



# Introduction to Islamic Finance, Securitization and Sukuk

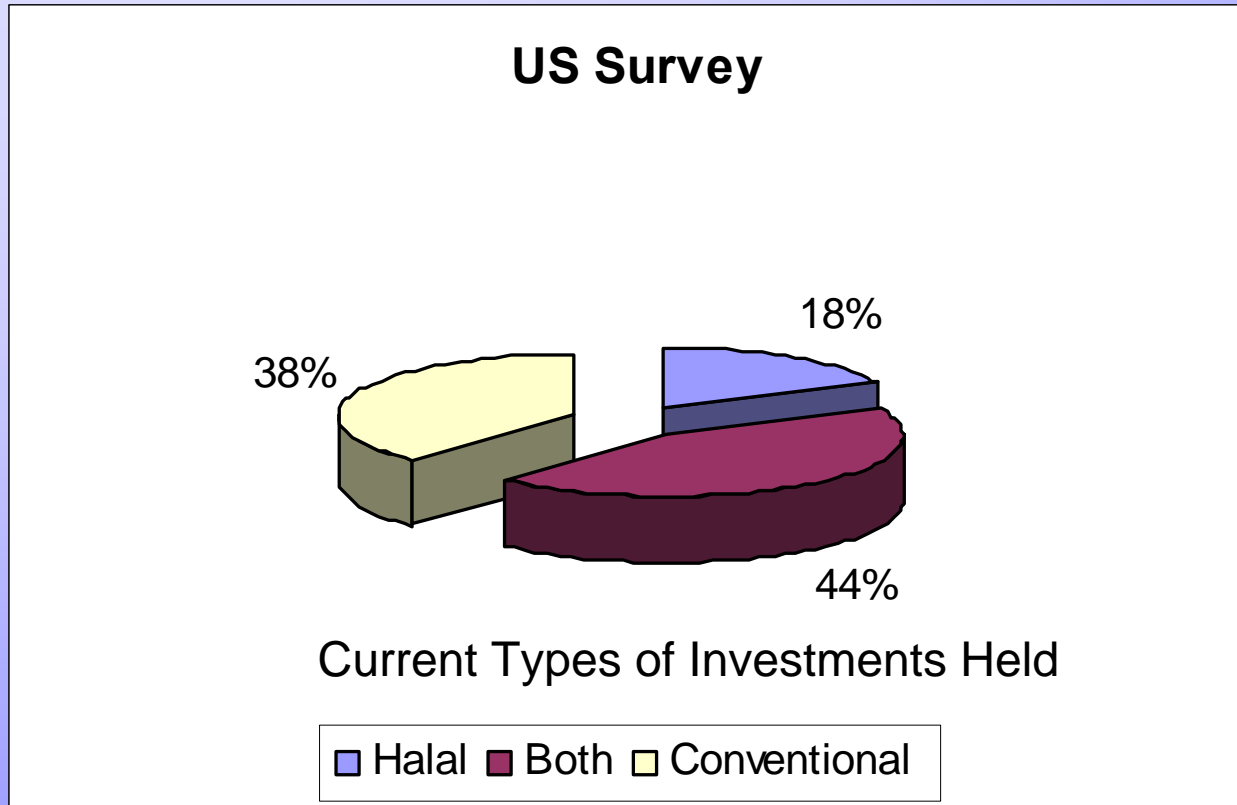
*By Amer Khalil ur Rehman*

*Disclaimer: Views expressed here in a personal capacity*

# Global Islamic Banking Market

1. **Muslims** make over 20% i.e. **1/5<sup>th</sup> of world population**
2. **Profits** during 80's averaged 15%-20% p.a. and in 90's onwards averaged **10%-15% p.a. return**
3. **Foreign Banks,**  
**ABN Amro Bank,**  
**Citibank,**  
**Deutsche Bank,**  
**Hong Kong & Shanghai Banking Corporation,**  
**Merrill Lynch,**  
**Standard Chartered,**  
**Union Bank of Switzerland etc,** doing Islamic Banking for profit, and market size potential, and not (necessarily) for religious reasons
4. **Singapore Eateries & Fast Food Chains**

