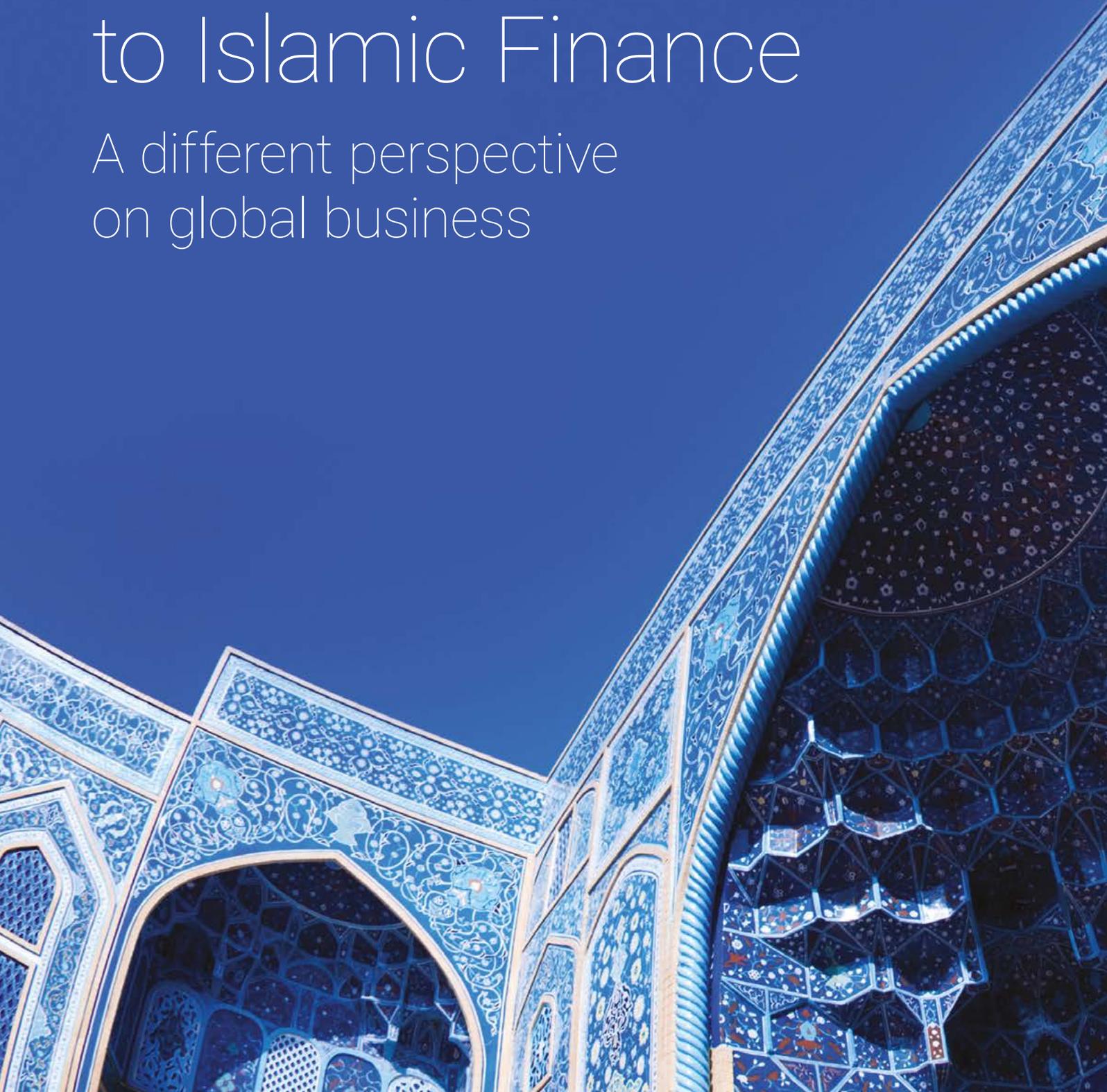




An introduction to Islamic Finance

A different perspective
on global business



Welcome

Now a dynamic area of the international financial services sector and with a rising demand for a more ethical approach to finance, Islamic finance is set to continue increasing in importance over the next decade.

Following the successful review of the original CIMA Certificate in Islamic Finance we took the opportunity to develop the structure of the qualification and how it is offered to reflect the changing requirements for Islamic finance in business. Students can now specialise in areas of their choice which provides a more relevant and focused learning and development.

The guide will introduce you to the exciting developments currently taking place in Islamic finance. The past 30 to 40 years has seen dramatic changes in this sector of the finance industry with a marked growth in both the demand for and the provision of products and services. The Islamic finance industry is still growing at an exceptional rate as more companies expand into or further develop their offerings in this area.

To know how Islamic finance may impact you or your business efforts and what opportunities it may pose you need to understand the basic principles. We hope that this brief introduction will help you on your journey.

Learn more about the award-winning CIMA Islamic Finance Qualifications and what support CIMA can offer on Islamic finance at www.cimaglobal.com/islamicfinance.

“I was always interested in moving into Islamic finance by my personal preference and the career opportunity available in this fast growing industry.”

Chistie Moinuddin,
Senior Manager, Finance, HSBC Amanah

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Introduction

Islamic finance, despite its name, is not a religious product. It is however a growing series of financial products developed to meet the requirements of a specific group of people. Conventional finance includes elements (interest and risk) which are prohibited under Shari'ah law. Developments in Islamic finance have taken place to allow Muslims to invest savings and raise finance in a way which does not compromise their religious and ethical beliefs.

