NINTH HARVARD UNIVERSITY FORUM ON ISLAMIC FINANCE
HARVARD LAW SCHOOL - MARCH 27-28, 2010

BUILDING BRIDGES ACROSS THE FINANCIAL COMMUNITIES: A SHORT REPORT

The Ninth Harvard University Forum on Islamic Finance was held on March 27-28, 2010 in Austin Hall of Harvard Law School. The conference was premised on the theme *Building Bridges Across Financial Communities* and divided into three plenary sessions and four parallel sessions spanning the course of two days. A number of globally-renowned scholars and practitioners participated as both speakers and audience members, evoking a highly informed and insightful level of discussion.

This forum was the culmination of efforts over the past fourteen years to bring together scholars and practitioners from around the world to discuss Islamic finance's most important issues. Previous forums have taken up Islamic finance and economics in more depth to examine areas such as legal and regulatory issues, global challenges and opportunities for the industry, dynamics and development, as well as innovation and authenticity. This year's forum sought to move forward from these introspective considerations by focusing on the broader issue of how Islamic finance can now build bridges into a wider range of financial services and communities. In line with this theme of building bridges, the conference addressed such questions as: How can organizations use Islamic finance as a framework for becoming more socially responsible? What are the initiatives other faiths can and have taken toward improving business practices? What does current academic research suggest about the trends and future direction of Islamic finance, particularly at this important junction after the financial crisis?

Part of this global discussion focused on the need for greater and improved ethics, values, and social responsibility in modern finance. This included a lively discussion on how religious principles and moral teachings can assist in defining the post financial crisis world. Religious thought has historically been a significant source of ethics and values in the world of finance among different communities and continues to be today. This forum stood out from past forums in its emphasis on interfaith dialogue. Speakers from different religious groups shared their faith's perspectives on finance and how Islamic finance can take a broader multi-faith approach while industry practitioners explored the possibility of adopting Islamic finance values in countries serving non-Muslim populations. Together, the speakers' and audience's diverse group of perspectives contributed to a stimulating discussion on how Islamic finance should embrace lessons from the past and address present challenges to continue moving forward in the field.

As part of the opening remarks, special acknowledgment was made to the Project sponsors HSBC Amanah and Kuwait Finance House for their continuous support, and in particular to the Ninth Forum sponsors: Al Baraka Islamic Bank, HSBC Amanah, Islamic Research & Training Institute of Islamic Development Bank, Kuwait Finance House, Rasameel Structured Finance Company, and Al Subeaei Group.

MOVING FORWARD FROM THE FINANCIAL CRISIS

The first plenary session, entitled "Islamic Finance After the Global Financial Crisis," was chaired by Samuel L. Hayes, Jacob H. Schiff Professor Emeritus at Harvard Business School. The session focused on two discussion papers: Ibrahim Warde's After the Meltdown: New Perspectives on Islamic Finance, and Kilian Bälz's Islamic Finance in Crisis? The Financial Crisis and the Quest for Islamic Business Ethics.

Warde identified several flaws in Islamic finance as an alternative course to regular finance, including: the challenge of actually putting the principles to practice; the industry's lack of direction in terms of balancing what is successful with what is religiously permissible, and the religious moral hazard of mixing religion and finance in general. He also highlighted criticisms of regular finance towards Islamic finance, particularly the vetting process through Shari'a boards, which he argued limits innovation. Bälz also identified issues with Islamic finance as an alternative to regular finance such as the need to establish Islamic business values and change the process of Shari'a. For instance, he suggested that part of the solution would be a separation of standard-setting from the application of the standards.

These insightful papers and critical remarks stimulated a very interesting discussion from the panel respondents as well as the audience. Thomas Baxter of the Federal Reserve Bank of New York emphasized the similarities between regular finance and Islamic finance and outlined five universally-recognized ethical principles: honesty, responsibility, respect, fairness, and compassion. He then connected these to incentive compensation and equity participation, arguing that we need to look for principles of risk management (like prudent incentive compensation or creating a stake in enterprise) that will lead to more disciplined decision making and honest behavior by all. This need for prudential supervision, discipline, and greater transparency transcends religion, culture, or geography as the global nature of the financial crisis has demonstrated.

