



# ISLAMIC BANKING AND FINANCE: THE FACTS

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# Presentation Outline

- *Features of Islamic Banking*
- *Objectives of Islamic Banking & Performance Analysis*
- *Key Differences in Islamic and Conventional Banks*
- *Global Financial Crisis 2008: A Litmus Test*



# What is Islamic Banking?

Islamic Banking can be defined as a system of conducting trade and banking activities in line with the principles of Shari'ah.

In Islamic Banking three aspects must be avoided:

- *Riba* (Interest);
- *Gharar* (uncertainty);
- Financing of *haram* (impermissible) activities.



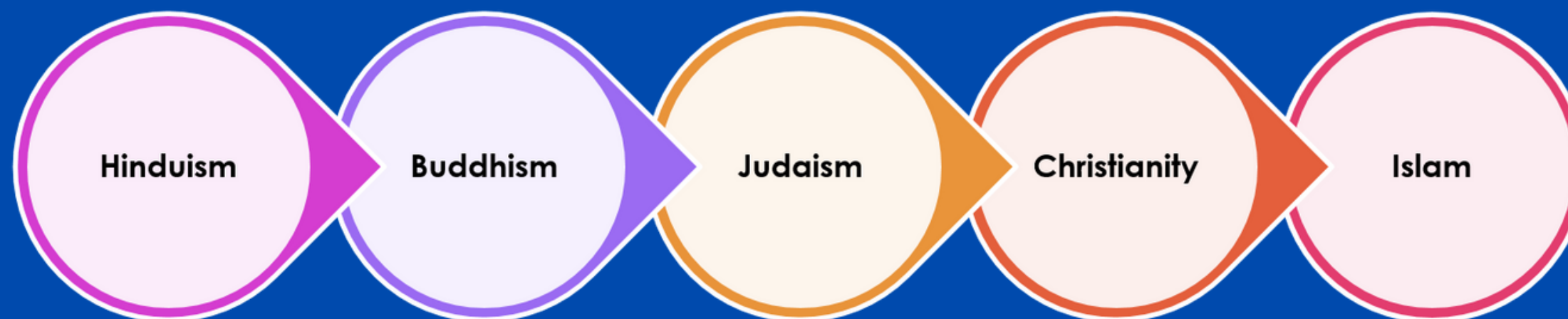
# FEATURES OF ISLAMIC BANKING



# Prohibition of Riba in Major Religions

Riba, the concept of which has been around for 4000 years, has been repeatedly condemned and prohibited on moral, ethical, religious and legal grounds.

Among its most visible and vocal critics have been religious institutions of:



# Prohibition of Riba in Hinduism and Buddhism

Among the oldest known reference to Riba are found in ancient Indian Religious Manuscripts i.e. the Vedic Texts (2000-1400 BC) in which the usurer (Kusidin) is mentioned several times.

More frequent and detailed references to interest payment are to be found in Later Sutra Texts (700-1000 BC) as well as Buddhist Jatakas (600-400 BC).

**Vasishtha:** A well known Hindu Law Maker of that time, made a special law which forbade the higher castes of Priests (Barahmans) and Warriors (Kshatryas) from being usurers or lenders at interest.

**Jatakas:** Refer to it in a demeaning manner “hypocritical ascetics are accused of practising it”.

# Prohibition of Riba in Judaism and Christianity

Charging interest (called Riba in the Qur'aan and Ribit in the Torah) is divinely prohibited in Judaism and Christianity:

New Testament in Matthew 25: 14–30 & Luke 19: 12–27 where the recipient is criticised for "reaping that thou didst not sow".

Old Testament in Leviticus 25: 3–7, Deuteronomy 23: 19–20 and Exodus 22: 25 which states: "If thou lend money to any of my people that is poor by thee, thou shalt not be to him as a usurer, neither shall thou lay upon him usury".

# Prohibition of Riba in Judaism and Christianity

It is interesting to note that the rabbinical laws do not allow a Jewish person to stand as a witness in a Jewish court if he is involved in usury/interest.

It is also interesting to note that in the early days of the Catholic Church, a Catholic who participated in usury/ interest through charging it or receiving it was denied a Catholic burial.



