

## **Islamic Windows of the Conventional Banks: Challenges and Solutions**

**Dr. Shamsalden. Aziz Salh,**

**Law Department, Faculty of Law and International Relations, Soran**

**University**

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### **Abstract**

After conventional banks realised that many investors and customers invested with Islamic banks due to the religious reason, conventional banks started to open windows that offer services to those who want to invest on the interest-free basis. There are many conventional banks that provide services in accordance with Shariah principles. However, at first, these conventional banks could not receive large number of clients because that clients have doubt that these banks are unable to provide interest-free banking services. Recently, Islamic windows of conventional banks have improved and attempted to offer various services that are similar with interest-free banks to their customers. Opening Islamic windows in conventional banks is a complex process. There are many rules and regulations that should be applied by conventional banks to establish an Islamic window.

Although the number of Islamic windows is increasing, there are still some challenges. There are two major challenges that these conventional banks have to overcome. One is the inability of these banks due to the reality of insufficient experienced staff and scholars in Islamic banking; another one is the doubt of the customers that the financial services including contracts and transactions provided by the Islamic windows of these banks may not be Shariah-compliant. Due to these challenges, the Islamic windows are short of clients.

Under such context, this paper discusses the challenges that are faced by Islamic windows and then tries to offer suitable solutions. For the collection of data, this study follows qualitative approach which collects data from both primary and secondary sources such as Acts, textbooks, journal articles and relative websites.

Keywords: Islamic windows, conventional banks, challenges and solutions.

### **1- Introduction**

The services that are offered by conventional banks through Islamic windows are similar to the interest-free banks'. The products of the Islamic windows must be designed according to the Shariah frame. Under this principle, Islamic windows should follow Shariah supervisory committee's instructions. In that context, having a strict Shariah supervisory committee and having experienced Shariah scholars for this committee are necessary. In addition, hiring knowledgeable staff who work under Islamic windows is crucial. These staff should have at least basic knowledge about Shariah principles and they must follow Shariah scholar's advices.

In addition, it is one of the most important conditions for the conventional banks to establish a special department for the Islamic windows. The department can provide technical assistance to the Islamic windows and the staff. Therefore, in this article, conditions and preconditions for the Islamic windows to be established will be stated according to the Shariah law. Furthermore, Islamic windows of the conventional banks will be critically analysed. Moreover, challenges and obstacles of the Islamic windows will be determined. After pointing out the issues of the Islamic windows, then the solution will be shown. For achieving the aim of this article, secondary data will be considered, such as books and journal articles.

### **2- What is Islamic Windows**

When conventional banks intend to provide services in the interest-free based system there should be a method for doing so. Hence conventional banks open Islamic windows in order to provide interest-free banking products. The services that are provided by interest-free banks are the same services provided by Islamic windows. Thus, an Islamic window is defined as 'a department or a division or even a separate finance company set up by a conventional financial institution which offers Islamic products and services to customers who prefer Islamic finance

over conventional finance'.<sup>(1)</sup> Thus, "Islamic windows offer products to those conventional clients<sup>2</sup> who choose interest-free transactions, Islamic banking window refers to a situation whereby a conventional banking system offers some of the Islamic banking products or services".<sup>(2)</sup> Some customers of Islamic windows are new while some other are the old customer of the conventional bank and they switch their accounts from conventional to interest-free account through Islamic windows. In these countries such as Malaysia and Saudi Arabia that Islamic windows are allowed to be practiced, there should be a specific regulations and rules to manage their practices. As same as the interest-free banks, Islamic windows have set off rules and regulations. Thus, different jurisdictions have different approaches to the conversion of a conventional bank to open Islamic banking windows.<sup>(3)</sup> Therefore, Islamic windows shall follow the conditions that are determined by the central bank as same as interest-free banks.