Bambang Brodjonegoro, Director General of Islamic Research Training Institute at Islamic Development Bank, agreed with Warde that Islamic finance is not a panacea and that there is a need to improve the efficiency of the system itself by systematizing and standardizing it. Like Baxter, he emphasized how ethics applied to the current crisis and specified areas he felt could improve Islamic finance, such as retail sukuk and Islamic microfinance.

Mukhtar Hussain, Chief Executive Officer of HSBC Malaysia, identified how Islamic finance has grown faster than conventional finance on a one to one basis, which reflects a consumer demand and industry potential sustainable only by the introduction of more competitive products. He argued that Islamic finance is a complement and not a competitor to conventional finance and identified the needs of the industry including: greater innovation, particularly regarding sukuk as Bambang had explored; the need for government sponsorship at a higher level in terms of regulation; institutionalization; sponsorship; and more counterparties and research to allow Islamic finance to develop into a global market.

Nizam Yaquby, a Senior Shari'a Consultant, stated his greater agreement with Warde's stance over Bälz's. Specifically, he was skeptical of Bälz's dichotomy between business values and Islamic finance's legal application, arguing that in fact proper application of Shari'a will lead to the desirable business values.

Following the comments of the panelists, the audience and speakers from other sessions asked about the foundation of ethics, the connection between Islamic finance and regular finance in community development and reputational risk, and whether ethics promotion should be done in a secular educational curriculum or within the system.

THE ROLE OF ISLAMIC FINANCE IN POST-CRISIS GLOBAL RECOVERY

In order to continue the debate on this subject, five papers were selected pertaining to recovery from recession. These papers were presented in a parallel session entitled "Recovering from Recession," moderated by Kristen Stilt, Associate Professor at Northwestern University. The first, Necati Aydin's Free-Market Madness and Human Nature, examined the role of human nature and behavioral patterns in exacerbating greed and excess in the financial system. Aydin argued that these morally deficient aspects of human nature must be limited and well-regulated in order to avoid similar financial crises in the future. Masudul Alam Choudhury and Sofyan S. Harahap's The Future of Monetary Reform and the Real Economy: A Problem of Trade Versus Interest examined the potential to remodel the monetary, financial, and real economies based on Islamic values. It also analyzed the position of Islamic economics and law with respect to the capitalization of assets with interest-free financing.

Majid Dawood's Islamic Finance After the Global Financial Crisis addressed Islamic finance's capability to offer a better economic system that would avoid other major economic crises. After outlining the major causes of the economic crisis of 2008, the authors examined the prevalent needs of most consumers: checking and savings accounts, a credit card, a mortgage, and insurance. All of these needs could potentially be Shari'a compliant. Therefore, Choudhury and Harahap concluded that Islamic finance could potentially play a major role in global finance. The authors also argued for such a role based on the nature of Islamic finance: while Muslims self-select out of conventional finance for moral reasons, anyone may participate in an Islamic finance system. They regard the system's inherent inclusiveness as a driving factor in its potential for a global position.

Challenging the Parameters of Permissible Hedging in Islamic Finance: Rationale and Implementation of Recent Shari'a Rulings from a Legal Draftsperson's Perspective by Robert Rilk sought to demarcate the limits of permissible hedging in Islamic finance according to recent Shari'a rulings on the subject. Rilk concluded that based on current rulings, a derivates market in Islamic finance would lack the necessary liquidity due to an insufficient number of speculators. He also criticized recent Shari'a rulings for their failure to give a precise formula to distinguish between speculation from hedging, instead continuing to rely upon the intentions of a particular investment.

Finally, Jahangir Sultan's Portfolio Diversification during the Financial Crisis: An Analysis of Islamic Asset Allocation Strategies provided a quantitative performance analysis contrasting conventional financial institutions with their Islamic counterparts The analysis revealed that Islamic funds perform much better than conventional funds during calm economic times, and moderately better during times of crisis. Based upon this evidence, Sultan hypothesized that Islamic asset allocation models may be safer during times of economic and financial distress.

