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Theoretical foundations of the Conversion Towards the Islamic Banking System.

الأسس النظرية للنظام التحويلي للمصارف الإسلامية.

Dr. Bouaita Abderrezzak ♦

University of Al-Bashir Ibrahimi, Bordj Bou Arreridj, Algeria.

Dr. Benahcene Ahsan Salaheddine

University of Al-Bashir Ibrahimi, Bordj Bou Arreridj, Algeria.

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Abstract

From the fact that the banks play a financial intermediary role between the surplus holders and the disability holders. Islamic banks emerged in order to mobilize savings of individuals that do not want to deal with conventional banks relying on the rate of interest – which does not differ from riba which is forbidden by sharee'ah.

Due to the large expansion and effective role that Islamic banks play in the economy, many conventional banks have opened branches or even new banks that operate under financing tools that do not rely on the interest rate prohibited by sharee'ah. This has led to the emergence of the terms of transformation and openness to Islamic banking.

Keywords

Conversion;
Branches;
Meta-Decisions;
Islamic Banking
System.

الملخص

انطلاقاً من كون البنوك تمثل دور الوسيط المالي بين أصحاب الفائض وأصحاب العجز، ظهرت البنوك الإسلامية من أجل حشد المدخرات للأفراد الذين لا يرغبون في التعامل مع البنوك التقليدية التي تعتمد على سعر الفائدة أحداً وعطاء؛ والذي لا يختلف عن الربا المنهي عنه شرعاً. ونظراً للتوسع الكبير والدور الفعال الذي لعبته البنوك الإسلامية في الاقتصاد، تواجه العديد من البنوك التقليدية لفتح نوافذ وفروع أو حتى بنوك جديدة تعمل وفق أدوات تمويلية لا تعتمد على سعر الفائدة المحرم شرعاً وهذا ما أدى إلى ظهور مصطلحي التحويل والانفتاح للعمل المصرفي الإسلامي.

الكلمات المفتاحية

التحول؛
الفروع؛
القرارات الفوقية؛
النظام المصرفي
الإسلامي.

♦ **Corresponding author:** Bouaita Abderrezzak, **Email:** abderrezzak.bouaita@univ-bba.dz.

1. Introduction :

The Islamic Banking System performs the same functions as the conventional banking system which include the payment system management, the financial intermediary and meeting the business sector financial needs. The basic feature of the Islamic banking system is that it is mainly based on the Islamic shari'ah rules, and it draws all its components and practices from it. The fundamental difference between conventional and Islamic banking system is the way in which the latter performs its functions, particularly regarding the mediation role.

A number of contemporary Muslim economists have differed on how to shift to the Islamic banking system. The first group sees the possibility of creating an Islamic banking system without waiting for reaching the perfect Islamic society, and it can be applied even in non-Islamic countries, but its application in the ethically conscious and justice-oriented Islamic environment would be better. They argue that the process of conversion must be gradual, in stages and in a sufficient period that does not last without a legitimate reason. The other group believes that the conversion towards the Islamic system must be comprehensive to all systems (political, economic, legal...etc.), they reject even the idea of a complete conversion of one part of the regime while the other systems remain. They quoted the Egyptian « Meet Ghamr » experience that failed for political reasons, and argue that the Islamic system application is a matter of ideological and psychological positions.

Through this the following problem raises : « **what are the theoretical foundations that show how to convert into an Islamic banking system ?** »

2. The conversion towards Islamic banking system, concept, motives and requirements:

The banking industry in many countries of the world especially in the Islamic countries is witnessing traditional banks offering Islamic products, or a total conversion into Islamic banking.

3. The concept of conversion towards an Islamic banking system :

The conversion is the shift from a situation that is corrupt in shari'ah to a valid one. The corruption in the conventional situation required to be switched lies in dealing with various types of transactions which are contrary to types of shara (at the top of them dealing in usury)¹, this applies to conventional banking that deals with various types of banking transactions that are contrary to the provisions of the Islamic shari'ah, and its transition from conventional banking based on the interest rate to Islamic banking based on the principle of participation in profit and loss, and replacing transactions contrary to shari'ah by banking transactions that God has permitted involve the achievement of justice among dealers in the light of the purpose of the Islamic law.

