

Conversion into Islamic Banks: Jurisprudence, Economic and AAOIFI Requirements

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Abstract - The objective of this study is to investigate the conventional banks conversion into Islamic banks. It provides a significant opportunity to develop the understanding of the *Sharia* requirement to conversion process and what the conventional banks have to do in order to be converted into Islamic banks. In addition, it discusses the jurisprudential and financial motivations behind traditional banks converted into Islamic banking. Moreover, it discusses the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) conversion standard. The study suggests that the conventional banks must commit with all conditions to successfully complete the conversion process and to be fully committed with *Sharia* law.

Keywords: AAOIFI, Islamic banks, conversion, Jurisprudence

I. INTRODUCTION

Islamic finance is not just increasingly attractive to the 1.6 billion Muslims across the world but, there is a global explosion of activity in Islamic finance[19]. He argued that Islamic finance and Islamic financial institutions growing fast and will be the major global force. This enormous growth has attracted conventional banks to capture the huge market by creating a new Islamic window or converted themselves into fully-fledged Islamic banks or even just offering Islamic products [2]. The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) issued standard number (6) which represents the conversion issue and identifies its requirements and how the banks deal with it. This study tries to shed the light on the *Sharia* requirement to the conversion process and what the conventional banks have to do to be converted into Islamic banks. In addition, this study highlights the jurisprudential and financial motivations for traditional banks to be converted into Islamic banks. Moreover, the study also discusses the AAOIFI conversion standard.

The paper is organized as follows. Section I is the Introduction and section II discusses the conversion process. Section III highlights the motivations of conventional banks to be converted into Islamic banks. Section IV discusses conversion forms. Section V discusses AAOIFI conversion standard. Section VI is the conclusion.

II. CONVERSION PROCESS

Islamic banking assets with commercial banks globally are set to exceed US\$1.7t in 2013, suggesting an annual growth of 17.6% [19]. This huge growth of Islamic banks is attracting large financial institutions such as HSBC, Citibank, Deutsche Bank to keep up with this growth by providing Islamic financial services, opening an Islamic branch of the bank (or window within the banks), or even fully converted to Islamic banking[26]. The conversion process is different from bank to bank according to the motives of the transformation process [4]. It is necessary here to clarify exactly what is meant by the conversion process? According to [7]; it refers to the process of changing or causing something to change from one form to another (almost from a corrupted status, to the right way). This definition commonly includes that a conventional bank converts to work according to *Sharia* law; thereby the entire bank's activity is run according to *Islamic* principles.

III. MOTIVATIONS FOR CONVERSION INTO ISLAMIC BANKING:

Prior literature discusses the drivers of conversion into Islamic Banks. It identifies jurisprudential and financial reasons for the conversion process [3]; [4]; [23] [5]; [11]; [21]. The following paragraphs discuss these reasons in details.

A. The jurisprudential reasons:

The jurisprudential reasons refer to Religious scruples that motivate a conventional bank to change its activity and work according to *Sharia* law, especially dealing in “*riba*” (interest) that is prohibited in Islam [7]. According to [3] the primary motivation of about 62% of converted banks is the adherence to *Sharia* which includes that Muslims should obey all *Allah*'s orders such as the “*riba*” (interest) prohibitions and to intend to repent to *Allah*. To fully understand the jurisprudential reasons, next section explains the following issues related three concepts: the inclusiveness in *Islam*; the usury prohibition and the repentance to *Allah*.

1- Inclusiveness in Islam:

The concept of Inclusiveness in *Islam* means that *Islam* is for all times and places regardless of who a person may be or where he may be. Islam should be his religion and his way of life. Muslims must obey *Allah*'s orders (*Islamic* law or *Sharia* law) which regulate all aspects of a Muslim's life. Islamic finance is based on *Sharia* law. *Sharia* depends upon the holly

book of Allah (The Quran) and the traditions (Sunnah) of his Prophet Mohamed (*peace be upon him*). Also, Islamic jurisprudence (*fiqh*) is a source of *Sharia*. It is developed by different schools of *Islamic* thought over centuries which all agreed about the fundamental *Sharia* principals (*Ejmaa*) and sometimes hold different views on applications (*Ejtihad*). There is not a problem in this life which has no solution in Quran or Sunnah. Allah said in Quran:

وَنَزَّلْنَا عَلَيْكَ الْكِتَابَ تَبْيَانًا لِّكُلِّ شَيْءٍ وَهُدًى وَرَحْمَةً وَبُشْرَىٰ لِلْمُسْلِمِينَ (سورة النحل: الآية 89)

And we have sent down to you the Book as clarification for all things and as guidance and mercy and good tidings for the Muslims (Quran 16:89).

