

02.09.09 The Issue

- 04 UAE and Canada hold talks to boost trade relations
- 12 DGCX volumes show marked resilience in August
- 22 Middle East airlines post \$20 million earnings in Q2

The Talk

“ For the district cooling industry, consolidation is the way forward **AHMAD BIN SHAFAR**
EMPOWER P16



The Numbers

OIL (Brent crude)	DIRHAM/POUND	DIRHAM/EURO	DUBAI Index	ABU DHABI Index
↗ \$69.90 (+\$0.25)	↗ 6.075 (+0.0192)	↗ 5.350 (+0.0231)	↘ -0.97%	↗ +0.54%

24/7

LEADING NEWS



Islamic finance still in search of

■ Global financial crisis exposes weaknesses of conventional systems ■ Dearth of initiatives to educate

DUBAI **Karen Remo-Listana**

The lack of credibility and innovation is a big obstacle to the Islamic finance growth, said analysts speaking to **Emirates Business** unanimously. And because it has started from a low base, the Islamic finance practice has been growing by 15-20 per cent every year for the past decade, according to a report by Standard & Poor's.

Now that the crisis has exposed the loopholes and weaknesses of the conventional system, Islamic products have become more popular because its principles have shielded them from the sub-prime crisis. Debt-selling, which derivatives are primarily about, is not allowed in Islamic finance. The growing Muslim population worldwide is also expected to boost the Islamic financial practice.

Despite this, acceptance levels globally remain low. Dr Mohamad Akram Laldin, CEO and Executive Director of International Shariah Research Academy for Islamic Finance (Isra) said the industry is only about five per cent of the total financing industry while Omar Shaikh, Member of the Islamic Finance Council United Kingdom and Executive Board Member of Ernst & Young UK put the figure at one to two per cent only. Both experts, who will be speaking at the Fleming Gulf's World Islamic Retail Banking in Dubai, agree that the barriers are mostly rooted from the dearth of marketing innovation.

"One big hurdle is the credibility and

awareness element," Shaikh said. "The reality is people just don't understand finance in general and number two, they don't understand Islamic finance because it is new. Third is the question of credibility, hang on a minute what makes this product Islamic? This looks just the same as conventional."

"The most important thing is to understand the dogma that Islamic finance is not only for Muslims," Laldin said. "I believe that the market is not taking enough initiatives to educate people that Islamic finance is not only for Muslims, it is also for the non-Muslims."

Majority of Islamic product subscribers in Malaysia are non-Muslims. "Therefore, the market perception needs to be changed in order for institutional and retail investors to invest in Islamic products," Laldin added.

Shaikh and Laldin stressed that Islamic banking is all about ethical banking. But this message is hard to be sent across the Muslim and non-Muslim stakeholders because the names of Islamic products are more or less Arabic. Shaikh said of the 1.6 billion Muslim population, only 20 per cent of them are living in the Arabian peninsula. "In Islamic finance the terminology for insurance is called takaful. Then we have the ijara, mudaraba and others, which are all Arabic terminology but how many of the Muslims are Arabs? About 200-300 million? It's minimal. People from other parts of the world do not understand what the terminology means," he said.

In Malaysia, Laldin said most of the products are Arabic because most people are Muslims but non-Muslim Chinese are also in-



Omar Shaikh

creasingly becoming huge users of Islamic products. "That is why I tell people in this system that you do not have to name your products with Arabic name," Laldin said.

"When people hear the Arabic name they will always associate the product to Muslims," he added. "You can name your products with any name but what is important is that the concept used is Shariah compliant. I know a company in Singapore, which does not use Arabic names and they are well in the market nowadays. It's how you brand and market your products that really matters because at the end of the day many investors are looking at the ethical side of finance." It is, however, difficult to separate Islamic fi-

nance to being a Muslim, whose beliefs are based on Quran, the basis of Islamic faith.



Mohamad Akram Laldin

Under Islamic principles, Shariah law defines the framework within which Muslims should conduct their lives.

The overarching principle of Islamic finance and banking products is that all forms of interest are forbidden. The Islamic financial model works on the basis of risk sharing.

The customer and the bank share the risk of any investment on agreed terms, and divide any profits or losses between them.

global credibility

customers affects global reach of Shariah products



Malik Sarwar

tion is not permitted to lend to other banks at interest. Laldin said the principles in Islamic finance are based on ethical standards, which can be applicable to everyone, not only for Muslims.

"Recently in the UK there is someone from the Vatican, who came and supported Islamic finance - that's a huge endorsement coming from an institution in the Vatican. This highlights that there are many common ethical values Islamic finance can inspire or reignite whether Muslim or not," Shaikh said.

