

Queen Mary University of London

BSc Economics, Finance and Management Economics Project 1

**Islamic Banking and Financial Products Going Mainstream:
Challenges and Opportunities**

Charles Edward Ho Kit CHONG

Student ID: 160273258

Supervisor: Dr. Konstantinos Evangelos Zachariadis

April 2019

Introduction

Islamic finance or Shariah-compliant financing activities revolve around Islam's "Shariah" laws and the practical application of developing Islamic economics. The emergence of Islamic finance was evident at the turn of the century, following the tremendous growth in the population and level of wealth of nations in the Middle East. However, distribution of Islamic financial products have, hitherto, been primarily to Shariah-compliant funds, and to a lesser extent, to certain institutional investors seeking diversification from mainstream financial products.

This paper discusses the challenges and opportunities faced by Islamic financial products as they seek to become a mainstream financing option. It also considers in detail the various factors that make financing and financial products successful and widely adopted in global capital markets, and how Islamic financial products measure up against each of these factors.

Methodology

This paper considers and analyses existing published literature documenting the views of academics, supranational organisations, corporations, market practitioners and capital markets participants on Islamic financial products – their origin and development, their use and issuance by sovereigns and corporations seeking financing, their adoption by investors globally, and the challenges and opportunities faced by stakeholders in adopting, promoting and popularising the use of Islamic financial products as a mainstream financing option.

The author is a national of, and lives in, Malaysia, a country that is at the forefront of Islamic finance. The Government of Malaysia is the earliest adopter of Islamic financing, and Malaysia is now a major centre for Islamic banking and Islamic finance.

In-depth interviews and consultations were conducted with several key opinion leaders, regulators and practitioners of Islamic finance in Malaysia and Hong Kong, to gather the latest information on developmental trends and current issues facing Islamic finance.

These include:

- a doctoral student in an Islamic university in Malaysia who is conducting research on the regulatory framework governing Islamic products;
- the co-founder and director of one of the largest Islamic financial planning services companies in Malaysia;
- a senior investment banker who used to be a regulator of Islamic products at the Securities Commission of Malaysia; and
- several capital markets bankers whose speciality is the issuance and sale of Islamic financial products.

The above interviews and consultations provided empirical evidence, supported by the views of senior practitioners of finance, on the relevance of Islamic finance in the capital markets. They also reveal the issues faced by stakeholders in promoting and expanding the scope of Islamic financial products, and the challenges that proponents of Islamic finance will face in seeking to make this a mainstream asset class across the globe.

Overview of Islamic Finance

Islamic finance is not just about ethics; it is a whole moral code about “right” or “wrong” in Islam, one of the largest religions in the world. Its foundation is built on the principles of ethical business practices, social responsibility and fiscal conservatism.

Islamic stock indices must not include enterprises that pay or receive interest of any form, such as banking and financial institutions. As a result, the percentage of listed firms that are fully in compliance with Shariah law is much smaller than conventional stock indices. Islam also bans investments in industries which are considered “haram” such as alcohol, pork, gambling and pornography (the so-called “sin stocks”).

Islamic banking (a subset of Islamic finance) may have a certain advantage over conventional banking in certain jurisdictions, as the moral foundation of banking is at the core of Islamic banking principles. This consideration has become more important since banking abuses and excesses in the last decade were partially blamed for the exacerbation (if not as the primary cause) of the global financial crisis. For example, Islamic banking rejects much of the complex financial engineering and derivative instruments used by conventional and investment banks, much of which underpinned the “housing bubble” which was blamed for the financial crisis in 2008.

Islamic banks profess to treat customers more fairly than conventional banks. However, they are generally seen as falling behind in best industry practices and failing to deliver a simple, easy-to-understand, banking experience. Islamic banks are more likely to be asset-based and also dependent on Islamic principles of Profit and Loss Sharing (“PLS”) in their transactions – a principle which involves the shifting of credit risks from the bank to its investors and depositors.

Islamic finance is potentially appealing to all mainstream investors because of its ethical basis:

- Islam teaches that money should be channelled toward the “real” economy, the production of real goods and services, and not the “financial” economy such as hedge funds and derivative instruments; this helps stakeholders keep in touch with the real economy and away from speculation; and

- The zero-sum game of maximising profit and charging interest is a practice forbidden under Shariah law.

