

An instrument on the rise

by Oliver Agha

Islamic finance, long considered in the West as more of an oddity rather than an opportunity, is on the rise.

Standard & Poor's currently puts the market for Islamic financial products including banking, mortgages, equity funds, fixed current income, insurance, project finance, private equity and even derivatives at about \$400 billion and expects it to reach \$1 trillion in two years. Islamic finance is estimated to have grown at over 15% annually in the past three years, and looks set to expand further as the petro-economies of the Gulf boom and Western investors acclimatise to some of its cultural characteristics.

Some believe that Islamic finance has awoken from a deep slumber and, like the rapid expansion of Islam across the Middle East, Africa and Asia in the early years of the religion, it is now being accepted and embraced by the mainstream bankers and financial institutions in non-Islamic jurisdictions. Is this just a trend? Or is Islamic finance a groundswell movement that may herald a change in aspects of modern banking?

Principles

Islamic finance is based on the following principles: foregoing a risk-free return on money; assuming risk (with the intention of spreading the benefit of wealth to all segments of society); engendering true partnerships (with a shared interest in the success of a venture) and through these actions achieving a spiritual closeness with God.

Not surprisingly, a distinctive feature of Islamic finance is its focus on developmental, social and charitable goals.

A transaction will generally be Islamic if (a) any returns follow from the assumption of a genuine

risk and (b) wealth accumulates through permissible means and not through, eg, prohibited investments such as investing in alcohol, gambling or tobacco.

Relationships

Well-recognised Islamic finance avenues include those seeking to accomplish the following relationships between contracting parties: Mudaraba (partnership financing between money provider and talent provider); Murabaha (goods financing where a financier purchases goods and sells to a party

A distinctive feature of Islamic finance is its focus on developmental, social and charitable goals.

on a deferred payment basis); Musharaka (classic shared-risk partnership financing); Ijara (financier purchases and leases assets to an entity); and Istisna'a (procurement contract).

Islamic jurisprudence has evolved over the past 1,400 years and certain rules and principles have developed that govern the transactional relationships between the parties. Islamic finance derives its standards from Islamic jurisprudence referred to as the Shari'ah. The Shari'ah has four prime sources: the Quran, Hadith, consensus and analogy. Certain fundamental premises of Islamic jurisprudence, however, are directly supported in the Quran.

"Those who devour Riba (usury) will not stand (on the day of Resurrection) except as stands one whom Satan (the evil one) by his touch hath driven to madness. That is because they say, 'trade is like Riba (usury) but Allah hath permitted trade and forbidden Riba (usury)'.

Those profiting from usury gain material wealth without risk and earn disfavour with God. Under Shari'ah, therefore, there is no concept of interest-bearing lending and if and when a loan is granted it should be done voluntarily without the expectation of any return (Qard Hasan). An oft quoted story is that of the Prophet's relative, and the fourth Caliph, Ali, who refused a lift from one of his debtors in a crowded street to avoid the appearance of receiving a benefit for granting a gratuitous loan to the man.

It is apparent that in some current Islamic financings the structures (and the constructs upon which they are based) are bent to achieve conventional risk profiles.



Is Islamic finance a groundswell movement that may herald a change in aspects of modern banking?

It is our view that to the extent that Islamic structures offer no genuine assumption of risk (or in effect they guarantee a return) then they are, in spirit, not Islamically compliant.

New and hybrid structures can be, and are, routinely developed by financiers. There is no limit to innovation in Islamic jurisprudence.

Commercial goals

With innovation and creative but critical thinking it is entirely possible to achieve commercial goals through Islamic financing without simply replicating conventional structures (for example by substituting terms such as profit for interest).

Any structures or deals which merely replicate conventional structures and purport to be Islamic are non-compliant and further run the risk of contravening the Islamic principles of *riba*, *gharar* or deception.