FROM ISLAMIC FINANCE TO MULTIFAITH FINANCE

The second parallel session Faith and Finance, chaired by Noah Feldman, Bemis Professor of Law at Harvard Law School, discussed the potential of faith's impact on finance through the lens of two papers: Seamus Finn's Faith and Finance: A Catholic Consideration and Nejatullah Siddiqi's Faith and Finance: Value-Guided Pursuit of Interests. In his presentation, M. Nejatullah Siddiqi, Professor Emeritus at Aligarh Muslim University, India, emphasized relationships, especially those between man and man, man and his environment, and man and God. He contended that faith offers universal values that can guide all men in these relationships. Seamus Finn, Director, Justice, Peace & Integrity of Creation, Missionary Oblates, discussed the Catholic social teaching and the universal values that have emerged from these teachings. Both authors presented the following challenge to Islamic finance: how can it serve broad ethical values while meeting the more specific legal constraints?

The panel discussants presented complications, critiques, and suggestions to the theses of the guiding papers. Yusuf DeLorenzo, Chief Shari'a Officer at Shari'a Capital, agreed with the authors that Islamic finance institutions must preserve and advance these ideals in their enterprises. Practitioners need to ask questions such as, "What are we doing for our communities?" in order to carry out the underlying values of Islamic finance. To help ensure this, Islamic financial institutions need to educate consumers, become standardized, and utilize prudent Shari'a governors to oversee activities. He believes that Shari'a boards have been successful in keeping managers focused on important values, though room for improvement exists. Shari'a board policies such as rotating board seats to incorporate younger scholars would help the boards have greater cognizance of the impact of their activities on the next generation, and will train future Shari'a scholars to recognize these universal values.

Jay Harris, Harry Austryn Wolfson Professor of Jewish Studies at Harvard University and Shahab Ahmed, Assistant Professor of Islamic Studies at Harvard University, pointed out the far-reaching consequences of a focus on universal values. It would affect a country's investments and its politics, potentially making it difficult for an investment vehicle to be successful. What Siddiqi and Finn are proposing, Harris warned, is a very delicate matter that needs careful consideration.

Ahmed questioned the way faith is employed in the context of Islamic finance. Currently, faith is external to finance and needs to be brought into the discourse. In reality, Islamic finance is a discourse on morality, specifically the economics of morality and a moral economy. The fundamental principle of Islamic ethics is that Muslims should not cause harm to others, and the idea of this moral economy would imply that the Muslim community has a large humanitarian interest. For example, adherence to these values would mean that Islamic finance institutions have obligations like solving humanitarian crises by cutting off trade with countries involved. Islamic finance institutions must ask themselves what mechanisms are in place to identify and affect financial activity in a moral economy.

In agreement with Ahmed, Harris stated that our concern is more with morality and economics rather than faith and economics. He disagreed with Siddiqi's call for universalistic faith values, instead arguing that we need to acknowledge the reality that faiths have evolved their own way of developing an in-group versus out-group morality with different rules and different moral and legal traditions for each. It is inevitable that the need to adopt a faith's position to be morally and exemplary reliable casts doubt on the decency of those outside of that faith. With this in mind, we need to remove ourselves from just the world of faith to embrace something larger.

Feldman framed the challenge to Islamic finance with Siddiqi and Finn's emphasis on universal values, the puzzles Harris and Ahmed posed that complicate it, and the potential response presented by Yusuf DeLorenzo to supplement legal constraints with broader ethical considerations. The question and answer session posed even more complications to the shift towards universal values, including the increasing political instability in Muslim countries and the role of governments in working with IFIs to promote values in their economic activities.

FAITH IN FINANCE: ACCOUNTABILITY AND TRANSPARENCY

In order to complement the above discussion, five papers were presented in a session entitled "Religious Perspectives on Finance" which was chaired by Taha Abdul-Basser, Shari'a consultant and Chaplain of the Harvard Islamic Society. Each of the panel discussants introduced their papers and findings for how to bridge faith gaps in finance.

