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# Finance ISLAMICUS

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The financial year promises a lot with respect to Islamic finance in India. The vocalism on Islamic finance has been resonating with unprecedented reverberations in the country! The pattern of happenings in the new financial year is very encouraging and motivating for all involved with the promotion of Islamic banking and finance in India. Let's join together to redeem our pledge to contribute towards organizing the industry.

**EDITORIAL**

## **REDEEMING OUR PLEDGE TO FOSTER ISLAMIC FINANCE**

**SHARJEEL AHMAD**



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# REDEEMING OUR PLEDGE TO FOSTER ISLAMIC FINANCE

SHARJEEL AHMAD

April marks the beginning of a new financial year, and the beginning of new happenings, new hopes, new commitments and resolutions, new achievements, new learning... The financial year promises a lot with respect to Islamic finance in India as well. The vocalism on Islamic finance has been resonating with unprecedented reverberations in the country! The pattern of happenings in the new financial year is very encouraging and motivating for all involved with the promotion of Islamic banking and finance in India. You would remember how the Kerala High Court had earlier put a stay on the activities of Al Barakah Financial Services Company, which was planning to promote a Sharia-compliant non-banking financial company (NBFC) with the participation of Government of Kerala and other promoters. In a recent order, **the High Court has lifted the stay order on Al Barakah, and has ruled that it could continue its operations as an independent company; albeit without the government's participation.** The Court would hold further debates and discussions on the aspect of allowing a state body to participate in such initiatives at a later stage. This unprecedented ruling comes as a colossal espousal and endorsement for the advent of Sharia-compliant investments and Islamic finance in India!



Another major elevating incidence can be seen by the recent inclination of the Finance Ministry to pave way for Sharia-compliant NBFCs as the gateway to introducing Islamic banking and finance in India. According to a recent article in the Economic Times, the Finance Ministry is exploring the options to **relook** at issues such as **“asset classification, accounting standards, capital adequacy, and provisioning for bad and doubtful assets”** to identify any relaxations that can be put to use to favorable use in introducing Sharia-compliant NBFCs in India.

To give other indications, eminent economist **M S Swaminathan** has heralded Islamic banking and finance system as an effectual solution to farmer suicide crisis in India. Mr. Swaminathan expressed this while speaking at the Karuna Ratna award function at Chennai. Needless to mention, a statement of this standing coming from a persona as exalted as Mr. Swaminathan is self-expounding on the epitome of Islamic banking and finance system. As another practical evidence of the rising confidence of Islamic finance in India, **the Economic Times** has testified, **“Sharia or Ethical Funds ... are doing much better in terms of returns on investment (RoI) than a host of traditional funds.”** Two major Sharia-compliant insurers, **Bajaj Allianz Life Insurance** and **Tata AIG Life Insurance**, have starkly outperformed the conventional funds to the tune of offering returns as high as 109%! Another encouraging development that has taken place is **the constitution of an All-India microfinance society called Sahulat Microfinance Society.** The Sahulat Microfinance Society has been constituted as a national-level NGO to provide interest-free microfinance options with the primary objective of bridging the socio-economic disparities in India.

**Finance Islamicus** is proud to announce its association as the media partner of the forthcoming **India Shariah Finance Summit 2010**, being organized by **Business Edge Conferences.** The Shariah Summit is aimed at exploring the implementation options of Islamic finance in India to unleash the hitherto locked potential of Muslim investors. The Summit, being organized in New Delhi, India, from **April 26, 2010 to April 28, 2010**, will see many eminent national and international speakers, including government representatives, academicians, and industry experts. In the next issue, we will present the highlights of the Summit, InshaAllah.

The first issue of **Finance Islamicus** was delayed due to various reasons beyond our control. However, the delay was mitigated by the extremely encouraging responses that we received from our esteemed readers! In this issue, we redeem our pledge to contribute towards organizing the industry yet again. In our endeavor to capture the exact verbatim of our readers, we present the reactions and feedback of the esteemed readers in our new column titled **Readers Resonance.**



## REDEEMING OUR PLEDGE TO FOSTER ISLAMIC FINANCE SHARJEEL AHMAD

Continuing with our column on **Islamic Finance Education Special**, we present to you an exclusive discourse on Islamic finance education as reckoned by **Michael Gassner**, Director, Islamic Finance Engineer at Bank Sarasin, Zurich, Switzerland. The greatest takeaway of this discourse is Michael's urge to consider Islamic finance more as business and management, rather than limiting its scope to Sharia law. **"Implementing and bringing Islamic finance forward needs a better understanding on how to manage the constraints and turn them into a benefit - we need more entrepreneurial thinking,"** is what Michael categorically acclaims!

