



# Islamic Finance- Did it Resist the Global Crisis?

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# The Outline

- Why did Islamic Finance resist the global crisis?
- What is the Treatment of Market Risk in Islam?
- Is Shari'ah Risk Management Dynamical and Efficient?.

## Why did Islamic Finance resist the global crisis?

- As always, in many presentations, I have said and argued that Islamic finance did indeed resist the crisis, but only because all those *sukuks* they wanted to issue were not ready in time.
- Had those *sukuks* been ready and issued before the crisis I am convinced that Islamic banking would not have escaped.

## Why did Islamic Finance resist the global crisis?

- The difficulty is in defining and clarifying what could be called “**best practices**” in Islamic finance most particularly with regard to uncertainty *gharar*, which Islamic banking seems not to understand.
- That is, they want to take the same amount of risk and use the same amount of debt-to-assets as western banks.

## Why did Islamic Finance resist the global crisis? Cont.

- Now: western banking crashed because of this very thing-too much debt and not enough assets, causing very risky operations, and they lost everyone's money when things turned out bad.

## Why did Islamic Finance resist the global crisis? Cont.

- So, Islamic banking as some want to practice it is no guarantee against banking crises; but if the rules for *avoiding gharar -and reselling debts-* is followed, then, in that case, yes, Islamic banking could avoid these banking crises experienced every ten or fifteen years by western banking.

## Why did Islamic Finance resist the global crisis? Cont.

- However, if an Islamic bank makes bad investments- say, in property, which turn out to be just plain bad investments-then it would not matter what kind of banking is used, the money will be lost.
- Good banking and investment practices must be followed regardless of the type of banking system used.

## Treatment of Market Risk in Islam

- The following are summary results and illustrations pertaining to the economics and finance of the teachings of the Shari'ah.
- **Shari'ah Risk Management is Dynamic and Efficient**
- The Shari'h contains explicit and implicit teachings on economics, especially on enterprise and market risk management.

## Treatment of Market Risk in Islam

- The core concept is that risk must be fully apportioned among a broad base of participants.
- It does this by prohibiting fixing the market value of obligations and rewards, thereby allowing valuations to reflect their true worth across time as economic realities change.

## Treatment of Market Risk in Islam. Cont.

- It is a dynamic system, which mitigates the negative effects of constantly changing valuations in an economy.
- And it is in sharp contrast with conventional interest-based systems, whose weakness is in fixing the value of obligations and rewards for different enterprise participants in an economic regime of continuous valuational changes.

## Treatment of Market Risk in Islam. Cont.

- With respect to funding enterprises, Shari'ah teachings disallow lending money or value at a fixed rate of return.
- Therefore, if it is necessary to borrow capital, it must be loaned at “benevolent” terms at no interest, paid back whenever the lender wants.

## Treatment of Market Risk in Islam. Cont.

- Such terms are not practicable for most instances, considering the time value of money and its opportunity cost.
- A practical alternative is to enlist partner investors.
- As with any investment, these will share in the risks and the rewards of the enterprise.

## Treatment of Market Risk in Islam. Cont.

- If it fails, all lose in proportion to what has been invested, and no further payments are due.
- If it succeeds, all investors share in the rewards proportionately, just as their losses would have been shared.

## Treatment of Market Risk in Islam. Cont.

- This system spreads enterprise risk from one individual to the enterprise-entity, reducing entry and start-up costs with respect to risk premiums being born disproportionately by any one party.
- Contrast this to a simple loan at interest. No matter what happens to the object for which the loan was obtained, the loan must, in any case, be paid back, even if the generator of future funds -the enterprise- has been lost.



THANK YOU  
FOR LISTENING

*Any questions?*