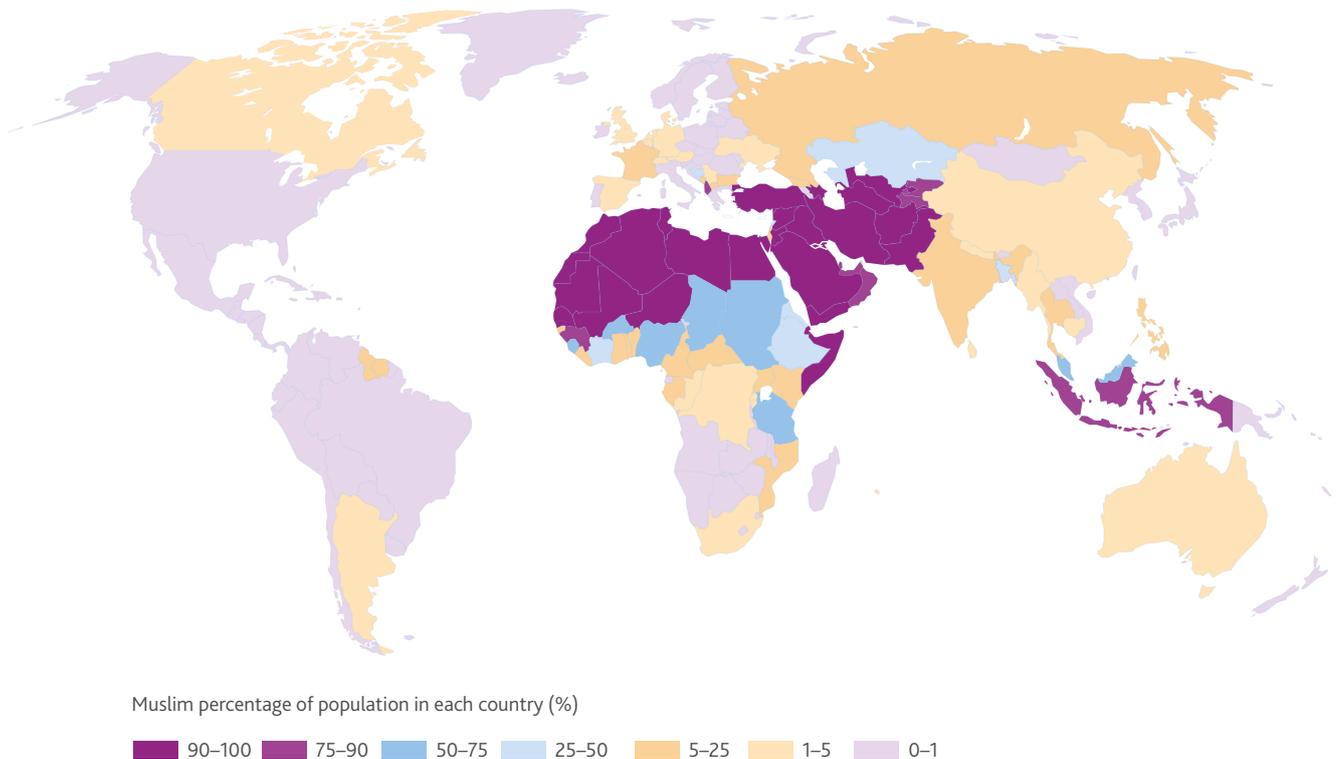
It is estimated that between 1.5 and 1.8 billion people (one quarter of the world's population) are Muslim. Geographically, most Muslims live in Asia (over 60%) or the Middle East and North Africa (about 20%). Despite these figures, Islamic finance is still very much a niche market, with the vast majority of Muslims, who have access to finance, using conventional financial products. The following map shows the geographical spread of the Muslim population throughout the world as a percentage of each country's population, with the highest concentration in the darkest shades of purple.

While most think of Islam as being focused in the Middle East and South East Asia, the vast majority of Muslims live outside of these two regions. Some examples are referenced in the table No.1

While Islamic finance is a relatively small player in global terms, most commentators agree that the current growth of between 15% and 20% in this niche market shows no sign of reducing in the short to medium-term. It is estimated that assets in the industry will reach \$1 trillion by the end of 2010. This continued growth has been spurred by the actions of many governments around the world keen to see Islamic finance develop. The UK government in particular has already publicly backed growth in this sector, introducing changes to Stamp Duty rules to facilitate the growth in the Islamic mortgage market and the promise of the issue of a UK sovereign Sukuk (bond).

Islamic finance, while emerging over the past four decades, has its roots in the past as well as the present. These links to the past relate to the fact that it is based on principles and features which were established more than 1,400 years ago. Its links to the present relate to the fact that these ancient features are now being presented to contemporary society in a form which is both modern and innovative. Islamic finance is distinct from conventional finance in many respects but has a common goal in achieving the same economic benefit as conventional finance offers to society.

Muslim percentage of population in each country



World map showing figures sourced from: Miller, Tracy, ed. (October 2009) Mapping the Global Muslim Population: A Report on the Size and Distribution of the World's Muslim Population, Pew Research Center

1.1 Islamic tradition

The essence of Islam is that it derives its principles and values from the Qur'an and the Traditions of the Prophet Muhammad. The history of Islamic law begins with the revelation of the Qur'an which contains legal principles and injunctions dealing with subjects such as ritual, marriage, divorce, succession, commercial transactions and penal laws. In contrast, the Traditions of the Prophet Muhammad record the sayings, actions and tacit approvals of the Prophet Muhammad. The literature of the Traditions of the Prophet Muhammad covers a much wider range of topics than the legal verses in the Qur'an.

Muslims believe that Islam starts from a given or self-evident premise, namely the revelation. It was with the aim of directing and guiding humanity to the realisation of its moral potential and worldly worth that Islam undertook to create a system known as the Shari'ah. Shari'ah refers to commandments, prohibitions, guidance, and principles under Islam and is the clear path for believers to follow in order to obtain guidance in this world and deliverance in the next.

The Shari'ah provides guidance in terms of belief, moral conduct and practical rulings or laws. According

to Islam, a complete system of life is based on both legal prescriptions and moral and good conduct. Moral values have been incorporated as legal requirements in some specific contracts such as Amanah (honesty) in Murabahah (mark-up) financing. Other principles of moral values pertaining to commercial transactions include:

- ▶ Timeliness in the payment of debt or delivery of an asset. The failure to observe this aspect might involve legal consequences.
- ▶ Tolerance in terms of bargaining, where the parties are encouraged to be considerate to other's requirements and circumstances.
- ▶ Mutual revocation of a contract on request by one party if one party finds him or herself uncomfortable with the outcome of the transaction.
- ▶ Honesty or Amanah in all statements, representations and warranties.

These principles are not meant to be exhaustive but rather to highlight areas where, according to Islam, morality is relevant in commercial dealings.

Table 1:

Country	Muslim population	% of country' total population
China	21,667,000	1.6
India	160,945,000	13.4
Russia	16,482,000	11.7
Sri Lanka	1,711,000	8.5
UK	1,647,000	2.7
Example populations in Middle East and South East Asia		
Malaysia	16,581,000	60.4
UAE	3,504,000	76.2

Source: Miller, Tracy, ed. (October 2009), Mapping the Global Muslim Population: A Report on the Size and Distribution of the World's Muslim Population, Pew Research Center



1.2 The meaning of Islamic finance

Islamic finance is a term that reflects financial business that is not contradictory to the principles of the Shari'ah. Conventional finance, particularly conventional banking business, relies on taking deposits from and providing loans to the public. Therefore, the banker-customer relationship is always a debtor-creditor relationship. A key aspect of conventional banking is the giving or receiving of interest, which is specifically prohibited by the Shari'ah. For example a conventional bank's fixed deposit product is based on a promise by the borrower to the bank to repay the loan plus fixed interest to the lender (the bank) that is the depositor. Essentially, money deposited will result in more money which is the basic wealth-producing structure of interest-based finance.

