

# Islamic Finance

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# Outline

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The Islamic religion prohibits the payment of *riba* and other activities

- Riba is usually translated as *usuary* or *excessive interest*
- Usuary has been and remains an issue in western banking
  - Interest loans banned in ancient Greece and Rome
  - Early Christian prohibition of usuary left market for lending to those aligned to judaism
  - Names like *Rothschilds* and *Goldman Sachs* and (Warburg)

# Sharing of risk

The emphasis in Islamic finance is the *sharing of risk* and having a real product underlying all financial transactions

- With interest payments, there is no risk and therefore money is making a return for itself
- Islamic finance does encourage entrepreneurial activities
- Islamic products are usually designed to share the risk
- There is also prohibition of activities linked to alcohol, prostitution, gambling and other prohibited actions

# Islamic banking

The main Islamic banking products are

- **Musharakah:** A joint venture established by bank and borrower. Profits and losses are shared in fixed proportion. Fixed payments are prohibited.
- **Ijara:** A rental agreement that will allow a someone to use an assets (house, car, machinery) for a fixed period and a fixed price
- **Mudarabah:** A partnership where one party provides the money for an investment while the other provides the management and the labour
- **Hibah:** A gift given voluntarily. This is a proportion of the profits. Islamic banks pay customers a gift on savings.

# Capital market products

The main Islamic product is the *Sukuk*. These are bonds that conform with Shariah law.

- Sukuk represent part ownership of tangible. Risk and gains are shared.
- Sukuk are administered through *Special Purpose Vehicles* (SPV) by the issue of certificates
- There are some disputes over the legal access to the assets of the SPV
- There are some risks that Islamic scholars decalre securities that were *halal*
- There are futures and warrant markets in Malaysia

## Among the issues

- Islamic sukuk issuance costs are above those of conventional bonds (Asian Development Bank). Profits on Sukuk in Malaysia are 8% higher
- Higher advisor fees because more complex
- Sukuk bond are almost as cheap as conventional in Middle East
- Efforts to make London a financial hub of Islamic finance: Islamic finance taskforce
- Is Islamic finance more stable than conventional finance? IMF says no.