Poona College of Arts, Science & Commerce, Pune, India organized an international conference on **Interest Free Banking as a Means to Inclusive Finance in India**. The conference saw an avid and esteemed participation of delegates ranging from India to Malaysia, Iran, Afghanistan, and other countries. The conference extolled the concept of Islamic finance as an important economic restructuring tool for all. We inaugurate another column of the newsletter, titled **Media Corner**, in this issue with a detailed report of the conference.

Islamic banking is a dysphonic term in India; even though it has been recommended by the Dr. Raghuram Rajan's Committee set up by the Reserve Bank of India. Although Islamic banking has been introduced and is working successfully in many secular countries such as Malaysia and the UK, the Indian panorama is quite different. **Dr. Shariq Nisar, our Chief Editor**, reflects on the **Epilog to Islamic Banking in India** to look at these dimensions of Islamic banking in India. In addition, endorsing our commitment towards contributing to the education of Islamic finance, we introduce a new column in this issue, titled **Learn Islamic Finance**. This column would include brief discourses on the fundamentals and practicalities of Islamic banking and finance.

We encourage our esteemed readers to send their articles, contributions, feedback, and suggestions to further enhance the newsletter. This fervent initiative reflects the cadence of each one of us, and would be really deficient without your avid expressions. Write to us at [edit@financeislamicus.com](mailto:edit@financeislamicus.com) or [feedback@financeislamicus.com](mailto:feedback@financeislamicus.com).

Wish you a happy reading!

# Few RESPONSES

FROM OUR ESTEEMED READERS  
ON THE LAUNCH OF THE NEWSLETTER!

Thanks.  
Very attractive.  
May Almighty Allah grant it long life and serve its objective effectively.

Wassalam  
**Dr. Abdul Azim Islahi, Expert on Islamic Finance**

Dear Sharjeel,

Assalamo Alaikum Wa Rahmatullahe Wa Barakatahu.  
Hope and pray that this mail finds you in the best of health and eiman, insha-Allah! May Allah bless you with good health, lots of wealth, peace, prosperity and happiness!

Congratulations on the launch of your much-awaited newsletter! May Allah make it a great success and help you deliver what is best for the society!  
Wish you and your team true success!

**Shakeel Ahmad, Owner and Coordinator, Bihar Anjuman, Dubai, UAE** - shakeeluae@gmail.com

Salam Brother Sharjeel,  
Checked the Jan-Feb issue  
Congratulations, it's well crafted and nicely edited.

Wassalam  
**Amjad Suri** - amjadkhansuri@gmail.com

Mabrook on the publication of Finance Islamicus. What a creative name?! Wish you all the very best.  
Warm regards.

Wassalam.  
**Dr. Wasim Ahmad, Preston University, Ajman**  
- malikwasimahmad@gmail.com

Assalamoalikum,  
It's been a pleasure reading the magazine "Finance Islamicus" ....

**Abdullah Farooqi, Pursuing P.G. Diploma in Islamic Banking and Finance from AMU, Aligarh**  
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# Reflections of Michael Gassner

**Michael Gassner** is Director, Islamic Finance Engineer at Bank Sarasin, Zurich, Switzerland. Michael Gassner also owns and runs a Web site [www.islamicfinance.de](http://www.islamicfinance.de), which is portal offering free information on Islamic finance. Gassner dedicates this Web site as a free service to the cause of Islamic finance. This interview is an excerpt of his responses from an expert survey conducted by the Committee on Courses in Islamic Finance at Aligarh Muslim University, Aligarh, to gauge the efficacy of introducing a course in Islamic finance.

## 1. What do you consider the main differences between Islamic and conventional finance and what in your opinion is important to teach students regarding this?

