

WILEY FINANCE

The Islamic banking and finance workbook

*Step-by-Step Exercises to help you Master the
Fundamentals of Islamic Banking and Finance*



BRIAN KETTELL

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and Finance Workbook

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Brian Kettell



 **WILEY**

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To my wife Nadia, our son Alexei and daughter Anna. Nadia keeps the whole fleet on an even keel with only the occasional shipwreck.

Preface

The ongoing turbulence in the global financial markets has drawn attention to an alternative system of financial intermediation: Islamic banking and finance. This sector is now one of the fastest growing within the marketplace and has, so far, remained on the sidelines of this financial unrest. Since the inception of Islamic banking, about three decades ago, the number and reach of Islamic financial institutions worldwide has risen significantly. Institutions offering Islamic financial services constitute a significant and growing share of the financial system in several countries.

Indeed the Islamic finance industry is in the midst of a phenomenal expansionary phase, exhibiting average annual growth rates of about 15% in recent years. This rapid growth has been fuelled not only by a surging demand for *Sharia*'a-compliant products from financiers in the Middle East and Muslim countries, but also by investors around the world, thus rendering the expansion of Islamic finance a global phenomenon.

Besides its wide geographical scope, the rapid expansion of Islamic finance is also taking place across the whole spectrum of financial activities, ranging from retail banking to insurance and capital market investments. But perhaps the most striking has been the fast growth of *sukuk* (Islamic bonds), the most popular form of securitised credit finance within the industry. *Sukuk* issuance soared over the period 2001–2007 although it has fallen back more recently.

Educational and training material for the industry is, however, lagging far behind the speed at which the industry is evolving. Indeed the lack of quality educational and training material has now become a serious obstacle to effective training and education. This workbook is designed to provide students and practitioners with the *first ever workbook* that enables readers to test their understanding of the underlying principles. Emphasis is placed on multiple choice questions and tests of the basic concepts. Suggested answers are provided.

It must be stressed that the newness of the industry means that designing quality educational and training material is fraught with problems. In addition to this newness the industry also faces the challenge of changing *Sharia*'a interpretations of many of the products. Although this factor should not be exaggerated, given that *Sharia*'a law has been around for centuries, the existence of different schools of Islamic jurisprudence (*Fiqh*) combined with controversies revolving around some of the contracts has certainly created some uncertainties as to how the contracts are being applied.

These aspects may lead to the potential for controversy over some of my suggested answers. No doubt some of the answers will be disputed. I cannot claim to have universal answers and would ask that readers please assume that these may change over time.

If readers do feel strongly that they have an alternative answer I would certainly welcome a dialogue. Indeed if anyone wishes to provide me with reasons for their proposed alternative solutions I would urge them to please do so, and I will be delighted to thank them in later editions. It is this dialogue that is so important for the health and future of the industry and I look forward to an active debate with the readers. My email address is brian.kettell@islamicbankingcourses.com.

Companion texts are available from the publishers: *Introduction to Islamic Banking and Finance* and *Case Studies in Islamic Banking and Finance*.



The original intention of this book is to provide a comprehensive guide to the industry for those who are interested in Islamic banking and finance. The book is intended to be a practical guide to the industry and to provide a comprehensive overview of the industry. It is intended to be a practical guide to the industry and to provide a comprehensive overview of the industry. It is intended to be a practical guide to the industry and to provide a comprehensive overview of the industry.

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About the Author

Brian Kettell has a wealth of practical experience in the area of Islamic banking and finance. He worked for several years as an Advisor for the Central Bank of Bahrain where he had numerous Islamic banking responsibilities.

Subsequently, Brian taught courses on Islamic banking and finance at a range of financial institutions including the World Bank, National Commercial Bank (Saudi Arabia), Global Investment House (Kuwait), Noor Islamic Bank (UAE), the UK Treasury, the Central Bank of Iran, the Central Bank of Syria, the Chartered Institute for Securities and Investment, the Institute for Financial Services and Scotland Yard.

Brian's vast academic expertise in Islamic finance is highlighted by his role as former Joint Editor of the *Islamic Finance Qualification Handbook* and his past teaching work at a number of top universities worldwide including the London School of Economics, the City University of Hong Kong, the American University of the Middle East in Kuwait and London Metropolitan University Business School.

Brian's impressive list of publications include over 100 articles in journals, business magazines and the financial press including *Islamic Business and Finance*, *Islamic Banking and Finance*, the *Central Banking Journal*, *Euromoney*, the *Securities Journal* and the *International Currency Review*. He has also published 16 books on Islamic banking and financial markets.

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What Do You Know About Islam?

1.1 LEARNING OUTCOMES, SUMMARY OVERVIEW AND PROBLEMS

1.1.1 Learning Outcomes

After reading Chapter 1 you should be able to do the following:

- Describe the role played in Islam by the Prophet Mohammed.
- Explain the Islamic five pillars of faith.
- Describe *zakat*.
- Define the Islamic creed.
- Explain how one becomes a Muslim.
- Distinguish *zakat* from *sadaqah*.
- Describe *Salat*.
- Explain the Islamic belief in angels.
- Describe the *hajj*.
- Explain the Islamic belief in *Qada'ar*.
- Describe the *Shahada*.
- Explain the Islamic belief in the Apostles.
- Define the *Ulema*.
- Explain the importance of Ramadan to Muslims.
- Describe *Tawhid*.
- Define *imam*.
- Contrast the *hajj* with the *umra*.
- Explain the Islamic belief in the Hereafter.
- Explain the Islamic belief in the revealed Books.
- Test that you have fully understood the Islam beliefs that drive Islamic banking.

