Overview of Islamic Finance

By Blake Goud, IHI Executive Director

Cambridge, Massachusetts, U.S.A. — On April 13th, 2007 the Harvard Islamic Society presented an **overview of Islamic finance** at the Harvard Business School. The room, holding roughly 40 students and others interested in Islamic finance heard three panelists discuss the general principles of Islamic finance and answer questions about the practical issues involved. Islamic finance prohibits *riba*, commonly interpreted as interest (a fixed guaranteed rate of return) and *gharar* (excessive speculation or trading in risk) as well as any money made in industries which are not halal (e.g. conventional banks, tobacco, alcohol, pork or defense-related industries). The three panelists were Dr. Samuel Hayes, III (Jacob Schiff Professor of Investment Banking at Harvard Business School), Dr. Ibrahim Warde (Adjunct Professor of International Business at Tufts University) and Aamir Rehman (formerly at HSBC Amanah).

Dr. Hayes described the general principles of Islamic finance starting with the pronouncement for Muslims to be fair in all dealings and not to take unfair advantage of their associates. Islamic finance, a form of ethically-based finance places a high value on creating a level playing field between businesspeople and restrict activities which puts businesspeople at excessive risk of financial ruin. Dr. Warde described the history of Islamic finance from the economic activities in the Islamic 'golden age' and the resurgence of Islamic economics and finance beginning in the 1960s which accelerated rapidly during the 1970s. He attributed the significant growth in the 1990s to the effect of banking deregulation in the 1980s. Dr. Warde described how the U.S. Treasury under Paul O'Neill woke up to the rapid growth of Islamic finance and appointed a scholar-in-residence on Islamic finance[1]. He offered an estimate that the Islamic financial industry grew 30% between 2005 and 2006. Mr. Rehman described the strategic landscape in Islamic finance[2]. He suggested that the growth of OIC countries and new product development. He presented an idea that the Islamic financial industry should move away from developing debt-based Shari'ah-compliant products and more towards savings- & investment-focused Shari'ah-based products.

Islamic Microfinance: A New Approach to Fighting Poverty

By Blake Goud, IHI Executive Director

Cambridge, Massachusetts, U.S.A. — The Harvard Islamic Finance Project at the Harvard Law School held a **conference on Islamic microfinance** with well over 100 scholars, practitioners and academics discussing ways the microfinance industry and Islamic financial industry can bridge the gap in understanding each others' work and cooperate on fighting poverty with microfinance.

The conference opened with Keynote Addresses from Robert Annibale, Global Director of Citigroup's Microfinance Group in London, UK. Aamir Rehman, speaking on behalf of Iqbal Khan, founding CEO of HSBC Amanah, presented their views from the conventional microfinance and Islamic finance perspective. Mr. Annibale described the high costs associated

[1] The first Treasury Department scholar-in-residence at the Treasury Department was Dr. Mahmoud A. El-Gamal. Dr. El-Gamal is the Chair of Islamic Economics, Finance and Management at Rice University in Houston, Texas where he is also a Professor of Economics and Statistics.

[2] Mr. Rehman was filling in for Iqbal Khan, the founder of HSBC Amanah who was unable to attend the event.

with microfinance because of its labor-intensity and the focus on efficiency gains to lower the costs of microfinancial services (MFS) to the end clients. Mr. Rehman described the need for Islamic banking and finance to embrace poverty-reduction and a social agenda, which it has not been able to do while it established its commercial viability. He reminded the audience that 3 billion people live on less than $2 per day and connected this need with the similarities on poverty-reduction between the religions and emphasized that it was one of the five pillars of Islam (*zakat*).

In the first panel, several papers were presented including a case study of the diverse Islamic banking and microfinance market in Indonesia, the use of a monetary waqf, microfinance in crisis situations with applicability to Afghanistan. Samer Badawi, the communications officer at Consultative Group to Assist the Poor (CGAP)[3] described the potential to grow a viable Islamic microfinance meeting the demand from tens of millions of poor Muslims with assistance from Islamic finance and multilateral institutions without forgetting that the vast amount of financial services to the poor are in some way connected with government banks.

Finally, Saif I. Shah Mohammed, a JD candidate at Columbia University described the difficult issues in bringing Islamic finance together with microfinance. He suggests that Islamic microfinance should focus on partnerships with existing microfinance institutions and capitalize on their experience delivering financial services to the poor. He described some of the built-in insurance in MFS such as disaster rescheduling as well as the many other programs which piggyback on microfinance like technical assistance, education, savings and healthcare. He questioned whether an equity is more efficient and desirable than debt accompanied by insurance and other bundled services.

After the conference resumed following a lunch break, the format switched to a discussion of some issues in Islamic microfinance with Michael Ainley (Head of International Firms at the Financial Services Authority, U.K.), Robert Annibale, Nadeem Hussein (President & CEO of Tameer Microfinance Bank in Karachi, Pakistan), Aqil Abdus Sabur (Interim President at Philidelphia Commercial Development Corp.) and Shyakh Nizam Yaquby, a prominent Shari'ah scholar.

The spirited discussion focused on appropriate products (mudabara versus murabaha), One of the most interesting insights Shyakh Yaquby provided on this debate was that while most scholars prefer mudaraba (profit-and-loss sharing [PLS]) while he prefers murabaha because the Qur'an and Sunna have more references to deferred sales than to PLS partnerships. The conference ended with an upbeat assessment of the promise of Islamic microfinance as long as it knows its markets, develops sustainable ownership and management structures, has due diligence and can deal with possible conflicts of interest and recognizes the difference between growing institutions and large organizations that are not growing as quickly but are much larger.

Institute of Halal Investing: http://www.investhalal.org/

[3] CGAP is a consortium of 33 public and private development agencies working together to expand access to financial services for the poor in developing countries. CGAP was created by these aid agencies and industry leaders to help create permanent financial services for the poor on a large scale.