- Technical focus on asset finance and equity finance to replace money lending.
- Total Risk Management Approach: Understanding the different risk components of credit risk, equity investment risk, market risk, liquidity risk, and operational risk. Knowing the details of residual price risk of a leasing contract, understanding the different approaches of commercial banking, investment banking, community banking, microfinance and non banks like leasing companies, venture capital firms and private equity firms.

## 2. There are a number of institutes spread across the globe offering Islamic Finance education. If asked to analyze their strengths and weaknesses, how would you look at them?

- Most are based in the faculty of economics and therefore are too far away from technical issues relevant to running an Islamic financial institution.

## 3. What is the most important and critical aspect of Islamic Finance education?

- Learning the best practices from the asset finance industry in great detail
- Shifting the benchmarking from conventional banking to conventional leasing and asset finance adds greater depth and helps to increase the degree of Sharia compliance
- Shifting away from the word banking to the more general approach of finance.

## 4. When a center of higher learning or a university is offering an Islamic Finance course, how should it distinguish itself?

- Studying the practical issues surrounding the financial industry
- Following an approach to understand the wider picture and the functions of the different financial institutions and how it fits with Islamic finance

## 5. What is more important in Islamic Finance, education or training?

- Both are indispensable
- Training is short term fix for a lack of genuinely trained experts

## 6. What area of Islamic Economics and Finance do you think has great prospect but currently neglected by Islamic finance teachers?

- Economics and Finance are two different fields, this is often not enough emphasized
- Analyses of the various financial institutions, their regulatory environment and how they fit in catering Islamic finance thinking the ideal Islamic financial group of companies, each under its set of regulations and complementing each other, in order to service the society

## 7. Islamic Finance is more about Sharia and law than about business and management. Your comment?

Disagree...

- Islamic finance has to be in the faculty of business and management to teach finance from an Islamic perspective



# Reflections of

Michael Gassner

- Economics and Sharia are supporting/auxiliary sciences in which students have to have sound knowledge
- Implementing and bringing Islamic finance forward needs a better understanding on how to manage the constraints and turn them into a benefit we need more entrepreneurial thinking:
- On IBFnet, one economist suggested to use Zakat to start Microfinance, Sharia scholars rejected with the argument that this violates Sharia, as ownership must be transferred, which is not the case with a loan.
- A clear case of lack of management: An Islamic financial expert would have found a solution for this, complying with the form and substance of Sharia and serving the economic purpose.

## 8. What kind of specialization would you expect from a student of Islamic Finance?

- Finance, Fiqh, Economics, Common/Civil Law of the country specifically regulations and basic tax knowledge

## 9. Any comments or suggestions that you consider important while designing an Islamic Finance course?

Adopting a new methodology away from purist haram halal

- Teaching: Haram, Makruh, Mubah, Mandub
- Putting people in charge to struggle for the recommendable and not just avoid the prohibited!

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CFO  
Barwa Bank, Qatar

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# International Conference

on Interest Free Banking as a Means to Inclusive Finance in India

By Dr. Aftab Alam and Dr. M. B. Mistry



March 19-20, 2010,  
Poona College of  
Arts, Science  
& Commerce,  
Pune, India

The world that we see today is pregnant with numerous economic malice. In fact, USA, subprime crisis has given a bad name to conventional banking which is heavily based on interest. Interest Free Banking, or Islamic Banking, offers an alternative, where a loan is taken not on the basis of interest payouts but profit sharing. In order to explore this alternative, **Dept. of Economics, Poona College of Arts Science and Commerce, Pune, India** organized an International Conference on the subject **Interest Free Banking as a Means of Inclusive Finance in India.**

The conference was held on 19th and 20th March 2010, where experts from Malaysia, Iran, Afghanistan and other countries, in addition to educational experts from all over India, participated and presented their expert opinions. The conference also witnessed the participation of corporate executives and bankers. The participants largely deliberated on the possibility and feasibility of interest free banking in India.