# Prohibition of Riba in Islam

From the Islamic View point:

The body which is nourished by non-pure sources is bound to hellfire.

On the day of Judgment, a person will not be moved from the place on which they stand until they are asked about the sources of their income, and the ways they spent it.

Purifying the source of ones' nourishment is one of the most important conditions for the acceptance of supplications by Allah.



# ISLAMIC BANKING SERVICES

| MUDHABARAH   | MURABAHAH  | TAKAFUL   | SUKUK  |
|--|--|---|--|
| Partnership to raise deposits between bank and investors. Bank acts as funds manager, invests in Shari'ah compliant activities | Cost-plus financing contract to substitute loans.<br>Mutually agreed upon markup not reliant on income, loan amount etc. | Alternative to insurance. All participants pool money into <i>takaful</i> funds. Provide loss guarantees to each other. | Shari'ah compliant alternative to financial bonds. It is a financial certificate sold as an undivided share of ownership of a tangible asset |



# Asset Based Financing

Banks and financial institutions deal in money and monetary papers only and do not trade in goods.

Islam, on the other hand, does not recognize money as a subject-matter of trade, thus all financing done by Islamic Banks are based on real assets whereby the Islamic Banks bear the risks associated with ownership of those assets and suffers loss due to obsolescence and destruction of those goods before sale to customers for example destruction of goods before Murabaha sale.

Related inventory is carried and shown in Balance Sheets of Islamic Finance Institutions (IFIs).





Shari'ah boards comprising of highly qualified shari'ah scholars supervise and oversee overall shari'ah compliance of IFIs.

A specific report issued by Shari'ah Supervisory Board reflecting Shari'ah compliance of Islamic Banks is also part of Annual Reports of Islamic banks.



Any non shari'ah compliant income is identified through shari'ah audit mechanism and is given into charity in order to ensure purification of Income. This is evident in "Statement of Charity and uses of funds" in Annual Reports of Islamic Banks.

# Financing of Permissible Activities only

Riba Free (Islamic Banks) do not finance activities of businesses involved in impermissible activities such as:

- Manufacturing, selling or offering liquor
- Gambling
- Night club activities
- Pornography
- Prostitution
- Lending on Interest etc.



# OBJECTIVES OF RIBA FREE BANKING

## **Equitable Distribution**

Circulation of Wealth in society

## **Avoid Impermissible transactions**

Including *Riba*, *Gharar*, and *haram* activities

## **Promote participation**

Asset-based financing via partnerships

## **Fulfilling halal customer needs**

Ethical and socially responsible needs approved by Shari'ah





# GLOBAL ISLAMIC BANKING

**Around 700 + Islamic financial institutions**

**Islamic Banking Services maintained positive growth of 11.4% in 2019**

**Islamic Banking Services total worth ~ US \$2.44 Trillion (Islamic Financial Services Industry (IFSI) Stability Report 2020 by the IFSB)**

**Islamic Finance projected to reach US\$3.69 trillion by 2024 (ICD-Refinitiv Report 2020)**

**100 million+ customers world wide using Islamic Financial services**

**250+ Shariah compliant mutual funds with \$ 300bn funds**

**Over 12,000 International Islamic outstanding sukuk issued till date**

**Takaful (Islamic insurance) contributions > US\$ 27.1 billion with 353 established takaful institutions (IFSB Report 2020)**

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# **Riba Free Banking- Success Story**

## **MORE THAN 90 COUNTRIES HAVE ISLAMIC BANKING INSTITUTIONS**

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APPROX. 50 MUSLIM COUNTRIES INCLUDING KUWAIT, DUBAI, SAUDI ARABIA, IRAN, MALAYSIA, BRUNEI AND PAKISTAN  
APPROX 40+ NON-MUSLIM COUNTRIES INCLUDING USA, UK, CANADA, SWITZERLAND, SRILANKA, SOUTH AFRICA AND AUSTRALIA.

NEW PLAYERS INCLUDE OMAN, TANZANIA, DJIBOUTI, SINGAPORE, GERMANY, HONG-KONG , RUSSIA, UKRAINE ETC.