### **3- General Conditions of the Islamic windows**

Conventional banks can open Islamic windows according to conditions and instructions of these countries where conventional banks are allowed to provide Islamic banking services. These rules and conditions are stated by central banks in these countries. In addition, the Banking Act or Islamic Banking Act in that country should determine special rules for Islamic windows. There are some general conditions for the conventional banks to open Islamic windows. Certain preconditions and conditions are necessary, such as opening a special department for Islamic banking windows and separate record-keeping of accounts for the branches.<sup>(4)</sup> In addition, these windows should also have Shariah supervisory boards and qualified staff members who are proficient in Islamic banking transactions and contracts. These preconditions and conditions are important in order to create a conducive environment to conduct Islamic banking activities.<sup>(5)</sup>

#### **3-1- Special Islamic Window Department**

The Islamic window of the conventional bank should be independent. And it should have a special department. The Islamic window department should manage all businesses of the window. All staff and managers of the Islamic window would be part of the department. It is a responsibility of the Islamic window department to train and open courses for the staff. The department must provide all necessary assistance to the Shariah scholars and the staff. Any problem of the Islamic windows is solved by the Islamic window department.

It is very important for the Islamic window department to be liberated and it is vital for the department to not be influenced by the conventional bank in issues related to Shariah principles. Thus, the bank cannot force the department to apply any type of transaction while the department or members of the Shariah committee believe that this transaction is not in compliance with the Shariah rules. The Islamic window department has two main responsibilities. Firstly, all technical issues of the Islamic window should be solved by the department. Secondly, the application and implementation of the laws and regulations for the Islamic window should be under the supervision of the department.

The Islamic window department contain staff that are familiar with both legal and Shariah aspects of the Islamic finance. The staff should know about Islamic banking transactions and contracts which are used as modes of finances by interest-free banks. As Shariah supervisory committee is responsible to give advice to Islamic window staff, the Islamic window department is responsible to give legal and financial advices to the staff.

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<sup>(1)</sup> Bank Nizwa, 'Looking For The Perfect Islamic Window' Global Islamic Finance Report GIFR 2014), 110.

<sup>(2)</sup> Audu Bello and Mika'ilu Abubakar, 'Challenges and Solutions to Islamic Banking System in a Pluralistic-Secular Country like Nigeria' Mediterranean Journal of Social Sciences, 6 (2014), 26.

<sup>(3)</sup> Inwon Song, and Carel Oosthuizen, 'Islamic Banking Regulation and Supervision: Survey Results and Challenges' IMF Working Paper, WP/14/220, 2014, 9.

<sup>(4)</sup> M Mansoor Khan and M Ishaq Bhatti, 'Islamic Banking and Finance: on Its Way to Globalization' (2008) 34 Managerial Finance 708, 719.

<sup>(5)</sup> Preconditions could also enhance public confidence in the Islamic banking industry. However, the author believes that under the current system in Iraq, it is difficult to control the Islamic banking windows of conventional banks due to the fact that there is no specific law governing the Islamic banking industry and there is limited expertise in the Islamic banking field.

### **3-2- Establishing Shariah Supervisory Committee**

Like interest-free banks, the Islamic window should establish a Shariah supervisory committee to oversee the contracts and businesses of the Islamic window.<sup>(1)</sup> If the Shariah committee does not exist then the Islamic window is not considered as interest-free banks. In this context, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) did not consider the Islamic windows or the conventional banks that offer Islamic services as Islamic banks because Shariah supervision committee did not exist.<sup>(2)</sup> Therefore, establishing a Shariah supervisory committee is a condition for the Islamic windows to guarantee the validity of the transactions. The role of the Shariah supervisory committee is to ensure that all products and transactions of the Islamic windows are compliant under Shariah principles.<sup>(3)</sup> In addition, the Shariah supervisory committee has an important role in directing staff and managers of the Islamic windows. Thus, the role of the Shariah supervisory committee of the Islamic windows is not less than the role of the Shariah committee of the interest-free banks. The Shariah supervisory committee should consist of at least three Shariah scholars who have Shariah background while having knowledge in modern economic system and law. The Shariah supervisory committee should be free in decision-making and should not be influenced by the conventional bank.<sup>(4)</sup> The committee has a vital role in marketing Islamic banking products. For the marketing purpose, the committee have to ratify all products and transactions applied by the Islamic windows.