The most important views on the definition of the conversion towards the Islamic banking phenomenon can be mentioned as follows² :

3.1.The first definition : «the legitimate origin of the transition is derived from the principle of repentance and return to god and stop dealing with usury taking and giving, by having a sincere desire to repent through the cessation of banking transactions that conter sharee'ah and replacing them by others that comply with the provisions of islamic sharee'ah ».

3.2.The second definition : «the creation or the conversion of some branches of conventional banks into islamic branches can be considered as a phenomenon of transition from conventional banking to islamic banking ».

3.3.The third definition : « The conversion phenomenon is the branches belonging to traditional banks that perform all banking activities in accordance with the provisions of sharee'ah ».

3.4.The fourth definition : « the existance of regulatory units run by conventional banks specialized in providing financial services ».

As we can see, most of the previous definitions focused on the partial transition i.e : the conversion of a conventional bank's branch into an islamic branch or opening an islamic window in a conventional bank, or even turning a conventional bank into an islamic one. On the other hand they neglected the fundamental goal of the conversion which is the establishment of an islamic banking system.

4.Motives for the conversion towards the Islamic Banking3:

Some observers believe that the conversion of a number of conventional banks into islamic banks in the last few years is based on repentance and quitting financial and banking services that violate the provisions of sharee'ah, and the increasing number of customers that see the sanctity of dealing with benifit rates, and turning to islamic banks

The conversion's reasons have also pure profitable and commercial dimentions due to the remarkable success of islamic banks, such as the high profitability rates and the returns of financing operations compared to the conventional financing returns, in addition to technical reasons, such as the desire of conventional banks to invest rather than the financial mediation « lending » and « borrowing », and getting specific benefit of so-called «debt trading », while the islamic banking operations extend to direct investment activity for itself or for others, alongside with the financial intermediation i.e they are « comprehensive banks ».

5.Requirements of the conversion towards Islmaic Banking :

Prior to the bank's conversion, or offering islamic banking products, some requirements should be met before the implementation4 :

- The approval of the regulatory bodies (Monetary Agency, Central Bank) ;
- creating a legitimate body (or a legitimate observer) ;
- Designing the work systems which include the preparation of:
 - documentary courses ;
 - forms and documents ;
 - legal and legitimate contracts ;
 - accounting systems ;

- automated systems.
 - Selecting and preparing human resources ;
 - Setting up an advertising campaign targeting customers of these branches.
- The development of human resources is one of the prerequisites for a successful conversion process towards the islamic banking, that is through :
- selecting leaders with expertise in the conventional banking and preparing them for the islamic banking ;
 - selecting people experienced in the islamic banking field and preparing them for it ;
 - making a plan for training people for the islamic banking that includes the following programs :
 - islamic banking concepts ;
 - alternative financing formulas to meet customer's needs ;
 - accounting controls and standards for islamic banking operations ;
 - an islamic banking financing method (feasibility study, financial analysis, financing standards, management and collection of non-performing loans)
 - an islamic banking management method ;
 - a legitimate control and review on islamic banking operations.

6.The Conversion Sources, Forms and Methods :

under the visibly seen growth in the islamic financing industry in all countries of the world, the emergence of financial institutions that operate according to the islamic sharia has taken several forms. Some of them have preferred to start with just an islamic window in a conventional bank, whereas others have set up islamic branches, while a third group has chosen to set up an integrated islamic bank and finally some countries headed towards the adoption of an Islamic banking system.

7.The Conversion Sources :

We mean by « a source of conversion » the entity that seeks to convert the conventional bank into a bank performing in accordance with the islamic provisions. This entity may be from inside or outside the bank, and may be public (governmental) or private, as follows:

The conversion decision towards islamic banking could be made by the conventional bank's decision makers.

The conversion towards islamic banking could be made by an external private entity interested in purchasing the bank and converting it to perform in accordance with the islamic provisions. Several methods can be used to do so, they are as follows :

An external entity –whose statute emphasizes on the strict commitment to islamic provisions- acquires a stake in a company Through buying shares of an existing company, and trying to change the statute in the general assembly.

entering into a partnership without the condition of performing in accordance with the islamic sharia, and once the partnership gets a considerable moral and

financial position, the owners choose between the withdrawal of the new partners and becoming an islamic sharee'ah compliant company.