Advancement of Islamic Banking and Islamic Finance in Global Capital Markets

Islamic financing products are growing rapidly as an alternative investment class for both Muslim and non-Muslim investors. A major reason for the increasing popularity of Islamic finance and Islamic financing products is the continued rise of Islamic nations of the Middle East, especially those which have benefited from oil production and trading relationships with the United States of America, Europe and China; these countries include The Kingdom of Saudi Arabia ("Saudi Arabia"), the United Arab Emirates (the "UAE"), The Kingdom of Bahrain ("Bahrain"), The State of Qatar ("Qatar") and Turkey.

There are seven main players in the global Islamic finance market, namely Qatar, Republic of Indonesia ("Indonesia"), Saudi Arabia, Malaysia, the UAE, Bahrain and Turkey.

Islamic banking assets are expected to grow at a cumulative annual growth rate ("CAGR") of 20% over 2013-2020, to reach US\$3.034 trillion. Among the seven countries, Malaysia's Islamic finance assets are the largest, at US\$412 billion; Saudi Arabia's is worth US\$217 billion and UAE, Qatar, Indonesia and Turkey, in aggregate, have Islamic finance assets worth US\$424 billion. Saudi Arabia, Malaysia and Luxemburg dominate in terms of global Islamic fund issuances, at a combined market share of approximately 70% of total global issuance.

Below are some statistics on global Islamic finance assets and global Islamic funds*:

- Global Islamic finance assets:
 - US\$200 billion in 2003
 - US\$1.35 trillion in 2012
 - US\$1.71 trillion in 2013
 - US\$2.00 trillion in 2016

- Global Islamic funds:
 - Islamic funds sector: estimated at US\$62 billion (approximately 4.7% of global Islamic assets)
 - Asset under management of Islamic mutual funds: US\$46 billion

** Sources: Thompson Reuters (2012), EY (2013), International Investor (2016) and IMF (2017)*

The growth of Islamic funds has been phenomenal, with 576 funds in 2007 and not fewer than 1,065 funds in 2013. Sources of Islamic funds are approximately 20% Institutional investors and 80% retail investors, whereas conventional funds see institutional investors making up 70% of their source of funds, with retail investors making up the remaining 30%.

Although the Islamic finance market is developing and expanding rapidly, Shariah-compliant financial assets are estimated to make up only around 1% of the world's financial assets.

The above statistics are interesting, as they suggest that while larger institutions tend to invest in conventional financial products, the power of religion is able to draw retail investors of a particular faith (in this case, Islam) and non-Muslims into a significant funding system that complies with the religion's laws and economic principles.

The Muslim population, especially in the Middle East, is one of the fastest growing in terms of numbers, and fast coming up the curve in terms of rising disposable income. Over time, increased savings and investments will need to be met by Shariah funds, which comply with Islamic laws and demanded by Muslim investors. Today, we witness Western or non-Islamic sovereigns, corporations and financial institutions jumping onto the Islamic financing bandwagon to raise financing, tapping into a new and very large pool of investors (see "Sukuk" bond examples later).

Conventional vs Islamic Bond Financing

The three major avenues of financing for a firm are (a) equity financing, (b) bank loan financing and (c) bond financing. Bank loan and bond financing are important as these do not involve the participation in the equity upside of the firm by the financiers; the lenders simply get the pre-agreed periodic payment – known as interest (or coupon in the case of bond financing) – on the amount of financing, plus the principal amount on maturity.

A discussion on Islamic finance would be incomplete without a discussion on bond or loan financing, as Islamic finance specifically prohibits “riba” (the practice of generating money from money) i.e., interest or usury. Does that mean that Islamic financing is cut out of all fixed income and bank loan financing? This restriction in Islamic finance – the inability to charge interest – was recognised by Muslim scholars at the turn of the century, and they have come up with a solution that is acceptable to Muslim clerics.

But first, let us look at bond financing.

Bonds are also known as “fixed income” instruments, as they generate fixed returns in the form of interest (coupon) payments to bondholders. Fixed payments reduce overall risks to both the borrower (issuer of the bond) and the investor (holder of the bond), as there is certainty of pay-out (barring default) and both the issuer and the investor know what to expect in terms of costs and returns, respectively.

Interest rate fluctuations in the market will cause bond prices to go up or down; if yields in the market increases, bond prices will fall, so that the fixed return from the bonds, set against a lower bond price, matches the yield required (and vice versa). Capital loss is also possible with exchange rate fluctuations, especially in the case of bonds denominated in a currency other than the issuer’s home currency.