Furthermore, experienced members of the Shariah supervisory committee assist the Islamic windows to attract large number of clients. In that context, the members of the committee should be knowledgeable in all bank-related information. In addition, the members of the Shariah supervisory committee are preferred to have ability to issue fatwa.<sup>(5)</sup> The committee has an important role in giving advice to the staff and managers of the Islamic windows in Shariah-related issues. Due to the reason that most of the staff of the Islamic windows and interest-free banks came from conventional background, the Shariah supervisory committee's job turned to be more difficult. The committee ought to open monthly training courses for the Islamic windows' staff and managers. The staff of the Islamic windows are required to have sufficient knowledge about Islamic banking mode of finance, such as Musharakah, Mudharabah, Murabahah etc. It is the duty of the Shariah supervisory committee to determine which transaction is in compliance with the Shariah law and which transaction is not. In case that any transaction applied by the Islamic window was not in compliance with the Shariah principles, this transaction should be cancelled. The Shariah supervisory committee for the Islamic windows should be established before opening the windows. In addition, the members of the Shariah committee should be reliable scholars who are well known among people.

It is important to mention here that the shortage of professional Shariah scholars is one of the issues facing the Islamic banks and Islamic windows. However, the shortage of Islamic banking experts is not always due to the insufficient numbers of scholars, but also because these scholars are not professional experts. Most Islamic banks wish to appoint well-known professionals on their Shariah supervisory committees. There are a lot of people who are qualified to be Shariah scholars and have been appointed as members of the Shariah supervisory board, but they are not amongst the top-ranking professionals.<sup>(6)</sup> Therefore, the banks that open Islamic windows must

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<sup>(1)</sup> Bank Nizwa, 'Looking For the Perfect Islamic Window' Global Islamic Finance Report (GIFR 2014), 111.

<sup>(2)</sup> Fatma Ahmed and Khaled Hussainey, 'Conversion into Islamic Banks: Jurisprudence, Economic and AAOIFI Requirements' European Journal of Islamic Finance, (2015) 3, 5.

<sup>(3)</sup> Sawsan Ahmed Saeed and Saba Ahmed Saeed, 'Requirements of Activation the Legitimate External Control in Islamic Banks' (2013) 9 Tikrit Journal for Administration and Economic Science 256, 259

<sup>(4)</sup> Chowdhury Shahed Akbar, 'Looking Through the Eyes of Islamic Windows, special Report, "<https://islamicmarkets.com/publications/looking-through-the-eyes-of-islamic-windows>" accessed 21 February 2019.

<sup>(5)</sup> Chowdhury Shahed Akbar, 'Looking Through the Eyes of Islamic Windows, special Report, "<https://islamicmarkets.com/publications/looking-through-the-eyes-of-islamic-windows>" accessed 21 February 2019

<sup>(6)</sup> The National, 'Islamic finance industry needs more experts' <<http://www.thenational.ae/business/industry-insights/finance/islamic-finance-industry-needs-more-experts>> accessed 14 June 2018.

bring the most famous Shariah scholars for their Shariah committees before they start to offer Islamic banking services.

### **3-3- Experienced Islamic Banking Employees**

Besides having experienced scholars, the Islamic windows need to have sufficient number of experienced employees.<sup>(1)</sup> Thus, opening Islamic window in any conventional bank needs to have numbers of employees that have capabilities in running Islamic banking business. The staff of Islamic banks should have training courses and knowledge in Islamic finance and Islamic transactions. It is a responsibility of the conventional bank to create employees for its Islamic window. Indeed, interest-free banks have problem of lacking of the knowledgeable and skilful employees who are qualified for running Islamic banking business. Therefore, the issue of the shortage of qualified Islamic banking employees in Islamic windows of the conventional banks is bigger. The qualifications that are necessary for the employees in Islamic windows are to have sufficient information in Islamic banking transactions, such as Murabahah and Musharakah. In addition, those employees should have banking transaction experiences. Therefore, conventional banks that intend to provide Islamic services should train a group of its employees before opening the window. In such case, opening training courses and providing enough funds for this purpose are necessary. Furthermore, conventional banks can have relation with an interest-free banks, which may provide them necessary assistance in order to offer banking services that are in accordance with the Shariah principles.