In other non-banking businesses, conventional products and services, such as insurance and capital markets could be based on elements that are not approved by Shari'ah principles such as uncertainty (Gharar) in insurance and interest in conventional bonds or securities. In the case of insurance, the protection provided by the insurer in exchange for a premium is always uncertain as to its amount as well as its actual time of happening. A conventional bond normally pays the holder of the bond the principal and interest.

Conventional practices could also involve selling or buying goods and services that are unlawful from a Shari'ah perspective. These might be non-halal foods such as pork, non-slaughtered animals or animals not slaughtered according to Islamic principles, alcohol or services related to gambling, pornography and entertainment. In short, conventional business practices could be non-compliant from a contractual structure perspective (if they are based on interest and uncertainty) and / or from a transactional perspective when they are involved in producing, selling or distributing goods and services that are not lawful according to the Shari'ah.

The components of Islamic Finance

2.1 Banking and interest (Riba)

Islamic banking is the branch of Islamic finance that has seen the most growth to date. It is also the branch of finance that needs to be viewed from a different perspective as it cannot replicate conventional banking. This is because the most important underlying principle of conventional banking is that money creates money or that money has a premium, known as interest or usury. This practice (known in Arabic as Riba) is the antithesis of Islamic finance because Islamic law, from the beginning, has categorically denounced it. Money has never been perceived as a commodity for which there is a price for its use. Instead, Islamic law consistently views money

as a medium of exchange, a store of value and a unit of measurement.

As money on its own cannot earn money, a link has to be introduced between money and profit as an alternative to interest. It is against this backdrop that Islamic banking has been primarily involved in trading, leasing and fee-based transaction as well as investment activities. Those involved in Islamic banking are not in a position to either borrow or lend money for interest. Subsequently, the nature of the Islamic banker-customer relationship varies according to the different contracts that Islamic banks and their customers enter into.

Deposit/liability: contractual relationship

Conventional banking

Failure to maximise the benefits of our strategic partnerships

Islamic banking

Depositor-custodian relationship

Lender-borrower relationship (but free from interest)

Investor-entrepreneur relationship

Financing/asset: contractual relationship

Conventional banking

Failure to maximise the benefits of our strategic partnerships

Islamic banking

Purchaser-seller relationship

Lessee-lessor relationship

Principal-agent relationship

Entrepreneur-investor relationship

2.1.1 Islamic banking – the relationship between the user and the supplier of funds

The relationship of the bank with the suppliers of funds can be that of agent and principal, depositor and custodian, investor and entrepreneur as well as that characterising fellow partners in a joint investment project. Similarly, the relationship of the bank with the users of funds can consist that of vendor and purchaser, investor and entrepreneur, principal and agent, lessor and lessee, transferor and transferee, and between partners in a business venture. This is in sharp contrast to that of conventional banking, which is simply a lender-borrower relationship.

The difference in relationships between Islamic and conventional banks is demonstrated in the following table:

The below illustrates that Islamic banking has departed from the concept of loans to use other contracts which are compliant and free from the element of interest in both deposit taking and finance provision.

2.2 Takaful – Islamic insurance

With regards to Islamic insurance, better known as Takaful, the insurer, that is the insurance company, is prohibited from providing indemnity to the insured, that is, the policyholders, as this is not acceptable in Shari'ah principles. This is because both the premium paid by policyholders and the indemnity paid by the insurer are uncertain and therefore not permissible as they contain the element of uncertainty or Gharar.

Conventional life insurance companies are profit-seeking entities and need to allow for things like average life

expectancy and high-risk customers when setting their premiums in order to ensure that they profits from offering life insurance to its customers.

Takaful introduces the contract of donation among the participants/policyholders as a substitute for the contract of sale of indemnity for a premium as practiced in conventional insurance. This is to make uncertainty irrelevant financially, because in Islamic terms uncertainty is only tolerable in gratuity or in a unilateral contract such as a donation. The presence of the element of uncertainty in a donation contract, which is unilateral in character, does not render it invalid. A donation contract can accept and tolerate any uncertainty because the purpose of any unilateral contract is not a commercial gain.

2.3 Islamic capital markets

Islamic capital markets that consist of both equity investments and fixed income instruments must avoid some conventional elements and principles from both contractual and transactional perspectives. In addition to interest and uncertainty, issues such as gambling, which is a zero-sum game, investments in unlawful activities and capital guarantee elements in equity-based products are to be avoided. In short, Islamic finance, unlike conventional finance, must be distinctive in its contractual and transactional features to render it different from conventional finance although ultimately, both may achieve the same economic benefits.

The Salient features of Islamic Finance

3. The salient features of Islamic finance

As mentioned above, Islamic finance, especially Islamic banking, enjoys certain peculiar features that are not found in conventional banking. These features are as follows:

3.1 Interest-free

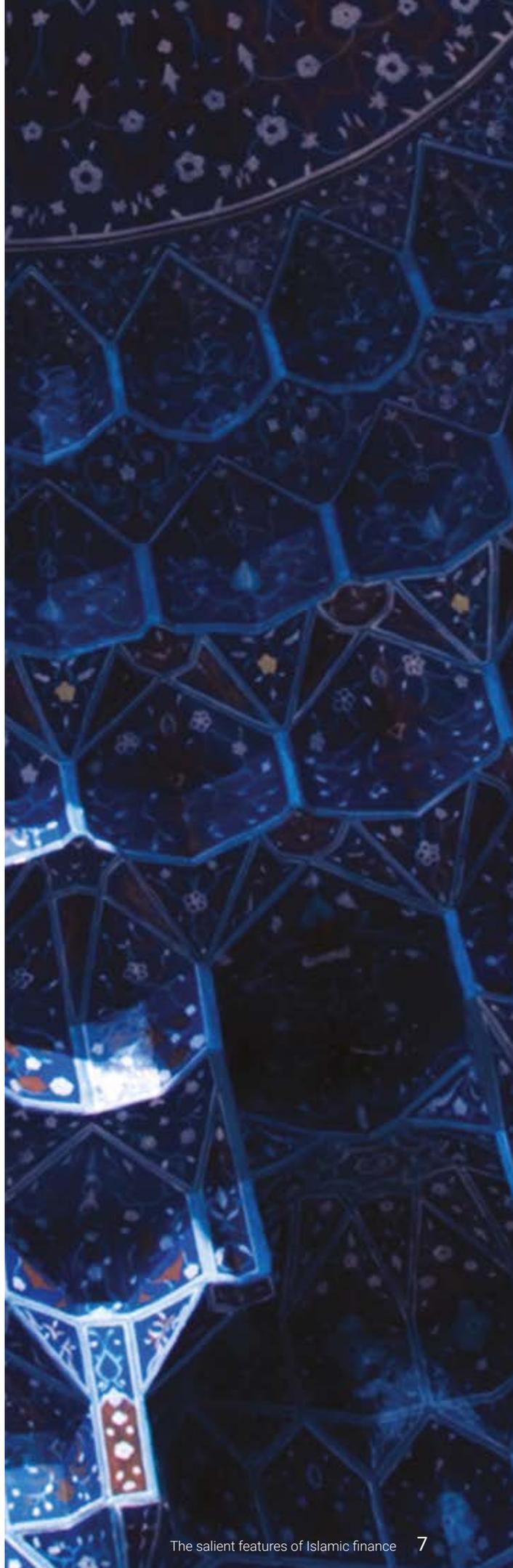
Islamic banking is interest-free, meaning that all banking business and activities must prima facie be free from any element of interest. In Islamic law, interest can arise when there is an exchange of two similar usurious items or assets such as money for money or main food for main food. In banking, the leading practice from which interest originates is the exchange of money for money, that is, money lending. Mainstream banking is based on the lending of money for a premium – interest. Islamic banks must eliminate interest in all its forms, be it in cash or kind. A fixed deposit account in a conventional bank is a good example of how the bank pays interest in cash. A good example of the avoidance of interest in kind is the prohibition of any advertisement of gifts for prospective saving and current account holders when these accounts are based on a Wadiah (safekeeping) or Qard (loan) contract. This is deemed to be promising a form of interest in kind payable to savings and currents account holders. Although a gift such as a pen or umbrella or savings box is not in monetary form, it is still deemed as an extra gain for the lender. Interest, be it in cash or in kind is not permissible.

3.2 The need for underlying assets

Islamic finance requires that all banking business based on sale or lease must have an underlying asset. As the Islamic bank either acts as a seller or a service or usufruct vendor, or lessor, the asset or service is of paramount importance. The absence of an underlying asset will render the contract void ab initio. This is in contrast to conventional banking where the asset element is not a necessary requirement. Its importance lies only in terms of collateral security in the sense that the asset purchased using the loan money may be charged or assigned as security in favour of the bank. The asset was never part of the loan transaction.

3.3 The avoidance of uncertainty or gambling

All transactions made by Islamic financial institutions (IFIs) must be free from elements of uncertainty (Gharar) and gambling (Maisir). This is because Gharar might lead to disputes caused by an unjustified term in the contract arising from misrepresentation and fraud. Gambling is seen as an action that always enriches one party at the expense of the other; a zero-sum game.



3.4 Profit and loss sharing

Profit and loss sharing is possible in some Islamic banking activities. The bank will share the profit made with its customers either on a proportionate basis or on an agreed profit sharing ratio. In the case of a loss, the loss will be borne by the bank under a Mudarabah contract or by both parties proportionately in the case of a Musharakah contract. This concept is in direct contrast to fixed-income products. Again, the concept of profit and loss sharing is distinctive to Islamic banking although, strictly speaking, Islamic banking is not an equity market, which is normally represented by the stock market.

3.5 Rights and liabilities of banks and customers

The rights and liabilities of both banks and their customers are well documented not only in conventional banking laws but also the legislation of many countries including Contracts Acts, the Sale of Goods Acts, Consumer Protection Acts and the Hire Purchase Acts. An important and significant feature of Islamic banking is the new perspective it gives to this relationship. This has pushed Islamic banking beyond normal and conventional 'banking business'. An Islamic bank is neither a lender nor a borrower, but can instead become a bona fide trader licensed under banking law. This aspect of the transaction has not been given proper attention until now, although certain amendments to various legal systems have been made.

Amendments to the Stamp Duty Act in the UK illustrate this aspect. The buying and selling of property, for example, would otherwise attract a double stamp duty for the two transactions required to achieve the financing features of the product. The changes also preclude a gains tax arising from the sale of the property to the customer by the bank – the second of two sales transactions. The first transaction occurs when the financier purchases the asset from the vendor. The second transaction occurs when the financier sells the same asset at a mark-up to their customer. Without these necessary amendments, a gain would result from both transactions. In practice, this cost or extra tax would have to be borne by the customer making Islamic products more costly from a customer's perspective.

3.6 Shari'ah compliance

The central focus of Islamic finance is Shari'ah compliance. To ensure compliance a distinctive feature of Islamic finance is the establishment of a Shari'ah advisory or supervisory board to advise IFIs, Islamic insurance companies, Islamic funds and any other providers which offer Islamic financial products. The establishment of a board, the opinions of which are binding on all IFIs, is required to guide the institutions towards Shari'ah compliance. An institution cannot claim to be doing Islamic financial business until and unless it sets up a Shari'ah board (scholars) or committee consisting of qualified scholars who are of high reputation and who possess the necessary skills.

3.7 Unlawful goods or services

Another equally important feature is that Islamic finance must not be involved in any activities pertaining to unlawful goods and services. These prohibited goods and services include, among others, non-halal foods such as pork, non-slaughtered animals or animals which were not slaughtered according to Islamic principles, intoxicating drinks, entertainment and pornography, tobacco-related products and weapons. Non-involvement is not only limited to buying or selling but also includes all chains of production and distribution, such as the packaging, transportation, warehousing and marketing of these prohibited goods and services.

3.8 Overriding principles of Islamic law

Islamic finance essentially refers to Shari'ah compliant financial activities. In addition to observing the above-mentioned features, Islamic financial products and services must not contain any principles, terms and conditions which are contradictory to established legal maxims or legal principles. These legal maxims are the overriding principles and essential parameters of Islamic law, widely accepted by Muslim jurists. An example would be the principle that the capital in equity-based financing or investment cannot be guaranteed by the manager or a related partner. An equity contract must be free from capital guarantee to reflect the very essence of equity investment. In other words, equity investors must bear the risk of loss of capital.

Riba and Gharar

“It is reported that the Prophet Muhammad said: “Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, and salt for salt, like for like, equal for equal, hand-to-hand, if the commodities differ, then you may sell as you wish provided the exchange is hand-to-hand.”

4. Riba and Gharar

As a key to understanding Islamic finance it is important to further explain the meaning of two terms or concepts that must be avoided by Islamic finance in all circumstances: Riba and Gharar. The avoidance of these two elements is a basic requirement of all Islamic financial activities.