The faith in Islam obliges believing in Allah and His Prophet and obeying all his orders. In the Quran Allah warns the human being against disobedience to His orders and from following our desires:

وَمَا كَانَ لِمُؤْمِنٍ وَلَا لِمُؤْمِنَةٍ إِذَا قَضَىٰ اللَّهُ وَرَسُولُهُ أَمْرًا أَنْ يَكُونَ لَهُمُ الْخِيَرَةُ مِنْ أَمْرِهِمْ وَمَنْ يَعْصِ اللَّهَ وَرَسُولَهُ فَقَدْ ضَلَّ صُلْبًا مَبِينًا (سورة الأحزاب: الآية 36)

It is not fitting for a believing man or a believing woman to have an option in their affairs when a matter has been decided by Allah and His Messenger and whoever disobeys Allah and His Messenger has indeed strayed into a clearly wrong path (Quran 33:36).

إِنَّمَا كَانَ قَوْلَ الْمُؤْمِنِينَ إِذَا دُعُوا إِلَى اللَّهِ وَرَسُولِهِ لِيَحْكُمَ بَيْنَهُمْ أَنْ يَقُولُوا سَمِعْنَا وَأَطَعْنَا وَأُولَئِكَ هُمُ الْمُفْلِحُونَ (سورة النور: الآية 51)

The only statement of the [true] believers when they are called to Allah and His Messenger to judge between them is that they say, "We hear and we obey." And those are the successful (Quran 24:51).

So Muslims must return to Quran and Sunnah (guided by the righteous scholars) in all aspects of life and leave their lower desires.

وَكَذَلِكَ أَنْزَلْنَاهُ حُكْمًا عَرَبِيًّا وَلَئِنِ اتَّبَعْتَ أَهْوَاءَهُمْ بَعْدَمَا جَاءَكَ مِنَ الْعِلْمِ مَا لَكَ مِنَ اللَّهِ مِنْ وَلِيٍّ وَلَا وَاقٍ (سورة الرعد: الآية 37)

And thus we have revealed it as an Arabic legislation. And if you should follow their inclinations after what has come to you of knowledge, you would not have against Allah any ally or any protector (Quran 13:37).

يَا دَاوُدُ إِنَّا جَعَلْنَاكَ خَلِيفَةً فِي الْأَرْضِ فَاحْكُم بَيْنَ النَّاسِ بِالْحَقِّ وَلَا تَتَّبِعِ الْهَوَىٰ فَيُضِلَّكَ عَنْ سَبِيلِ اللَّهِ إِنَّ الَّذِينَ يَتَّبِعُونَ عَنْ سَبِيلِ اللَّهِ لَهُمْ عَذَابٌ شَدِيدٌ بِمَا نَسُوا يَوْمَ الْحِسَابِ (سورة ص: الآية 26)

[We said], "O David, indeed We have made you a successor upon the earth, so judge between the people in truth and do not follow [your own] desire, as it will lead you astray from the way of Allah." Indeed, those who go astray from the way of Allah will have a severe punishment for having forgotten the Day of Account (Quran 38:26).

ثُمَّ جَعَلْنَاكَ عَلَىٰ شَرِيعَةٍ مِّنَ الْأَمْرِ فَاتَّبِعْهَا وَلَا تَتَّبِعِ أَهْوَاءَ الَّذِينَ لَا يَعْلَمُونَ (سورة الجاثية: الآية 18)

Then we put you, [O Muhammad], on an ordained way concerning the matter [of religion]; so follow it and do not

follow the inclinations of those who do not know (Quran 45:18).

Islam is a holistic system for women, men and societies which organizes all aspects of human life politically, socially and economically. In some cases the *Sharia* experts (*Ulama*) disagree in some issues, Ibn Taymeya reported that the people must not forbid anything not forbidden in the Quran or Sunnah or legitimated anything except what Allah legitimized without evidence from Quran or Sunnah. As it is also obvious from Quran:

يَا أَيُّهَا الَّذِينَ آمَنُوا أَطِيعُوا اللَّهَ وَأَطِيعُوا الرَّسُولَ وَأُولِي الْأَمْرِ مِنْكُمْ فَإِن تَنَازَعْتُمْ فِي شَيْءٍ فَرُدُّوهُ إِلَى اللَّهِ وَالرَّسُولِ إِن كُنتُمْ تُؤْمِنُونَ بِاللَّهِ وَالْيَوْمِ الْآخِرِ ذَلِكَ خَيْرٌ وَأَحْسَنُ تَأْوِيلًا (سورة النساء: الآية 59).