### **3-4 - Separate Record–Keeping of Accounts**

Due to the fact that the Islamic banking window is part of the conventional bank, there is a possibility for the Islamic window's capital to be mixed to conventional banking capital. Therefore, it is necessary for the Islamic window to have a separate record-keeping account from the conventional banking record.<sup>(2)</sup> The resources that are invested by the Islamic window of the conventional bank should be separated from the resources of the conventional service due to the avoiding of interest (Riba). Thus, separate record system is needed for the window. It is the responsibility of the Shariah supervisory committee to ensure that sources and funds of the Islamic window is separated from the conventional one's. In this sense, the Shariah supervisory committee have to enforce strict compliance for the conventional bank regarding the Islamic window. Hence, the Islamic window could be required to create a separately audited financial statement which can be consolidated at the conventional bank level for regulatory reporting purposes.<sup>(3)</sup>

## **4- Challenges Facing Islamic Windows**

Due to the fact that the Islamic windows are part of the conventional banks, there are some challenges facing the windows. One of the challenges of these windows is the shortage of clients. Second challenge is the lacking of skills. And finally, non-separate record keeping account is another challenge for the Islamic windows.

The shortage of clients of the Islamic windows is a clear issue for the conventional banks. Due to the reason that clients believe that Islamic windows of conventional banks are unable to offer fully Islamic banking products, they do not invest with Islamic windows<sup>(4)</sup> in other words, those clients who want to invest their money according to interest-free based principles; they would invest with fully interest-free banking not with Islamic windows of conventional banks. The investors think that the business of the fully-fledged Islamic banking is more compliant under Shariah law due to the reason that these banks are monitored by skilful Shariah scholars. In

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<sup>(1)</sup> Bank Nizwa, 'Looking For the Perfect Islamic Window' Global Islamic Finance Report (GIFR 2014), 113.

<sup>(2)</sup> M Mansoor Khan and M Ishaq Bhatti, 'Islamic Banking and Finance: on Its Way to Globalization' (2008) 34 Managerial Finance 708, 719.

<sup>(3)</sup> Bank Nizwa, "Looking for the Perfect Islamic Window" Global Islamic Finance Report (GIFR 2014), Chapter 6, P 15.

<sup>(4)</sup> Asharq Al- Awsat, 'Islamic Windows or Islamic Banks' Business, Interviews, Jul 22, 2010 | accessed 28 February 2019.

addition, the investors of the Islamic windows want to ensure that their funds and their money are invested in transactions that are allowed under Shariah principles.

In this sense, customers know that the fully-fledged Islamic banks conduct all their business according to Shariah law as they have strict Shariah supervisory committee while there is possibility for the Islamic window to invest clients' money in non-compliant Shariah transactions. Therefore, clients and investors try to deal with fully-fledged Islamic banks instead of investing with Islamic windows of conventional banks. For resolving problem of the lack of clients, firstly, Islamic windows should keep existing customers who are opting to switch to Islamic finance; and secondly, Islamic windows should attract new customers from existing banks, including Islamic banks.<sup>(1)</sup> In addition, conventional banks should give guarantee to their investors of Islamic windows that all transactions are under Shariah principles. The Islamic windows should provide enough information about all contracts and transactions to their clients and investors. The Islamic windows have to establish a department for Islamic banking services and should have a strict Shariah supervisory council and Shariah advisor. A special customer service is also necessary for the Islamic windows in order to give information to their clients and make them trust the Islamic windows.

Another challenge of the Islamic windows of the conventional banks is the lacking of proper skills. In general, interest-free banking skill is a big issue for the Islamic financial institutions in the world. Most of the interest-free banks in the world have problem of the shortage of skills,<sup>(2)</sup> for both Shariah scholars and workers. Insufficient Islamic banking skills is a big challenge for the Islamic windows before fully-fledged Islamic banks. Most of the famous Shariah scholars work in big and fully-fledged interest-free banks. In that context, it is difficult for the Islamic windows to find skilful and well-known Islamic banking scholars as most of the famous scholars prefer to work with fully-fledged interest-free banks.