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# Islamic Banking training

Islamic Banking Certifications, Degree Programs and Research Centers have been launched by a number of Globally Reputed Universities and Professional Bodies:

Chartered Institute of Management Accountants – CIMA (UK)

Association of Certified Chartered Accountants - ACCA (UK)

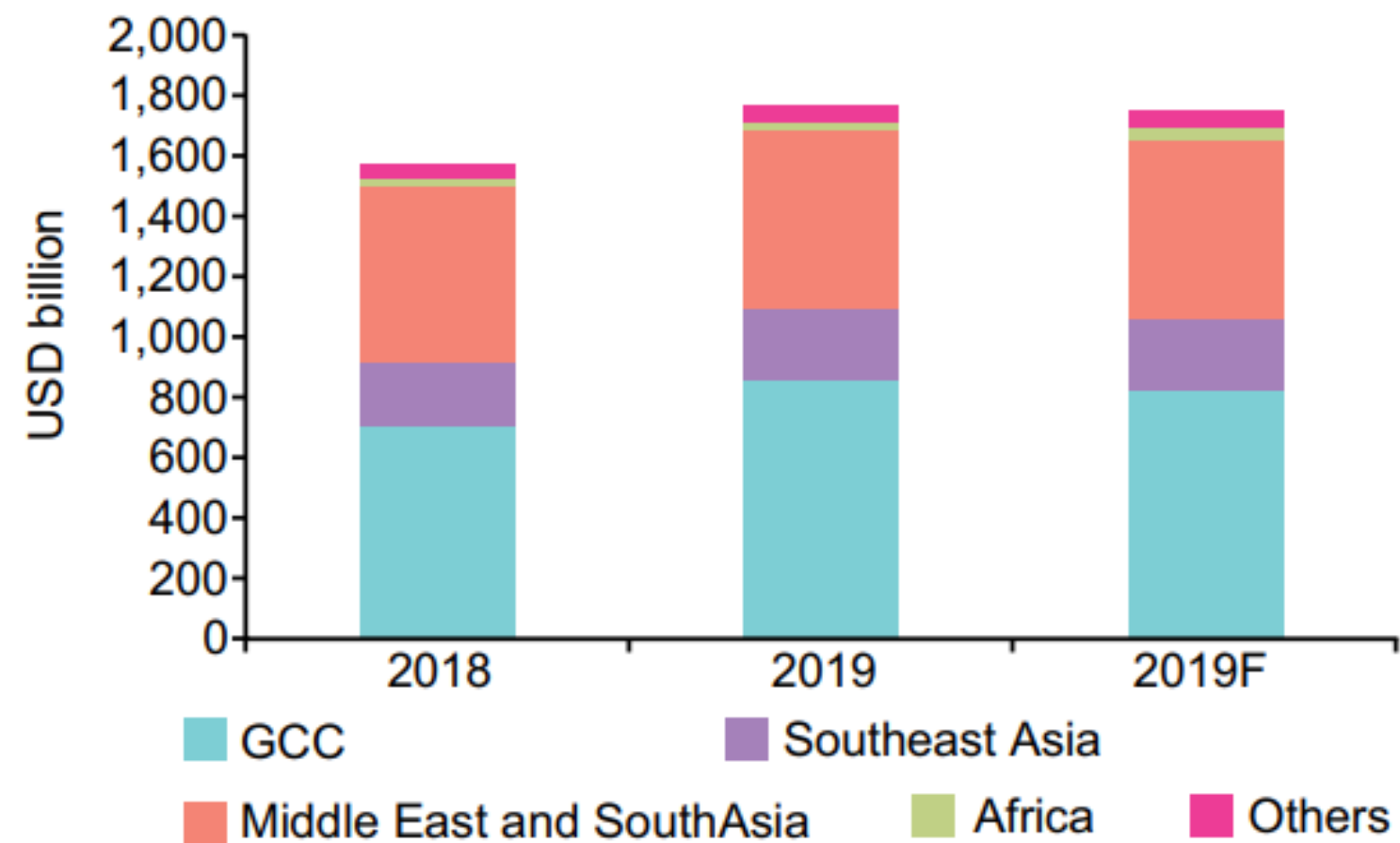
Centre for Islamic Finance - Bolton University