O you who have believed, obey Allah and obey the Messenger and those in authority among you. And if you disagree over anything, refer it to Allah and the Messenger, if you should believe in Allah and the Last Day. That is the best [way] and best in result (Quran 4:59).

إِنَّا أَنْزَلْنَا إِلَيْكَ الْكِتَابَ بِالْحَقِّ لِتَحْكُمَ بَيْنَ النَّاسِ بِمَا أَرَاكَ اللَّهُ وَلَا تَكُن لِّلْخَائِنِينَ خَصِيمًا (سورة النساء: الآية 105).

Indeed, we have revealed to you, [O Muhammad], the Book in truth so you may judge between the people by that which Allah has shown you. And do not be for the deceitful an advocate (Quran 4:105).

2- Usury Prohibition :

Usury or *riba* is an Arabic word which means growth and it is a synonym for the term "interest" used in conventional banking [20]. Islam bans usury because of its absolute injustice. Ibn taymeya argued that the root of dealing with *riba* arises from the need. Poor people who need money are often blackmailed by the rich people. Hence Islamic *Sharia* seeks to build transactions based upon fairness and justice. Many verses of the Holy Quran expressly prohibit *riba*. The first verse reveals a strong punishment for those dealing in usury. In *sura Al-Baqarah* Allah said:

الَّذِينَ يَأْكُلُونَ الرِّبَا لَا يَقُومُونَ إِلَّا كَمَا يَقُومُ الَّذِي يَتَخَبَّطُهُ الشَّيْطَانُ مِنَ الْمَسِّ ذَلِكَ بِأَنَّهُمْ قَالُوا إِنَّمَا الْبَيْعُ مِثْلُ الرِّبَا وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا فَمَنْ جَاءَهُ مَوْعِظَةٌ مِنْ رَبِّهِ فَانْتَهَىٰ فَلَهُ مَا سَلَفَ وَأَمْرُهُ إِلَى اللَّهِ وَمَنْ عَادَ فَأُولَئِكَ أَصْحَابُ النَّارِ هُمْ فِيهَا خَالِدُونَ (سورة البقرة: الآية 275).

Those who consume interest cannot stand [on the Day of Resurrection] except as one stands who is being beaten by Satan into insanity. That is because they say, "Trade is [just] like interest." But Allah has permitted trade and has forbidden interest. So whoever has received an admonition from his Lord and desists may have what is past, and his affair rests with Allah. But whoever returns to [dealing in interest or usury] - those are the companions of the Fire; they will abide eternally therein (Quran 2:275).

يَمْحَقُ اللَّهُ الرِّبَا وَيُرْبِي الصَّدَقَاتِ وَاللَّهُ لَا يُجِبُ كُلَّ كَفَّارٍ أَثِيمٍ (سورة البقرة: الآية 276).

Allah destroys interest and gives increase for charities. And Allah does not like every sinning disbeliever (Quran 2:276).

The second verse in *surah Al Imran* where prohibition of interest (usury) is clearly declared.

يَا أَيُّهَا الَّذِينَ آمَنُوا لَا تَأْكُلُوا الرِّبَا أَضْعَافًا مُضَاعَفَةً وَاتَّقُوا اللَّهَ لَعَلَّكُمْ تُفْلِحُونَ
(سورة آل عمران : الآية 130)

O you who have believed, do not consume usury, doubled and multiplied, but fear Allah that you may be successful (Quran 3:130).

The consensus view of Muslims about the prohibition of *Riba* based transactions a severe sin [12]. In addition of the previous mentioned verses of Quran. There are many verses in Quran strongly condemn *Riba* and many *Ahadith* (written sayings of the Prophet Muhammed SAW) in *Sunnah* pertain to various aspects of *Riba*, like its prohibition, the severity of its sin and its different forms.

-عن ابن مسعود رضي الله عنه قال: " لعن رسول الله صلى الله عليه وسلم أكل الربا وموكله" ((رواه مسلم)). زاد الترمذي وغيره: وشاهديه، وكتابه

Abdullah bin Mas'ud (*May Allah be pleased with him*) reported: The Messenger of Allah (PBUH) cursed the one who accepts *Al-Riba* (the usury) and the one who pays it. [Muslim]. The narration in *At-Tirmidhi* adds and the one who records it, and the two persons who stand witness to it.

