

Legal Framework for Shariah Compliance of Moroccan Islamic Banks

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Abstract :

Morocco has adopted, in 2014, a new banking regulation (law 103-12), which introduced a specific title related to Islamic banking. The new banking regulation gives the Higher Council of Ulema (HCU) the exclusive prerogative to set the rules and serve as the final arbiter for Shariah compliance of Moroccan Islamic banks.

Furthermore, the law 103-12 requires Moroccan Islamic banks to create, within them, independent functions that will be responsible for ensuring compliance with the decisions and advices of the Supreme Council of Ulemas.

In this paper, we provide an analytical study of the Sharia compliance model introduced by the Moroccan legislature for Moroccan Islamic banks. As such, the paper analyzes the basis of the choice made by the Moroccan legislature, the missions, roles and responsibilities of the different actors of the Moroccan Shariah compliance model and, finally, its perspectives. A benchmark is also carried out in order to draw lessons from the best practices of other jurisdictions.

The research main conclusion is that in spite of some gray areas that have to be addressed by the legislature, the Moroccan model will allow developing national Shariah standards and ensure a perfect mitigation of conflict of interests. Furthermore, the Moroccan model will help participative banks to be cost-effective, mitigate reputation risk.

Keywords: Central *Shariah* Board, notice of compliance, *Shariah* compliance, *Shariah* audit, Higher Council of Ulemas.

الإطار القانوني للائحة البنوك الإسلامية المغربية

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الملخص:

اعتمد المغرب سنة 2014 لائحة مصرفية جديدة (قانون 12-103) أعطت الضوء الأخضر لانطلاق عمليات الصيرفة الإسلامية بالمملكة. ويعطي النظام المصرفي الجديد الحق الحصري للمجلس العلمي الأعلى في تحديد ومتابعة إطار الائتمثال للمصارف الإسلامية المغربية. وعلاوة على ذلك، ألزم القانون 12-103 المصارف الإسلامية المغربية أن تحدث داخل هيكلها التنظيمية وظائف مستقلة تكون مسؤولة عن مراقبة وضمان الائتمثال لقرارات وتوجيهات المجلس العلمي الأعلى.

نعرض في هذه الورقة البحثية دراسة تحليلية لنموذج الائتمثال لأحكام الشريعة الإسلامية الذي اعتمده المشرع المغربي للمصارف الإسلامية من حيث الأسس التي بنى عليها المشرع المغربي اختياره وكذا المهام الموكولة لكافة الفاعلين ومسؤولياتهم، كما تم إعمال معيار لأخذ دروس من ممارسات مثلى في مناطق أخرى.

يخلص البحث إلى أنه بالرغم من وجود مجموعة من الجوانب الغامضة التي يتعين على المشرع العمل على توضيحها، فإن النموذج المغربي سيمكن من إنتاج معايير موحدة ستمكن المصارف الإسلامية المغربية من تفادي حالات تضارب المصالح. كما سيكون لهذا النموذج أثر كبير في التخفيف من مخاطر السمعة التي قد تتعرض لها هذه المصارف في حال مخالفتها لمبادئ الشريعة. كما أنه يمكن المصارف التشاركية من تقليل التكاليف وبالتالي التخفيف من مخاطر السمعة.

كلمات مفتاحية: الهيئة الشرعية المركزية، إشعار الائتمثال، الائتمثال الشرعي، التدقيق الشرعي، المجلس العلمي الأعلى.

1. INTRODUCTION :

The Moroccan banking law¹ defines participative banks as legal entities authorized, inter alia, to receive investment deposits from the public and to finance customers through the *Murabahah*, *Ijarah*, *Mucharakah*, *Mudarabah*, *Salam* and *Istisna* products.

Moreover, the Moroccan legislature indicates that all the commercial, financial and investment operations that will be carried out by the participating Moroccan banks must be submitted to a notice of compliance of the HCU.

The obligation to obtain compliance notices of the Higher Council of the Ulemas was illustrated in article 62 of the Moroccan banking law and is reinforced by two main obligations:

- to send annually to the HCU a report evaluating the compliance of the bank's operations and activities with the opinions of the Council²,
- to set up within each participative bank and by their governing bodies functions whose mission will be to ensure the compliance of the operations of these banks with the opinions of the HCU³.

In order to supplement the Moroccan legislative framework on participative finance, the Royal Decree⁴ no. 1.15.02 was issued on 20 January 2015 which updates the article 3 of the Royal Decree no. 1.03.300, relating to the reorganization of the Councils of the Ulema. This update focused on the extension of the prerogatives of the Higher Council of Ulema to issues of participative finance.

In fact, the Royal Decree no. 1.15.02 has set up a specialized committee within the Higher Council of Ulemas whose role will be to decide on the compliance with the precepts of Islam of the operations carried out by participative finance institutions and financial products proposed by these institutions to their clients. The committee is called the Shariah Committee for Finance⁵.

As a result, it seems clear that the Shariah compliance mechanism for Moroccan participative banks is based on two main pillars:

- **a regulatory pillar** represented by the Higher Council of Ulemas and the Shariah Committee for Finance (CSB),
- **an operational pillar** represented by the compliance functions the Moroccan participative banks must create.