Usman Hayat, author of Faith in Finance Should Mean Transparency and Accountability, argued that regardless of whether one has faith or not, the best means of conducting financial operations are the same: transparency and accountability. That institutions associate themselves with faith in finance, such as in Islamic finance, simply means that they must set higher standards of transparency and accountability.

Janell Nakia Irving also de-emphasized the role of particular creeds or religions, arguing that operational strategy in any faith-based group, such as well-developed strategic partnerships, case statements, strategic diversity planning, and evaluations will strengthen community collaboration and outcome success. Her paper Garnering Federal Support for Faith-Based Initiatives: Building Bridges through Islamic Leadership focused on how the Office of Faith-Based and Neighborhood Partnerships specifically facilitates such interactions.

Omar Kalair and Aznan Hassan, presenting their paper Faith and Finance: Multicultural Banks vs. Islamic Banks, outlined how other faith groups are interested in the usury-free and other ethical filters available in Islamic financial institutions and argued that multicultural banks including these components are a better alternative than exclusively Islamic banks.

In her paper Is Faith a Luxury for the Rich? Examining the Influence of Religious Beliefs on Individual Financial Choices, Ayesha Khan investigated how religious preferences affect banking account decisions. Presenting her methodology and data, Khan showed how individual religiosity and wealth were important determinants of an individual opening an account with an Islamic finance institution. In fact, the performance of Hajj was the single most significant predictor for opening an Islamic account because it connected both wealth and religiosity. Her analysis of these findings suggested that there may be a kind of "faith premium" associated with Islamic bank accounts in the positive non-monetary benefits associated with them

Shahzad Siddiqui and Talha Ahmad, presenting The Alpha and Omega of "Abrahamic" funds: Successes and Failures of Faith-based Funds, proposed the creation of an "Abrahamic" mutual fund drawing on the Judeo-Christian as well as the Islamic tradition to broaden its parameters and appeal to a larger audience of investors. They demonstrated how common interests—such as the reduction of interest, socially responsible investment, and concerns with social justice—connect the three faiths and have broad financial potential, as both Islamic and Catholic funds have empirically outperformed their conventional counterparts.

SOCIAL RESPONSIBILITY

Efforts to identify potential areas of innovation in the industry coincided well with the Forum's exploration of the industry's level of social responsibility, the topic of Plenary Session Three, chaired by Asim Ijaz Khwaja, Professor of Public Policy at the Harvard Kennedy School. Two papers were presented:, Sayd Farook and Rafi-Uddin Shikoh's Integration of Social Responsibility in Financial Communities and Marcy Murninghan's Money and Morality: Pathways Toward a Civic Stewardship Ethic

In their presentation, Farook and Shikoh raised the question of how Islam can influence business strategy to affect social change and justice through financial institutions. They concluded from the empirical evidence presented that the role of financial institutions within business and industry is one of high-impact, serving as engines of social responsibility and as a means of mitigating poverty and other transnational challenges such as global warming. Panelist Steve Lydenberg summarized the three primary assertions of their paper: that financial institutions owe a contribution to a public good, that that they should be exemplary, and that they have an obligation to address social justice.

Marcy Murninghan, Senior Researcher at Harvard Kennedy School, responded that an alliance between Islamic finance and Social Responsible Investment (SRI) practitioners is both necessary and natural. The alliance is natural because the 'money morality movement' is part of the legacy of the 1960s era priorities based in social justice – a shared priority in Islamic finance. Commenting on her paper, Lydenberg summarized that Murninghan believes institutions need to integrate universal values, that doing so requires the appropriate vocabulary, and that integration also means a blended engagement with other SRI communities. Mary Jane McQuillen praised the Murninghan paper for serving as a wake-up call to members of the industry to avoid complacency and bureaucratization in SRI.

Providing her opinion on both papers, commentator Laura Berry expressed optimism about the end of the financial crisis. For Berry, this is a time for both the SRI and Islamic financial communities to take roles of global leadership in light of the failures of secular finance since both its practitioners and beneficiaries are looking for alternative practices.