Lower risks, however, also mean lower returns. Bond returns are generally lower than equity returns, with the exception of high yield bonds (also known as “junk bonds”), which carry higher coupons as the firms issuing them are of higher risks (e.g., highly leveraged corporations, early stage / start-up companies, or pre-cash flow enterprises). Most investors keep a portfolio comprising equities and bonds to achieve their investment objectives in a balanced portfolio.

From a capital structure standpoint, bonds rank ahead of equity in terms of liquidity preference. In the event of the liquidation of a firm, bondholders (especially secured bondholders) get paid first out of the proceeds of liquidation (after the government and employees are paid), hence making bondholders a more “secure” class of financiers.

Interest, seen as the cost of bond or loan financing, is a measurement of the risks to be borne by the financier. It is the amount of money that the financier would earn when making funding available to the borrower. The interest charged for bond or loan financing reflects both the yields in the market and the credit-worthiness or stability of the borrower. Larger and more secure borrowers, benefiting from a higher credit rating, enjoy lower interest rates when borrowing, whereas more risky borrowers pay more for their financing.

Lower interest rates allow borrowers to borrow more, hence spending more, creating a multiplier effect of increased spending in the economy, and thus, allowing output and productivity to increase to bring about increased economic growth. Higher interest rates make it harder and more expensive for borrowers to borrow, thus reducing spending power. This reduces demand for goods and services and will generally lead to lower inflation.

How then, does Islamic finance deal with bond or loan financing?

One of the most widely accepted Islamic financial products is the “sukuk,” which is essentially a form of financial certificate that bears some resemblance to a bond or debenture in Western finance. At the turn of the century, sukuk issuances took off in a big way across the world as even non-Islamic corporations and sovereigns took advantage of its popularity to raise financing in very significant amounts. It was also a time when both sovereign and institutional investors from the Middle East experienced a period of liquidity following the increase in crude oil price from US\$18-19 per barrel to just over US\$40 per barrel.

Sukuks have to comply with Islam’s Shariah laws. As such laws prohibit the use of interest to compensate investors or financiers for the provision of capital, a solution or work-around was needed. This takes the form of the sukuk issuer issuing a certificate to investors in return for capital invested, and then purchasing a business or an asset (e.g., plant, machinery, etc.) (hereinafter referred to as “underlying business or assets”) with the proceeds.

Investors in the sukuk will have fractional ownership of the underlying business or assets acquired. The sukuk certificate will also entail a contractual commitment by the issuer to redeem the certificate in the future at par value, at which point any surplus in the value of the underlying business or assets would be the profit earned by the investors.

Sukuks provide a direct link between the returns (or cash flows) of the underlying business or assets acquired with the returns to investors holding the instrument. In other words, the investors' returns are directly correlated with the underlying business or assets acquired. This work-around avoids the prohibition of "riba" (or charging of interest) under Shariah law and allows investors to participate in the financial returns from the financing. The shortcoming of this solution is that this form of financing can only be used for the acquisition of, or investment in, specifically identifiable businesses or assets.

The value of any sukuk investment is hence determined by, or correlated with, the value of the underlying business or assets acquired using the proceeds of the sukuk issuance. Investors in a sukuk, therefore, are not owed a debt obligation by the issuer, but instead, have fractional ownership of the underlying business or assets that is/are linked to the investment, and they receive their pro rata share of the income or earnings generated by the underlying business or assets.

The most prevalent form of a sukuk is a trust certificate. Ironically, both practitioners of Islamic finance and investors prefer the use of Western contractual laws to govern issuances of such trust certificates.

The legal structure of sukuks is relatively complicated. The issuer typically uses an offshore special purpose vehicle ("SPV") to issue trust certificates to qualified investors. Proceeds of the issuance are then applied to make the investments stated in the trust certificate (in an underlying business or assets). In return, investors are promised pro rata share of the earnings from the underlying business or assets.

The first sukuk was issued by the Government of Malaysia. Bahrain followed soon after in 2001. Today, sukuks are used by both Islamic and non-Islamic sovereigns, corporations, utility companies and state-run organisations as a method of raising financing, and they are an important asset class in the global bond market.