In this paper an analytical study of the Shariah compliance model adopted by the Moroccan legislature for Moroccan Islamic banks is developed.

As such, the paper analyzes the basis of the choice made by the Moroccan legislature, the missions, roles and responsibilities of the different actors of the Moroccan Shariah compliance model and, finally, its perspectives.

¹ Law 103.12 of 24th december 2014.

² Law 103.12. Article 63.

³ Law 103.12. Article 64.

⁴ The term "Royal Decree" means a *Dahir* in Arabic as issued by His Majesty the King of Morocco.

⁵ We choose to name this committee in the present paper Central Shariah Board (CSB).

A benchmark is also carried out in order to draw lessons from the best practices of similar experiences.

In this paper the authors try to address the main questions below:

- What are the foundations of the Moroccan Shariah compliance model for participative banks?
- What are the key responsibilities and prerogatives of the model's actors?
- What are the key characteristics of the Moroccan Shariah compliance model?
- Are there any gray areas in the studied model?
- What are the perspectives of the model?
- What recommendations should be made to enhance the reliability of the model?

To this end, we propose the following plan for our paper:

- Section 1 : A general overview of the Moroccan banking sector,
- Section 2 : The Shariah compliance regulatory system of Moroccan participative banks
- Section 3 : Shariah compliance device in Moroccan participative banks
- Section 4 : Main characteristics and perspectives of the Moroccan Shariah compliance model participative banks
- Section 5 : Recommendations.

2. GENERAL OVERVIEW OF THE MOROCCAN BANKING SECTOR:

The Moroccan banking sector is known for its maturity and resilience. In fact, Morocco has 83 credit institutions approved by the Central Bank, Bank Al Maghrib (BKAM)⁶.

These institutions are classified by category as follows:

Type of Institution	Quantity of Each Type
Banks	19 institutions
Finance companies	33 institutions ⁷
Off-shore banks	6 institutions ⁸
Micro-credit associations	13 institutions
Money transfer companies	10 institutions
Others	2 institutions

The shareholding of the banking system comprises a predominant share of private ownership which includes holdings of private Moroccan groups, insurance companies, social welfare organizations and foreign banking groups.

⁶ Bank Al Maghrib. Banking supervision report. 2016

⁷ This category includes consumer finance companies, leasing companies, property loan companies, surety companies, factoring companies, etc.

⁸ These banks are established in Tangier free zone in the north of Morocco.

At the end of 2016, the Moroccan banking network had 6,283 branches. The rate of banking of the population has increased in 2016 by 2 points to 69% compared to 2015. At the same time, the number of accounts opened on bank books increased to a total of 24 million accounts or more than one million additional accounts compared to 2015.

For its part, the number of cards issued by banks in 2016 reached 12.9 million, almost 1.1 million more cards compared with the previous year (+ 10%)⁹.

At the same time, the expansion of the automated teller machine (ATM) network continued with the installation of 292 new units, reaching 6,821¹⁰, or 2 wickets per 10,000 inhabitants.

The number of staff employed by credit institutions and similar bodies reached 53,801 employees, at the end of December 2016, of which nearly 77% were employed by banks.

In terms of assets, the total assets of the Moroccan banking market reached 1.199 billion dirhams¹¹ at the end of December 2016¹². The contribution of the top three banks increased by 0.4 point to 65.9%¹³.

Regarding deposits, they reached 854 billion dirham at the end of 2016¹⁴. The shares of the top three banks rose to 66.1% (+0.1 points)¹⁵.

as for loans, they reached 775 billion dirhams in 2016. The top three banks accounted for 64.8%¹⁶ of the total.

In the second half of 2017, five Islamic banks, or participative banks as they are called in Morocco, and three participative windows started their activities after the approval of Bank Al Maghrib.

The approved banks are:

- Umnia Bank a subsidiary of CIH Bank Group and Qatar International Islamic Bank,
- Bank Tamweel Wa Al Inmaa (BTI) a subsidiary of BMCE Bank of Africa Group and Dalla Al Baraka Group,
- Al Yousr Bank a subsidiary of La Banque Centrale Populaire Group and Guidance Financial Group,
- Al Akhdar Bank a subsidiary of Crédit Agricole du Maroc Group and the Islamic Corporation for the Development of the Private Sector « ICD »,
- Bank Assafa a subsidiary of Attijariwafa Bank Group.

The participative windows approved are:

- Najmah within BMCI a BNP Paribas subsidiary,
- Arreda within Crédit du Maroc a subsidiary of the French group Crédit Agricole,

⁹ Bank Al Maghrib. Banking supervision report. 2016

¹⁰ Bank Al Maghrib. Banking supervision report. 2016

¹¹ Bank Al Maghrib. Banking supervision report. 2016

¹² One US Dollar is about 10 Moroccan Dirhams.

¹³ Bank Al Maghrib. Banking supervision report. 2016

¹⁴ Bank Al Maghrib. Banking supervision report. 2016

¹⁵ Bank Al Maghrib. Banking supervision report. 2016

¹⁶ Bank Al Maghrib. Banking supervision report. 2016

▪ Dar Al Aman within Société Générale a Société Générale Group subsidiary, Currently, in comparison with the conventional finance the market share of participative finance is insignificant. All the studies carried out predict that this industry is bound to know an important expansion over the next few years¹⁷.