Recent developments in Islamic Takaful (insurance) underline the innovation possible in creating compliant Islamic structures. Structures are being developed that both meet Shari'ah expectations and achieve commercial objectives of insurers. Takaful premiums, currently estimated at \$2 billion, are expected to quadruple over the coming years particularly as Takaful insurers become able to offer commercially viable alternatives to conventional insurance.

Takaful is a form of Islamic insurance based on the Quranic principle of *Ta'awun* or mutual assistance and it provides mutual protection of assets and property and offers joint risk-sharing in the event of a loss by one of its members. Takaful, at its core, is similar to mutual insurance. One of the main differences between Takaful and conventional insurance is the grant of a refund to the insured of a portion of the premium in the event that losses do not occur.

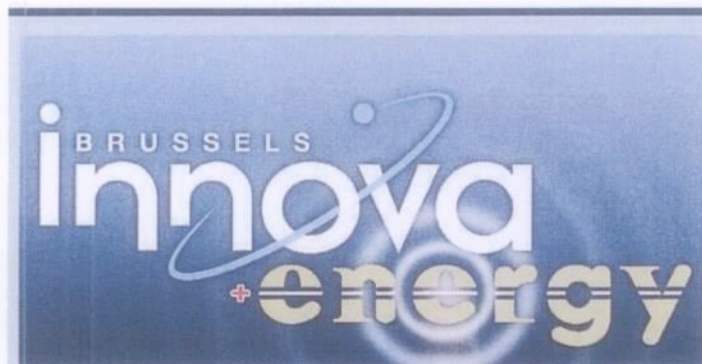


Oliver Agha
is Partner and Global Head
of Islamic Finance at
DLA Piper.

Islamic finance is increasingly becoming a feature in project financings and spawning Islamic banks across the Middle East. And it is becoming a progressively more important area for participation by Western banks. Islamic finance will continue to grow as developments take further hold in the fast growing and vibrant economies of the Middle East. The key challenge moving forward will be the capacity and capability of the world's Islamic finance institutions, scholars and professionals to lead and manage change in a dynamic sector while upholding the principles of Shari'ah.

As Islamic finance develops, Islamic scholars and lawyers have an ongoing duty to develop Islamic finance in a manner that serves both the prescriptives of a Shari'ah board and the higher law that binds us all. ■

Takaful,
at its core,
is similar
to mutual
insurance.



Energie et climat

Quelque 150 exposants, des symposiums, des conférences, des débats, des workshops, des inventions et des expériences multiples ont rythmé les quatre journées du Salon international Innova et Energy, qui s'est tenu fin novembre dernier au Heysel.

Cette vitrine internationale a accueilli les plus grands du secteur énergétique avec l'appui et la présence des plus hautes institutions fédérales et européennes, de même que le monde académique représenté par les universités. Tous ces acteurs ainsi que le grand public ont été invités à prendre conscience du challenge de l'innovation et des avancées rapides de ce secteur.

Parmi les moments forts de ce salon, on peut citer, en matière de production, le témoignage de Siemens sur ses réalisations dans l'énergie -une centrale électrique sur cinq dans le monde bénéficie de sa signature- ou celui d'une PME belge comme Van Parijs-Maes, qui met en place une production d'électricité décentralisée avec récupération de chaleur pour les besoins de ses clients, petits et grands.

Sur le plan de la consommation, un panorama de l'offre d'énergie aux consommateurs belges a été présenté. Dans le domaine de la construction, l'exemple de Renove Electric a été cité: cette société a conçu son bâtiment pour éviter quelque 8 tonnes de rejet de CO₂ dans l'atmosphère. Ou celui du groupe Altran, qui suscite la réflexion en matière d'économie d'énergie et développe des solutions innovantes intéressantes de plus en plus d'entreprises.

Le transport a également été abordé, notamment via l'apprentissage d'une conduite automobile plus fluide, donc économique et écologique, avec le groupe D'Ieteren et sa voiture-test VW.

Une foule de projets, d'exposés et d'inventions ont été présentés pour mieux responsabiliser tous les acteurs face au défi mondial que représente une meilleure utilisation de l'énergie (info: www.innova-energy.com).