# Market Potential



**Over 62%** had **Halal Only** investments, or **Both**.

Indicates that about **two-thirds Muslims are concerned with having Halal investments**, in line with their religious beliefs

# Prohibition of Riba

# Why Islamic Banking?

- Interest, Usury, or Riba is forbidden in almost all major religions of the world e.g.
  - Judaism
  - Christianity
  - Islam
- **Plus Strong Business Case and Market Potential**

# Judeo Christian Tradition

**“Thou shalt not lend upon usury  
to thy brother,  
usury of money,  
usury of anything that is lent upon usury”**

**(Deutonomy 23:19)**

# Judeo Christian Tradition

“**He that hath not given forth upon usury,**

**neither hath taken any increase,**

**that hath withdrawn his hand from iniquity,**

**hath executed true judgment between man and man,**

**hath walked in my statutes,**

**and hath kept my judgments,**

**to deal truly; **he is just** He shall surely live, **said the Lord GOD**”**

**(Ezekiel 18: 8,9)**

# Judeo Christian Tradition

**“He that by**

**usury and unjust gain increaseth**

**his substance, He shall gather it for him**

**that will pity the poor”**

**(Proverbs 28:8)**



## Judeo Christian Tradition

“In thee have they taken gifts to shed blood;  
thou hast taken usury and increase,  
and though hast  
greedily gained of thy neighbours by extortion,  
and hast forgotten me, said the Lord God.”

[Ezekiel 22:12]

# Sources of Fiq'h in Islam (and Riba)

- **Quran**
- **Sunnah**
- **Ijama'e Ummah (Consensus of the Ulema)**
- **Ijtehad / Qiyas**

# Riba in the Quran

# Riba in Quran

## First Revelation:

“That which you give as **interest to increase** the people’s **wealth increases not with God**;

but that which you give in **charity**, seeking the goodwill of God, **multiplies manifold.**”

(The Rome – Sura al-Rum 30:39)

# Riba in Quran

## Second Revelation:

“And **for** their **taking interest** even though it was **forbidden** for them

and their wrongful appropriation of other peoples' property.

We have prepared **for those** among them **who reject faith** a **grievous punishment**”

(Woman – Sura Al-Nisa' 4:161)

# Riba in Quran

Third Revelation:

“O Believer, **take not** doubled and redoubled **interest** [**interest on interest**], and fear God so that you may prosper.

Fear the fire which has been prepared **for those who reject faith**, and obey God and the Prophet so that you may receive mercy”

(The family of Imran – Sura Al-Imran)

# Riba in Quran

## Fourth Revelation:

“Those who **benefit from interest shall be raised like those who have been driven to madness by the touch of devil; this is**

**[just] BECAUSE THEY SAY: “Trade is like interest”**

while **God has permitted trade and forbidden interest.**

Hence, those who have received the admonition from their Lord and desist, may keep their previous gains, their case being entrusted to God’ but those who revert shall be inhabitants of fire and abide therein forever”

(The Cow – Sura Al-Baqara 2:275)

# Riba in Quran

## Fourth Revelation:

**“... God has permitted trade  
and forbidden interest...”**

**(The Cow – Sura Al-Baqara 2:275)**



# Riba in Quran

**“God deprives interest of all blessing,  
but blesses charity; He loves not the  
ungrateful sinner”**

(The Cow – Sura Al-Baqara 2:276)

## Riba in Quran

“**O believers**, fear Allah, and **give up** what is still due to your from the **interest** (usury), **IF [indeed] you are true believers[!!!]**.

If you do **not** do so, **then** take

**Notice of War from Allah and his Messenger.**

But, if you repent, you can have your principal.