Morocco is considered, by many experts, as an important emerging Islamic finance market with vast opportunities for investment.

Some surveys showed that 98% of Moroccans expressed an interest in Islamic banking products, once they become available in Morocco¹⁸. Moreover, 88% of Moroccans would be interested in taking out an Islamic financing product if it were available¹⁹.

In view of the interest expressed by Moroccan consumers, the Moroccan participative banking assets could potentially reach between 3% and 5% of total banking assets by 2018. This could mean participative banking assets of between US\$ 5.2 billion and US\$ 8.6 billion, generating a profit pool of between US\$ 67 million and US\$ 112 million for Islamic finance providers²⁰.

3. THE SHARIAH COMPLIANCE REGULATORY SYSTEM OF MOROCCAN PARTICIPATIVE BANKS:

This paragraph is an analysis of the prerogatives, roles and tasks of the Higher Council of Ulemas (HCU) and the Shariah Committee for Participative Finance or the Central Shariah Board (CSB).

3.1. Higher Council of Ulemas (HCU):

3.1.1. Brief historical background :

Established by the Royal Decree No. 1.80.270 of 8th April 1981, the Higher Council of Ulemas (HCU) is placed under the direct tutelage of His Majesty the King of Morocco in his title as Amir Al Muminin; i.e., "Commander of the Faithful".

As stated by the Royal Decree that instituted the HCU, the Higher Council of the Ulemas is the translation of a royal will to endow the Kingdom of Morocco with an institution that the role of which is to make Islam known and show that its teaching meets the needs in both the spiritual and the temporal spheres and, thus, dispenses with the use of doctrines or ideologies which have no affinity with the values which constitute the identity of the Moroccan nation²¹.

In 2014, the Royal Decree no. 1.03.300 on the restructuring of the Higher Council and Local Councils of Ulemas was published.

¹⁷ Thomson Reuters. Morocco Islamic Finance country report 2014.

¹⁸ Thomson Reuters. Morocco Islamic Finance country report 2014.

¹⁹ Thomson Reuters. Morocco Islamic Finance country report 2014.

²⁰ Thomson Reuters. Morocco Islamic Finance country report 2014.

²¹ Royal Decree No. 1.80.270 of 8th April 1981 related to the establishment of the Higher Council of Ulemas.

In fact, the Royal Decree above highlights that the restructuring of these institutions is the effective implementation of the royal will to broaden the HCU and the local Councils fields of action in order to make these institutions suitable to accompany the modernization and the developments that Moroccan society is experiencing.

Moreover, it was clearly stated in the Royal Decree No. 1.03.300 that the fatwa falls to the HCU and the Local Councils. As such, these institutions must take into account, in carrying out this critical task, the novelties and developments that have touched the Moroccan society.

Finally, the Royal Decree No. 1.03.300 specifies that the fatwas must necessarily take into account the principle of moderation acclaimed by Islam.

3.1.2. Higher Council of Ulemas Organization :

3.1.2.1. Membership :

The King of Morocco, Amir Al Mouminine, is the president of the HCU²². The composition of this Council is as follows:

- the Minister of Awqaf and Islamic affairs,
- Eminent Ulemas designated, *intuitu personae*, by His Majesty the King and whose number can not exceed half of the number of the presidents of the Local Councils of Ulemas,
- the HCU's Secretary General,
- and the Local Councils of Ulemas Presidents.

The Royal Decree, quoted above, specifies that the presidency of the HCU sessions may be delegated, by the King, to an authority designated by His Majesty.

Indeed, it should be noted that the tradition observed in this case is to delegate to the Minister of Awqaf and Islamic Affairs the presidency of the HCU sessions.

On convocation of its President, His Majesty the King, the HCU have to hold, at least, two sessions per year. The King may convene extraordinary sessions²³.

If the need arises, the HCU has the discretion to invite experts to attend its sessions²⁴.

3.1.2.2. Responsibilities and duties of the HCU's General Secretariat:

The Secretary General of the HCU is appointed by His Majesty the King. The Secretary General, in consultation with the Minister of Awqaf and Islamic Affairs, is in charge of²⁵ :

- the preparation of the HCU sessions agendas including the matters submitted to the Council by the King and those suggested by the Council members,
- the follow up of the HCU decisions,
- the management of HCU current affairs,

²² Royal Decree No. 1.80.270 of 8th April 1981 related to the establishment of the Higher Council of Ulemas.

²³ Royal Decree No. 1.03.300. Article 4.

²⁴ Royal Decree No. 1.03.300. Article 4.

²⁵ Royal Decree No. 1.03.300. Article 6.

- Receiving fatwas requests.

The Secretary General presents to the King a detailed report on the fulfillment of his missions and has to keep the Minister of Awqaf and Islamic Affairs informed of the activities of the HCU²⁶.

²⁶Royal Decree No. 1.03.300. Article 6.