The lack of the skilful employees who have Islamic finance background is another problem for the Islamic windows. Most of the employees of the Islamic windows do not have sufficient knowledge about Islamic banking contracts and transactions,<sup>(3)</sup> they only know conventional transactions. Thus, beside lacking of scholars, Islamic windows face the shortage of experienced staff who can run Islamic banking business. The solution for the lack of Shariah scholars and shortage of employees for running Islamic windows is that conventional banks should have sufficient number of skilful human resource before opening the Islamic windows. Furthermore, Islamic windows can get benefit from Shariah council firms. Moreover, having relationship between fully-fledged interest-free banks and Islamic windows can reduce the issue of the shortage of staff and Shariah scholars. In addition, conventional banks should provide enough funds for educating their staff who run Islamic windows to be knowledgeable in Islamic banking principles and businesses.

Finally, creating non-separate record keeping account is another challenge for the Islamic windows of the conventional banks. The funds that used in Islamic window should be separated from the funds that used for the conventional banking transactions. The interest-free banking transactions are free of Riba while the conventional banking transactions are based on Riba. In that logic, it is prohibited to mix Islamic windows capital with conventional banking capital. To avoid mixing of principals and investments of both the conventional banks and its Islamic window, there should be a separate record-keeping account for the Islamic windows. The income and the money that are invested in the Islamic windows should not be mixed with the conventional banks' funds. It is the Shariah scholar's role and responsibility to ensure that there is a separate record-keeping account for Islamic windows which is different from conventional

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<sup>(1)</sup> Bank Nizwa, 'Looking For the Perfect Islamic Window' Global Islamic Finance Report (GIFR 2014), 110.

<sup>(2)</sup> Hiam Muhammad Abdulqadir Zedanain, 'Sharia Supervision of Islamic Banks Between Originality and Practice' (2013) 40 Sharia Science and Law studies 89, 100

<sup>(3)</sup> Tahreem Noor Khan, 'Closing the Gaps of Human Resource in Islamic Banks: Literature Review Analysis' International Journal of Business and Social Science, (2015) 5, 169.

bank account. In addition, Shariah scholars have to monitor all the capitals and resources of Islamic windows in order to make sure their way of investing of the funds.

## **5-Conclusion**

As the number of the Islamic bank's customers rose, the conventional banks started to offer Islamic services through their Islamic windows. In some countries the conventional banks are allowed to open Islamic windows while in some other countries they are not allowed. There are numbers of conditions that have been stated for the conventional banks to open Islamic windows. Having a special department for Islamic banking, establishing a Shariah supervisory council, creating a separate record-keeping and having skilful staff are the most important conditions for the conventional banks to be allowed to provide interest-free banking services. Although Islamic windows are practiced by many conventional banks in the world, there are some challenges facing these windows. The shortage of customer for the Islamic windows is one of the issues that face these banks. Most of the clients believe that products that are offered by Islamic windows of conventional banks are not compliant with the Shariah rules since they consider that Islamic windows is not separated from the conventional banks as they are part of these banks. Therefore, the commitment to Shariah principals is a condition for the Islamic windows.<sup>(1)</sup>

The lack of skilful employees is another problem for Islamic windows. Due to the reason that most of the staff of Islamic windows are the same staff of the conventional bank, they are not experienced in running Islamic banking business. Therefore, it is the responsibility of the bank to offer training courses and provide sufficient funds for educating their staff in Islamic banking.

The lack of separate record-keeping account for the Islamic windows is another problem for these windows. Sometimes the Islamic window's capital is mixed with conventional bank's capital as the Islamic window is a part of the conventional bank. In order to be legal and to be in compliance with Shariah principles, there should be a separate record-keeping account for the Islamic window. The money of the Islamic window should not be mixed with the conventional banking money. Finally, for the Islamic window to be legal and Shariah compliance, it should have a proper Shariah supervisory committee for monitoring contracts and transactions that are practiced by the Islamic window. Therefore, any conventional bank should establish a Shariah supervisory committee before establishing an Islamic window.

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<sup>(1)</sup> Fatma Ahmed and Khaled Hussainey, ' Conversion into Islamic Banks: Jurisprudence, Economic and AAOIFI Requirements' European Journal of Islamic Finance, No 3, 2015, 4.

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