The Conference focused on the following areas in detail:

1. Interest free banking in India
2. Obstacles in the working of interest free banking in India
3. Modes of interest free banking in India
4. Role of interest free banking in Money Market
5. Role of interest free banking in Capital Market
6. Micro-Finance and interest free banking
7. Interest free banking and insurance sector
8. Interest free banking and entrepreneurs
9. Interest Free Banking and Self Help Group (SHG's)
10. Interest Free Banking and Agriculture Sector

**Padmashree Dr. Mahmoodur Rehman**, Chairman, Jammu and Kashmir State Finance Commission, Govt. of Jammu and Kashmir was the chief guest. He stressed the need to introduce interest free banking in India for overall growth and development. "It is a practical way of banking and will bring prosperity to the common people. If it is initially introduced in certain banks, it will benefit small businesses and industries," maintained Dr. Rehman.

**Dr. M. Y. Khan**, Former Economic Advisor of Securities and Exchange Board of India (SEBI), delivered the key note address. He said that interest free banking is needed to take banking facilities to the less privileged.

**Mr. G. Chenoy**, GM Corporation Pune gave a talk on financial inclusion and branchless banking.

**Dr. Izhar Ahmed**, Professor of Economics at AMU, Aligarh, spoke on Islamic insurance or Takaful.

**Dr. Sayed Afzal Peerzade** from Women's University Karnataka spoke passionately on financial inclusion as a study of conventional and Islamic banking.

**Dr. Rahmatullah Akbar Peerbhoy** from College of Commerce, Mumbai, who is also associated with an NGO AICMEU, spoke elaborately on how Islamic banks and financial institutions can be established in India.

**Dr. Shakeel Ahmed**, Head, Department of Economics and Vice-Principal Poona College, said that Muslims are the most disadvantaged Community in the financial sector according to the Sachar Committee report. Due to



## International Conference

on Interest Free Banking as a Means to Inclusive Finance in India

By Dr. Aftab Alam and Dr. M. B. Mistry

interest-based deposits and credits from commercial banks, 80% of the Muslims are financially excluded. The worker participation of Muslims in financial sector is also low.

**Mr. M. M. Razvi**, a banker, averred that sooner or later interest free banking will be implemented in India. He lucidly explained the obstacles that need to be removed from conventional banking to implement interest free banking in India.

Among the foreign delegates, **Professor Ali Raza Eghbali** spoke on how recession can be prevented through the use of interest free banking and finance. **Dr. Abbas Mirakhor**, former executive director at IMF and current holder of INCEIF Academic Chair in Islamic Finance, **Ms. Shabnam Mokhtar** etc. All contributed a paper on "Interest Free Banking ... A Malaysian Paradigm". Other foreign delegates spoke on different topics.

In the Valedictory function, **Dr. Khurseed Najmi**, former officer at Reserve Bank of India (RBI) and presently a practicing lawyer at Delhi, spoke about the possibilities of introducing Islamic banking and finance within the existing legal framework in India.

**Dr. Shariq Nisar**, Director Taqwaa Advisory and Sharia Investment Services Pvt. Ltd (TASIS), Bangaluru, discussed the establishment and success of Islamic banks in the USA, the UK and other European countries, Bahrain, Malaysia, and other countries. He highlighted the findings of Anand Sinha committee constituted by RBI in India for exploring the viability of introducing Islamic financial products in India. Dr. Nisar also explored the Raghuram Ramrajan committee report (2008), which recommended Islamic banking in India for financial inclusion of the Muslim community. Dr. Nisar also aptly highlighted the fact that many Non Muslim experts are working in the domain of Islamic finance.

**Mr. M. A. Batki**, Former Legal Advisor to RBI, concluded that very soon interest free banking will be implemented in India. However, political will and social acceptance are necessary for this to become a reality.



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## Prelude to Introducing Islamic Banking in India

DR. SHARIQ NISAR

Islamic finance is the name referred to a financial system based on certain values and prohibitions. Many of these values and prohibition are common across various religions. Interest, for example, is prohibited not only in Islam but also in Christianity and Judaism. References of interest being abhorred could also be found in Hindu religion. Similarly, alcohol, gambling, and harmful businesses are prohibited in most of the religions. These values are common heritages of the humanity and not just of Islam's.

Another important feature of Islamic finance is its inbuilt stability emanating from the principle of risk sharing. Islam wants participants in businesses to share the ups and downs of business. Those who have found themselves not capable (such as widows, poor, and old-elderly) of such risks are provided with other avenues of savings and investments.