Riba is not restricted to only interest. *Riba* also applies to nonmonetary exchanges and includes sale/exchange transactions, which has important implications even today [28]. The term *riba* is used in the Sharia in two senses; the first is *Riba al-nasiah* and the second is *Riba al-fadl*. *Riba al-Nasi'ah* refers to the time that is allowed to the borrower to repay the loan in return for the 'addition' or the 'premium'. Hence *Riba al-nasi'ah* is equivalent to the interest charged on loans while *Riba al-fadl*: refers to an excess in weight/measure [14].

أَخْبَرَنَا إِسْحَاقُ بْنُ إِبْرَاهِيمَ، قَالَ حَدَّثَنَا سَفْيَانُ، عَنِ الزُّهْرِيِّ، عَنِ مَالِكِ بْنِ أَوْسِ بْنِ الْحَدَّادِ، أَنَّهُ سَمِعَ عَمْرَ بْنَ الْخَطَّابِ، يَقُولُ قَالَ رَسُولُ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ "الذَّهَبُ بِالْوَرَقِ رِبًا إِلَّا هَاءَ وَهَاءَ وَالتَّمْرُ بِالتَّمْرِ رِبًا إِلَّا هَاءَ وَهَاءَ وَالتَّبَرُّ بِالتَّبَرِّ رِبًا إِلَّا هَاءَ وَهَاءَ وَالتَّشَعِيرُ بِالتَّشَعِيرِ رِبًا إِلَّا هَاءَ وَهَاءَ" (صحيح البخاري).

Umar bin Al-Khattab said: "The Messenger of Allah said: '(Exchanging) gold for silver is *Riba* unless it is done on the spot. (Exchanging) dates for dates is *Riba* unless it is done on the spot. (Exchanging) wheat for wheat is *Riba* unless it is done on the spot. (Exchanging) barley is *Riba* unless it is done on the spot."

From the above references from the *Quran and Sunnah* we can derive a number of results:

- *Riba al-nasiah* relates to loans while *riba al-fadl* relates to trade [15].

- When the commodities of exchange are similar, excess and delay are prohibited, e.g. gold for gold or wheat for wheat, dollars for dollars and so on.

The prohibition of *Riba* is intended to prevent the accumulation of wealth in few hands [12].

3- Repentance to Allah:

Repentance '*Tawbah*' is to repent from the sins we commit. Making sincere repentance or *Tawbah* raises a Muslim's status with Allah because the process of making *Tawbah* involves the following steps: Devotion to Allah without showing it to people, recognizing ones mistakes and sins, feeling ashamed of violating Allah's trust of complete submission to His commands, Quit wrongdoing by making a promise never to repeat such behaviour including reinstatement of rights and that repentance be at a time of repentance [13]. A number of verses of the Holy Quran refer to *Tawbah* for example:

قُلْ يَا عِبَادِيَ الَّذِينَ أَسْرَفُوا عَلَىٰ أَنفُسِهِمْ لَا تَقْنَطُوا مِن رَّحْمَةِ اللَّهِ إِنَّ اللَّهَ يَغْفِرُ الذُّنُوبَ جَمِيعًا إِنَّهُ هُوَ الْغَفُورُ الرَّحِيمُ (سورة الزمر : الآية 53)

"Say: O My slaves who have transgressed against themselves (by committing evil deeds and sins)! Despair not of the Mercy of Allah, verily, Allah forgives all sins. Truly, He is Oft-Forgiving, Most Merciful (Quran 39:53).

He also says in the Quran:

إِنَّ اللَّهَ يُحِبُّ التَّوَّابِينَ وَيُحِبُّ الْمُتَطَهِّرِينَ (سورة البقرة : الآية 222).

Indeed Allah loves those who repent and purify themselves (Quran 2:222).

And as the Prophet (peace and blessings of Allah be upon him) said:

وعن أبي عبد الرحمن عبد الله بن عمر بن الخطاب رضي الله عنهما عن النبي صلى الله عليه وسلم قال: "إن الله عز وجل يقبل توبة العبد ما لم يغر" ((رواه الترمذي وقال: حديث حسن)).

Abdullah bin 'Umar bin Al-Khattab (*May Allah be pleased with them*) reported that: The Prophet (*peace be upon him*) said, "Allah accepts a slave's repentance as long as the latter is not on his death bed (that is, before the soul of the dying person reaches the throat)". (*At-Tirmidhi*, who categorised it as *Hadith Hasan*).