Many interesting questions and comments were raised during the subsequent question and answer session. Shikoh identified what he considers a common problem throughout the Muslim world: while individuals sincerely adopt the practices and values of the Prophet into daily life, a lack of infrastructure to support religion persists in the Muslim world. He challenged practitioners of Islamic finance to incorporate these values at an institutional level in their societies, noting the transformational potential of finance to create societies reflecting individual values.

The theme of cross-cultural collaboration continued in the parallel session Social and Corporate Consciousness which was moderated by David Ager, Lecturer on Sociology at Harvard University. While covering a breadth of issues, many of the papers emphasized the partnership potential between social responsibility and Islamic finance and the need for more effective advisory oversight.

Kabir Hassan and Mamunur Rashid, presenting their paper Ethical Index and Market Value of Islamic Banks, evaluated the performance of banks in Bangladesh, Malaysia and Arab Gulf States using the ethical Identity Index. Their findings suggest that commitments to debtors and the products and services offered were the top priorities in the overall ranking of these banks, with commitments towards society, clarity in mission and vision statements, and supervision by Shari'a supervisory boards standing as the weakest areas. They concluded that there is a need to focus on developing these areas and further ethical identity disclosure requirements for Islamic Banks.

Aly Khorshid, author of Adding Social Responsibility to the Mandate of Shari'a Advisory Boards, challenged the procedure in which advisors are appointed to Shari'a boards, focusing especially on a need to prevent over-commitment by advisors. He argued that this should be the golden age for Islamic banking to take advantage of the credit crunch but that Islamic Finance in some ways lacks accountability because of its patronage in the advisor selection system and the lack of young, new talent being recruited the field. Khorshid expressed his admiration for the Malaysian system, encouraging other states to follow suit in bringing in a new generation of Shari'a advisors who would improve the system by abiding by more stringent mandates, such as a requirement to only sit on one board.

Mohammad Akram Laldin also emphasized the critical role of effective Shari'a boards in ensuring that legal requirements are met and that Islamic finance products are further developed and improved. In his paper Empowering Corporate Social Responsibility (CSR), Social Responsible Investment (SRI), and Social Enterprises (SE) in Islamic Finance, Laldin argues that corporate social responsibility, socially responsible investment, and social entrepreneurship have not been consistently accepted and implemented to drive achievement in these areas, although they are an integral component of being Shari'a-compliant. As a solution, he proposed the Maqasid System which takes CSR, SRI, and SE and the five basic interests of religion, life, intellect, lineage, and wealth into account. He concluded by raising challenges faced by Islamic finance in the future, including providing Islamic microfinance services and being wary of poor corporate governance and Shari'a advisory.

In A Critical Analysis of Obstacles to the Alliance between SRI and Islamic Finance, Luc Van Liedekerke and Reza Zain Jaufeerally investigated the real obstacles preventing Islamic finance and SRI from joining in a mutually-beneficial partnership. During their presentation, they discussed various differences between the two, such as how Islamic finance looks at the leverage of assets and ethical quality of financial institutions offering it, while SRI does not. Conversely, there is a high level of transparency in SRI which is relatively lacking in Islamic finance, particularly with Shari'a boards as Laldin and Khorshid had also discussed.

Sajjad Shah, author of An Investment Evaluation Framework for Socially Responsible Investing and Islamic Finance, presented a detailed graphical analysis of Markowitz's "Efficient Frontier" to evaluate the conventional financial theory in light of the emerging fields of SRI and Islamic finance. His analysis found that there is a need for a more flexible framework which extends beyond the traditional risk and return paradigm to recognize that the incorporation of elements like Shari'a-compliance can create a new, smaller frontier.

In the discussion, the audience raised questions with respect to the shape of an ethical index function, the process of bringing in a younger generation of Shari'a advisors, interpretation of the Efficient Frontier, and the broadness of the claim that Shari'a boards lack accountability. The engaging discussion was both informative and inconclusive, conveying the many complexities involved in developing social and corporate responsibility.