3.1.2.3. Higher Council of Ulemas prerogatives :

The Royal Decree 1.03.300 has assigned the following prerogatives to the HCU:

- to study all matters submitted to the HCU by its President His Majesty the King of Morocco,
- to set up an annual action program including the activities that the Local Councils of Ulemas must carry out,
- to supervise the activities of the Local Councils of Ulemas and coordinate their actions,
- to issue recommendations and orientations to rationalize the activities of Local Councils of Ulemas and ensure the effectiveness of their interventions in the supervision of the religious life of Moroccan Muslim citizens,
- to prepare and approve the rules of procedure of the Religious Consultation Instance which is in charge of issuing fatwas,
- to transmit to the Religious Consultation Instance, in charge of fatwas, all requests concerning the matters submitted to it to issue the appropriate fatwas,
- to develop scientific cooperation relations with Islamic institutions and organizations pursuing the same objectives locally and internationally.

Following the publication of the Royal Decree No. 1.15.02 of January 20, 2015²⁷, the prerogatives of the HCU were extended to issues related to Islamic finance known as participative finance in Morocco.

As such, the HCU is required to issue compliance notices, to the precepts and purposes of Shariah, of the commercial, financial and investment activities and operations carried out by financial institutions and organizations²⁸.

Furthermore, the Royal Decree above has set up, within the Religious Consultations Instance²⁹, a Central Shariah Board (CSB), dedicated to participative finance, called the Shariah Committee for Finance.

The Royal Decree stated that the compliance notices requests must be addressed to the CSB by³⁰ :

- Bank Al Maghrib (BKAM), the central bank of Morocco, for requests coming from banks and credit institutions,
- Moroccan Insurance and Social Welfare Authority (MISWA) for requests coming from insurance companies,
- Moroccan Capital Markets Authority (MCMA) for requests coming from sukuk issuers.

²⁷The Royal Decree No. 1.15.02 sets up the Central Shariah Board, called Shariah Committee for Finance, within the Religious Consultation Instance which is in charge of fatwas issuance.

²⁸Royal Decree No. 1.15.02. Article 3

²⁹The Religious Consultation Instance is a body of the HCU in charge of fatwas. This instance address all requests concerning the matters submitted to it to issue the appropriate religious fatwas.

³⁰ Royal Decree No. 1.15.02. Article 10a 3

3.1.3. ShariahCommitte for Finance – Central Shariah Board (CSB) :

The Shariah Committee for Finance or the Central Shariah Board (CSB) has been set up within the authority/body in charge of Religious Consultation, fatwa.

The CSB was endowed with very wide prerogatives³¹. Indeed, the CSB is called to rule on the participative products, services and activities compliance with the precepts and purposes of Islam.

In this section, we will examine two major aspects:

- the organization of the CSB,
- and the prerogatives granted to this committee.

3.1.3.1. CSB's Organization³² :

The Shariah Committee for Finance or the Central Shariah Board (CSB) has been set up within the authority in charge of Religious Consultation, fatwa.

The CSB is composed of a coordinator and 9 members. All the CSB members are specialized Ulemas in the Islamic jurisprudence and recognized for their capacity to rule in the questions that will be submitted to them.

The CSB members are chosen from the HCU members and are appointed by decision of the Secretary General of the HCU.

The CSB will also have resort to five experts in the legal, participative finance, banking, insurance and capital markets sectors. The selected experts may be legal or natural persons.

In the same way as the members of the CSB, the experts are appointed by decision of the HCU Secretary General. They are linked to the CSB by contracts.

The CSB coordinator is empowered to invite experts to attend committee meetings if the need arises. The CSB has also the flexibility to set up specialized working groups composed of its members in order to study the issues submitted to it and draw up detailed reports.

The CSB deliberations must be recorded in a special register and signed by the entire committee members.

Moreover, the CSB must establish its rules of procedure that have to be submitted for the validation of the HCU. These regulations must specify the operating procedures of the committee and those related to opinions requests.

Finally, it should be noted that the CSB members can not be affiliated to one or more of the organizations mentioned in the chapter 5 of the Royal Decree 1.15.02. These are, mainly, BKAM, MISWA, MCMA, the Deposits Guarantee Fund of Participative Banks, Credit Institutions, Insurance and Reinsurance companies, Capital Market operators and companies wishing to issue Sukuk. The purpose of this rule is to prevent conflicts of interest that may arise from the involvement of CSB members in entities under their control.

³¹Royal Decree N°1.15.02 on Ulemas Councils restructuring.

³²Royal Decree N° 1.15.02. Chapter 5.

3.1.3.2. CSB Prerogatives:

The CSB prerogatives are quoted in the article 10 of the Royal Decree 1.15.02 and can be summarized as follows:

- to issue, whenever necessary, compliance notices, to the precepts and purposes of the Shariah, of the participative financial products and the contract models relating to these same products.
- to issue compliance notices, to the precepts and purposes of the Shariah, of the Governor of Bank Al Maghrib³³ circulars relating to participative financial products, investment deposits and operations carried out by the deposit guarantee fund of participative banks,
- to issue compliance notices, to the precepts and purposes of Shariah, of Takaful insurance transactions carried out by insurance and reinsurance companies in the context of participative finance.
- issue compliance notice, to the precepts and purposes of the Shariah, of Sukuk issuance operation regardless of the issuer's nature.