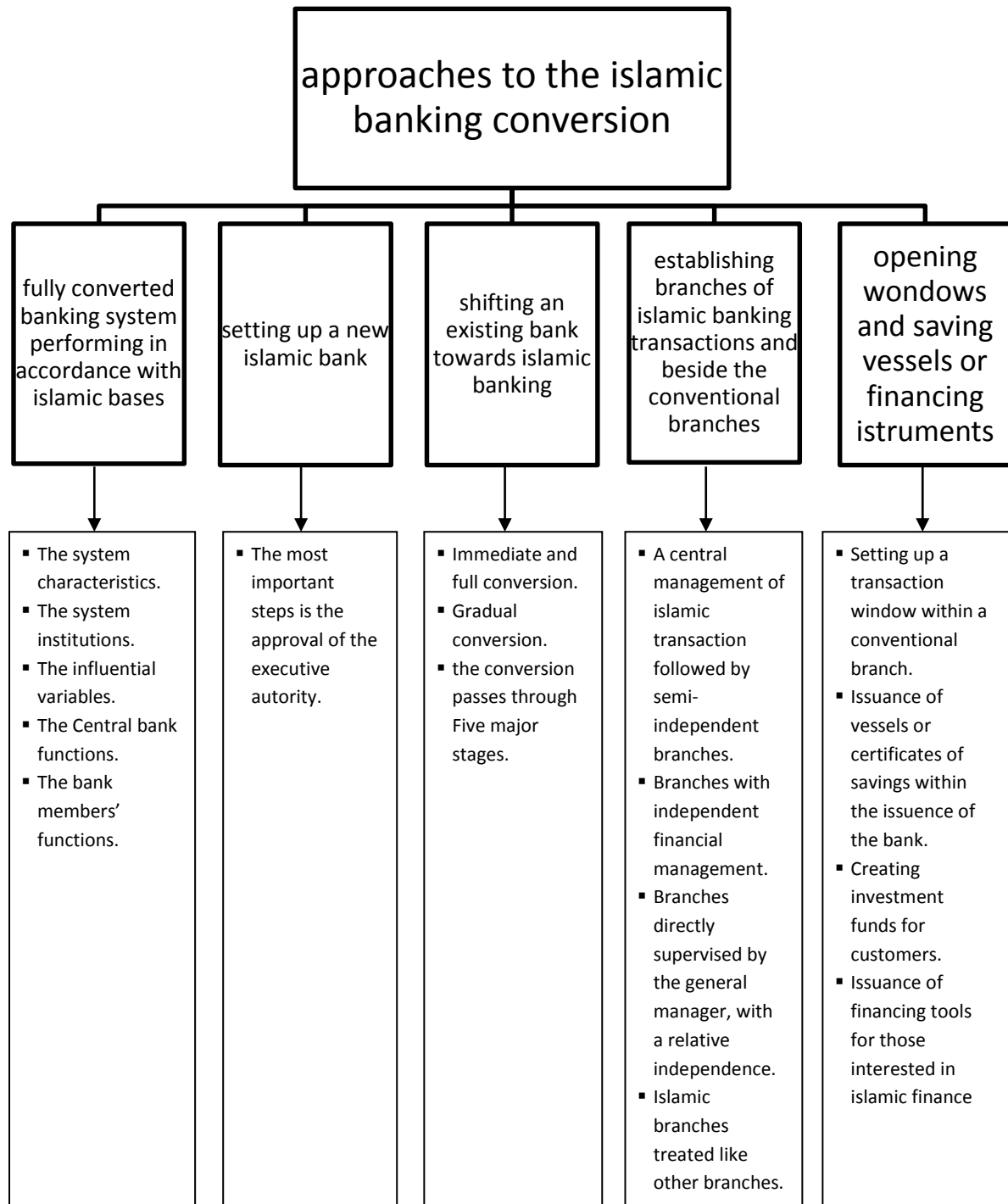
financing companies -whose some of the owners want to operate according to the provisions of islamic sharee'ah- through islamic formulas in order to rid them of infringing acts, and consolidating them by buying their shares, in order to influence the majority of the owners' convictions to convert towards operating in accordance of islamic sharee'ah.