He said getting the correct branding and marketing strategy has become a lot more pertinent in the UK and other Western coun-

tries. "The issue of branding, marketing and terminology is more highlighted here that in the Gulf - as most of them are Muslims anyway," he said.

"There is a massive opportunity that we are missing. Some players have recognised that. For example, Salam Halal Insurance, the only stand-alone Islamic insurance provider here, has different products in different markets. One market is Muslim market so they are Salam Halal for other markets they brand the company/product in ethical approach."

There are thought to be about 1.8 million Muslims in the UK or three per cent of the population. About 50 per cent of these are estimated to reside in the London area. There are also estimated to be about half a million regular Muslim visitors to the UK and about 12 million Muslims living in the EU, principally in France and Germany.

Islamic financial products are available in the UK from a number of High Street banks, which offer current accounts and mortgages tailored for Muslims. The UK is home to the first wholly Shariah-compliant retail bank in the West, Islamic Bank of Britain, which was authorised by the FSA in 2004.

The FSA has also authorised the European Islamic Investment Bank which is the first such investment bank. While the main centres for Islamic banking still tend to be concentrated in the Middle East and Gulf, London has become a key financial centre with major global firms and Middle East's traditional banks offering Islamic products.

LEVEL PLAYING FIELD

As there are inherent difference in Islamic and conventional products, Western governments have decided to be flexible and change their tax laws to create a "level playing field".

The UK's FSA operates under a single piece of legislation that applies to all sectors, the Financial Services and Markets Act 2000.

The FSA's policy towards Islamic banks, and indeed any new or innovative financial services company, can be summed up simply as "no obstacles, no special favours". One of the most important issues for the FSA is that of Islamic deposits. The UK legal definition of a deposit is: "a sum of money paid on terms under which it will be repaid either on demand or in circumstances agreed by the parties".

In other words, money placed on deposit must be capital certain. For a simple non-interest bearing account there is no problem. The bank safeguards the customer's money and returns it when the terms of the account require it to do so. However, with a savings account there is a potential conflict between UK law, which requires capital certainty, and Shariah law, which requires the customer to accept the risk of a loss in

order to have the possibility of a return. Islamic banks resolve this problem by offering full repayment of the investment but informing the customer how much should be repayable to comply with the risk-sharing formulation. This allows customers to choose not to accept full repayment if their religious convictions dictate otherwise. The UK has also begun to modify its tax laws to avoid, for example, double taxation.

Shaikh said: "If you buy a house in the UK you pay a stamp duty, which is about two per cent of the house purchase transaction. In Islamic finance transaction, the bank cannot just lend you money so it has to sell you something, an asset.

"In home purchase, banks have to buy the house first then they sell it to you whereas in a conventional operation, the bank will lend you the money and you buy the house. The difference is because the bank has to buy the house now, stamp duty kicks in, then you buy the house from the bank and another stamp duty kicks in. This is where the government needs to amend the laws and this is what the UK Government has done but changing tax laws is not something that happens overnight."

ROBUST GROWTH IN THE GULF

The popularity of Islamic finance in the wholesale and retail is gaining grounds and is in fact growing faster than conventional products, said Malik Sarwar, Head of Global Wealth Management at Abu Dhabi Islamic Bank.

"There is a growing interest in Islamic finance in the region as it matches with people's spiritual values. It is growing much faster than conventional banking," he said.

On the wholesale side as an example, Malik said there is growing interest in sukuk issuance while retail is also performing well due to increasing awareness, greater product offering, avoiding use of derivatives in products, and Islamic finance being in line with people's values. Knowledge about it is not widely spread yet. However, clients feel comfortable with the concept and many of them transact with Adib just on basis of trust," he said.

"Knowledge about Islamic Finance is growing rapidly and Adib's goal is to spread it as a culture rather than just knowledge about products that are labeled as Islamic."

The issue of profitability, if properly addressed can also further spur the

growth of Islamic Finance, says Laldin. "The initial principle in Islam is that you generate commercial activities. The reason why Islamic banking exists is based on real economic activities," he said, adding: "In conventional banking there is borrower and lender relationship with a contracted interest regardless of the outcome. But you see the problem is caused by derivatives that is selling and buying of debt without even knowing the origin of the debt."

He said: "It's been used all over again to the point that the economy nearly collapsed. When you think profitability, the profit in conventional is not sustainable and that is important because we have the underlying activity which supports the way you get the profits. In conventional there is no strong foundation that will collapse as what we are experiencing nowadays."

Customer service needs to be more sophisticated as well, Laldin added. "Customer service is another area we need to look at. But there are institutions operating through Islamic windows that already give good service because they already have existing infrastructures," said Laldin.