4. SHARIAH COMPLIANCE PROCESS IN MOROCCAN PARTICIPATIVE BANKS:

It is worth recalling, at the beginning of this paragraph, that the Moroccan legislature has not set rules on the possibility for Moroccan participative banks to set up Shariah boards at their level.

Indeed, the Moroccan regulations³⁴ clearly specify that the CSB is the only body authorized to issue compliance notices relating to the products and operations of participative finance³⁵.

However, the Moroccan banking law stipulates that, in order to ensure compliance with the HCU opinions, Moroccan participative banks are required to set up compliance functions³⁶.

Moreover, the Moroccan banking law requires from the participative banks to submit, yearly, an evaluation report of the compliance of their operations and activities to the HCU notices of compliance³⁷.

In addition, it should be made clear that the Moroccan banking law stipulates that the modalities of functioning of the participative banks compliance functions will be defined by specific circulars of the central bank (BKAM).

In this paragraph, we will analyze the organization of the participative banks compliance functions and the prerogatives entrusted to them by the Moroccan legislature, in the light of the Moroccan banking law and the draft of the central bank circular on the conditions and *modus operandi* of these functions.

³³ In Morocco, the Central Bank Governor has the title of *Wali Bank Al Maghrib*.

³⁴ These include the Law No. 103.12 on credit institutions and similar companies, banking law, and the Dahir No. 1.15.02 related to the restructuring of the Ulemas Councils and establishing the Shariah Committee for Finance.

³⁵ Law 103.12 on credit institutions. Article 62.

³⁶ Law 103.12 on credit institutions. Article 64.

³⁷ Law 103.12 on credit institutions. Article 63.

4.1. Shariah compliance function organisation:

In its 6th article, the BKAM circular draft on the Shariah compliance functions stipulates that the participative banks compliance functions have to report to the participative banks management bodies³⁸.

Taking into account the size of the participative finance activity, the management body must make all the necessary resources available to the compliance function to enable it to carry out its tasks.

In addition, the compliance officer and his / her staff must demonstrate a high level of competence in the participative finance fields.

The management body assesses the required level of competence of the compliance function staff according to the degree of the responsibilities they are in charge of.

Finally, internal audit assesses the functioning and effectiveness of the Shariah compliance function. It should communicate to compliance officer the non-compliance risk management process weaknesses and dysfunctions.

4.2. Shariah compliance function prerogatives³⁹ :

The legislature has signed to the Shariah compliance functions of Moroccan participative banks several broad missions. As such, the Shariah compliance functions are in charge of:

- Identifying and preventing the Shariah non-compliance risks through :
 - *the preparation, the classification and the revision of the list of non-compliance risks,*
 - *the implementation of appropriate measures allowing the follow-up, detection and evaluation of the non-compliance and reputation risks,*
 - *a permanent and continuous review of the participative bank non-compliance measure device to ensure that it covers all these risks.*
- the follow-up, the implementation and the monitoring of the HCU council through the following actions :
 - *to carry out a follow-up of the application by the internal entities of the establishment of the conformist opinions, guides and recommendations emanating from the Superior Council of Oulema,*
 - *to review and control the operations carried out by the participative finance institution, as well as the documents, contracts and content of the advertising campaigns, and evaluate their compliance to the advice, guides and recommendations emanating from the HCU,*
 - *to ensure the dissemination of the compliance notices, guides and recommendations of the HCU within the participative finance institution.*

³⁸ In the case of a stand alone participative bank, the management organ may be represented by the CEO or the directoire. For the participative window, the management organ is represented by the window's head.

³⁹ BKAM circular draft on Shariah compliance function *modus operandi*.

- to set up a procedure manual and check if the institution entities comply with it through :
 - *the establishment of detailed guide of all the institution marketed products and services,*
 - *the implementation of a control methodology that will help verify the products compliance with the participative finance regulations,*
 - *to ensure the updating of all the institution's internal procedure in order to ensure their compliance to HCU guidelines.*
- to advise the adoption of the required measures in the event of the non-compliance of the conditions relating to the presentation to the public of a product which has received the assent of the HCU through:
 - *informing the Audit Committee of any identified deficiencies and recommending appropriate corrective measures,*
 - *informing the management body of the participative bank, or the participative entity's head, and the bank's committee in charge of the risks identification, monitoring and management of any violation or failure to comply with the HCU notices and suggesting corrective measures to avoid such situations.*
 - *receiving and answering the clients and bank's agents questions on the corrective measures adopted by the establishment, targeting the respect of the HCU opinions, guides and recommendations.*
- to contribute to the development of new products and to participate in drawing up the relevant contractual documentation before submitting, these documentation, to the management body or the participative entity's head and, where appropriate, to the board in order to seek the assent of the HCU via Bank Al-Maghrib,
- to sensitize and train the bank's staff about the participative products marketed by the institution as well as the compliance with the Shariah questions relating to HCU advises, guides and recommendations,
- to draw up an annual action plan which must be approved by the bank's management body or the participative entity's head. The action plan should address:
 - *the operation review program to make sure of their concordance with the HCU guidelines and recommendations,*
 - *the follow up of the non-compliance corrective measures' implementation,*
 - *the follow up of the HCU validation of the contractual documentation modifications,*
 - *the preparation of the annual compliance report referred to in the article 63 of the Law 103-12.*
- To set up a product guide, approved by the governing body or the the participative entity's head. This guide must include :
 - *the definitions of the products and and the criteria to be met in order to guarantee the validity of each operation,*
 - *the documentation and the applications procedures.*

- to periodically revise the guide in order to adapt its content to the legislative and regulatory texts and to the HCU opinions, guidelines and recommendations taking into account the new activities carried out by the institution,
- to keep the management body, or the participative entity's head, and the committee responsible for risks identification, monitoring and management informed on a regular basis about the reports summarizing the main weaknesses in relation to compliance with the HCU opinions, guidelines and recommendations to initiate appropriate corrective actions.