وَعَنْ أَنَسٍ - رَضِيَ اللَّهُ عَنْهُ - قَالَ: قَالَ رَسُولُ اللَّهِ - صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ - { كُلُّ بَنِي آدَمَ خَطَاءٌ، وَخَيْرُ الْخَطَائِينَ التَّوَّابُونَ } أَخْرَجَهُ التِّرْمِذِيُّ. وَابْنُ مَاجَةَ وَسَنَدُهُ قَوِيٌّ

Anas (RAA) narrated that *Allah's* Messenger (*peace be upon him*) said: "All the sons of Adam are sinners, but the best of sinners are those who repent often." Related by *At-Tirmidhi* and *Ibn Majah* with a strong chain of narrators.

The above verses and *Ahadith* (written sayings of the Prophet Muhammed, *peace be upon him*) emphasized that it is important for conventional banks to get rid of usury deals and to give rights back to their owners.

B. Economic reasons:

Prior research [23]; [10]; [24]) reported that Islamic banks are more profitable than the conventional banks. Recent study like [24] investigated the differences between Islamic and conventional banks in the GCC region on the basis of financial characteristics alone. According to ROE Islamic banks are more profitable and therefore, reward shareholders with higher returns than conventional banks also the operating expenses to assets are higher for Islamic banks while Islamic banks are less risky than conventional banks because of their

reliance on shareholder capital. Hence the conventional banks seek to maximize their profit. In this context [3] reported that the main motivation toward the conversion process is the desire of conventional banks to achieve maximize their profit. In addition [3] identifies two motivations for the conversion to the Islamic banking industry. These include the potential benefits from the expansion by working in Islamic banking activities and the weak and the poor levels of competitiveness of the conventional banks.

Furthermore [27] revealed that conventional banks have a motive to offer services to a growing Muslim population and to benefit from the growing number of international investors which are attracted to *Sharia*-compliant products. Moreover [4] argued that the work in the banking sector according to *Sharia* is very profitable so it is axiomatic that conventional banks resorted to tap into it as much as possible.

Other study [24] investigated the most important motives behind the conversion process. He found that conventional banks converted to Islamic banks to (1) keep their customers; (2) because of the believe in the prohibition of usury; (3) the competence to attract the *Sharia* product customers and (4) to emulate the success in Islamic banking and achieve a higher rate of return. Most recently [2] investigated traditional banks conversion motivation into Islamic Banks using two banks in Kuwait, one of them fully shifted to Islamic banking and the other national bank of Kuwait opened an Islamic division (or window within the banks). The results also found the motivation of conventional banks conversion to Islamic banks is two-fold: on the one hand, there is a Religious scruple; but there is also a vital success of Islamic banking role that is equally important. Many traditional banks like HSBC, City Bank, Deutsch Bank and Chase JP Morgan established Islamic branches to cope with the Islamic banking growth. This phenomenon proved feasible and resulted in a significant presence of Islamic banking.

IV. CONVERSIONS FORMS:

Conversions forms, according to [4] are referring to the way that conventional banks choose to enter into the Islamic finance world. Prior studies [26]; [4]; [3]; [2]; [16] show that there are several forms of conversions. In the simplest sense [23] divided the conversion forms as follows. The full conversion: In this case the conventional banks are converted into to Islamic banks. This might be caused because of a legal conversion of a country (such as Iran, Pakistan and Sudan) or because of the decision of the conventional banks to be full-fledged Islamic banks. The other way is the micro conversion which takes many shapes such as (1) establishing an Islamic window in the conventional bank; (2) providing some Islamic products, instruments or investment funds and (3) converting a branch or more of conventional banks into Islamic branches.

A. The main forms of conversion from jurisprudential point of view:

Some conventional Islamic banks are seeking to increase their capacity of Islamic banking services because of its higher profitability (or for ideological reasons). The conversion forms are different according to the conversion motivation.

Every bank has a different goal and plans[9]. By keeping track of the views of many of the *Sharia* scholars and economists, it is clear that there is a divergence of views on whether the conversion is compatible with *Sharia* principles or not [23]; [9]; [7]. Before explaining the jurisprudential requirement, we will discuss the forms of conversions.