The legal authority of the state decides to apply the islamic provisions, and quite exercising any contrary act. Thus, it quites dealing with Riba and other factors that violate the provisions of islamic shaaree'ah through conventional banks, and working on converting them to operate in accordance with the islamic sharee'ah. What happened in Iran, Pakistan and Sudan are good exemples, where the intervention of the state has a strong influence on the transactions, especially the interest rate. Another exemple is what happened in the recent financial crisis, when Japan and the USA reduced the interest rates to zero or to near zero, and the resulting improvement of their economies, and all the banks committed to the application of the law.

8.Forms of conversion :

The conversion forms depend manly on its motives. If the motive is the repentance to almighty god and to get rid of Riba accordingto his saying peace be upon him « All the usury (riba) of the Ignorance (pre-islmaic) days are abolished, and the first usury i abolish is that of Abbas ibn Abd al Muttalib, for it is all abolished». This motive calls for the need to the full conversion towards the performance in accordance with the islamic sharee'ah and stop dealing with usury. But if the motive of the conversion was to achieve more profits and to expand the banking business, there are several forms that fit with it as shown in the following form :

Form1 : forms of conversion towards the islamic banking



Source : Al-Ghareeb Nasser, the origins of islamic Banking and Operatind Issues, Dar Abu Lulu for printing and publishing, cairo, Egypt, 1996, P 335.

The practice of islamic banking in conventional banks has taken many forms, either by establishing a unit or a department dedicated to islamic banking such as what happened in the USA, Germany and Switzerland, or by setting up an islamic banking window like most of Malaysia's banks, or an integrated branche or a branche specialised in islamic banking such as the Egyptian case. Finally, this may take the form of an independent islamic bank owned by the parent bank, such as The Islamic Citybank in Bahrain.

Although these experiences may have their pros, they are not free of cons such as the funds mixing of islamic branches with funds of the parent conventional bank, and that is what the depositors often fear, also the opening of islamic branches by foreign conventional banks may be a tool to attract Muslim clients without a strict commitment to islamic banking fundamentals⁶.

9. Islamic banking windows and vessels :

Islamic banking windows and vessels mean adopting the idea of introducing some islamic banking services by a conventional bank, in order to meet the needs of a segment of the banking market customers seeking this kind of products. This formula is widespread in many islamic countries such as Malaysia, Morocco and Saudi Arabia, as well as non-Muslim countries such as Great Britain, Switzerland, Germany and the United States⁷.

These windows are easy to implement, and do not require any change in the banking structure nor approvals for the exercise, and its motives are often trying to gain a share in the islamic banking market or not to lose some customers who desire to deal with the bank through islamic saving or financing formulas. So this method mainly aims to meet some customers' needs who wish to deal with the islamic banking system so as not to turn to dealing with islamic banks⁸.

10. Branches for Islamic Conversion :

The islamic branch is a financial entity owned by a conventional bank, independent in its activity from the parent's bank activities⁹. It attracts savings and invests them and provides banking services according to the provisions of the islamic sharee'ah, and has a sharee'ah supervisory board that gives an advisory opinion and monitors its activities. Some of the most important characteristics of the islamic branch are the following 10:

The dependence to conventional banks in terms of legal and ownership adaptation, so it appears within the organizational chart of the conventional bank which owns branches operating according to the conventional method

Branches exercise all banking activities including the granting of good loans.

The islamic branches's transactions go according to islamic provisions and principles.

They aim to achieve a numerous purposes which can be summerized as follows :

-The application of islamic provisions and principles in the banking industry ;

-Maitain current customers and attract another segment of customers ;

- The contribution to the economic and social development ;
- Acquiring expertise in the islamic banking.

Islamic branches within conventional banks face many problems, the most important of which are¹¹ :

-The lack of interest from the parent bank, and seeing them from the profitability perspective not from the extent of compliance with islamic provisions and rules ;

-The problem of transferring the excess of liquidity from the islamic branch to the conventional parent bank in exchange for interest ;

-The focus on the Murabaha for the purchase order formula, and sometimes it is applied in suspicious ways in terms of legitimacy ;

-Most of the branches' employees in the islamic branches ignore the provisions and principles of sharee'ah;

-The problem of scheduling the late clients' debts by increasing the term for debt increase.

