STATE OF QATAR:
END OF ISLAMIC BANKING WINDOWS

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At the beginning of February, 2011, Qatar Central Bank (QCB) notified all conventional banks in Qatar that they were required to stop operating Islamic Windows (IWs) by the 31st of December 2011. On the 10th of February 2011, QCB issued a public press release detailing the requirements and explaining the reasons for its decision to stop the operation of the IWs.

What are conventional banks required to do?

New Operations

The press release indicated that conventional banks are required to stop the following actions:

- Opening Islamic branches;
- Accepting Islamic deposits; and
- Entering into Islamic financial operations.

Existing Operations

For existing assets and liabilities, including deposits and finance operations, conventional banks are obligated to do the following up to and including 31 December 2011:

- Collect the relevant assets and liabilities and dispose of their obligations within any earlier agreed upon dates; and
- Pay back all Islamic deposits upon any earlier agreed maturity date.
- Following 31 December 2011, to the extent that neither of the above options could be exercised, banks may do the following:
- Manage the remaining Islamic assets in a special portfolio;
- Transfer some of the remaining Islamic assets to the existing Islamic banks; and
- Convert the existing Islamic window branches to conventional branches.

Although it is not stated, there appears to be no reason why such conventional banks could not open independent Islamic banks and then transfer the existing assets to the newly established Islamic banks. This option, however, appears not to have been clearly provided for and has created a situ-

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ation where customers of such IWs have been left without a clear understanding of their rights and obligations. It is argued that QCB should now categorically provide a mechanism whereby IWs should be allowed to convert to full Islamic banks and that the process should be simplified and made clear to ensure that this is affected in a smooth and transparent manner.

In the publicly available information from QCB, it is not clear whether it would be possible for existing Islamic banks to acquire the IWs portfolios and thus allow the conventional banks to dispose of their IWs portfolios. To the extent that the QCB agrees with and allows such disposal, it may be that the customers of such IWs may not wish to deal with the existing Islamic banks and this may have been a reason as to why such customers did not choose the existing Islamic banks in the first place.

Another possible, voluntary scenario on the part of all the IWs, their customers and existing Islamic banks may provide for a program whereby the IWs agree with their customers to bring to maturity their existing relationship. At the same time the IWs agree with existing Islamic banks to provide the same facilities so that the customers of the IWs are not commercially affected. Subject to Qatari law, this may even be achieved by the parties entering into a novation agreement. It is argued, however, that this may not be a workable solution from a commercial perspective as the existing Islamic banks may not be willing to provide the same terms to the IWs customers as they currently have, on the basis that existing customers of the Islamic banks may be under different terms which may not be on par with the IWs' terms.

Why is QCB stopping the operations of Islamic windows by conventional banks?

QCB has provided two categories of reasons for its decision:

- Supervisory issues and
- monetary policy issues, both of which are dealt with in full detail below.

Supervisory Issues

QCB believes that, under Article (1) of the Qatar Central Bank Law No.33, enacted in 2006, a bank may either conduct its affairs following conventional banking practices or it may conduct its affairs according to Islamic banking and financing principles. There is no option for the same entity to provide both conventional and Islamic banking, and, as such, Islamic windows are incompatible with the law.

QCB further believes that there is no need to provide Islamic window operations, on the basis that there exist well-established Islamic banks which are capable of meeting the needs of investors and depositors who wish to conduct their affairs according to Islamic banking and finance principles.

QCB contends that conventional banks are effectively commingling the non-Islamic banking practices and Islamic banking practices, and, as a result, are having difficulty in managing the following specific risks.

1. Bank Risks

The principle of Islamic banking is based on trade and a return on a specific trade, which always has an element of ownership, as opposed to conventional banking, which does not look at trade or base its return on trade or a value of a product of a trade, but rather on a direct increment of an amount borrowed or lent. Thus, the general risk profiles of Islamic and conventional banking are completely different.

As more large and complex transactions are entered into, both Islamic and conventional deposits are being utilised for the same transactions. Clearly, the rates of return for conventional interest-bearing deposits are wholly different from deposits based on Islamic banking practices. QCB appears to contend that both Islamic and conventional risks are getting recorded in the same manner, and therefore that reliability, application of oversight, calculating ratios and indexes, and preserving the rights of conventional and Islamic depositors are becoming increasingly complex. The risk related to commingling has been widely debated by leading scholars in the past. The end result of the debate appears to be that insofar as strict controls are adhered to, then effectively there are no particular issues that cannot be overcome. The controls discussed by the leading contemporary scholars such as Taqi Usmani are as follows:

2. Segregation of Funds

The conventional funds and the Islamic funds should be completely segregated. This means that Islamic funds should be held in separate accounts and that books and records should be maintained which evidence the segregation so as to ensure that there is no commingling of conventional and Islamic funds.

3. Shariah Supervision

The bank should have a group of Shariah scholars who are fully independent of the bank, whose decisions should be fully binding on the bank, and who provide effective supervision of how the bank conducts itself. The Shariah scholars would effectively control each and every aspect of the operation of the bank so as to ensure that each and every product that is stated as being Islamic does indeed comply with the Shariah.

4. Managerial Commitment

It is argued that the management of the bank should be fully committed to Islamic banking and should not be there simply for the purpose of "exploiting practicing Muslim investors and in so doing unfairly compete with Islamic financial institutions".

5. Providing Security for Investors Funds

To the extent that Muslims only deposit their funds with the bank, this amount should be fully guaranteed, and even where the bank is only acting as an investment manager, there should be proper screening and security in place to protect Muslim investors from such matters as fraud and deception.

6. Adhering to Islamic Standards

It is paramount for a bank to adopt either the AAOIFI Standards or the Islamic Financial Services Board ("IFSB") standards and clearly demonstrate this. It is argued by many whether a conventional bank operates a window or incorporates a wholly owned subsidiary the net effect is the same and