**Neither** should you **commit injustice**, **nor** should you be **subjected to it.**”

(The Cow – Sura Al-Baqara 2:278-9)

# Riba in Quran (Related in context to 2:278)

**“The only reward of those  
Who make War upon Allah & his Messenger,  
and strive after corruption in the land, will be that they will be**

- 1. Killed**
  - 2. Or, Crucified,**
  - 3. Or, have their Hands and Feet on alternate sides Cutoff,**
  - 4. Or, will be Expelled out of the land.**
- Such will be their **degradation in the world**, and
  - in the **hereafter**, theirs will be **an awful doom.**”

(Quran: The Table Spread - Al-Maida Chapter 5: Verse 33)

# Riba in Hadith

# Riba in Hadith

## “The Prophet cursed

- the **receiver** and
- the **payer** of interest,
- the one who **records** it and
- the two **witnesses** to the transaction
- and said: **“They are all alike (in guilt).”**

(Sources: Jabir ibn Abdullah, Muslim, Tirmidhi, Musnad Ahmed)

# Riba in Hadith

**“A dirham of riba which a man receives knowingly is worse than committing adultery thirty six times.”**

(Sources: Abdallah ibn Hanzalah. Mishkat al-Masabih.Bayqahi)

# Riba in Hadith

The Prophet said: “Riba has seventy segments, the least serious being **equivalent to a man committing adultery with his own mother.**”

(Sources: Aby Hurayrah, Ibn Majah)

The Holy Prophet said: “**Even when interest is much, it is bound to end up in paltriness.**”

(Sources: Ibn Mas`ud, Ibn Majah, Musnad Ahmad)

# Riba Al-Fadl in Hadith

The Prophet said: “Sell,

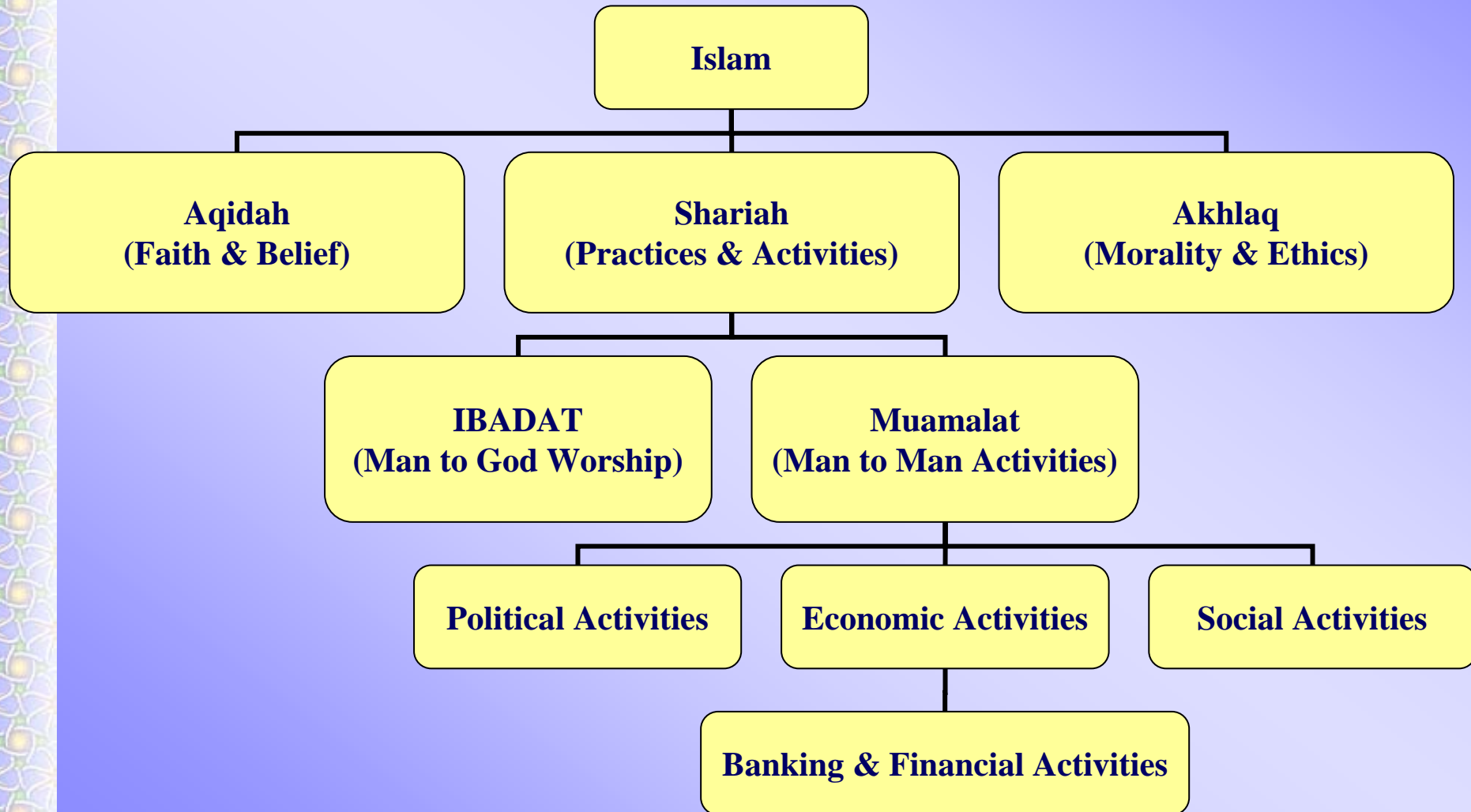
- **Gold** in exchange of equivalent Gold,
- **Silver** in exchange of equivalent Silver
- **Dates** in exchange of equivalent Dates
- **Wheat** in exchange of equivalent Wheat
- **Salt** in exchange of equivalent Salt
- **Barley** in exchange of equivalent Barley