11. Converting an existing bank into islamic banking :

This is done by one of two ways :

11.1.The first method : consists of turning the bank entirely to the islamic banking by replacing transactions that do not comply with the sharee'ah by others complying with it, and quit practicing businesses that are contrary to the sharee'ah, especially dealing with usury. This form is the most credible forms of conversion¹².

11.2.The second method : depends on the gradual conversion by shifting the bank's elements from the current conventional position into the islamic banking in stages and within an appropriate period of time¹³.

For this purpose, a plan must be developed and supervised by an expert in the islamic finance. This plan should include the following¹⁴ :

The treatment of shareholders' equity resulted of the difference between benefits and payables seized by the bank before the conversion ;

The treatment of the interest-bearing loans granted by the bank before the conversion, and developing the necessary contracts for their settlement ;

The treatment of interests deposits received by the bank before the conversion ;

Training the staff of the bank on the Islamic banking ;

Setting standards and accounting restrictions, and updating the computer system ;

Preparing forms of investment formulas and Islamic financing contracts ;

Preparing models of investment formulas and islamic financing contracts ;

The conversion approach and the timetable for its implementation.

12. Establishing a new Islamic bank :

The establishment of a new islamic bank is the core of the Islamic banking, and the best form of the gradual conversion towards the Islamic banking. The establishment of a new bank means controlling from the beginning the establishment

elements and components insuring nno defects in any of them. If the new bank was established on sound rules that really comply with the Islamic sharee'ah, the nit must have a good reputaion and a better performance.

Despite the establishment of an Islamic bank that deals with the public in Islamic financing and saving formulas, the problem remains with regard to how the Islamic bank deals with the Central Bank, especially in light of the monitary policy implementation in order to control the amount of money circulating in the economy. Hence, we find that the conversion towards a comprehensive Islamic banking system is inevitable for the optimal application of islamic banking in accordance with the islamic principles.

13.The comprehensive conversion towards islamic banking :

The complete shift to the Islamic banking is the main objective, whether through the conversion or the gradual shift. Since the Islamic banking system is a part of the islamic economic system, it drives its characteristics from this sytem's characteristics, and from the principles and assets governing the origin of its existance and operating mechanisms which are also indivisible. The fact that it is a part doesn't mean that the separation from the whole, in fact it means the liaison and the integration with other parts of the system, such as the financial, production, ditribution and other systems. Therefore, considering the change in the existing banking system to perform an an islamic basis is a kind of changing a part of the whole and leaving the whole unchanged, if this is not accompanied by a quick change in all other parts of the economic system, the islamic banking system will be in the situation of the expatriate from the wole system, and it is a situation that may be better than a mixed situation, but it does not achieve the goal of the islamic conversion as desired¹⁵.

By combining all the views of contemporary economists on the islamic banking system institutions, we conclude that they consists of a central bank and a number of member banks in addition to financial institution specialized in finance and credit. As for how to convert, the more correct way is through the ruling authority by, this is done by imposing strict laws on all institutions, including judicial and economic in which it prohibits all banking transactions that are in violation of the provisions of the sharee'ah, and the start should be the suspension of dealing with the interest rate (how not and developed countries reduce the interest rate to near zero and sometimes to zero in order to overcome the capitalist system crises). After that the graduation in applying islamic banking system's mechanisms in accordance with the economic situation of the country. The comprehensive conversion to the islamic banking system depends primarily on political and religious backgrounds¹⁶.

14. Conclusion :

The conversion towards islamic banking is one of the most prominent developments in the banking industry. The conversion is about excluding all banking transaction that do not comply with Islamic Sharee'ah, on top of them the interest rate -taking and giving- and the access to a banking system that complies with the principles of the islamic sharee'ah. The study concluded that the most important factors supporting the conversion towards islamic banking is the existance of a set of laws regulating and conducting the islamic banking in the countries willing to adopt it, as well as the meta-political decisions that support the conversion process.

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