1- Full-Fledged Islamic Banks:

Prior studies [6]; [23]; [3]; [2] consider this form the most compatible with *Sharia* law. Ttraditional banks which choose a full conversion consider it the wisest choice because it helps the bank to build a confidence and trust with their customers. He gives examples of full converted banks like Aljazeera Bank in the Kingdom of Arabia Saudi and National Bank of Sharjah, United Arab Emirates [2]. The main features of this form are the full adoption of *Sharia* principals and the existence of *Sharia* supervisory board. The full convertor bank did not deal with usury (*Riba*) [3]. *Sharia* scholars state a number of conditions to deal with converted conventional banks: Firstly, the commitment to *Sharia* principals. Secondly, the independence from the parent traditional Bank in terms of (1) accepting money and investing, (2) working according to Islamic *Sharia* in contracts, regulations, and (3) not to apply any systems or perform transactions that violated *Sharia*. Finally, working under *Sharia* supervision and it must have a *Sharia* supervisory board [6]. The *Sharia* scholars agreed about that it is permissible to deal with these banks if it conforms to the terms of *Sharia* [8]; [9].

2- Islamic windows (units) and branches:

The Citibank Bank (1996), Dresdner Kleinwort Benson Bank (1988) and New Zealand and Australia ANZ group were the earliest conventional banks that opened Islamic units. Opening windows / Islamic units in traditional branches or Islamic windows means that traditional banks allocate part or space to provide Islamic banking services [9]while Islamic branches is a conventional branch of conventional bank transformed to offer Islamic banking services [2]. Conventional banks generally turn to this form to avoid losing their customers who want to deal according to *Sharia* and to attract customers interested in Islamic products by opening new windows or transfer branch, or offer more Islamic products [7].

There is a debate between *Sharia* scholars and Islamic banking experts regarding jurisprudential views. There are three groups; the first group encourages establishing Islamic branches and windows and the other groups are against it. Firstly, the view favouring the establishing of branches /Islamic windows in commercial banks; argued that Muslims can deal with the Islamic subsidiaries of banks if these branches have a full commitment to the provisions of Islamic *Sharia* law in all their dealings [6]. They pointed out some reasons supporting their view. First; the Islamic branches will stop usury which is considered as one of the most important Islamic rules [6]. Secondly, in some countries it is so difficult to obtain permission to establish Islamic banks; therefore, Islamic windows or branches are the sole alternative.

In addition, the success of these branches may tempt conventional banks to be fully converted into a full-fledged

Islamic bank [9]. Moreover [27] argued that Islamic branches are a primary step to apply the Islamic banking system until such time to shift the entire bank into an Islamic bank. Finally Islamic windows or branches can benefit from an accumulated experience of conventional banks and that of hundreds of years to support and develop Islamic banking and increase its effectiveness. A Chairman and Executive Member of the Fatwa and Sharia supervision for a number of Islamic banks, insurance companies within Islamic Qatar, [27] states that it is permissible to deal with these branches if they adhere to the conditions of Islamic banking. In addition it reflects a real commitment to the provisions of Sharia in order to get rid of the *riba* gradually (Aljazeera programs, Religion and Life, 2005). On the other hand; the view that disagreed with Islamic units or branches argued that the Islamic branches are a new way to deceive Muslims and drain money without a real conviction in Islamic approach [9]; [7]. They tend to an inadmissibility of dealing with Islamic subsidiaries deduced from verses in *Sura Albaqara*:

يَا أَيُّهَا الَّذِينَ آمَنُوا اتَّقُوا اللَّهَ وَذَرُوا مَا بَقِيَ مِنَ الرِّبَا إِن كُنتُمْ مُؤْمِنِينَ ﴿٢٧٨﴾ فَإِن لَّمْ تَفْعَلُوا فَأْذَنُوا بِحَرْبٍ مِّنَ اللَّهِ وَرَسُولِهِ وَإِن تُبْتِغُوا فَلَئِمَّ رُءُوسُ أَمْوَالِكُمْ لَّا تَظْلُمُونَ وَلَا تُظْلَمُونَ (سورة البقرة : الآية 278)

O ye who believe! Fear Allah, and give up what remains of your demand for usury, if ye are indeed believers. If ye do it not, Take notice of war from Allah and His Messenger: But if ye turn back, ye shall have your capital sums: Deal not unjustly, and ye shall not be dealt with unjustly Quran (2:278).

In order to do that [27] pointed out that some *Sharia* scholars have raised concerns regarding its legitimacy of establishing themselves using capital from conventional banks. In the same vain; [27] stated that dealing with these branches may lead to mixing permissible with impermissible money according to *Sharia*. Another group expresses that dealing with Islamic branches or windows in certain cases is considered better than dealing with pure conventional banks [9]. *Ibn Alqayem* stated that when permissible and impermissible money are mixed, we must purify the impermissible money percentage and retaining the rest (permissible) [9]. The main methods to get rid of the impermissible money are: the General Islamic Relief Worldwide; Scientific and technical assistance to poor Islamic countries; Islamic educational, medical and social institutions; and Homeless, orphans and poor Muslims [5].

