



Peddling Religion?

What is Islamic Finance?
&
Should we support it?

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Is there an *Islamic Finance*?



All financial products available today are *suspect* :

- “Mortgages”, and other forms of secured finance are not mentioned in the Qur’ān and Sunnah
- “Islamic” alternatives are not completely devoid of suspicion of Ribā:
 - Questionable adaptation of classical contract, bizarre justifications by highly paid “Sharī‘a scholars”:
 - *Murābaha financing* – markup equal to market interest
 - *’Ijāra financing* – lease to purchase with rent = interest
 - *Declining Mushāraaka financing* – same as *’ijāra financing*, with full co-ownership and sharing in equity gains/losses
 - How relevant/practical are historical nominate contracts?

Islamic finance = *juristic 1-degree of separation*



Mon, February 03, 2003 12:31 GMT

HSBC Launches Islamic Vehicle Finance - Frequently Asked Questions

How can a conventional (interest-based) bank offer a Shariah compliant financial service?

Islamic law (Shariah) does not require that the seller of a product be Muslim, or that its other services be Shariah compliant as well. This is the considered opinion of our Shariah Supervisory Committee.

Conventional banks charge and pay interest, and the HSBC Group, or which we are a part, is a conventional bank. But we are also a customer-driven institution, and we provide Shariah compliant products to serve a genuine financial need among Muslims. Of course, our Shariah compliant products are available for Muslims and non-Muslims alike.

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Mon, February 03, 2003 12:31 GMT

Since HSBC is an interest-based bank, what would be an acceptable source of funding for HSBC MEFCO? Are you going to mix conventional and Shariah compliant funds?

The Shariah (Islamic law) does not require that the seller of a product be Muslim or that his/her own income be halal (permitted). **We will therefore, initially use funds from conventional sources to finance Amanah Vehicle Finance.**

Muslims may be understandably concerned about mixing conventional funds with Shariah compliant funds. ... **To buy something or obtain financing, however, funds do not have to be from a halal source. The relationship with the seller must be in line with the Shariah-the seller's relationship with other parties, however, is not the purchaser's responsibility.** This is the opinion of HSBC's Shariah Supervisory Committee.

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Mon, February 03, 2003 12:31 GMT

How do you calculate the price of Amanah Vehicle Finance? Are the payments similar to a conventional vehicle loan? If so, is this acceptable under the Shariah (Islamic law)?

HSBC MEFCO determines the rates on Amanah Vehicle Finance using a fixed payment scheme that is competitive with conventional vehicle loans available in the market. **As determined by our Shariah Supervisory Committee, Shariah permits using the conventional market as a benchmark.**

According to the Shariah, the profit rate in a Murabahah transaction can be set at any value agreed between the buyer and seller. ... **There is no particular reason why a vehicle financed Islamically should be any more or less expensive than a vehicle financed using a conventional vehicle loan.** The criterion for acceptability by the Shariah is that the transaction be compliant with Shariah, regardless of the price of the good or how that price is determined.

Islamic finance = *juristic 1-degree of separation*



Conclusion of the last 3 slides:

A conventional bank may use its conventional banking funds to offer “Islamic financial products”, and to charge the same conventional interest rate to its “Islamic finance” customers (!), provided that it adheres to the contract conditions that the Sharīʿa boards glean or adapt from classical books of Islamic jurisprudence.

Let's take a closer look at those contracts and conditions...

Islamic finance = *juristic 1-degree of separation*



- OCC #867, 1999: “... lending takes many forms ... Murabaha financing proposals are functionally equivalent to, or a **logical outgrowth of secured real estate lending and inventory and equipment financing, activities that are part of the business of banking.**”
- OCC #806, 1997: “Today, banks structure leases so that they are equivalent to lending secured by private property... a lease that has the economic attributes of a loan is within the business of banking. ...Here it is clear that UBK’s net lease is **functionally equivalent to a financing transaction in which the Branch occupies the position of a secured lender...**”

Perceived difference



M. Taqi Usmani on *Murābaha*:

“If in cases of genuine need, the financier appoints the client his agent to purchase the commodity on his behalf, his different capacities (i.e. as agent and as ultimate purchaser) should be clearly distinguished. As an agent, he is a trustee...

After he purchases the commodity in his capacity as agent, he must inform the financier that, in fulfilling his obligation as his agent, he has taken delivery of the purchased commodity and now he extends his offer to purchase it from him. When, in response to this offer, the financier conveys his acceptance to this offer, the sale will be deemed to be complete, and the risk of the property will be passed on to the client as purchaser. At this point he will become a debtor...”

Usmani, M.T. *An Introduction to Islamic Finance*, Karachi: Idaratul Ma`arif, 1998, p.152;

Repeated verbatim in Usmani, M.T. *An Introduction to Islamic Finance*, The Hague: Kluwer Law International, 2002, p.67

Perceived difference



Taqi Usmani on *Ijāra*:

- In leasing, the agent/customer can also sign the lease before acquiring the asset on behalf of the financier (ibid., pp. 73-4)
- (ibid. p.71): “The determination of rental based on the basis of aggregate cost incurred in the purchase of the asset by the lessor, as normally done in financial leases, is not against the rules of Shari’ah, if both parties agree to it, provided that all other conditions of a valid lease prescribed by the Shari’ah are fully adhered to”.
 - Paraphrase: determining “rent” as equal to the interest payment in a conventional mortgage is allowed, as long as legalistic conditions are satisfied
- All references for such conditions refer to ‘ibn ‘Abidin’s Radd Al-Muhtar (pp. 71, 73, 80, 81). ‘ibn ‘Abidin based many of his conclusions on the convention (*‘urf*) of Damascus circa 1800!
 - ‘ibn ‘Abidin used 237 references to convention (*‘urf*) as the basis for rulings, stating openly “[local] convention receives high consideration in leases”

Islamic prohibitions and finance



- *Ribā* : Neither “interest” nor “usury”
 - There is *Ribā* without interest, and interest without *Ribā*
 - Percentage does not matter, exploitation not the issue
 - Time value of money recognized, as well as credit risk
 - My definition: *Ribā* = “trading in credit”
 - Explanation: pre-commitment through marking to market
- *Gharar* : Neither “gambling” nor “uncertainty”
 - Many examples of unnecessarily vague contracts
 - Examples of *necessary* and excessive uncertainty in sales
 - My definition: *bayʿ ul-Gharar* = “trading in risk”
 - Explanation: Avoid loss-aversion-based mis-pricing

Nominate contracts and finance



- “Fine print” for classical conventional contracts
 - May be dispensable in current regulatory environment
- Avoiding *Ribā* and *Gharar* for a given regulatory environment: Should we use classical contracts?
 - What was forbidden then need not be forbidden now
 - What was permissible then need not be permissible now
- Accountability cannot be delegated to highly-paid “Sharīʿa scholars”, *all* with obvious conflicts of interest (no credibility), and most lacking proper credentials

Should we support Islamic finance?



Thought experiment/analogy:

- If the only drug that will cure you contains 10% alcohol, majority view is to use it
- If an alternative (marketed as “Islamic”) contains only 5% alcohol, ask yourself:
 - How much more does it cost, and why?
 - If supporting the new product can help finance more R&D, the extra cost may be justified
 - If the institution helps the Muslim community, the extra cost may also be justified
 - If it is just a scam to enrich lawyers and “scholars” (most lacking proper credentials/credibility), perhaps the extra cost is not justified