1.1.2 Summary Overview

The books of the Islamic faith shape both the culture and philosophy of the Muslim world.

1.1.2.1 The Books of Islam

- **The *Qur'an*:** For Muslims, the *Qur'an* is the 'Word of God'. Muslims believe the identical book is in Heaven and Allah sent the angel Gabriel to Mohammed to reveal his 'Word'. The *Qur'an* is divided into 114 chapters or *Surahs*. These *Surahs* are revelations given to Mohammed during his 23 years of 'Prophethood' from AD 610 to 632.

The *Qur'an*, composed during Mohammed's lifetime, corresponds to the time and circumstances of his life. The *Surahs* can be divided into three time periods. The earliest are the shortest and known as *Early Meccan*, and date from AD 610 to 622. These were composed in Mecca, prior to the Hegira where Mohammed fled to Medina in September AD 622.

The *Median Surahs* were composed during the time when Muslims controlled the city of Medina. They date from AD 622 to 630.

The *Late Meccan Surahs* were written between AD 630 and 632, during the last two years of Mohammed's life and after Mecca surrendered to his authority.

At this time, *Surahs* were not collected in one book but were memorised and collated on various items. The *Hafiz* were Muslims who had committed much of the *Qur'an* to memory. In the battle of Yamamah in AD 633, many of the *Hafiz* died.

With the urging of Umar, Zayd ibn Thabit, one of Mohammed's most trusted secretaries, was appointed to the task of collecting the *Qur'an* into one book. Still later, after different versions of the *Qur'an* began to appear, Zayd was put in charge of collecting all the *Qur'ans* throughout the Muslim world and issuing an authorised copy in the place of the one's collected.

- **The *Hadith*:** After the death of Mohammed, his followers collected his sayings and actions in books to guide and direct their beliefs. They gave additional meaning behind the *Surahs* and helped interpret their meanings. The most respected *Hadith* are the collected works of *Bukari*. Muslims do not feel that the *Hadith* is the 'Word of God'. They would compare the *Hadith* to the Christian Gospels, which report what Jesus said.

1.1.2.2 Who is a Muslim?

A Muslim is someone who submits to Allah by confession of the *Shahada*, which is part of the five pillars of faith – observances in Islam that are foundational practices, or duties, that every Muslim must observe:

- **The Five Pillars of Faith:**

- 1. The Confession: 'La ilaha illa Allah' ('There is no God but God'); the *Shahada* (testimony); the *Kalima* ('There is no God but Allah, and Mohammed is the Prophet of Allah').
- 2. *Salat* (prayer) five times a day facing Mecca.
- 3. *Zakat* (almsgiving).
- 4. Fasting during the month of Ramadan, from sunrise until sundown.
- 5. *Hajj*: pilgrimage to Mecca once in a lifetime.

In addition, there are five major beliefs or doctrines in Islam:

- **The Five Articles of Faith:**

- 1. *God*: There is only one true God and his name is Allah. Allah is all knowing, all-powerful and sovereign judge. Yet Allah is not a personal God, for he is so far above humans in every way that he is not personally knowable.
- 2. *Angels*: Angels in Islam serve Allah's will, as with Gabriel delivering the *Qur'an* to Mohammed. Angels do not perform any bodily functions (sexual, eating and so on) because they are created from light. Angels serve different purposes. Each person has two recording angels who record his or her good or bad deeds.
- 3. *Scripture*: There are four inspired books in Islam: *Qur'an*, Torah (the 'Books of Moses', Ingil (Gospel of Jesus) and Zabur (Psalms of David). These are the books mentioned in the *Qur'an* as God's Word, but most Muslims feel the latter three books are corrupt. For this reason Allah, gave Mohammed the '*Qur'an*'.

- 4. *Prophets*: In Islam God has spoken through numerous prophets down through the centuries, including Adam, Noah, Abraham, Moses and Jesus. The greatest prophet and the last prophet is Mohammed; he is the seal of the prophets.
- 5. *Last Days*: The last days will be a time of Resurrection and judgement. Everybody will be resurrected to stand before Allah to be judged on the Last Day. Those who follow Allah and Mohammed will go to Paradise. Others will go to Hell.

1.2 QUESTIONS

1. What does Islam mean?



2. Muslims make no distinction between

A:

B:

3. A Muslim is

A:

B:

4. How does one become a Muslim?



5. What are the two main sects within Islam?

A:

B:

6. What are the similarities between *Shia* Islam and *Sunni* Islam?

 _____

7. What are the differences between *Shiites* and *Sunnis*?

 *Shiites* believe: _____

 *Sunnis* believe: _____

8. List the Five Pillars of Islam.

 A: _____

 B: _____

 C: _____

 D: _____

 E: _____

9. What are the principal sources of the *Sharia'a*?

 A: _____

 B: _____

 C: _____

 D: _____

10. Give four examples of Islamic investment principles.

 A: _____