In addition, Islam puts a check on non-serious financial transactions, betting and wagering, which constitute almost 95% of capital movement in the world today. In absence of all these exotic financial products and activities, there is no doubt that the size of the world economy would be reduced by many zeros from both the sides of the balance sheet; but the world is likely to be safer and happier and that is the objective of all our

economic activities (isn't it?). Reducing billions of dollars from the asset side would not reduce our welfare but liabilities from the other side of the balance sheet definitely would. This is nothing but reducing Financial Obesity, which will eventually prove good for our economic health.

Islamic finance has proven to be free from severe instability faced by conventional financial system. Stable financial system will have more resources at its disposal for public welfare than a system prone to crises needing provisions for bailout.

No longer does the viability of Islamic banking require any justification. That it is definitely much safer than conventional banking is something that has been proved by eminent economists associated with the world's leading financial institutions. Apart from the usual regulatory obstacles that Islamic banking faces in many countries, in India it also faces a different set of challenges. Most of the secular countries that have accommodated Islamic banking are homogeneous in many respects; which is not the case in India. India is a very heterogeneous country in terms of language, culture, and social preferences. Policymaking processes in India are very slow for the abovementioned reasons. They require a fairly long period to build a consensus due to the various political setups and pressure groups active in the country. Moreover, it is an established fact that India is a religiously sensitive country. With a long history of communal riots and tensions between Hindus and Muslims, it becomes very challenging for even the staunchest secular Hindu to sympathize with anything that has an Islamic connotation.

### Bottlenecks

The roadblocks are many: right from political will to regulatory and administrative matters, there are a host of challenges that Islamic banking is faced with in India. Although the high-level report by the Dr. Raghuram Rajan committee has itself advocated the establishment of interest-free banking (in other words, Islamic banking) for the upliftment of the downtrodden and financially backward in India, it is the executive's discretion to accept any committee's report. Even if the Report is accepted, it does not mean that implementation will start immediately.



## Prelude to Introducing Islamic Banking in India

DR. SHARIQ NISAR

We have had instances in the past where a committee's report was not accepted at all, partially accepted, or the recommendations were not agreed or implemented upon. Dr. Raghuramrajan Committee is no exception to this. We also need to understand that the Committee in question was established to advise government on the matter of financial inclusion of large sections of our population (Muslims included), which are still away from mainstream finance. In this regard, the Committee's recommendation on introduction of Interest-free banking is just one of the many recommendations it has made to the government.

Another interesting aspect to view here is whether or not the term "Islamic" banking would appeal to Indians, given the diverse cultural and religious backgrounds. Indian policy makers favoring introduction of Islamic banking in the country have been airing their views on this. I do not consider this to be a big issue because even in certain Muslim countries, we see the avoidance of the term Islamic. What is important in this regard however, is that Islamic laws are not circumvented. When an individual does so it is seen as weakness or lack of commitment; whereas when a system does so, it smacks of conspiracy and that could be counterproductive. We have many alternative words for Islamic banking such as Sharia Finance, Ethical Finance, Interest-free Finance, or Special Finance. Dr Raghuramrajan Committee has used the word Interest-free Finance. Anything is okay as long as it is not used to exploit the sentiments and there is genuineness and sincerity in following the Sharia.

Yet another aspect to note is the way we would treat the accounting aspect. Malaysia has set a good example by adopting a mix of IFRS and AAOIFI accounting standards; however, it is doubtful if India would allow any concession on accounting policies. This would be like opening a Pandora's box for it. However, India is committed to bringing its accounting policies in tune with IFRS by the next financial year, which signals a ray of hope.

### Moving towards Implementation of Islamic Banking in India

When thinking of implementing Islamic banking in India, we need to keep in mind that India is not an Islamic country. An overwhelming segment of the Muslim population is below the poverty line and struggling for their day-to-day existence. Nevertheless there are

Certain groups engaged in creating awareness about Islamic finance among the general public. Muslims in academia, especially those in economics, finance, and management are also putting their efforts into creating awareness about the opportunities. However, these are not sufficient considering the size of the country and the Muslim population that it has. Some professionals have floated a Sharia advisory firm (called TASIS), which is India's only Sharia advisory institution in financial matters till date. Of late, the firm has had some successes, as when it helped launch India's first Sharia compliant Mutual Fund, India's first Sharia compliant insurance scheme and also a venture capital fund. GIC of India (a government of India owned company) has started a Sharia compliant Retakaful scheme with the guidance of TASIS. These four are the only Sharia compliant products in India at the moment. There are a few other corporations that have some products which they identify as Sharia-friendly; however, they have not availed the services of any Sharia board for authenticating their products as Sharia-compliant.