5. MAIN CHARACTERISTICS AND PERSPECTIVES OF THE MOROCCAN PARTICIPATIVE BANKS SHARIAH COMPLIANCE MODEL:

The Moroccan legislature defines the notion of Shariah compliance in two ways:

- compliance with the Shariah precepts and purposes which is incumbent on the HCU through its specialized committee the CSB,
- and the compliance with HCU recommendations incumbent on the compliance functions of participative banks.

The examination of the organization and the roles of the participative finance compliance bodies, envisaged by the Moroccan legislature, enabled us to identify several important characteristics that we set out in this paragraph.

Our analysis allows us to identify some gray areas which deserve clarification as well as some interesting perspectives to explore further.

5.1. Main characteristics of the Moroccan Shariah compliance model:

5.1.1. Shariah Committee for finance (CSB):

The analysis of the prerogatives enshrined in the Royal Decree 1.15.02 to the CSB enables us to underline the broad independence enjoyed by this institution. Indeed, this independence is the result of the CSB's attachment to the HCU which gives it an extended field of action.

Moreover, the CSB independence was reinforced by the obligation for its members to not join any other body of those mentioned in the 5th chapter of the Royal Decree 1.15.02.

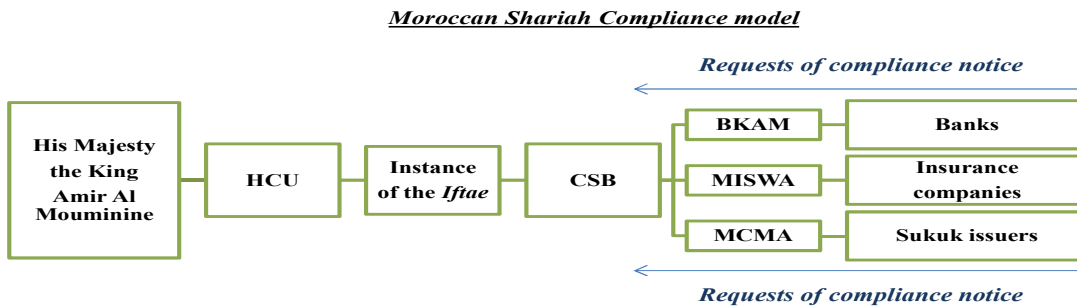
By doing this, the legislature aims to prevent any situation of conflict of interests and to ensure full autonomy for the CSB and its members.

In addition, we note that by opting for the establishment of a central committee responsible for issuing compliance notices on participative finance, the legislature has unified the Shariah reference of the various actors in the finance sector. This choice will allow coherence in the practices of the institutions operating in this sector.

Moreover, the Moroccan legislature makes no reference to the Shariah committees that the participative financial institutions may set up at their level. Only the CSB is

empowered to issue compliance notices. This choice is in perfect coherence with the aim and the prerogatives of the HCU which is the only fatwa body in Morocco. Finally, the legislature permits the CSB to be aided by independent experts. This measure will help the CSB to acquire various expertises enabling it to carry out its heavy tasks appropriately.

The figure below summarizes the Shariah compliance model chosen by Morocco for its participative finance sector:



5.1.2. Compliance functions of Moroccan participative banks :

The analysis we have carried out of the organization and the prerogatives, set by the legislature for the compliance functions of participative banks, allows us to identify several important characteristics.

The legislature sought to link the compliance functions with the management bodies of the participative banks and insisted on the need to provide these functions with adequate human and material resources to enable them to carry out their tasks properly.

Since the management body is responsible for the operational management of the participative bank, it is important to wonder about the adequacy of the Shariah compliance function attachment to this entity. Indeed, the choice of this linkage, inspired by the model used in the case of conventional banks, raises several questions about the level of independence enjoyed by the compliance function.

In addition, the Circular draft on the compliance functions of participative banks did not define any link between these functions and the investments accounts holders.

On the other side, the legislature has planned to submit the compliance functions to the controls of the participative banks internal audit entities. This measure enables the compliance functions to ensure the effectiveness and efficiency of their methods and the relevance of their actions.