4.1 Riba

Riba may be best equated to usury or financial interest. Any premium charged on money borrowed is tantamount to Riba irrespective of the amount paid. Riba in its simplest sense is an advantage to one party at the expense of another for no appropriate consideration. Islamic commercial law addresses the issue of this unjustified advantage from two possible transactions, namely in a loan or currency exchange contract as well as in a barter trading contract.

Muslim jurists have unanimously agreed that two separate classes of assets are susceptible to Riba, namely currency or money and a few commodities, mainly food items. The requirements of an exchange involving these two types of assets are the same.

These requirements are only applicable when there is an exchange of one currency for another currency whether it is the same currency or different currencies. The requirements also apply to the exchange of a food item for another food item, be it of the same food item or of different types and kinds.

A summary of the above tradition and its inherent requirements is depicted in the following table.

The below table clearly illustrates that Riba is confined to these categories of assets, provided they are exchanged within the same class, that is, currency for currency. An equal amount of the counter value is required in exchange of assets of the same class. Spot exchange, or the simultaneous delivery of counter values, is also required when one currency is exchanged for another currency or when a food item is exchanged for another food item, irrespective of whether these currencies or food items are the same or different types. Any delay in the delivery will render the exchange tantamount to Riba, known as Riba al-nasiah, that is, Riba by virtue of deferment in the exchange or delivery of these two counter values.

Currency for currency

Food item for food item

Subject matter	Shari'ah requirements	Subject matter	Shari'ah requirements
Same currency (GBP for GBP)	<ul style="list-style-type: none">• Spot transaction• Equal amount	Same food item (barley for barley)	<ul style="list-style-type: none">• Spot transaction• Equal amount
Different currencies (GBP for USD)	<ul style="list-style-type: none">• Spot transaction	Different food items (barley for wheat)	<ul style="list-style-type: none">• Spot transaction

From another perspective, the exchange of these two assets is also subject to the same amount or quantity of the two counter values if they are of the same type. The failure to observe this would lead to the practice of Riba called Riba al-fadl, namely Riba by an excess of one of the counter values. However, the requirement to have the same quantity is not applicable if they are of different types such as GBP for USD or wheat for barley.

This Tradition is the foundation of the permissibility of currency exchange, done on the basis of the prevailing rate of exchange, for example to exchange GBP1,000 for USD3,000, provided this is done on a spot basis. Any deferment of the exchange or delivery as in the case of a forward currency exchange is not in line with the requirements of the Tradition, and is thus prohibited. The amount of exchange is not relevant when the exchange involves two different usurious items such as USD for GBP.

The theory of Riba could therefore be summarised in the table 2.

From the above, a loan in GBP provided by conventional banks and other institutions that imposes on the borrower the requirement to repay the principal amount borrowed plus a premium in the same currency would come under the purview of Riba (interest/usury). This practice of modern Riba in the banking sector relates to both Riba al-nasiah (Riba by deferment) and Riba al-fadl (Riba by excess) because the borrower is obligated to pay more than he borrowed and repayment will take place in the future. This is the reason why conventional saving accounts and fixed deposit accounts, as well as all financing modes based on loan-for-interest are not compliant with the Shari'ah principles. The theory of Riba also applies to currency exchange which can only be done on a spot basis. Forward or future currency transactions are not allowed.

4.2 Gharar

Gharar is another element that is to be avoided in any transaction. Gharar simply refers to a lack of knowledge or uncertainty that could result in an outcome detrimental to one party. This lack of knowledge, as well as a lack of control of the outcome of any transaction, may stem from misrepresentation, mistake, fraud, duress, or terms beyond the knowledge and control of one of the parties to the contract.

Gharar in practice relates potentially to issues such as pricing, delivery, quantity and quality of assets that are transactional in nature and would affect the degree or quality of consent of the parties to a contract. For example, one cannot buy an option at a certain price to have the right to purchase its underlying shares, as an option is not ascertainable and is thus uncertain. An option is just a right. It is not an asset whose specifications are clear and attainable. In conventional insurance, the premium paid by policyholders and the indemnity provided by the insurer upon a claim are equally uncertain, thus making conventional insurance non-compliant from an Islamic legal perspective.

Unlike Riba, which is determined by a fixed formula as previously explained in section 4.1, the determination of Gharar is based on many aspects. This is because the parameter of knowledge or consent and the risk tolerance by society is not fixed. Above all, Islamic commercial law has accepted the distinction between major uncertainty (Gharar fahish), which is to be avoided at all times, and minor uncertainty (Gharar yasir), which is tolerated by society.

Table 2. The Theory of riba

RIBA (1) =	RIBA (2) =
Exchange of two similar usurious items for different counter values and for deferred exchange, for example, GBP1,000 for GBP1,200 being exchanged for one another on a deferred basis.	Exchange of two dissimilar usurious items for deferred exchange, for example, GBP1,000 being exchanged for USD1,000 on deferred exchange.