3- Conventional banks offer Islamic products:

One of the simple methods that conventional banks follow to maximize profit is to attract *Sharia*-compliant investors. They offer diverse traditional and Islamic products. In this method, conventional banks offer Islamic instruments such as *Musharaka*, *Murabha* and *Ijara* [9]. This form is used by foreign banks in Muslim countries to satisfy the market needs [26]. These products are not separately managed, but are part of the conventional bank. This form needs to be more fully accepted by *sharia* scholars and has a lot of doubts about its credibility. *Sharia* scholars have different points of view. The first group argued that Muslims must avoid dealing with this form because of the absence of the compliance with the provisions and principles of Islamic law. The Second group

permits dealing with this form only if necessity and in the absence of specialized Islamic banks. In this case the profit must be purged and investigated to know the proportion of the sacred transactions [8].

V. AAOIFI STANDARDS AND THE CONVERSION PROCESS:

The Accounting and Auditing Organization for Islamic Financial Institutions AAOIFI is responsible for developing and issuing standards for international Islamic finance industry. AAOIFI appointed members from central banks, regulatory authorities, financial institutions, accounting & auditing firms, legal firms and so on. It is supported by over 200 institutional members from over 40 countries [1]. *Sharia* standards issued by AAOIFI considered as guidance on *Sharia* permissibility and rules for specific Islamic finance products and mechanisms. The collective personal reasoning (*Ijtihad*) of the AAOIFI is very important to all sides of Islamic economic life [28]. He considers that the existence of a *Sharia* supervisory board, management committed to *Sharia* principles and the compliance with the standards of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) are the main conditions to conversion process. Thereby; we shed the light toward AAOIFI *Sharia* standard number (6) which implies explanations of procedures, mechanisms and treatment which are required for the conventional bank to be converted into Islamic bank. AAOIFI did not consider the Islamic windows or the conventional banks that offer Islamic services as Islamic banks because *Sharia* supervision board did not exist to make sure of transactions validity. To make sure the conversion process succeeds and meets *Sharia* requirements; AAOIFI offers an overview about conversion process as follow:

A. Measures of conversion process:

1) *Setup necessary procedures and required tools of conversion*: [6] argued that this step needs a lot of effort especially with a dual banking system. The conversion plan must be under supervision of Islamic expert in *Sharia* and Islamic Finance [21]. He argued that this plan implies; Firstly doing settlements of the interest on loans by returning it back or donating to charity tubes; Loans granted by the Bank; Deposits and savings accounts; Secondly, developing a plan for training employees on the principles of jurisprudence and Islamic banking. Thirdly, modifying the bank accounting standards to be consistent with Islamic accounting standards.

2) *Changing operating licence according to Sharia*: The Articles of Association should explicitly consist of the existence of a *Sharia* board [28]. However, [23] argued that some converted banks is a part of the conventional bank. Almost 53% of the Islamic banks have a financial and administrative separation while 74% have not the same.

3) *Restructure organizational structure to fit conversion process*: According to this point [23] found that the restructuring process reflects the development of new department of Islamic banking management and nominate *Sharia* supervisory board. This suggests that 88% of the

Islamic banks sample restructure their organization while 12% did not do any modification.

4) *Changing employing procedures to fit conversion process:* To fit with Islamic values [21] pointed out that faith and morals are as important as banking experience. He indicated that this concept must be followed in the Islamic Bank employing selection

5) *Formation of a Sharia supervisory board:* Previous studies [28]; [27]; [6]; [11] argued it is necessary for any Islamic bank of any Islamic financial institution to have independent and fully free Sharia supervisory board to give opinions on proposed contracts and transactions. In the same regard [27]; [11] stated that Sharia supervisory board is an initial component to any Islamic bank. The bank should, therefore, take the conversion decision and provide permanent checking of contracts, transactions, and procedures. *Sharia* supervisory board should also consist of experts trustworthy scholars in *Sharia* and modern financial transactions, highly qualified to issue *Fatawa*. Almost every paper that has been written on *Sharia* supervisory board includes a section relating to the Articles of Association which emphasize the importance of the existence of a *Sharia* board, whose resolutions should be binding upon the Islamic bank's management.