Furthermore, the mandates and prerogatives granted by the legislature to the compliance functions make it possible to note the major importance given to these entities that are involved in several areas:

- the effective implementation of the HCU opinions and the monitoring of their observance,
- the set up of a non-compliance risk map and the monitoring of these risks,
- Informing the management body and the audit committee of any situation of non-compliance risk,
- the set – up of a procedures’ manual,
- the training and awareness raising of employees,
- the active participation in the launching of new products and new activities processes,
- the preparation of the annual compliance evaluation report referred to in the Article 63 of the Law 103-12,
- the preparation of the annual compliance evaluation report referred to in the Article 65 of the Law 103-12,
- the participation in the preparation of the contracts documentations relating to the products, services and activities of the participative bank,
- ...etc.

5.2. Grayareas:

The present analysis in this paper can not be complete without reviewing some gray areas that should be elucidated by the legislature. These include:

- the obligation for the participative banks to send to the HCU an annual report on the compliance of their products, operations and activities with the advices of the Council without specifying the nature of this report’s content,
- the obligation for the participative banks to send to BKAM an annual report on the compliance of their products, operations and activities with the recommendations of the HCU without specifying the nature of this report’s content.

The two points above need to be clarified by the legislature. In fact, the draft of BKAM’s circular, on the conditions and the modalities of functioning of the participative banks’ compliance functions, does not clarify this subject: there is no mentioning of the content of these reports in the circular draft. Indeed, it is not unlikely that some participative banks may understand that it is a single report.

It should also be pointed out that the current legal framework has not emphasized the roles that should be played, in the Shariah compliance mechanism, by the actors below:

- Risk management function,
- Internal Audit function,
- Risk committee reporting to the Board of Directors or to the Supervisory Board,
- Audit committee reporting to the Board of Directors or to the Supervisory Board,
- External Shariah auditors,

- Legal auditors.

As the Moroccan banking law and the Royal Decree instituting the CSB did not make any reference to the roles that these actors⁴⁰ and specific central bank circulars are needed to clarify these gray areas.

5.3. Moroccan Shariah compliance model's perspectives:

First of all, we would like to emphasize that Shariah compliance is the major purpose of participative finance. Indeed, it is not allowed that the Shariah compliance model, set up in a jurisdiction, would be subject to shortcomings which could reduce its credibility and that of the whole industry.

In Morocco, Shariah compliance encompasses, as we have mentioned in this paper, two complementary aspects. On one hand, a component of compliance, with the precepts and purposes of the Shariah, which falls to the HCU through the CSB.

On the other hand, a component of compliance with the opinions of the HCU that falls to participative banks.

The Moroccan model of Shariah compliance opens several interesting perspectives for the Moroccan participative finance industry.

In this section, we will present some of these perspectives in the light of the legal framework analysis results and the benchmark of similar experience that we have carried out.

In this context, our benchmark was carried out on the experiences of Oman, Malaysia, Sudan and Pakistan and allows us to achieve the following findings:

- **Malaysia** uses a two-tier centralized model with the Shariah Advisory Council (SAC) at the Central Bank level and Shariah Committee at the Islamic Finance Institution level. The SAC directs the Central Bank on Shariah matters and is the ultimate arbiter in Shariah interpretation disputes. The directives issued by the Central Bank of Malaysia in consultation with the SAC have binding authority over banks and Islamic entities. The members of the SAC are appointed by the ruling King of Malaysia⁴¹.
- In **Pakistan**, each of the State Bank of Pakistan and the Securities and Exchange Commission of Pakistan has its own Shariah Boards while the SECP has another board for Mudarabah sector. These three boards approve relevant Shariah compliance regulations and produce specimen of permissible Islamic financial contracts. The Shariah department of the Central Bank of Pakistan clearly states that they rely heavily on a basis of international standards such as AAOIFI and IFSB and corporate governance standards⁴².
- **Oman** was the last nation in the six-member Gulf Cooperation Council to introduce Islamic finance. Oman's central bank set up, in October 2014, a 5

⁴⁰ In the case of conventional banks, BKAM has implemented and systematically updated circulars defining the roles of the actors mentioned in this paragraph.

⁴¹ ISRA & Thomson Reuters. Islamic Commercial Law Report. 2016

⁴² ISRA & Thomson Reuters. Islamic Commercial Law Report. 2016

members Shari'ah board to help oversee the Sultanate's Islamic banking industry. The choice made by Oman aims to speed up product development, limit costs for Islamic banks and facilitate issues of Sukuk⁴³.

- In **Sudan**, the Shariah Advisory Council (SAC), set up in 2003, is responsible for fatwas, contract specimen, arbitration, consultations relating to Islamic legal aspects, training, research, lectures and seminars. The SAC members are appointed by the Sudanese President upon recommendation of the Central Bank of Sudan governor and minister of finance⁴⁴.

On the basis of our legal framework analysis and benchmarks, we can notify that the choice made by the legislature to unify the Sharia reference of Moroccan participative banks, beyond the fact of its perfect coherence with the Moroccan specificity, appoints the CSB as the highest Shariah authority in participative finance in the Kingdom of Morocco. As such, the CSB has the ultimate power to issue fatwa or to decide on issues faced by the industry.

The key position of the CSB and its membership entrust issuance of shariah compliance notices to scholars who are well-versed in fiqh, or *usul al fiqh*, independent and free from potential conflict of interest.

The Moroccan CSB will examine and endorse the validity of application of Shariah in Islamic financial products and operations which are submitted by Islamic financial institutions to the regulators.

