Editor's Note

Modern societies establish systems of laws to protect the individual rights of citizens from being unjustly violated by others. Similarly, religious doctrines establish ethical and moral frameworks aimed at promoting individual and societal well-being. Islam establishes such a framework in the *Shariah* principles, in which all Muslims adhere. In modern economic theory, however, there is often a conflict between the motives of the individual and actions that benefit society. One branch of economics, welfare economics, considers the aggregate behaviors of individuals and analyzes their effect on the wellbeing of society as a whole. In contrast, another branch of economics is motivated by the individual behaviors of self-interested, rational economic agents. Welfare economics gained popularity after the seeming failure of the markets following the Great Depression in the 1930s, but the following decades saw a predominance of the individual agent models, particularly in Western economies. However, the recent global financial crisis has brought about an increased interest in re-introducing ethics and societal welfare askeyeconomic considerations.

The differences in the treatment of societal goals in economics can perhaps explain some key differences in the economic outcomes between secular and Islamic financial systems. Both the Islamic and conventional financial systems place ethical standards on economic agents. In conventional economies, policy makers design regulations aimed at promoting ethical behaviour and protecting individuals from being unfairly exploited by others. Similarly, in the Islamic financial systems, all financial products and economic activity must meet the ethical standards of *Shariah*. While the goals of both these system are similar, the acceptance of ethical standards and resulting economic outcomes can often differ. For example, the complicated and ethically questionable use of derivatives was a major contributor to the 2008 financial crisis in the United States and other conventional economies. However, the risky derivative transactions of conventional finance are often not *Shariah* compliant and are not used in Islamic finance. As a result, Islamic financial institutions were relatively less affected during the crisis.

There are also marked differences with regards to how ethics and other financial regulations are accepted and adopted by economic agents. In conventional financial systems, the individual agent economic model prevails, and, as a result, regulations are often treated as burdens that constrain individual choices. For example, the accounting scandals in the United States that led to the failures of Enron and WorldCom and the dissolution of the accounting firm Arthur Andersen showed the need for greater corporate ethical standards. However, there was great debate over the regulatory costs of implementing such regulations. In the end, the Sarbanes Oxley Act of 2002 was implemented to impose better ethics on U.S. firms. However, there remains a great deal of animosity among corporate leaders in accepting such regulations. Some companies even went so far as to delist from U.S. stock exchanges in order to avoid the regulations. Thus, despite the acknowledgment that ethical standards are needed, it is not uncommon for firms to actively work to avoid them.

In Islamic finance, on the other hand, there is a much greater acceptance of ethical standards, which are derived from the religious principles of *Shariah*. The *Shariah* principles are reflected in the AAOIFI standards, and these standards are widely embraced in Islamic finance. As a result, the occurrence of ethical failures and banking crisis caused by self-serving individuals are far less common in countries with Islamic banking systems.

The first paper in this issue is by Dr. Rashidah Abdul Rahman and Siti Balqis from Universiti Teknologi MARA, Malaysia and Faisal Dean from the Aston Business School, Birmingham. The paper analyses the effectiveness of understanding, identifying, assessing, analysing, and monitoring risks among Islamic banks in Malaysia and Pakistan. The study analyzes the risk management processes and their effectiveness in each country, and it also compares and contrasts the banks from each country. The study finds that the Islamic banks in Malaysia and Pakistan implement risk management processes that are somewhat efficient; however, there are significant differences between the banks in the two countries in terms of understanding risk management and risk identification. The authors also conclude that risk identification and risk assessment and analysis are the factors that most significantly impact risk management practices in Malaysia and Pakistan.

The second paper is by Bijan Bidabad of the University of Tehran, Iran. This paper argues that the rate of return for Rastin PLS Bank is tied to the rate of real profits in the economy. Thus, the use of prefixed interest rates are eliminated in accordance with the Islamic principles. Under the Base System of Rastin PLS Banking, the bank takes on customers' deposits and invests them in one of the bank's products. A Rastin PLS certificate for the project is issued in return. The bank is therefore able to allocate the deposits to the individual entrepreneur. The bank then monitors the progress of the entrepreneur and distributes the profits and losses according to the regulations. The bank receives a commission for their capital management services. Under this arrangement, Partnership (Musharakah) Certificates are issued for finitude projects, while Subscripted (Pazireh) Certificates are issued for infinitude projects.

The third paper is this issue is from Hasan Kiaee, Hamid Abrishami, and Hasan Sobhani of the University of Tehran, Iran. The paper's main contribution is the use of a new methodology for assessing the relative performance of Islamic and conventional banking systems. The fact that Islamic banking has experienced such robust growth over the past several decades makes this paper relevant in that it is even more important to be able to accurately compare banking performance. Several methods of performance measurement have been applied in the literature. However, this paper suggests the use of a stochastic optimal control methodology. Under this methodology, an economic agent (bank) maximizes its objective function, subject to some set of stochastic constraints. In the model, it is assumed that loan schedules follow a Brownian motion process in both the conventional and Islamicbanking industries. There are components to each system that are unique in the model in order to account to realistic differences between the Islamic and conventional systems. For example, Islamic banks generally offer two types of loans, fixed return contracts and Musharakah contracts. The conventional banking system, in contrast, offers loans based on interest rates. The results of the model simulation show that the Islamic banking system outperforms the conventional banking system. In addition, the banking rates are also key factors in banking performance.

