

# Islamic Financial System: The Need to Shift Global Markets' Paradigm Post Crisis



Romy Buchari

Halal Congress Middle East  
December 16 -18, 2013  
Sharjah, UAE

PROPRIETARY MATERIAL

Any use of this material without specific permission from Emirates Islamic Bank is strictly prohibited

# Islamic Finance: an Introduction



## History

First Islamic savings institution - Egypt 1963  
First Islamic commercial bank - UAE 1975

## Need

A new financial system to address needs of:

- Avoidance of interest/usury-based lending or borrowing;
- Avoidance of financial transactions which involve high degree of Gharr (excessive uncertainty);
- Avoidance from commercial contracts which contradict Shari'a principles

## USP

- Asset Backed
- Principle Oriented
- Risk Sharing
- New and Developing

Money has no intrinsic value, it is a means to an end

*“Condemnation against usury/ interest-charging found across major religions: Buddhism, Christianity, Islam, Judaism”*

# Global Financial System



## Current State

Calamity!

### **Dominance of Debt/Loan**

Disconnect between depositors and businesses

### **Large Derivatives Markets**

Transactions based on trading of debts/interest; creation of 'ghost/parallel' demand & supply of activities/asset

### **Money Posses Intrinsic Value**

Charging of Interests/Usury, currency exchange for profits

### **Wealth Concentration**

2007: 85% of US private wealth owned by top-20% households. Excl. one's home value, top-1% owns 43%

### **Economy Bubble**

2008: Global GDP USD 61tn  
Global derivatives USD 741tn  
(Phantom economy 12x size of real economy)

### **Rampant Currency Speculation**

2008: Int'l trade volume avg. USD 88bn/day  
Global FX volume avg. USD 3,980bn/day (45x real trade)

## Ideal State

### **Dominance of Risk Sharing**

Markets of linked investors and businesses

### **Asset-Based Contracts**

Transactions on value-adding activities/asset

### **Money has No Intrinsic Value**

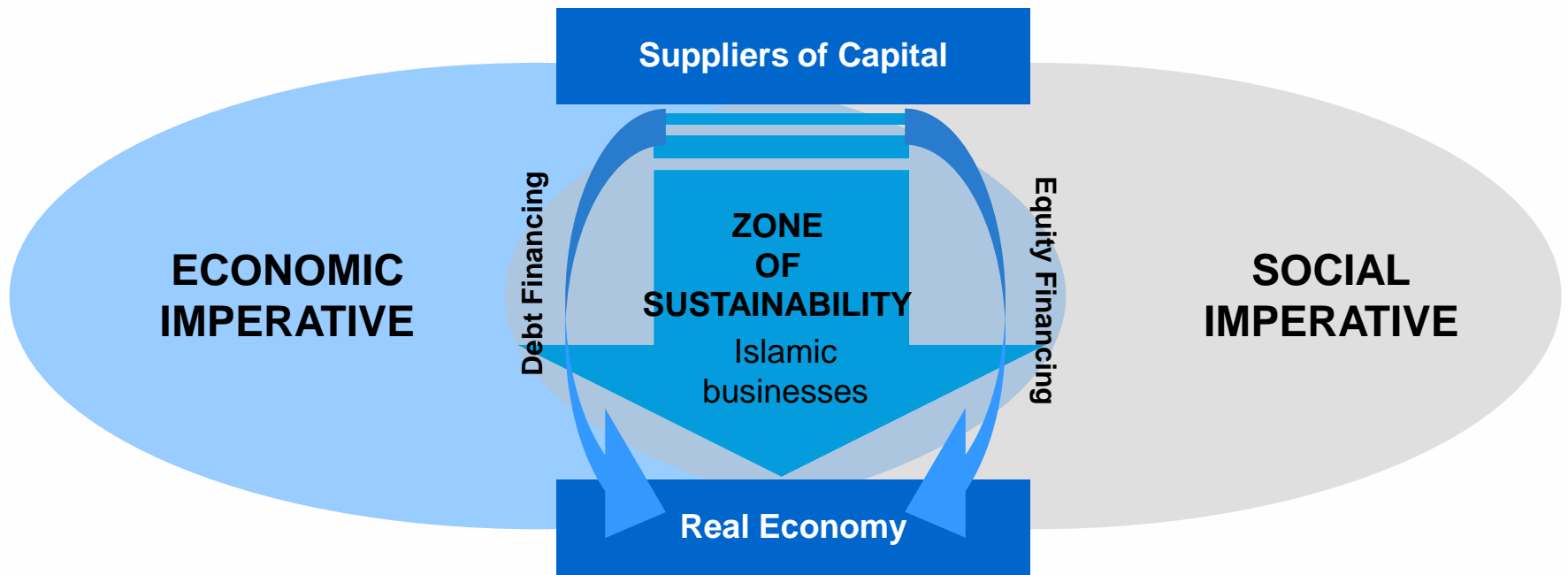
Money is only mean of exchange/common measurement