In fact, the CSB aims to develop national Shariah standards that will be applicable by all the participative finance actors.

On another level, the CSB will also be able to provide Shariah consultation to the regulators and relevant authorities and help to establish best practices in the areas relating to participative finance.

The position of CSB and its broad prerogatives enables it to resolve and settle complaints and issues raised by customers of participative banks to the regulator and provide Shariah expertise to the courts of law for any issues related to participative finance and participative banks.

Furthermore, the Moroccan model will ensure a perfect mitigation of conflict of interest and the promotion of standardization of practices. Thereby, the credibility of the participative finance industry will increase which will boost the confidence of clients and investors in its institutions and their offerings.

Moreover, the setting up of a CSB in Morocco will, without any doubt, help participative banks to be cost-effective, mitigate reputation risk, speed up product development and facilitate issues of sovereign Sukuk and Islamic syndicated financing.

The CSB is supposed to play a major role in strengthening the compliance, within participative banks, through the review of compliance reports that participative banks should provide yearly as well as the approving of a code of ethics for these institutions.

⁴³ ISRA & Thomson Reuters. Islamic Commercial Law Report. 2016

⁴⁴ ISRA & Thomson Reuters. Islamic Commercial Law Report. 2016

However, it should be made clear that the CSB will have the competence to recommend disciplinary measures against Shariah non-compliances done by participative banks.

Finally, in terms of public finance, the CSB is responsible for approving Sukuk structures and documentaries for sovereign and government Sukuk.

6. REASERCH MAIN CONCLUSIONS &RECOMMENDATIONS:

6.1. Reaserchmainconclusions:

In view of the analysis carried out in this paper, the following conclusions can be made:

- The Moroccan model will allow developing national Shariah standards that will be applicable by all the participative finance actors.
- The choice made by the Moroccan legislature will help to ensure a perfect mitigation of conflict of interests and the standardization of practices.
- The Moroccan model will help participatives banks to be cost-effective, mitigate reputation risk and facilitate issues of sovereign Sukuk and Islamic syndicated financing.
- The organizational positioning of the compliance function whitin the Moroccan participative banks is not clarifieb by the CSB and BKAM.
- The responsibilities of the various shariah compliance actors as well as the situations of conflicts of interest
- The content of the reports that Moroccan participative banks must send annually to the CSB and BKAM are note defined.

6.2. Recommendations:

The research made some recommendations which could be useful for strengthening the compliance mechanism.

Firstly, we suggest that the Moroccanlegislature clarifies the organizational positionning of the compliance function that a participative bank must set up.

In fact, the Circular draft on the the conditions and the modalities of functioning of the participative banks compliance functions stated that the compliance function must report to the management body but it did not define the various links that this entity must establish with the other participative bank governance bodies, in particular; the committees of the Board of Directors, the Board of Directors and the General Assembly of Shareholders.

Therefore, it seems importantthat the legislature defines the links that the compliance function should establish with the Board of Directors, the General Assembly, the Board's Committees and the investment accounts holders.

In fact, the establishment of functional links between the compliance function,the Board of Directors, the General Assembly, the Board's Committees and the

investment accounts holders is likely to reinforce the independence of this compliance function.

Secondly, the legislature should specify the responsibilities of the various shariah compliance actors as well as the situations of conflicts of interest. Thus, it is important to highlight the roles of the following actors:

- Risk management function,
- Internal Audit function,
- Risk committee reporting to the Board of Directors or to the Supervisory Board,
- Audit committee reporting to the Board of Directors or to the Supervisory Board,
- External Shariah auditors,
- Legal auditors.

There is no doubt that the clarification of the roles of the actors above will add an important value to the Shariah compliance process by defining the responsibilities of each actor and its sphere of action, monitoring the non-compliance situation, receiving and processing the requests emanating from the various stakeholders, including clients and regulators, and, finally, alert mechanisms of the bank's governance bodies and regulators in case of non-compliance risks.

Third and last, the legislature has to define, clearly, the content of the reports that Moroccan participative banks must send annually to the Central Shariah Board and to Bank Al Maghrib in order to standardize the format of these reports and to remove any confusion that the participative banks could have.

7. CONCLUSION:

Even if the participative/Islamic finance is making its first steps in Morocco, the history of this industry in Morocco is not recent. In fact, in 2007, the Kingdom had its first experience of offering alternative products which, for several reasons, did not achieve the expected success.

Indeed, the legal framework was not conducive. This situation did not encourage credit institutions to develop their offers.

Being aware that the success of participative finance in Morocco can only be achieved through the implementation of a solid and innovative legal framework, the legislature has given a great importance to this issue.

Indeed, since the promulgation of the Law 103.12, the Moroccan legislature is leading several projects to harmonize the banking law with the various regulations.

Shariah compliance is one of the projects to which the legislature pays particular attention because it is the purpose of participative finance.

A normative framework is being put in place and should standardize the Shariah reference as required by the Moroccan specificity. This choice is likely to allow homogeneous practices of participative banks and ultimate protection of the consumer.

The legal framework implemented, although solid, reveals some gray areas that call for reviewing by the legislature.

We have tried to bring added value to this newly developed system by proposing some recommendations that will reinforce it.

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