

## Historical context: Principles from the past guide usage in modern world

By Farhan Bokhari

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*Those who gorge themselves on usury behave but as he might behave whom Satan has confounded with his touch; for they say: "Buying and selling is but a kind of usury" – while God has made buying and selling lawful and usury unlawful. (verses from "Al Baqara" – the Koran)*

Since the dawn of Islam, devout Muslims seeking to follow religious tenets more than 1400 years old have relied on verses from the Koran, the Islamic holy book, to press their case in favour of following only those financial principles which are permitted by religion.

Some devout Muslims even today shirk from using regular bank accounts which offer a pre-set interest rate, though the growth of Islamic banking and finance has helped convince many others to join the fray.

For devout Muslims, pre-determined interest rates offered by conventional banks are illegitimate as they consider such a practice to be usury – a concept banned under Islam.

The demand for banking and other financial products from Muslims has spurred the growth of Islamic banks, which offer the opportunity of dealings based on sharing of profits and loss between depositors and borrowers, with the bank charging a fee for intermediation costs.

These principles have diversified to help the creation of a range of products, from Islamic equities to Islamic bonds known as *sukuk* and Islamic insurance services known as *takaful*.

The growth of Islamic banks has convinced some of the world's most renowned Islamic scholars and practitioners to argue that Muslims are increasingly patronising a host of emerging financial and business products.

"Muslims, whether they live in the East or the West, are almost universally aware of the prohibitions against *riba* (usury), even if they have little knowledge about the inner workings of Sharia-compliant transactions and contracts," says Sheikh Yusuf Talal DeLorenzo, a leading Islamic finance scholar and chief Sharia officer of Shariah Capital, a US-based Islamic finance consulting service which recently opened offices at the Dubai International Financial Centre.

"Muslims who live in the modern world need to finance homes and cars, education for their children, retirements and all the rest. They need to protect their assets and they need to manage and grow their wealth. Islamic finance is successful because it is providing Muslims with what they need," says Mr DeLorenzo.

While Islamic finance may be gaining increasing acceptability, experts say its evolution over time has gathered pace, mainly as a result of the Middle East becoming flush with petrodollars.

Rushdi Siddiqui, the US-based global director of the Islamic index group at Dow Jones, divides the growth of Islamic finance into three phases. This began with the work of some of the best known Islamic scholars on subjects relevant to financial issues, and in the second phase was followed by global institutions such as Dow Jones, HSBC and Citibank embracing the concept. The third phase of development is the global acceptability of the Islamic finance concept.

Practitioners, however, attribute the growing acceptability primarily to the way individual Islamic institutions have carved out Islamic equivalents for a number of financial products that were once considered the exclusive domain of conventional banks and institutions.

"Islamic banking has a certain appeal from a certain segment of society in Islamic countries. What has

helped this appeal to grow is the fact that Islamic banks are able to offer products today which were not on offer in the past,” says Sultan Allana, chairman of the privately-owned Pakistan based Habib Bank.

While there are more takers today for Islamic finance, the future of this relatively young industry is not without challenges. Conventional bankers argue that a number of principles followed by their Islamic banking compatriots were, in their purest form, best suited to the times when modern day business practices and the global marketplace did not exist.

“These practices best suited a time in the past. If you had so many kilos of wheat to offer to someone else, it was easier to say that you would get the same amount of commodity back with a go-between trader charging a sum for himself,” says a banker from a large western bank. “Today’s marketplace does not allow you to work in that way – you have to have a financial return, an interest payment”.

Islamic bankers disagree, arguing that their business practices are misunderstood. “People only look at the historical past of Muslims and argue their case. The truth is, Islam is a vibrant religion and the practices on offer today were in fact relevant in the past, they are relevant today and they will remain relevant in future,” says the head of an Islamic bank.

Mr DeLorenzo says there are similarities between Islamic and conventional institutions as both seek to offer similar products and services, but judging the industry must be about the ways in which Islamic institutions make their practices distinct from conventional ones.

“I am always amazed at people who question Islamic finance by pointing out the results are the same [as conventional finance]. ‘The monthly payment I make on my Islamic home finance contract is just as much as I’d pay on a mortgage’ is something I have heard more than once. My answer is: ‘That’s because Islamic home finance companies have put in the resources, time, money and human capital to be competitive’.

Mr Siddiqui notes that the Islamic finance and banking industry emerged on the scene just 40 years ago.

“There are a number of challenges faced by this emerging industry,” he says. “The industry players acknowledge the issues and work is being done [to resolve them].”

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