But if a person transacts in excess it is usury (riba), However, sell gold for silver anyway you please on the condition it is hand to hand (spot) and sell barley for dates anyway you please on the condition it is hand –to-hand.”



# Introduction – Part II

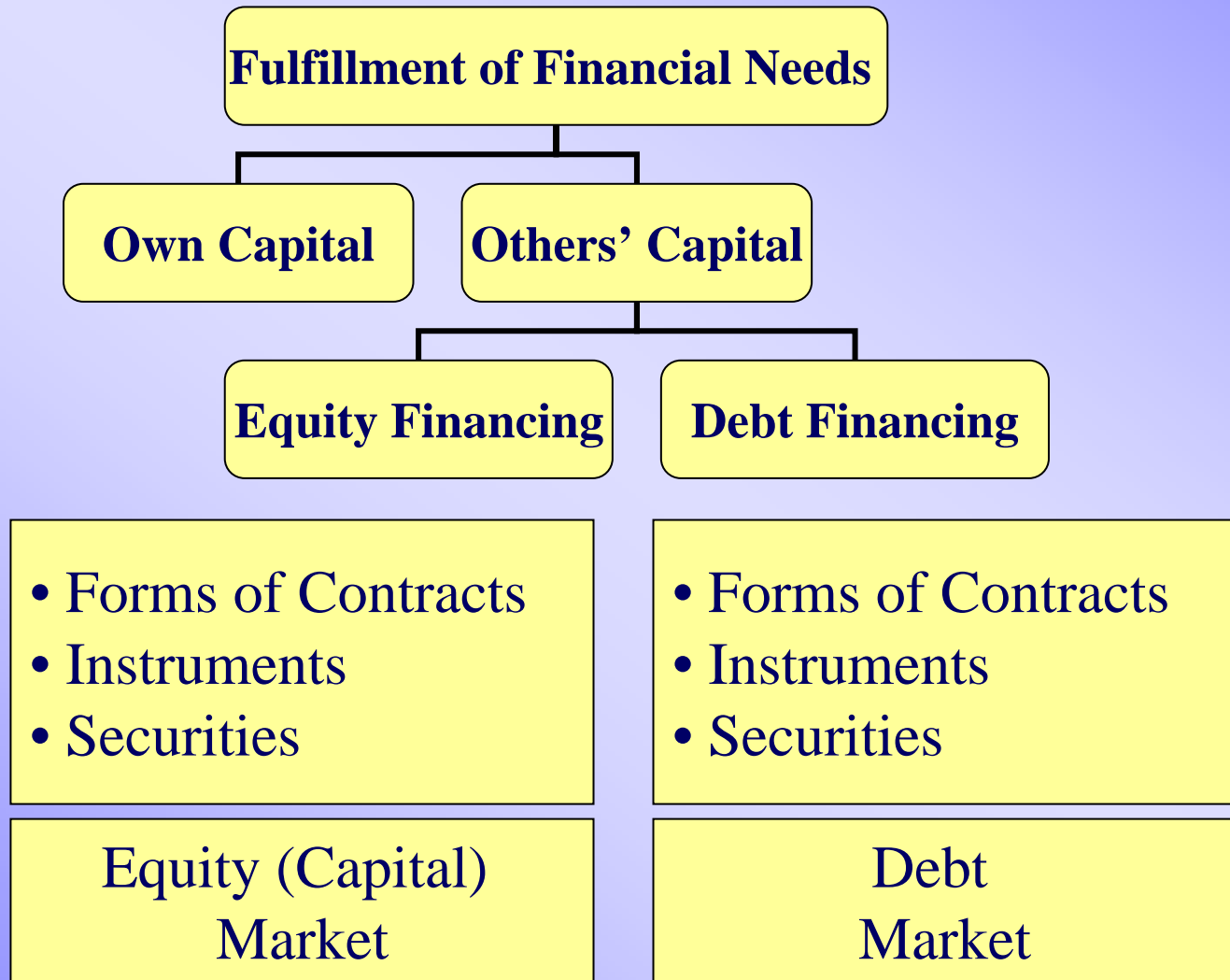
# Islam and Shariah



## Muamalat (civil transactions) should be..

- **Free from Riba** (an increase without 'iwad or equal counter-value)
- **In Compliance** with (objectives of) **Shariah**
- **Devoid of Gharar** (uncertainty, indeterminacy)
- Free from **Qimar** (gambling) and **Maysir** (games of chance)
- Free from **Ghishsh** (fraud) and **Khilabah** (cheating)
- **Entitlement to profit depends on liability for risk**
- **Contracts based on free mutual consent**
- **“What is not explicitly prohibited is permissible”**

# Human Financial Needs



# External (Equity & Debt) Financing

Equity Financing	Debt Financing
<b>Uqud al-Ishtirak</b> <b>(Contracts of Profit Sharing )</b>	<b>Uqud al-Muawadhat</b> <b>(Deferred Contracts of Exchange)</b>
<b>Al-Mudarabah</b> <b>(Trustee Profit Sharing)</b>	<b>Al-Bai' Bithaman (Mu)Ajil</b> <b>(Deferred Installment Sale)</b>