Sources: Muhammad Taqi Usmani "Post-Crisis Reforms. Some Points to Ponder", with citations from: BIS.ORG; World Bank, World Development Indicators; World Trade Organization; <http://en.wikipedia.org>

# Islamic Financial System



Balances economic development with social justice



- ▶ Market-driven, yet values-based
- ▶ Gradualist & evolutionary nature
- ▶ Symbiotic & synergistic relationship with mainstream

Source: HSBC Amanah "Towards Sustainable Financing", 2007

# Financial System: The Journey



Sources: Credit Suisse “The CDOs Strategy” Dec. 7, 2012; CNN Money “Risky Loans are Back” Sept 26, 2012



# IB Not Fully Immune to Crisis, ...

Operating within the larger conventional financial environment –  
Islamic Banking (IB) is not fully immune to global crisis

Shared Exposures:  
Islamic and  
Conventional Banking  
Systems

- Debt Ridden Balance Sheets
- Macro Economic Risk
- Credit Risk
- Rate Risk
- Liquidity Risk

Specific Exposures to  
Islamic Banking  
Systems

- Property Ownership Risk
- Fixed Profit Rates  
(Murabaha/Istisna)

# ..., but IB has Built-In Resistance



Compliance to Shari'a Principles bound Islamic Banks from taking excessive risks & only enter transactions with real underlying-asset

NO  
CDOs

- In the US Markets, CDOs were one of the important factors which contributed in aggravating the financial crises.

- Since it is based on out-right sale of debt, no Islamic Bank was involved

NO  
Derivatives

- Complex financial engineering created phantom parallel demand & supply of assets. Rendering basic purpose of hedging little relevance, compared to earning easy money on speculation

- Some Shari'a compliant derivatives were suggested, but those remain largely plain vanilla, and due to Murabaha based deals, Islamic derivatives fail to be as lucrative as conventional derivatives

