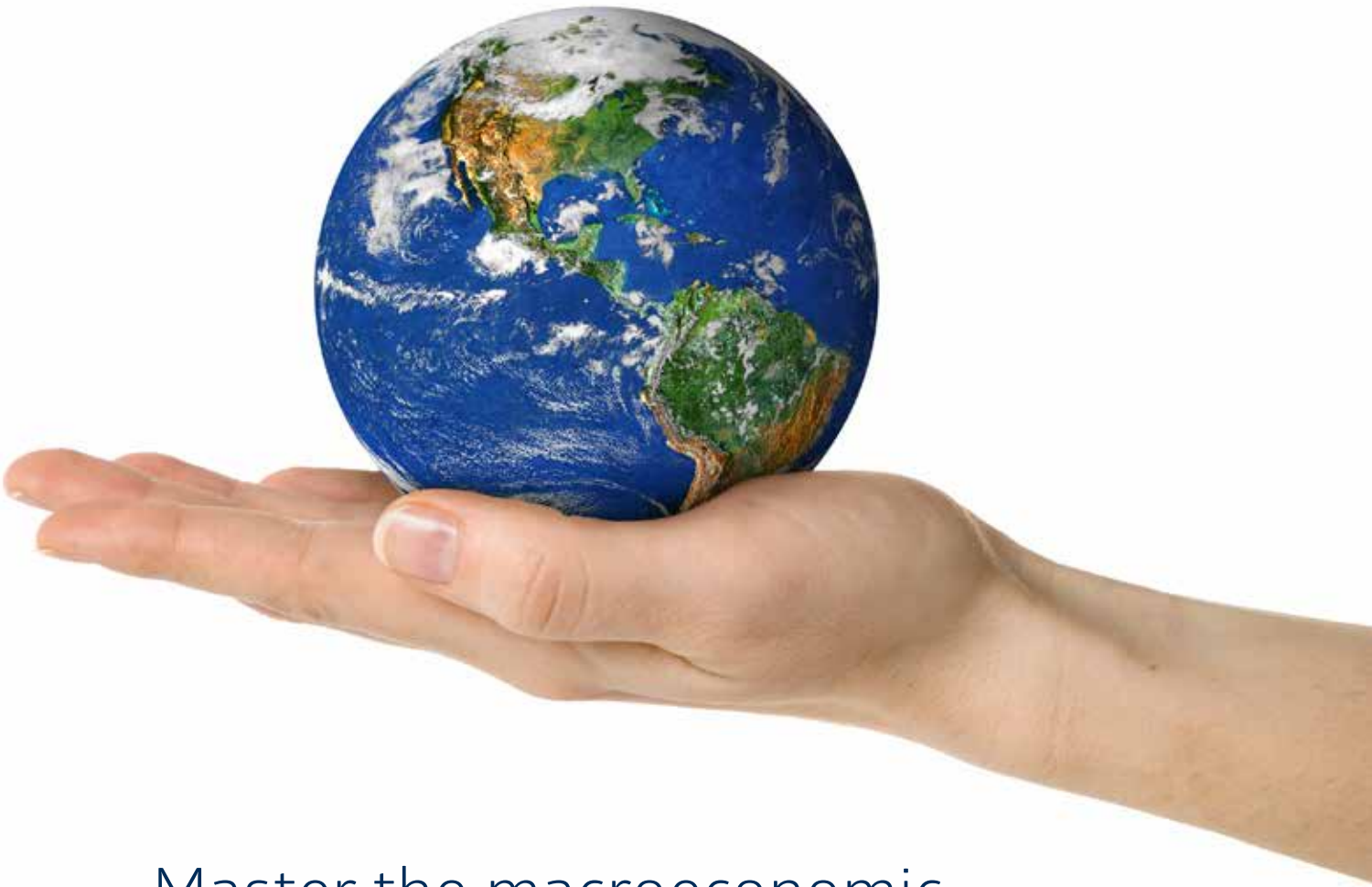


### Reach beyond Muslim communities

- Develop branding and marketing that taps into shared values and promotes Sharia-compliant products and services beyond Muslim-only communities by focusing on the ethical value proposition of Islamic finance and halal foods. Dubai is also key to this effort
- Consider participating in organisations designed to facilitate understanding between relevant groups. The European Commission's DIALREL project, which was established to address issues relating to the slaughter of livestock through facilitating dialogue between stakeholders, is one such example.
- Develop links and collaborations with secular standard-setting organisations such as the International Organisation for Standardisation (ISO) and work to incorporate Hazard Analysis and Critical Control Points (HAACP) food safety standards. Continue to coordinate and interpret the activities of the Basel Committee for Banking Supervision through the Islamic Financial Standards Board and Islamic Development Bank Working Groups.

### Provide direct government backing to the Islamic economy

- Undertake regular sovereign sukuk issuance to help Islamic financial institutions to manage their liquidity and for benchmarking purposes and subscribe to other sovereign sukuk issuance as necessary. Require state-owned enterprises and public-private partnerships to issue sukuk to meet a percentage of financing requirements.
- Level the playing field by harmonising fiscal treatment of Islamic financial products with conventional financial products to avoid recurring issues such as the double taxation of products financed through Sharia-compliant instruments. This is already underway in many countries.
- Fund trade- and investment-promotion agencies that specifically target Islamic industries and Islamic capacity building. The efforts of Singapore's Ministry of Trade and Investment (SPRING Singapore), the UK Trade and Investment Study on Islamic finance and recent efforts by the Irish Development Authority should be recognised and adapted for the needs of more jurisdictions.
- In the longer term, consider tax and migration incentives to attract both conventional and Islamic industries. Malaysia has already enacted a suite of incentives that may serve as useful guideline for future policy.
- Encourage entities to consider issuing retail sukuk through favourable incentives. This will increase popular investor awareness and help elucidate Islamic finance principles to a wider array of retail investors. A combination of increased retail sukuk and passporting rights for financial instruments between major centres of Islamic finance, such as the effort currently underway between the UAE and Malaysia, could encourage other countries to adopt similar regulatory structures to enable future membership.



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