Durham University Business School



# Riba Free Banking – Shares & Growth Trends

Chart 1.2.2 Islamic Banking Assets (2018–2019F)

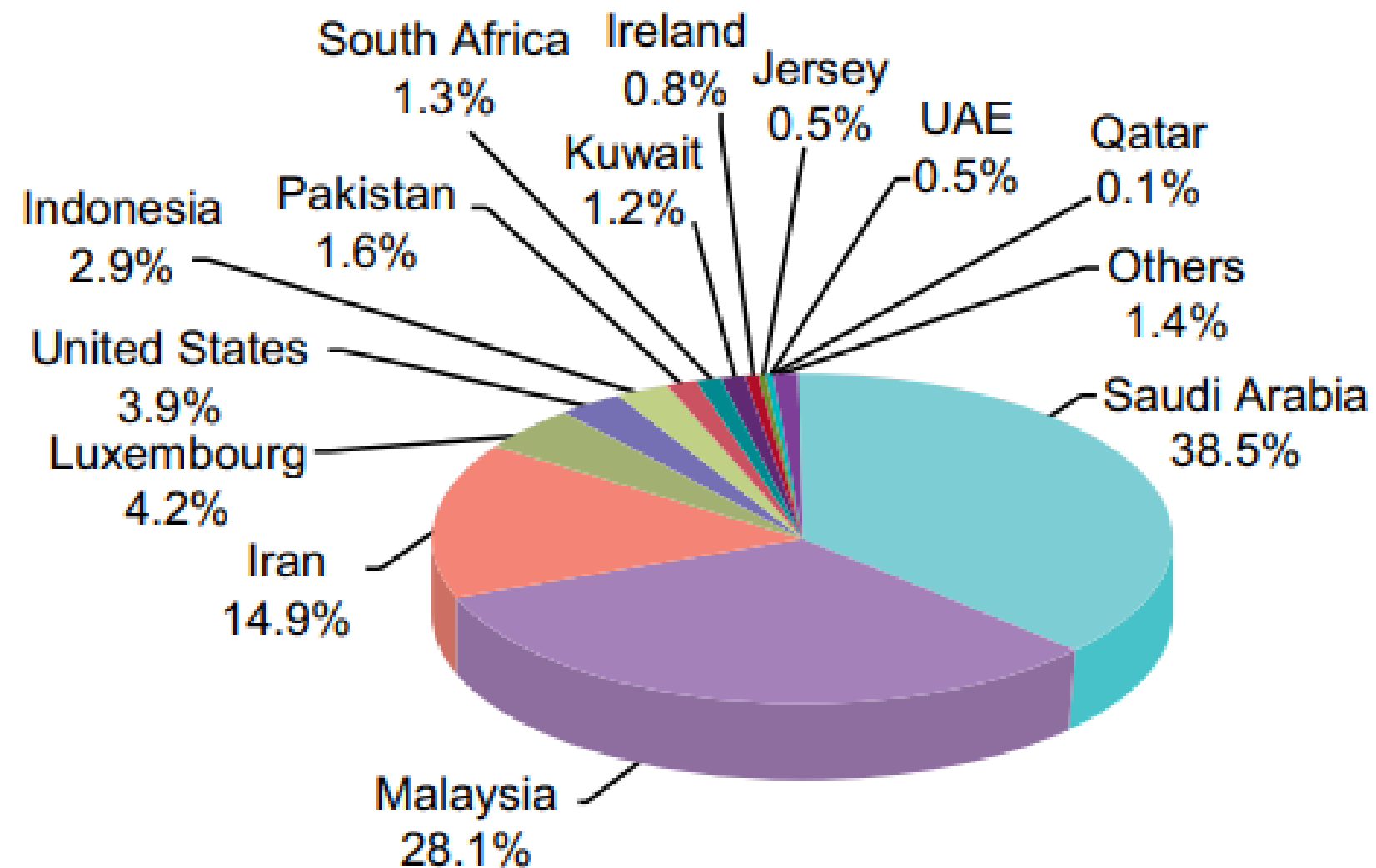


Source: PSIFIs, IFSB Secretariat Working.