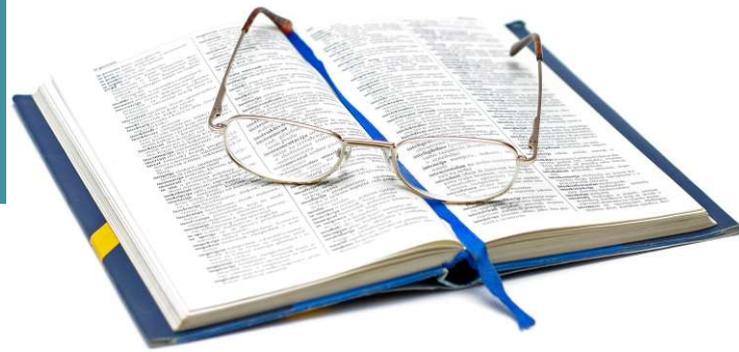
The Indian situation is much more unique than that of any other country witnessing the advent of Islamic banking today. In spite of this, as a start, the UK system could be a good model to replicate. More so because Indian regulators are familiar with UK and they can relate to its regulations.

### The Future is Beckoning

Currently there is only one Mutual Fund claiming Sharia compliance. There are two others that discretely follow Sharia. Performance of these funds has been very good but other funds too have performed well in the last one year. In fact, during the greater part of 2009, markets have been doing well all over the world, except in a very few places. In spite of these statistics, the advent of Islamic banking in India would largely depend on the political and economic situation in the country. If there is peace in the country, it would be easy for the policymakers to push for it.

Unlike the West, India is not in a hurry to introduce Islamic banking in the country. Maybe the economic situation in those countries is such that they cannot wait any further. However, India is not in such a situation and therefore does not feel the need for it as strongly at the moment. Would it then, be advisable to conclude that India is not shying away from the opportunity; it is evaluating the cost of the opportunity?

# Principles of Islamic Finance



Islamic Finance appears a very murky subject to study, and is often clouded with a lot of ignorance. A very interesting aspect of this domain is that it was hitherto being believed that practical implementation of this concept is very difficult. Almost all these speculations result due to ignorance of people with respect to the concepts of Islamic finance. People also feel that Islamic finance is something out of this world and is not congruent with the existing financial scenario. Through this column, we try to look at these aspects and in turn, learn about Islamic finance in a more practical and objective way.

Let's start by looking at the concept of Islamic banking and finance from the conventional banking and finance domain. In a conventional banking setup, a bank or financial institution generates funds and invests in some activities and gains profit or incurs losses. It further distributes the returns to its customers who have contributed in generating the funds for investment. Consider the three concepts of **i) generating funds, ii) investing, and iii) distributing the returns**. An Islamic bank or financial institution would work exactly the same way: generating funds, investing, and distributing returns to its customers. However, an Islamic bank/financial institution would differ from conventional banks/financial institutions: in what sense would it differ is what we look at first in this introductory module. We need to reckon these differences to be able to comprehend and analyze how Islamic banking/finance can be implemented in the present day scenario.

Before we explore the differences; though, let's first look at the basic principles or building blocks of Islamic banking/finance. After we have this knowledge of the principles of Islamic banking/finance, it would become easier for us to comprehend the differences. Even before we look at these principles, we need to look at the sources from where we acquire the information related to Islamic banking and finance. As the name itself suggests, Islamic banking/finance finds its origin and source in the Quran, which is a comprehensive dossier describing how a practicing believer (Muslim) must conduct himself/herself with respect to this world and the Hereafter. Another important source of information is the Hadiths, or the Prophetic Traditions. Based on these two primary sources, the Islamic law or Sharia is reckoned. Sharia or Islamic law can be broadly divided into categories, Ibaadat or worship, and Muamlaat or transactions. Islamic

finance comes under the category of Muamlaat or transactions. As per the conventions, this category of Sharia law allows whatever is **not prohibited**. Consequently and as a corollary, any investment that is NOT PROHIBITED is allowed as per Sharia.