<b>Al-Musharakah (Joint Venture Profit Sharing)</b>	<b>Bai' al-Murabaha</b> <b>(Cost Plus Profit Sale)</b>
<b>Others</b>	<b>Al-Ijarah (Leasing)</b>
	<b>Bai' al-Salam (Commodity Sale)</b>
	<b>Bai' al-Istisna' (Sale on Order)</b>
<b>Equity Market</b>	<b>Debt Market</b>

# **‘Banks Deal in Documents’**

# Documents

- **“Conventional Banks deal in Documents”**
  - Transaction Documents (“Loan Creation”)
  - Security Documents
- **“Islamic Banks deal in Goods and Documents”**
  - Transaction (Process) Documents (“Debt Creation”)
  - Security Documents (similar)

# Main Financial Contracts

- A. Debt creating Modes (Low Risk Category)**
  1. Qard Al-Hasan (interest-free loan)
  2. Bai Muajjal (Price deferred sale)
  3. Murabaha and Musawama
  4. Salam (Commodity sale)
  5. Istisna (Order to manufacture)
  
- B. Semi-debt Modes (Medium Risk Category)**
  1. Ijarah
  
- C. Sharing or Non-debt Modes (Full Risk Category)**
  1. Musharakah (Close to venture capital)
  2. Specific Purpose Mudarabah
  3. General Purpose Mudarabah



# Loan vs Debt Dilemma

# Conventional Vs Islamic Economics

## Difference in Factors of Production

### Conventional

- Land
- Labour  
(incl. Entrepreneur)
- Capital

### Islamic

- Land
- Labour  
(incl. Entrepreneur)