Source: IFSB Stability Report 2020

# Riba Free Banking – Shares & Growth Trends

Chart 1.3.2.2 Islamic Fund Assets by Domicile (2019)



Source: IFSB Stability Report 2020



# Key Differences among Riba Free and Conventional Banks

| Islamic Banking   | General Banking  |
|---|--|
| <p>Not money lending institutes; work as trading/ investment house</p> <p>Work under socio-religious guidelines that prohibit interest and impermissible transactions</p> <p>Do not permit financing to industries that may cause harm to society such as alcohol, tobacco etc.</p> | <p>In the business of lending and borrowing money based on interest</p> <p>No such restrictions. Interest is the backbone of this system and short selling, sale of debts and speculative transactions are common</p> <p>All types of industries are financed, only businesses deemed illegal by the law of the land are not supported</p> |

# Key Differences among Riba Free and Conventional Banks

| Islamic Banking   | General Banking   |
|---|---|
| <p>Business model based on trade this Islamic Banks need to actively participate in trade and production processes and activities</p> <p>Strong Shari'ah governing framework through the Supervisory Board which supervises transactions</p> <p>Products are usually asset backed and renting of assets based on participation in profit and loss by both parties</p> <p>Islamic banks recognise loans as non commercial thus exclude them from commercia transactions. Any loans given must be interest-free</p> | <p>Do not involve themselves in trade and only act as lenders</p> <p>No such framework present</p> <p>Treat money as commodity and lend it against interest as compensation</p> <p>All financing and deposit side products are loan based</p> |



# Modus Operandi of General Financial Institutions

| Type of Contract                            | Type of Income for Depositors | Nature of Contract  |
|---|-------------------------------|---------------------|
| (Qard) Borrowing from Customers/ Depositors | Interest Income               | Pre-determined Rate |

| Type of Contract | Type of Income  | Nature of Contract                      |
|------------------|-----------------|---|
| Loan             | Interest Income | Pre-determined rate (fixed or floating) |

# Modus Operandi of Islamic Financial Institutions

| Type of Contract                    | Type of Income for Depositors | Nature of Contract |
|-------------------------------------|-------------------------------|--------------------|
| Mudharabah for PLS Accounts         | Profit                        | Not Guaranteed     |
| Qard ul Hassan for Current Accounts | Hiba                          | Not Contractual    |

| Type of Contract         | Uses                        |
|--------------------------|-----------------------------|
| Musharakah (Partnership) | Working Capital Financing   |
| Ijarah (Leasing)         | House/ Vehicle Financing    |
| Murabaha (Sale)          | Inventory/ Import Financing |
| Salam (Sale)             | Agri/ Export Financing      |
| Istisna (Sale)           | Export Financing            |

# Top 10 General vs Riba Free Banks

| Top 10 Conventional Banks     | Top 10 Riba Free Banks    |
|-------------------------------|---------------------------|
| Citi Group                    | Al Rajhi Bank             |
| Bank of America               | Kuwait Finance House      |
| ICB of China                  | Dubai Islamic Bank        |
| HSBC                          | Bank Al Bilad             |
| JP Morgan Chase               | Qatar Islamic Bank        |
| Bank of China                 | Investment Dar            |
| China Construction Bank       | Abu Dhabi Islamic Bank    |
| UBS                           | Kuwait International Bank |
| Royal Bank of <u>Sctoland</u> | Gulf Finance House        |
| Mitsubishi UFJ Fin.           | Qatar Int'l Bank          |