Profit and loss sharing

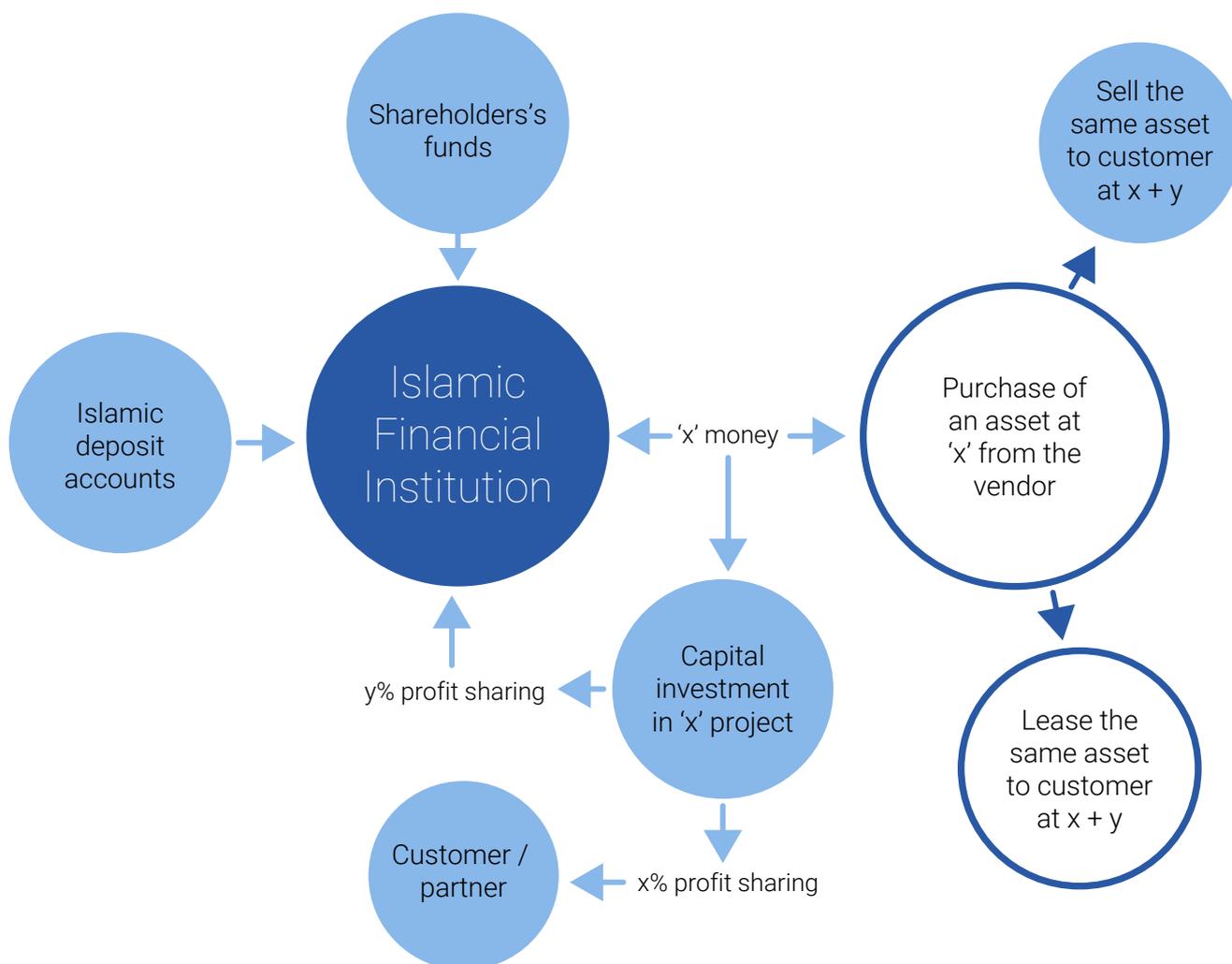
5. Profit and loss sharing

In addition to the two prohibited items outlined above, Islamic finance is also closely associated with the practice of profit and loss sharing. This is unique as IFIs will share the profit or loss, as the case maybe, with depositors as well as fund users if the contracts entered into by the two parties are based on either Mudarabah or Musharakah. In terms of deposit, the IFI act as the manager while the depositors are the capital providers who deposit their capital on the basis of a Mudarabah contract either through their savings or investment account. The depositors will share the profit with the bank based on a specified ratio. The depositor will also bear the loss entirely under the Mudarabah contract

while the banks will lose their time, work, effort and expected profit.

IFIs may finance their customers using either Mudarabah or Musharakah structure. In these instances the IFIs act as the capital providers and share the profit with their customers upon the realisation of their business venture. Loss will be borne by the IFI under the Mudarabah contract, but the loss is to be shared between the IFI and the customer under the Musharakah contract. This is a distinctive feature of Islamic finance when compared to conventional finance.

The function of money in Islamic finance



Islamic finance compared with conventional finance

6. Islamic finance compared with conventional finance

Islamic finance does not, and should not, deal with money directly as money cannot create more money by itself. Money must be put into real business activities to earn extra money. This is the whole basis of trading. In other words, IFIs facilitate the financing needs of customers by becoming sellers, lessors or partners as the case may be. The function of money has been transformed from a commodity into an enabler to facilitate trading, leasing and investment as illustrated in the diagram on the previous page.

The pool of money, collected through various Islamic accounts and/or shareholders' funds, is channelled to finance trade, lease or investment activities. From a micro perspective, the money has been transferred into real economic stock in order to generate more income. Thus, the profit generated by IFIs is the outcome of dealing with a real asset rather than a monetary asset.

Shari'ah compliance and the equity market

7. Shari'ah compliance and the equity market

The distinction between Islamic finance and conventional finance is more obvious in banking and insurance products as well as in fixed income instruments than it is in the equity market. Conventional banking and fixed income instruments are essentially based on interest, while the conventional insurance contract is based on the sale of an indemnity for a premium that contains a considerable degree of uncertainty. The distinction between the Islamic and conventional equity markets is however less clear because the prohibited elements are contained not in the structure of the respective contracts in the activities on which the transaction is based.

There is no Shari'ah issue on the contract of investment in the equity market as it is essentially based on the principle of profit and loss sharing. In other words, buying a share in any stock exchange is permissible as this purchase reflects a contract of Musharakah among the shareholders. This contract, per se, is compliant. However, Shari'ah objections are mainly concerned with the activities of the companies in which the capital, through subscription to the shares, is put. These activities may include the sale or purchase of assets and services that are not approved under Shari'ah principles such as the sale or purchase of non-Halal food and drink. Non-approved activities also include activities related to the balance sheet of the company such as the borrowing or raising of more capital through interest-based transactions such as overdrafts and conventional bonds.

Key issues

8.1 Prohibited trading items

In addition to avoiding interest (usury) and profit earned from uncertainty, Islamic finance should not be invested in activities involving, amongst other things, armaments, the consumption of pork, intoxicants, entertainment, games of chance or pornography. This prohibition includes the entire economic chain of activities relating to these industries, including their production, storage, transportation, marketing and advertising.

For a finance house to be able to trade under the banner of Islamic finance, its customers would have to be disconnected from any of the above. In a world largely run by mainstream financial and business practices, this is a tall order. Many businesses have either direct or indirect links to some or all of the prohibited activities (consider your local supermarkets, hotels and restaurants). Such businesses would not be suitable candidates for raising funds under Islamic finance either through banks or by issuing financial instruments such as shares or debentures.

8.2 Acceptable practice

Subject to the prohibitions mentioned, profit is tolerated in its own right, but the profit should be earned fairly (i.e. not at the disadvantage of others) and should result from some form of trading activity. Additionally (i) the funder should take part in the risk involved in a project, (ii) no party to a financial transaction should benefit disproportionately at the expense of another, (iii) parties should benefit in accordance with their contributions on a predetermined basis, (iv) financing projects should require some form of trading or partnership in trade and (v) profit should not be earned to the detriment of the environment.