# Conventional Vs Islamic Economics

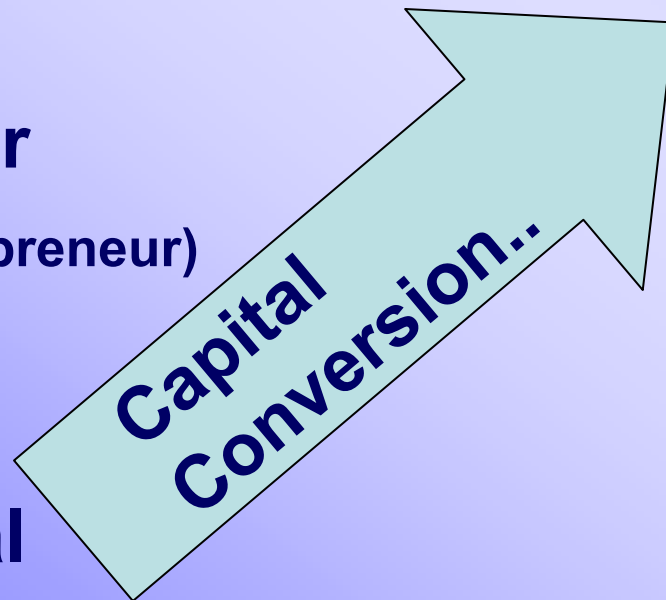
## Difference in Factors of Production

### Conventional

- Land
- Labour  
(+Entrepreneur)
- Capital

### Islamic

- Land
- Labour  
(incl. Entrepreneur)



# Money Lending vs Trade and Asset Backed Transactions

- **Money** ↔ **Goods** ↔ **Money**

Instead of

- **Money** ↔ **Money** ↔ **Goods**

- i.e. Loan vs Debt

- Islamic finance complements the credit by getting the title of goods financed in addition to the cash flows

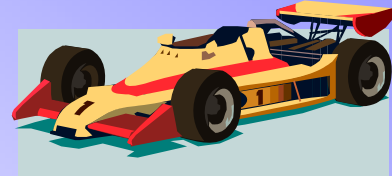
# Major Islamic Modes and their close Conventional Equivalents

Islamic Finance	Conventional Finance	
<b>Intermediated</b>	<b>Intermediated</b>	<b>Not intermediated</b>
<b>Murabaha</b>	<b>None</b>	<b>None</b>
<b>Salam</b>	<b>None</b>	<b>Future Contracts</b>
<b>Istisna`a</b>	<b>None</b>	<b>None</b>
<b>Ijarah</b>	<b>Leasing</b>	<b>Leasing</b>
<b>Musharakah</b>	<b>Shareholding</b>	<b>Venture Capital</b>
<b>Mudarabah</b>	<b>None</b>	<b>Venture Capital</b>

# Some Common Misconceptions...

- **Form Vs Substance Issue**
- **Return can (not?) be fixed** in Islamic Banking
- **Return can (not?) be same** as Conventional
- **Profit  $\neq$  Riba. Hence, Riba Free  $\neq$  Profit Free**
- **Benchmarking with Conventional** basis to match with Islamic Banking Returns

# *Bai'tan fil Bai'...*



***Inna'mal a'mal-o-bil-nia'at..***

***Aitkaf...  
(Bonus Sawab)***

***Ajar and Uj'rat***

***Sunnah, Sawab and  
Sadaqa'e Jaaria...***



# ONUS SHIFTS!!

- **Customer  
to Halal Restaurant Owner**
- **Halal Restaurant Owner  
to Halal Meat Supplier**
- **Halal Meat Supplier  
to Halal Abattoir / Butcher**
- **Customer to Islamic Banker**
- **Islamic Banker  
to Shariah Scholars**

# Major Challenges and Issues..

- **Misconceptions / Lack of Awareness**
- **Liquidity Management / Investment Opportunities**
- **Confidence & Credibility (Reputational Risk)**
- **Competition from Conventional (Tawarruq etc.)**
- **Human Resource Shortage**