Let's now look at the guiding principles on which Islamic banking/finance is based upon:

**Prohibition of Riba [Interest]:** Implies that interest payment is prohibited. In other words, when an Islamic bank/financial institution distributes the returns of its investments to its customers, the returns must not contain any element of interest in it. This is the basic differentiating factor between conventional and Islamic banks/financial institutions. [Note that Riba is a vast term with multiple interpretations by different schools of thought. We will Insha Allah provide elaboration on this topic in later issues.]

**Prohibition of Gharar or Undefined Risk, Uncertainty, and Speculation:** Implies that any transaction involving uncertainty, risk, and speculation is unlawful. Therefore, an investment that includes wide speculations with unknown implications is not permitted. Examples of such transactions could include futures and options.

**Encouragement of Profit and Loss Sharing:** Implies that a transaction must encourage sharing of both profit as well as losses by all the parties involved.

**Contract:** Implies a mutual agreement between all the transacting parties. In Islam, all transactions are based on intentions; however, Islam encourages documenting these intentions and agreements between all transacting parties to ensure a fair and just environment. Contracts are the most important part of all Sharia-compliant transactions; an otherwise legal transaction may become illegal and prohibited based on specific contracts.

**Conditionality:** Implies that making one contract conditional upon another contract is prohibited. Therefore, if the return on an investment were subject to the fulfillment of a condition included in some other contract, it would be unlawful as per Sharia.



# Principles of Islamic Finance

**Prohibited Commodities:** Implies that transacting in commodities and activities declared Haraam or unlawful in Islam is prohibited. For example, investing in liquor or pork products is unlawful as per Sharia.

**Compliance with Islamic Principles:** Implies that an Islamic bank/financial institution maintain a religious board that can audit all transactions and ensure they are Sharia-compliant.

**Public Need or Necessity:** Implies that investments focusing on public need and urgency are given priority in terms of investment decisions. Therefore, it is more objective to invest in projects that could help alleviate problems of poor countries as compared to investing in amusement parks in a rich country.

Therefore, if we were to differentiate between a conventional bank and an Islamic bank in terms of generating funds, investing, and distributing returns, it would be as shown in Table 1:



Investment Parameters/Bank Type	Conventional Bank/Financial Institution	Islamic Bank/Financial Institution
<b>Generating Funds</b>	<ul style="list-style-type: none"> <li>Generate funds through all available sources</li> <li>Do not consider the lawful and the prohibited in terms of Sharia</li> </ul>	<ul style="list-style-type: none"> <li>Generate funds only through Sharia-compliant means, such as profit/loss sharing agreements</li> </ul>
<b>Investing</b>	<ul style="list-style-type: none"> <li>Invest in all available options</li> <li>Do not consider the lawful and the prohibited in terms of Sharia</li> </ul>	<ul style="list-style-type: none"> <li>Invest only in Sharia-compliant options</li> <li>Do not invest in prohibited transactions such as alcohol and pork products</li> </ul>
<b>Distributing Returns</b>	<ul style="list-style-type: none"> <li>Almost a majority of banks/financial institutions agree to give a fixed return (interest) to the customers</li> <li>The fixed return (interest) is paid irrespective of the profit/loss incurred on the investment</li> <li>Almost a majority of banks/financial institutions keep a large portion of profit with themselves while forwarding only a partial amount to customers as interest</li> <li>Often the large portion of profit retained by the banks/financial institutions is reinvested, resulting in the creation of pseudo or plastic money</li> <li>Retention of large portions of profit increases the rich-poor divide</li> </ul>	<ul style="list-style-type: none"> <li>Returns generally distributed in proportion to the investments made by the customers</li> <li>All parties share profit as well as losses (as and when incurred)</li> <li>No creation of pseudo or plastic money</li> <li>Narrow down the gap between rich and poor</li> </ul>

We conclude the first module of our discourse on principles of Islamic finance here. In the next issues, we would explore each of these principles in detail, Insha Allah.

Questions and problems related to this module can be addressed to [edit@financeislamicus.com](mailto:edit@financeislamicus.com) Please tag the subject line with “Learn Islamic Finance” and mention the respective issue while writing to us.