In order to address these restrictions, financiers and insurers have had to develop new Shari'ah compliant products characterised by Arabic terminology drawn

from Islamic commercial law. These new products are based round a series of contracts, the principles of which most readers will recognise. These contracts completely change the relationship between bank and the suppliers of funds as generally observed in mainstream banking. It now can be that of agent and principal, depositor and custodian, investor and entrepreneur as well as between fellow partners in a joint investment project. Similarly, the relationship of the Islamic bank to the user of funds can be that of vendor and purchaser, investor and entrepreneur, principal and agent, lessor and lessee, transferor and transferee, and between partners in a business.

8.3 Major contract used

The main contracts used in the development of Shari'ah compliant products are:

- ▶ Bay' Mu'ajjal (deferred payment)
- ▶ Ijarah (operating lease)
- ▶ Istisna' (construction finance)
- ▶ Mudarabah (partnership contract)
- ▶ Murabahah (cost-plus)
- ▶ Musharakah (partnership contract where funder has executive involvement)
- ▶ Wadiah (safe custody)
- ▶ Wakalah (agency)

The two most popular forms of finance are Mudarabah and Murabahah.

Two most popular forms of finance are Mudarabah and Murabahah

Mudarabah

Under a Mudarabah financing contract the bank agrees to finance the entrepreneur on the understanding that both parties will share the profits of the particular venture being financed.

Deposits made to the bank by individuals under a Mudarabah contract are treated as an investment in the bank by the individual. The bank will use this investment to help make profits from its trading activities i.e. financing of individuals and businessmen. Under the Mudarabah contract the bank will have agreed to give the depositor a share of its profits in return for the investment based on a pre-agreed ratio.

Murabahah

Murabahah financing is a prevalent mode of asset financing and represents a significant portion of Islamic bank financing of either short-term or long-term assets. A murabahah contract refers to a cost plus mark-up transaction between the parties. Under this contract a three party arrangement is made where the customer places an order with the financial institution to purchase goods from a supplier. The customer may pay a security deposit with the financial institution and the amount of financing outstanding can be secured either in the form of collateral or guarantee. The financial institution having purchased the goods from the supplier then sells them to the customer at a price including mark up with a fixed credit period.

Requirements for sustained growth

9. Requirements for sustained growth

There is no doubt that the Islamic finance sector has felt the repercussions of the financial crisis, but on the whole it has weathered the storm better than conventional finance and its prospects remain high. Governments are in a position to give a direct impetus to this recovery through their involvement in the Sukuk market. The UK government has been in discussions for many years over the issue of a sovereign Sukuk, but deferred action in 2008. For the UK a sovereign Sukuk could be an ideal platform to help fund the 2012 Olympics. As it stands, 2010 could see several countries accessing the Sukuk market to help finance major investment projects. Such countries include the UK, Japan, Turkey and Russia who hope to tap into the massive liquidity which exists in Asia and the GCC via Shari'ah compliant investment products.

If Islamic finance is to compete with mainstream global finance, the industry needs to improve transparency and foster credibility by harmonising standards and practices, not least, the variety of Shari'ah interpretation between regions and at times between institutions. Regulatory oversight needs to be sharpened as well. These measures could be critical in broadening the appeal of Islamic finance and strengthening the credibility of the Islamic system as a sustainable alternative the mainstream financial system.

The Islamic finance industry also needs to work on innovation. Shari'ah compliant products can be more complex than mainstream ones because every transaction is based on a trading agreement. Many sustainable equivalents to mainstream financial instruments are still lacking, including corporate treasury and derivative products. At the same time, innovation is hampered by the limited number of Shari'ah board members (Shari'ah scholars) able to vet financial products for Shari'ah compliance. Finally there is a huge shortage of suitable skilled employees working within the industry. This scarcity of suitably qualified human capital can only be redressed by increasing awareness of the career possibilities within the industry and by the offering of globally accepted qualifications.

Two key areas of concern in the world today are:

- ▶ The credit crisis caused by the collapse of the sub-prime market.
- ▶ The increasing cost of food staples around the world.

A question asked by many interested in finance is whether a finance industry based on Islamic finance principles would have ended up in the same mess.

What if?

10.1 The credit crisis

Some leading markets with great international financial impact relaxed mortgage credit criteria based on the view that property prices would continue to rise to balance the additional risk of lending to individuals with little or no credit standing. These mortgage obligations were then converted into a variety of securities of differing tranches and seniority status which had little relationship to the underlying assets. With the fall in the value of housing stock, panic set in as the finance market realised that such securities were not underpinned by real assets.

Would this situation have arisen in a Shari'ah compliant financial system?

Under Islamic finance, the trading of debt at premium or discount is disallowed. Hence mortgage based securities are classed as non Shari'ah compliant, especially where the link to actual assets is tenuous. This link to assets is key to the acceptability of Islamic securities. A direct link to such assets should be the way income is earned. Goods that a seller does not own or cannot deliver cannot form part of an Islamic contract.

Customers would have been protected against such trading. However issues may have arisen with regards to liquidity of the market as the Islamic financial sector is in the process of developing more fluid liquidity tools.

10.2 increasing cost of food staples around the world

The current food crisis revolves around the fact that the physical quantity of staple crops (wheat, rice etc) grown in the world has fallen or is not keeping up with demand. As a result the price appears to be rising to a stage where much of the poorer population of developing countries, where these crops form the staple food of many, is finding it hard to afford basic food. The recent fuel crisis has added to this in that many countries, some of which are giving financial incentives to farmers to grow crops such as maize, which are necessary ingredients in bio fuels. Transfers to this type of crop means less land is producing staple food crops.

What's the link with the finance industry?

It is generally believed that speculators in the futures market may have added to the problem. Falling returns in the real estate and equities markets may have led traders to shift to commodities in the futures market. The view is that a large part of the price rises we are seeing have been caused by future expectations of price rises.

Would this situation have arisen in a Shari'ah compliant financial system?

Forwards, futures etc. involve risk and trading assets that are neither owned nor have the capacity of being delivered. This is strictly prohibited in the Shar'iah. For instance one may not sell an unborn calf or a bag of grains that are yet to be harvested, weighted and valued. The effect of the futures market on the price of staple food (if it is having an effect) would not have occurred under a financial system applying Shari'ah principles.

Three years on from the launch of the original certificate and after a detailed review by an independent differentiation exercise of the provision offered, CIMA concluded that the breadth and depth of the current qualification justified elevating the certificate to the level of a diploma. We also decided to change the structure of the qualification and how it is offered to reflect the changing requirements for Islamic finance in business.

Islamic finance is becoming more prominent throughout the financial institutions of the world. It is growing from a niche industry to a mainstream part of finance. It is this switch that prompted us to change the structure of the qualification.

The CIMA qualifications in Islamic Finance consist of two levels:

- ▶ Certificates in Islamic Finance
- ▶ Diploma in Islamic Finance

Who will benefit?

