



THIRD HARVARD UNIVERSITY FORUM ON ISLAMIC FINANCE
HARVARD LAW SCHOOL - OCTOBER 1, 1999

ISLAMIC FINANCE LOCAL CHALLENGES, GLOBAL OPPORTUNITIES: A SHORT REPORT

The Third Harvard University Forum on Islamic Finance was held at the Harvard University campus in Cambridge, Massachusetts, on Friday, October 1, 1999. In keeping with the precedent established by earlier Forums, the Third Forum continued to break new ground in the increasingly important field of Islamic finance. The Forum enjoyed the participation of over 150 banking and financial industry professionals, gathered in the world's premier academic environment. Academics, students, and community members brought attendance of the Forum to over 250 individuals. The conference's broad theme, "Local Challenges, Global Opportunities," combined with focused papers to describe an Islamic financial sector that has risen to the most sophisticated planes of research. Topics ranged from the theoretical to the practical, with much in between. The complexity and diversity of the papers presented reflected a revitalized commitment to raising the bar of research and development in Islamic finance.

The conference had two plenary sessions on the morning of October 1, 1999, and continued after lunch with two sets of three simultaneous sessions. The early morning sessions were chaired by Samuel L. Hayes, Professor Emeritus at the Harvard Business School. After a welcome from Thomas D. Mullins, Executive Director of HIFIP, the conference was opened by Mohamed Al Faisal Al Saud, Chairman of Dar Al-Maal Al-Islami Trust and a pioneer of Islamic finance. Al Saud briefly covered the history of Islamic finance, from its inception to the present day, and drew parallels between the motives, modes, and benefits of conventional and Islamic finance. He also highlighted the benefits that Islamic finance is likely to bring when practiced in western nations. Nizam Yaquby, the *shari'a* keynote speaker, highlighted the essential conditions for conventional banks to offer Islamic finance. M. Nejatullah Siddiqi, a renowned Islamic economist at King Abdulaziz University in Saudi Arabia, offered valuable insights into how Islamic finance reduces instability in financial markets and how exchange-rate fluctuations affect developing countries.

The second morning session, "Islamic Finance: Current Trends and Future Outlook," featured papers covering the views of both practitioners and large institutions on the future of Islamic finance. I. Malcolm Burnett, President and CEO of HSBC Bank USA, highlighted emerging trends and opportunities in the Islamic finance industry and the role HSBC is playing in the area. David Moran, President of Dow Jones Indexes, discussed the reasons for launching the new Dow Jones Islamic Index (DJII), marking the growing importance of Islamic finance in the United States and other western markets and reflective of the anticipated progress of the sector as a whole. Abdullah Sulaiman Al Rajhi, General Manager of Al Rajhi Banking and Investment Corporation, noted that large Middle Eastern Islamic financial institutions have been in the arena for a long time, and emphasized the global opportunities existing today and the impact of technological advances in today's environment.

The simultaneous sessions in the afternoon covered several specialized topics in depth. In the field of Islamic economics, Mahmoud El-Gamal of Rice University discussed the work of Ibn Rushd, how *riba* and *gharar* are essentially prohibitions for trading in credit and risk respectively, and that the two can be extended to show that their purpose is to increase efficiency. El Gamal also discussed that the simplified economic analysis suggesting that credit and risk can be properly priced is inapplicable in the current economic environment. Ramin Cooper Maysami of the Nanyang Business School in Singapore drew lessons on Islamic banking and monetary policy based on the Iranian experience. After covering the means of monetary policy available despite the absence of interest-based mechanisms, Maysami explained how central banks could conduct policy using Islamic modes of bank financing to supplement conventional monetary policy tools. Abdullah Yavas of Penn State University presented a paper on experimental tests of the homo economicus—the rational and self-interested individual whose prevalence is among the assumptions central to mainstream economic theory. He also noted some assumptions of neoclassical economic theory and how they would play out in research on Islamic economics.

Several papers on the *shari'a* were presented at the Forum as well. Especially notable was Gohar Bilal's presentation explaining the concept of partnership as uniquely dealt with in Islamic law. Bilal, a Visiting Research Scholar at HIFIP, proceeded to apply the Islamic principles of partnership to the design of an Islamic financial product. Shaikh Abdul Hamid of New Hampshire College provided an analytical review of Islamic issues involved when investing in equities. Hamid examined various industries and stocks in which Islamic law permits investment, highlighting critical accounting issues requiring additional exploration. Michael J.T. McMillen, a partner at the law firm of King & Spalding, summarized the principal elements, development, and implementation of the *rahn-'adl* collateral security structure for the Saudi Chevron petrochemical project, developed with particular sensitivity to the requirements of the Hanbali school of Islamic jurisprudence. In addition to covering describing the deal and the economic environment in which it was conducted, McMillen noted how the *rahn-'adl* structure has been refined in subsequent financings and how the structure is being used in other types of financings.