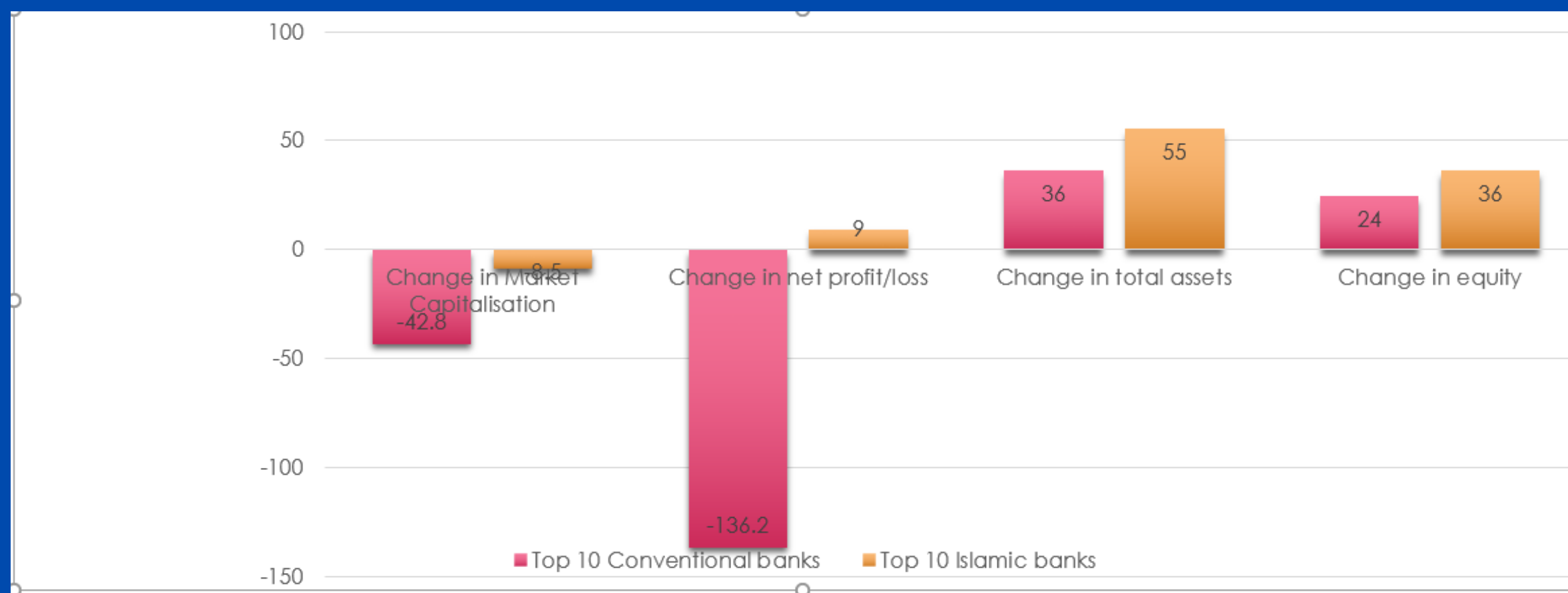
# Top 10 General vs Riba Free Banks

## Performance 2006-2008

| Parameters                    | Top 10 Conventional Banks                                   | Top 10 Riba Free Banks                           |
|-------------------------------|---|--|
| Combine Market Capitalization | Decline by 42.8%  | Decline by 8.5%                                  |
| Aggregate Net Profits         | USD116 billion in 2006 to<br>Net loss of USD42 billion-2008 | USD4.2 billion to USD4.6 billion<br>(9 % Profit) |
| Growth in Assets              | 36%   | 55%  |
| Growth in Equity              | 24%   | 36%  |



# Global Financial Crisis 2008: A Litmus Test



Five of the top 10 conventional banks received government financial assistance of USD163 billion in aggregate i.e. 26% of the affected banks' combined equity.

VS.

Only 1 Islamic financial institution required government assistance

As at end 2009, none of the Islamic banks needed any government rescue scheme.

# Stock Markets Decline in 2008 Comparison

Total returns on the Dow Jones Islamic Market World Developed Index declined by 24.7%

Vs.

The outturn for its counterpart/proxy, the Morgan Stanley World Index declined by 34.7%

The S&P Global Index lost 42.5%

Vs

The S&P Global Shari'ah Index fell by 36.8%

•The S&P 500 lost 38.6%\* compared with its Islamic counterpart which declined by 28.9%.



# Why are Riba Free Financial Institutions so resilient?

- Economically productive underlying activities
- Avoidance of interest-based transactions
- Avoidance of Sale of Debt
- Genuine trade and business transactions backed by real assets
- Avoidance of speculative transactions
- Entitlement of profit contingent upon risk taking



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