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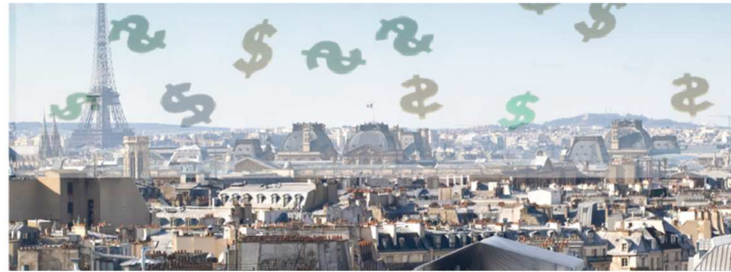

> EXCLUSIVE TO THE ISLAMIC BANKING & FINANCE NEWSLETTER

Ethical fusion

The movement towards ethical business practices in Europe has gathered pace since the 1970s, which coincides with the acceleration in growth of Islamic finance. Both share similar values. Mufti Barkatulla examines whether the two can work together to achieve their goals.

Ethical finance originated when demands for enhanced financial transparency—along with the conviction that finance could be used to achieve social change—began to take root. These early efforts to address social ethical environmental issues in finance primarily took the form of negatively screened socially responsible investment (SRI) funds. For much of the 1980s and 1990s, ethical investment in the UK involved, primarily, SRI activities. SRI continues to dominate media and public attention in the UK as the most well-known form of ethical investment.

Ethical finance can be understood as a response by consumers to the negative outputs of a global economy that can have devastating effects on local communities, the climate, and ecosystems. Innovations in ethical finance may reflect a concern about the limitations of capitalism to provide solutions to issues of social justice, such as the widening gap between rich and poor. Awareness of the cost of climate change, environmental damage, and child labour violations—to name a few—have galvanised support for not-for-profit organisations and provoked consumers to re-examine the activities their finances support.

Transformation in economic circumstances means a shift in the landscape for sustainable investment. Questions about corporate governance, previously seen as the preserve of the specialist, have moved centre stage as questions are asked about how the market's best and brightest bankers could preside over risk-taking that ultimately resulted in the biggest episode of wealth destruction since the Great Depression.

Yet, at the same time, there are risks that companies fighting for survival will see sustainability management as an unaffordable luxury. Various stakeholders in ethical finance present a compelling case that good management of environmental, social and governance risks will make them more resilient to the ups and downs of the global economy.

Like Islamic finance, ethical markets remain small and vulnerable. However, ethical financial reports show that despite the first tremors of the downturn being felt towards the end of last year, overall ethical spend in the UK reached £35.5bn in 2007, up 15% from £31bn in the previous year.
Banks that engage in ethical finance emphasise the transparency of operations, promote clarity in communications, and prioritise fair treatment of customers. The importance of treating customers fairly has been emphasised by an ongoing programme of the Financial Services Authority (FSA) and has entered into the banking code.

Ethical concerns are reflected more broadly in the efforts of the National Consumer Council and Which? to challenge banks on practices such as payment protection insurance (PPI), unauthorised overdraft charges, and delays in cheque clearing times. Recent reviews by the Competition Commission and the UK press have highlighted negative bank practices. High street banks have increasingly come under pressure to address public mistrust on these issues.

Broadly, ethical finance can be categorised into four areas of activity:

❶ Developing financial products or initiatives that combine financial return with a means to address social or environmental issues.
❷ Promoting sustainable principles in internal operations.
❸ Incorporating social and environmental considerations into investment and financing decisions.
❹ Treating customers fairly through transparency and clarity.

Both ethical and Islamic finance movements share many characteristics in addition to a similar background in development. They have a fundamental philosophy of social justice, responsible utilisation of resources and equitable distribution of income. Both detest harmful and noxious results arising from corporate growth under greed-led capitalism.

Translated into active policy decisions, the list of negative screens for investment illustrates the commonality between ethical and Islamic finance: tobacco, alcohol, gambling, porn and violent media, armaments, exploitation of children and animals, and environmental damage.

Ethical and Islamic finance have been criticised for heavy use of value-laden terminologies and strong brand labelling tendencies. Industry insiders have highlighted the challenges of marketing products as "ethical" and "Islamic", because the nature of values in ethics and the degree of Islamicity are difficult to communicate.

Many suggested that broader neutral terms such as "social", "sustainable" or "environmental" might be better suited. The late Dr Zaki Badawy preferred to term Islamic finance as alternative finance. New Islamic financial institutions have named their entities as neutral as possible: European Finance House, Gatehouse Bank And London and Middle East Bank.

Professor Rodney Wilson of the Centre for Middle East and Islamic Studies at Durham University clearly distinguishes between Islamic and ethical finance. "There are fundamental differences between ethical practices derived from religious teaching and those designed to appeal to popular secularist morality. Those involved in Islamic finance would regard their ethics as being enduring, as ultimately they are based on holy revelation, whereas ethics derived from social values are inevitably more transitory."

The inspirational sources may differ but the underlying philosophy is common: socio-economic justice and eco-concerns.Prohibition of interest is viewed as the nucleus of Islamic finance. Describing it simply as "interest free" does not do it justice. There are supporting principles that provide a shared platform with other ethical concerns. Even the religious prohibition of interest's rationale is social justice, because it is perceived to be unjust and exploitative.

Among the guiding principles of Islamic finance are sharing reward and risk, promoting entrepreneurship, discouraging speculative behaviour, preserving property rights, transparency of contractual obligations and asset-backed transactions. Clearly, Islamic Shariah-based economic development

financial instruments; making client endorsement from the Muslim community explicit rather than assumed; making corporate governance of Islamic institutions more transparent for major shareholders; and advocating affinity debit cards as a vehicle for zakat and social development.

There are many individual, institutional, and logistical impediments to their implementation. Governments and financial regulators have failed for years to incorporate social and environmental measures. Current systematic crises have witnessed much rhetoric by top state officials for responsible markets and moral economy. A Congressional Research Service report on Islamic finance last July notes: "Some view the integration of ethics and values in finance as a positive development, especially in light of recent US business corruption scandals. Many investors reportedly consider Shariah-compliant finance to be more reliable than conventional financing, given the global credit crisis and fears of economic recession."

We may take pleasure from the acknowledgment, but that really isn't good enough. We need to see concrete actions rather than empty assurances with little substance.

Mufti Barkatulla is member of the Shariah supervisory boards for several Islamic financial institutions and banks, including Islamic Bank of Britain and Lloyds TSB. Mufti is a lecturer on Islamic finance at a Ebrahim College, London. He is a prominent Islamic Shariah law scholar with a strong background in economics and finance

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