Practitioners and academics had ample time at the Forum to present their views on the cutting edge of the practice of Islamic finance itself. Andrew Cunningham of Moody's Investors' Service raised important questions analyzing the financial strength of Islamic financial institutions. Cunningham argued that rating agencies such as Moody's are qualified to rate Islamic financial institutions, and that differences lie only in the requirement to understand the structure of particular financial instruments and the ethical requirements of Islamic bankers. At the global level, Iqbal Ahmad Khan, Managing Director of HSBC Global Islamic Finance, suggested that a supporting framework and regulations are important in taking Islamic finance to the next stage of its evolution. Gradualism and implementation of a *shari'a*-based system of corporate governance are advised in the discussion of the monetary, fiscal, and regulatory measures required to make Islamic finance successful. On the subject of debt instruments, Saiful Azhar Rosly and Mohd. Azmi Omar, of International Islamic University Malaysia, proposed Islamic convertible bonds as an alternative to *bay'al-'inah* and discounted *bay' al-dayn* Islamic bonds. Such bonds are hybrids of *al-qard*, *al-wadi'ah*, *al-kafala*, and *al-mudaraba* contracts; Saiful and Azmi Omar argued that Islamic convertible bonds should widen the use of Islamic bonds in Malaysian corporate finance. Robert Toan, General Counsel of the Wafra Investment Advisory Group, explored a vital but hitherto scantily discussed issue: U.S. taxation of Islamic finance. Toan focused on *ijara* specifically and noted that American tax law grants favorable treatment to "finance" leases—those treated as loans for tax purposes. With careful attention to both Islamic law and American tax law and the different factors they emphasize in determining whether the lessor or the lessee is the "owner" of the leased property, *ijara* transactions can be structured to satisfy the *shari'a* while also securing favorable U.S. tax treatment.

Two papers presented in the realm of actual business models and commercial products are particularly noteworthy. Mohammad Al Omar, Assistant General Manager at Kuwait Finance House (KFH), discussed the workings of Islamic project finance in a case study of the Equate Petrochemical Company, which used an Islamic lease facility as part of its larger long-term financing package, where KFH underwrote, arranged, and syndicated the Islamic portion of the deal. The success of this project signals the debut of a new era of Islamic long-term financing in conjunction with conventional facilities. Khaled R. Al-Hajeri, of the Kuwait Awqaf Public Foundation, and Abdulkader Thomas, CEO of Al-Manzil Islamic Financial Services, suggest some ways the *wagf* formula can be applied globally. Although Muslim minorities once enjoyed substantial donations from private and public agencies in the Arabian Gulf region, such gifts have tapered off recently. One reason cited for this troubling trend is a desire by some donors to assure that good causes outlive the ability of any given donor to support them. Al-Hajeri and Thomas covered the goals of a major agency in transitioning from having a large donor and explained why their project is a durable, duplicable model.

The conference concluded with a banquet on the evening of October 1. David G. Mitten, Faculty Advisor to the Harvard Islamic Society, delivered the opening remarks, in which he commented on the Islamic financial community's impressive response to the Harvard Forum, as reflected in the size and quality of the attendance. He ended with an earnest plea for support of the Harvard Muslim community's attempt to build a proper mosque on campus. Muzammil H. Siddiqi, President of the Islamic Society of North America, then discussed the role of organizations such as ISNA and Harvard in developing a deeper appreciation of Islamic finance. Siddiqi explained that Harvard can help fulfill the need for pure research, while ISNA is particularly well placed to educate the North American Muslim community on the importance of Islamic finance. Taha Abdul-Basser, a Ph.D. student at Harvard and Coordinator of Software Development for HIFIP, gave a brief presentation on the HIFIP DataBank and unveiled HIFIP's Internet initiative to take its DataBank online and make it even more accessible to the Islamic financial community. The iDataBank was developed, and is maintained, by Buraq Integrated Solutions of Rawalpindi, Pakistan. Nazim Ali, HIFIP's Director of Operations, closed by thanking the sponsors, speakers, attendees, and HIFIP staff instrumental in the success of the Third Harvard University Forum on Islamic Finance.