- ▶ All staff working in the financial services sector who would like to be a part of this dynamic industry.
- ▶ Those currently working in Islamic finance who want to hone their skills and broaden their knowledge.
- ▶ Anyone wishing to enter the financial services sector and specialise in this dynamic subject area.
- ▶ Those in the legal and accounting profession who advise on Islamic issues
- ▶ Anyone who has an interest in Islamic finance, or companies wishing to trade in Islamic countries.

CIMA qualifications in Islamic Finance

11.1 Certificates in Islamic Finance

If you need specialist knowledge in just one area of Islamic finance, then we suggest you enrol onto one of the four individual certificates. Once you complete each certificate you can continue your learning and complete other certificates through to the diploma.

Each of the certificate allows you to focus on one key area of Islamic finance.

The four certificates are as follows:

- ▶ Certificate in Islamic Commercial Law
- ▶ Certificate in Islamic Banking and Takaful
- ▶ Certificate in Islamic Capital Markets and Instruments
- ▶ Certificate in Accounting for Islamic Financial Institutions.

11.2 CIMA Diploma in Islamic Finance (CDIF)

The CIMA Diploma in Islamic Finance will give you skills in Shari'ah compliance and knowledge of the complexities of the contracts that underpin this compliance. You will also develop confidence in using the terminology and applying the knowledge that sets Islamic finance apart from conventional finance.

Who is it for?

The diploma is valuable for newcomers to Islamic finance as well as finance professionals seeking to broaden their understanding of wider aspects of Islamic finance in a whole range of areas while gaining accreditation. It is designed to give professionals two significant advantages:

- ▶ the professional recognition of a CIMA international qualification
- ▶ demonstrable expertise in the complex, fast-growing world of Islamic finance.

What does it cover?

This diploma is a self-study qualification that you can study at your own pace. The diploma comprises of the four individual certificates and on completion, you will be awarded the CIMA Diploma in Islamic Finance and be able to use the honorific letters CDIF.

The estimated time to complete all four certificates is between six and 12 months, depending on your prior knowledge and experience.

11.3 How to enrol

Certificates in Islamic Finance and Diploma in Islamic Finance (CDIF).

To enrol on the diploma or one of the certificates please visit cimaglobal.com/if, click on 'apply now' then follow the on-screen instructions.

11.4 Fees

Fees for the certificates and diploma include all study materials required, including:

- ▶ A comprehensive study guide.
- ▶ Two exam attempts at the final assessment included at no extra cost.
- ▶ Online support materials.

Each further resit of a Certificate assessment, after the first two attempts costs £60.

Corporate and group special rates are available upon request, please email islamic.finance@aicpa-cima.com for more information.

11.5 Course developers

The International Institute of Islamic Finance Incorporated

The International Institute of Islamic Finance Incorporated (IIIF Inc.) was established to fulfil the global need for human development in Islamic finance. IIIF offers flexible learning opportunities and equips the industry with the relevant skills and expertise in Islamic finance. IIIF undertakes research that sets the pace and landscape for Islamic finance. It has a strong and established panel of consultants and Shari'ah scholars who are experienced in various aspects of Islamic banking and finance industry.

Dr. Mohd Daud Bakar

Dr. Mohd Daud Bakar is the President/CEO of International Institute of Islamic Finance (IIIF) Inc. (BVI) and Amanie Business Solutions Sdn. Bhd.

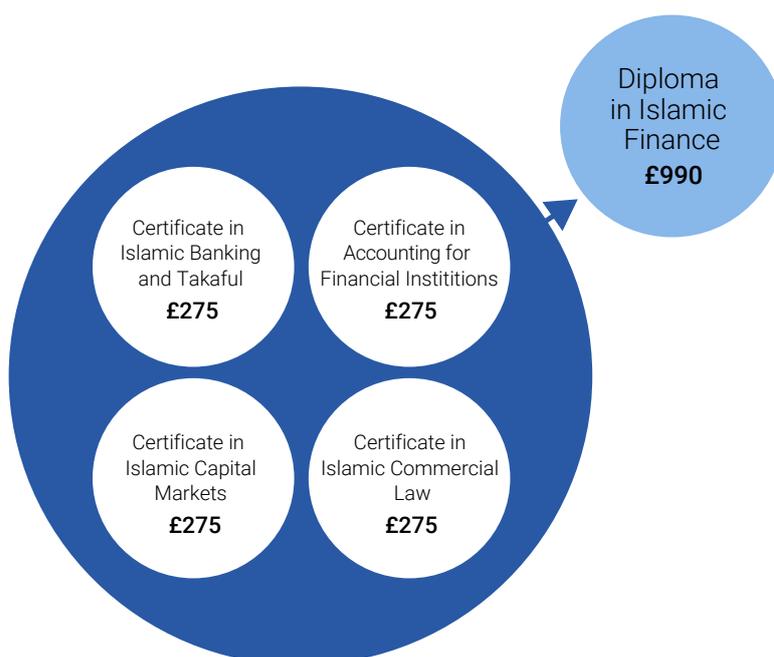
He currently sits as a Chairman of the Shariah Advisory Council at the Central Bank of Malaysia, the Securities Commission of Malaysia, the Labuan Financial Services Authority and the International Islamic Liquidity Management Corporation (IILM). He is also a Shariah board member of various financial institutions, including the National Bank of Oman (Oman), Noor Islamic Bank (Dubai), Amundi Asset Management (France), Morgan Stanley (Dubai), Bank of London and Middle East (London), BNP Paribas (Bahrain), Bank Al Khair (Bahrain), Islamic Bank of Asia (Singapore), Dow Jones Islamic Market Index (New York), Financial Guidance (USA).

He has published a number of articles in various academic journals and has made many presentations in various conferences both local and overseas. On the recognition side, Dr Mohd Daud has been honored with "The Asset Triple

A Industry Leadership Award" at The Asset Triple A Islamic Finance Award 2014 by The Asset magazine.

Dr. Syed Musa Alhabshi

Currently he is an Associate Professor in Institute of Islamic Banking and Finance, IIUM and was previously Dean of Institute of Islamic Banking and Finance (2014), IIUM and Dean of Graduate School of Business, University Tun Abdul Razak (2012-2013). He is also engaged as a Fellow Consultant with Amanie Business Solutions & International Institute of Islamic Finance Inc in providing advisory, research and training services to the Islamic financial services industry. He also currently serves as an Independent Board member of Takaful Ikhlas and MNRB Re-Takaful Companies in Malaysia as well as Shari'ah committee of both Takaful companies and Bank of Tokyo Mitsubishi Bank.



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