NO  
Short-selling

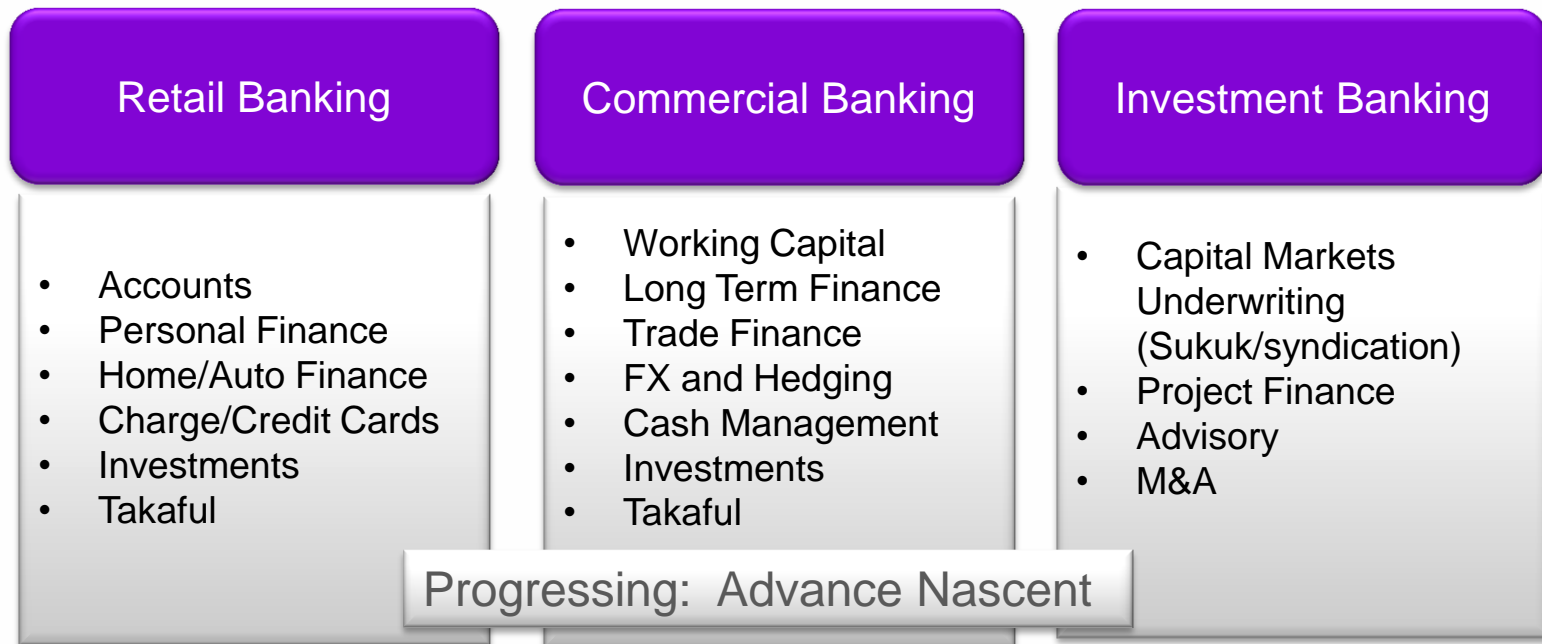
- From Properties to stocks, short selling remains one of the main sources of trade in any conventional system. However, when system fails, it has catastrophic effect on the economy

- Solutions for Urboon were restricted (with option of actual asset delivery), and cannot be overall considered as substitute to short-selling



# Islamic Banking a Viable Alternative to Conventional Banking

Started fifty years ago merely as an experiment. Today, Islamic Banking possesses **comprehensive offerings**, with nearly **One Trillion US Dollar of total asset** and growing



Source: Thomson Reuters: "State of The Global Islamic Economy, 2013 Report"



# Islamic Financial System: Nascent



Wider Islamic Financial markets still developing major pieces of the puzzle

## **Islamic Interbank Markets**

Limited avenue to absorb excess liquidity

Efforts to create liquidity management tools, e.g. supranational IILM

## **Takaful Markets**

Takaful industry lagging behind banking side

Current availability limited to few major Islamic markets

## **Equity Participations**

Industry still financing-centric; geared towards established corporates

IBs participation in smaller equity tranx; Islamic private equity/ venture capital firms making a comeback post-crisis

## **Pension & Sovereign Wealth Funds**

Lack/Limited Shari'a-compliant funds

Government initiatives needed, this will help create wholesale demand

## **Wider Range of Halal Products/Services & Market Standardizations**

Limited choices – still considered as specialty offerings; differing standards

Government initiatives to speed-up mainstream halal markets (UAE, Malaysia)



## Aspirations

- To be a major part of the financial system of Muslim-majority economies (e.g. Egypt, Indonesia, Malaysia, Morocco, Pakistan, Saudi Arabia, UAE)
- To be a key part within conventional economies with large Muslim-minority base (e.g. China, France, India, Philippines, Singapore, UK, US)

## Key Drivers

- Government-driven initiatives (industry landscape/regulation/level playing field)
- Industry initiatives (consolidation, equity-centric, technology, customer experience)
- Increasing trade between OIC members
- Advent of halal products (e.g. food, pharmaceutical, clothing, travel, media)

## Lets Start the Journey



P.O.Box 6564, Dubai, UAE  
[www.emiratesislamic.ae](http://www.emiratesislamic.ae)



Country's  
strongest brand  
Superbrand



Best Islamic Bank  
UAE - 2013  
World Finance Magazine



Best Islamic  
Corporate Bank - 2013  
Bankers Middle East



Best Islamic Bank  
UAE - 2013  
Capital Finance  
International Magazine