6) *Formation the Sharia auditing department in the bank:* Supervision and Consultation with this department is so important to ascertain whether the licensing of different activities, contracts as well as transactions are compatible with Islamic principles [11].

7) *Reformatting contracts to comply with Sharia standards:* An apparent principle behind Islamic is to maintain the moral purity of all transactions [27].

8) *Open local and international Islamic banks accounts:* It is an important step to prepare the Islamic branch to open individual, institutional, local and international Islamic banks accounts compatible with *Sharia* law [23].

9) *Revamping accounts that are maintained with conventional banks:* The bank could rely on a *tawarruq* instrument “contract whereby a customer requests a bank to acquire a specific commodity (e.g. metal or wool) on his behalf” to get rid of interest. Hence, through this transaction, the customer can purchase a commodity which will be repaid at later dates [27].

In order to prepare bank's employees to deal with Islamic banks practice, [21] reported that, in case of Shareqa bank (UAE), they offered two types of rehabilitation programs public and private program. Public programs offered to all the bank employees regarding principles and rules of Islamic banking and Islamic finance forms. After restructuring and allocation of staff in their departments, every specialized group get a private program convenient to their activity to help them to practice their work according to *Sharia*. Moreover, the conversion committee is responsible for surveillance the training process to make sure that everything in the right path. The absence of the employee training resulting in slow innovation in Islamic products and affects the relationship with central bank [26].

B. Dealing with other banks:

1) Opening investment accounts in the central bank. Central banks in some countries that ban to practice operations of direct sale and dealings in real estates and movables, in consideration of the nature of Islamic bank operations in the fields of trading and Murabaha, allow such banks to have, real estates, and goods. In addition, central banks modified some of the concepts considering the different nature of such Islamic investment accounts, based on participating in profits and losses, and subject to the rules of legal Mudaraba contracts [18].

2) Revamping the transactions with conventional banks according to *Sharia*. Regarding to [3] he pointed out that Islamic banks must cancel or modify the transaction with conventional banks and central bank to be compatible with *Sharia* law avoiding dealing with interest. Islamic banks have to provide intensify transactions with Islamic financial institutions and increase the collaboration between the Islamic institutions by opening dual investments accounts and banks transfers [3].

C. The effect and treatment of conversion process on bank's receivable and investments:

1) Liquidating all the previous traces of conventional transaction. In case of deposits, [21] argued that the converted bank as Shareqa bank (UAE) gave the bank's customers choice to withdraw their deposit or keep it as a Musharaka, Mudarba or any of Islamic finance contract. In addition; the bank legally is forced to keep the previous contract if the customer refused the settlement.

2) Increasing the bank capital by increasing the shareholders capital or any other permissible means such as issuing *Sukuk* and *Estesnaa* (manufacturing).

3) Issuance of Islamic certifications such as Mushaka, Mudarba and Ijara. One of the studies reported that 80 % of the Islamic instruments in Islamic banks in Saudi Arabia is Mudarba and Tawaroq due to its low risk [23].

4) Destroying impermissible tangible assets. It is not allowed to benefit from these assets by direct or indirect method and must be donated to charity if the bank sold these commodities and just receive the price.

5) Employing all lawful means to avoid paying interest. Notwithstanding converted banks seeking to get rid of interest by law; e.g. Shareqa bank (UAE); consider that if the bank did not convince the customers to finish impermissible transactions, it is permissible for the bank to receive the interest from the customers and pay it for the Interest deposits that legally the banks forced to pay and spent the rest of this interest in charity outlets [21].

6) In case of liabilities the bank Refuses to provide non permissible services even if it has to pay compensation.

7) Accelerating the redemptions of all impermissible pledges attached to the assets of the bank.

8) Any interest or impermissible earnings should channel to charity or general utility.

9) Paying Zakah: the liability of Zakah starts from the date of conversion if the conversion made by outsider while in case of shareholders they bind to pay the previous years even if it is the money impressible.

VI. CONCLUSION:

The conversions process is based on the belief that there is a need to make the right change. There is religious and financial motivation behind conventional banks conversion. The religious motivation must be supported by stable and good plan to guarantee a successful conversion. The conventional banks conversion into Islamic banking is obligatory in Islam. Independent Sharia supervisory board is a very important element in conversion to Islamic bank. Moreover, AAOIFI Sharia standard put explanatory procedures and show how to follow the conversion process. The conventional banks must adhere with all conditions to complete the conversion successfully and to be fully committed to *Sharia* law.

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