ISLAMIC FINANCE: ACADEMIC RESEARCH AND INNOVATION

As part of the established tradition of Harvard University Forum on Islamic Finance, one session was devoted to the exploration of academic research, including Masters as well as PhD dissertations. This session was chaired by Bambang P. Brodjonegoro, Director-General, Islamic Research & Training Institute, Islamic Development Bank, and focused on the academic research findings of its panelists' five papers. The session was particularly lively with a diverse variety of topics and receptive audience eager to evaluate and dissect the issues with the panelists.

Hanaan Balala, presenting her paper The Nature of Debt and the Legality of Its Sale, challenged the premises underlying the restriction of riba and concluded that receivables and debt rights are property rights that can be traded. A novel and provocative stance, her presentation evoked much discussion from the audience including a counter response from Nizam Yaquby who felt that riba is not a matter of ijtihad and that the exchange of receivables with goods cannot be conflated with the exchange of receivables with cash.

Shehab Marzban and Mohamed Donia were the next presenters, guiding the audience through their research findings in Shari'a-Compliant Equity Investments—Frameworks, Trends and Crisis. They proposed a standardized research framework to overcome the shortcomings of non-standardized Shari'a screening processes in order to raise compliance credibility and provide a more flexible and adaptable alternative. Their presentation also examined the performance of conventional and Shari'a-compliant portfolios, demonstrating that Shari'a-compliant portfolios empirically outperform their conventional counterparts.

Matt Herbert, presenting on behalf of Kim Wilson and Christine Martin in their joint paper Deepening Access to Islamic Banking Through Technology, introduced the creative proposition of mobile finance. In mobile finance, any phone is an access point to better reach the large unbanked sector in Islamic countries and to lower costs and raise availability for the banks as well. His presentation stimulated extensive discussion amongst the audience; numerous questions were raised regarding the appropriate actors for the proposition, the issue of personal security, and the relevance of its use in Islamic finance as opposed to regular finance.

Jiyoung Yang provided a case study of the prospect of Islamic finance in Korea, outlining legal obstacles like those with sukuk in her paper Regulatory Issues of Islamic Finance in Korea. Although the strong support from the government and top performing industries show the great potential to develop Islamic finance in Korea, many regulatory challenges need to be addressed, including the differences in legal systems and issues of dual taxation and inadequate regulations for Islamic finance.

FORUM BANQUET

The banquet featured two speakers, M. Nejatullah Siddiqi and Thomas Mullins. Mullins, the former Associate Director of Harvard's Center for Middle Eastern Studies, explained that in the post-crisis financial sector, Islamic finance has a unique opportunity to take the lead. According to Mullins, we currently lack a proper vision for humankind that incorporates socio-economic justice as part of one's unalienable human rights. If communities and executives can be on the same page, Mullins hopes, we can reconcile the fragmentation between the material and the spiritual.

Siddiqi reminded the audience that firms need to realize the consequences of their actions on both their clients and society. The quest for fairness extends beyond securing rights to also securing dignity. While practitioners of Islamic finance cannot be required to know the future, they can, by completing these obligations for fairness, aspire to create a more just socio-economic situation for each generation.

CONCLUDING REMARKS

The Ninth Forum concluded with Nazim Ali, Director of the Islamic Finance Project, thanking the audience, speakers, IFP staff and volunteers for their assistance throughout the conference and inviting them to join the Islamic Finance Program again for future events. A few names were given special recognition for their assistance in the organization of the Forum: Hassaan Yousuf, Sanjida Rehman, Sarah Akhtar, and Nafees Syed. There were others who had worked behind the scenes for specific tasks and who were thanked: Husam El-Khatib, Taha Abdul-Basser, Aamir Rehman, Abdur-Rahman Syed, Munir Zilanawala, Saif Shah Mohammed, Mansoor Shakil and Hisham Mabrook.

Feedback during and after the conference praised the organization of the event, its high level of attendance and particularly the engagement between the speakers and the audience, who contributed innovative ideas, critical reflections, and vibrant discussion to the conference. To continue the intellectual exchange after the conference, a subset of selected papers presented at this forum will be published in the form of a book similar to previous forum publications.