The forth paper is by Dr. Abdussalam Ismail Onagun ofMalaysia. The paper discusses several issues surrounding the TakÉful industry. The TakÉful

industry is SharÊÑah-justified substitute for the conventional insurance industry. In 1985, The Fiqh Academy determined that conventional insurance is forbidden due to containing elements of uncertainty and usury that are forbidden under Islamic finance. Instead, the academy approved the use of TakÉful that complies with the principles of SharÊÑah as an alternative to conventional insurance. This industry has experienced significant growth ever since. This paper examines the basis of the legality of TakÉful and when uncertainty is appropriate under Islamic law. The paper also analyses the contracts offered by TakÉful companies and describes how they are justified under *Shariah* as well as how they are different from conventional insurance activities. Specific attention is paid to the use of underwriting surplus and investing activities.

The fifth article is by Abu Umar Faruq Ahmad of ISRA, Malaysia and Khalid Hafeez of Dubai. The paper focuses on the legal restrictions preventing the spread of Islamic financial institutions in the U.K. relative to those ofAustralia. The paper goes on to suggests ways in which Australian laws could be changed to create a more fair environment for Islamic financial firms. The study examines the weaknesses of the Australian system with regards to barriers and legal frameworks that are preventing the growth of Islamic finance. It is concluded that the removal of many regulatory barriers would greatly improve the competitive environment for Islamic financial institutions. Improved awareness of Islamic financial products in Australia would also improve the industries recognition and growth. Finally, due to the significant differences between the Islamic and conventional banking systemsit is also argued that different legal frameworks may also be required in order to more adequately deal with the issues surrounding Islamic financial products and services.

The sixth article in this issue is by Mahmood Ahmed of IBBL, Bangladesh. The paper analyses the growth of the Islamic banking industry in Bangladesh over the past five years. It also analyses the use of *Shariah* compliant financial products in the Islamic banking system within Bangladesh. The paper uses several governmental resources to identify that the use of *Shariah* compliant products has led to a focus on risk reduction within the banking industry. The result has been a marked improvementin sustainable banking and economic growth within Bangladesh. In addition, Islamic banking practices require

better monitoring of the risks of the underlying projects within the economy, due to the fact that the banks bear a greater burden of that risk, compared to the conventional banking industry. The significant growth in the banking system, stable economic growth, and lower rate of business failure has helped to create an increase in well-being within Bangladesh, and has helped inachieving the Millennium Development Goals.This study can help to motivate future research with regards to Islamic banking acceptance within Islamic economies.

The seventh article in this issue is by ELESIN ʻ Abdulwahab Muhammad Jāmiʻ u of Nasarawa State University, Keffi, Nigeria. The paper discusses the adoption of Islamic banking practices in the country of Nigeria. The Central Bank of Nigeria is Nigeria's main central bank, and it just recently approved the use of interest-free banking within the country. As a result, debate has arisen with regards to uncertainties surrounding the implementation of Islamic banking. The paper defines Islamic banking and discusses the reasons behind its justification and establishes why it is superior to conventional banking methods. The paper also discusses Islamic banking and how it is applied in other parts of the world and discusses its relevance towards its use in Nigeria.

The eighth paper is by Md. Setaur Rahman and Md. Saidur Rahman of Islamic Bank Bangladesh Limited, Bangladesh. This paper discusses the opportunities of Islamic banking in Nigeria. The banking industry has great potential in the country of Nigeria over the next several decades. Nigeria has a population of over 150 million people and also has vast amounts of available land and resources. However, the country still remains underdeveloped. Therefore, there is a great need for financing infrastructure projects. This is an area in which banking services are particularly suited. The Commercial banking industry stands to benefit the most and Islamic banking can fulfil this role. Currently, approximately 46% of the Nigerian adult population has no access to banking facilities. Therefore, greater awareness and a rapid expansion of the banking industry serve not only as an opportunity for the Islamic finance industry but also an important growth opportunity for the overall well being of the country.

The ninth article is written by by Dr. Adel Mohammed Sarea from Ahlia University, Kingdom of Bahrain. The article discusses the need for global accounting standards for Islamic financial institutions. Islamic finance has

been expanding over the past several decades to include services that range across national borders. With the scope of Islamic banking now spanning many different economies, different accounting standards pose a threat to the continuity and efficiency of the Islamic financial system. The need to generate standardized accounting principles across the globe is of particular interest to researchers, academics, investors, and policymakers alike. The ability of investors to universally understand financial statements can be an important factor in the allocation of global capital. Previous studies have led to the development of more integrated international accounting standards for the conventional banking system. This paper acts to motivate the integration of accounting standards across borders from the perspective of Islamic finance.

Finally, the tenth paper in this issue is by Irfan Ul Haq and Chandrashekara Rao of Pondicherry University, India. This paper tests for integration between the SENSEX and SHARIAH 50 on the Bombay Stock Exchange (BSE). Both co-integration and causality are tested between these two indexes. In addition, the timescales are decomposed using wavelet analysis. This allows for integration and causality to be tested over different time periods. A series of Engle Granger co-integration tests show that the indices are co-integrated in the long run. In addition, there is a bidirectional flow of information between the indexes in the 2 to 4 day time horizon. However, there is no causality found over longer time horizons. This paper serves to expand the literature on market integration and efficiency in emerging markets.

I hope you will enjoy reading this volume of the journal.

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