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# Islamic capital markets

*Products and Strategies*

Edited by  
M. KABIR HASSAN  
MICHAEL MAHLKNECHT

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## *Products and Strategies*

**M. Kabir Hassan**  
**Michael Mahlke**

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# Islamic Capital Markets

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## Preface

Islamic finance is the only financial system in the world today that is based on the teachings of a major religion, and it proves to be increasingly attractive for secular Muslims and non-Muslims as well. While the conventional financial industry has been suffering a tremendous loss of reputation, due to its obvious shortcomings and its harmful impact on economies worldwide, a Shariah-compliant financial system appears to be profitable, viable, fair, and a clear survivor of the recent global debacle.

Islamic finance represents a fundamental departure from conventional interest-based and speculative practices, as it relies completely on real economic transactions, such as trade, investment based on profit-sharing, and other solidary ways of doing business. Rather than treating money as a commodity (as in capitalism), in Islam, money is no more than a measure of value.

Many of the features of Islamic finance are also found in other religions and ethical systems. For instance, the prohibition of interest is present in all Abrahamic faiths: Christianity, Islam, and Judaism. Interest was limited in Hindu law, the Code of Hammurabi, the Magna Carta, and Roman law, as well as in many US States until 1981. The rejection of financial speculation, which is detached from real economies, is shared by many observers and consumers in non-Islamic, Western countries. There is a significant overlap between Islamic principles and socially responsible investment (SRI), given that Islam preaches social justice, ecology, kindness, and what is called nowadays sustainability. All this makes Islamic finance a topic of truly global interest and relevance, as there is the potential for introducing a financial system which is both ethical and stable at the same time.

It must however be noted that the reality of Islamic financial systems nowadays is not yet close enough to those noble ideals. In several cases, the basic rules, such as the prohibition of *riba* (interest), have been circumvented, and pseudo-Islamic financial products were created, which were actually mere imitations of conventional financial products. By way of example, in the past there had been some types of *sukuk* (Islamic bonds), which exactly mimicked conventional interest-based bonds, and even instruments that resembled financial derivatives in an undesirable way. Pseudo-Islamic financial products strike at the foundations of Islamic finance, and in fact there is a growing standardization of financial instruments and practices, which will avoid such a misuse of traditional Islamic contracts.

Moreover, most existing Islamic financial institutions are Shariah-compliant in form, but few of them have aimed to achieve the higher objectives of Shariah, i.e. to add explicit "ethical" objectives and features to their financial products. For example, while modern microfinance

has been devised significantly by Muslims, such as Muhammad Yunus, Islamic microfinance funds only account for a very small share of Islamic fund products currently. Likewise, social responsibility has been integrated so far by very few Islamic fund managers and financial institutions. Other challenges include education and the creation of awareness, the development of suitable Islamic benchmarks for pricing of goods and services, the creation of efficient liquidity management tools, and the unification of Shariah-compliant risk management products.

To help bring discussion on the most imminent issues to a higher level, this book focuses on Shariah, regulatory, legal issues affecting the evolution of Islamic capital markets, economic theory and policy, as well as on major current market trends. It focuses on imminent real-life issues from various perspectives, which should make it a comprehensive reference material on the subject.

It is structured in four major parts: general concepts and legal issues; global Islamic capital market trends; national and regional experiences; and learning from Islamic finance after the global financial crisis.

In Part I, relevant legal aspects of Islamic capital markets are being analysed. **Michael McMillen** provides a cutting-edge and up-to-date analysis of trust laws in Islamic jurisdictions and explains the concept of Rahn in Saudi Arabia. **Ahcene Lahsasna** and **M. Kabir Hassan** focus on the Shariah process in product development, while **Sayd Farook** and **Rafi-uddin Shikoh** discuss the need for a broader ethical and social foundation of Islamic finance. Looking at the highly developed Islamic capital market of Malaysia, **Umar A. Oseni** and **M. Kabir Hassan** provide a discussion of the dispute resolution framework existing there, while **Murat Ünal** focuses on the world of Shariah Boards, and **Mufti Talha Ahmad Azami** and **Shahzad Siddiqui** look at the successes and failures of Abrahamic, faith-based funds.

In Part II, current practices of Islamic hedging and derivatives products are discussed from a legal perspective by **Priya Uberoi** and **Ali Rod Khadem**. **Andreas Jobst** shows how Islamic structured finance may help overcome some incentive problems in securitization, while **Mervyn Lewis** gives an overview of *Takaful* (Islamic insurance), its basic structural types, Shariah issues, and the further evolution of *Takaful* insurance products. Finally, **Valentino Cattelan** discusses a new model for options in Islamic law.

Part III contains various chapters that focus on relevant national experiences, situations, and potential with regard to Islamic finance. It is commenced by **Antonio Usama DeLorenzo** who explains in detail how the Malaysian Islamic capital market was built up. Malaysia is still the largest single national Shariah-compliant capital market in the world, and it provides a very inspiring example for the development of Islamic capital markets. The situation of Islamic finance in Germany is then described by **Azadeh Farhoush** and **Nicolas Schmidt**, while the case of France is explained in legal detail by **Laurent Weill** and **Ibrahim Cekici**. Both countries share several characteristics, which make an analysis of them interesting: they have the largest Muslim populations in the European Union, there are both French and German global banks acting in Islamic banking and capital markets abroad, but there is virtually no Islamic financial industry in place so far. This is in contrast to the USA and Australia, which are both non-Muslim countries, but with a longer tradition of Islamic financial institutions. **Blake Goud** and **M. Kabir Hassan** give an excellent, detailed, and highly comprehensive overview of Islamic finance in the USA, while **Anne-Sophie Gintzburger** takes a closer look at the comparative study of Malaysia and the GCC. Developments in Islamic finance in Australia are also described by **Abu Umar Faruq Ahmad** and **M. Kabir Hassan**.

Part IV discusses possible learning effects, which can be derived from Islamic finance in the light of the recent global financial market turbulences. **Rasem Kayed**, **M. Kabir Hassan**,

and **Michael Mahlke** search for lessons learned, analyse specific risks of the Islamic financial system, and compare its strengths and weaknesses with the prevailing conventional financial system. **Sami al-Suwailem** and **M. Kabir Hassan** analyse the specifics of Islamic financial engineering, again comparing it to its conventional counterpart. **Shehab Marzban** then studies the most important properties of Shariah-based investment, and again compares it to the conventional financial industry. Finally, **Mohammed Obaidullah** takes a closer look at Islamic microfinance, which still needs to be developed further.

We sincerely hope that this book, and the effort of all our esteemed contributors, will do the Islamic and ethical financial industry a good service.

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