As stated above, sukuks have to adhere to Islamic laws. Key differences between a sukuk and a conventional bond are as follows:

- Sukuks indicate fractional ownership of the underlying business or assets, whereas bonds represent a contractual debt obligation; sukuk investors, unlike bondholders, receive no interest but a pro rata share of the earnings generated by the underlying business or assets.
- Proceeds from sukuk issuance can only be invested in businesses or assets that are compliant with Shariah law; hence, these underlying businesses or assets cannot include products or services that are “haram” or prohibited by Islam, such as (a) interest-generating ventures or financial instruments, (b) enterprises that manufacture, distribute or trade in pork or alcoholic beverages, or (c) gaming / gambling businesses.
- Sukuks are priced and valued according to the value of the assets backing them, whereas bond pricing is based on credit rating; sukuk holders receive a portion of the earnings generated by the underlying business or assets, and hence, the sukuk is priced or valued based on the value of the underlying business or assets.
- Sukuks can increase in value when the underlying business or assets increase in value, whereas returns from bonds correspond to the pre-agreed fixed interests with no participation in the equity upside of the borrower; hence, it is quite common to see infrastructure- or property-backed sukuks as these assets tend to appreciate in value over time, and are popular with sukuk investors.
- When one issues a sukuk, one is essentially selling ownership in the underlying business or assets backing the sukuk, whereas the issuance of a bond is the sale of a debt; in essence, a sukuk is more a business collaboration rather than a borrowing exercise.

Although some may argue that the differences between sukuks and bonds are merely “technicalities,” these differences matter to Muslims. Muslim investors believe that the practice of profiting from money alone, at the expense of productivity and real people, has been one of the key drivers for many of the economic problems (e.g., recessions, financial crises) that have plagued the world in the last decade.

Interest burden and artificial inflation of prices based on debt, rather than on real value, is often blamed for economic or financial bubbles and the crisis that ensued when such bubbles burst.

The main advantage of sukuks over traditional bonds is that their value may increase in relationship to the underlying business or assets backing the sukuk certificate. If the value of the underlying business or assets rises, then the value of the ownership of that business or assets, backed by the sukuk, increases. Bonds do not have this characteristic. Bonds offer fixed returns which do not reflect any kind of tangible increase in value or productivity.

Sukuks and bonds, however, have similarities. Both can be turned into cash by selling them on the secondary market. Based on the strength of their backing, both sukuks and bonds can be ranked or rated.

Many Western or non-Islamic sovereigns and corporations have capitalised on the increasing wealth of the Islamic community by issuing sukuks to finance their ventures. Examples of major global sukuk offerings include:

- Goldman Sachs, Inc. (Wall Street's largest investment bank): the first conventional U.S. bank to issue an Islamic bond, raising US\$500 million (€388 million) in its debut sale of five-year Sukuk in 2014; this generated an order book worth US\$1.5 billion, reflecting heavy demands for new credits by cash-rich Islamic funds;
- The Middle Eastern subsidiary of HSBC (one of the world's largest universal banks): the first conventional bank that issued a Sukuk for US\$500 million in 2011;
- Great Britain (a sovereign nation): issued sovereign Islamic five-year Sukuk bonds raising £200 million (€254 million) in 2014, with an order book of over US\$2 billion; and
- Hong Kong (a territory of The People's Republic of China): its debut sovereign Sukuk in 2014 raised US\$1 billion, with an order book of over US\$4.7 billion.

Acceptance of Islamic Banking and Islamic Finance

The key to any financial system or products being accepted into the mainstream depend on the following factors:

- Competitiveness / Cost-effectiveness;
- Breadth and depth of offering;
- Clarity and ease of applicability of rules;
- Ability to provide hedging (including known volatility);
- Liquidity;
- Popularity;
- Flexibility in terms of structuring; and
- Ease of adoption.

Let us consider each one in turn.

Competitiveness / Cost-effectiveness

Islamic products need to be competitive in pricing and after-market performance compared to those offered by conventional institutions. Sukuks, which are structured to pay a fixed profit rate rather than a coupon (and which are commonly backed by, or based on, real estate or infrastructure) are popular with issuers in a rising interest rate environment. This short duration strategy is most effectively applied with the global sukuk asset class, which provides greater resilience and higher return probability.

A large part of the sukuk universe is domestic (i.e., in the country of the issuer), marketed locally in the local currency. The Malaysian Ringgit sukuk is the largest domestic sukuk market in the world. Larger sukuk issuances, especially by investment grade issuers or sovereigns, have increased the size and depth of the investment universe, and are a catalyst for further development and issuance of Shariah-compliant instruments in the public and corporate sectors.

The global sukuk market is today worth US\$367 billion, according to rating agency Moody's, with demand for sukuk products exceeding US\$1 trillion since 2017. This will help fully develop the Islamic capital market and enhance liquidity, which will also benefit the asset management industry, by allowing greater risk management and diversification for investors.

This is an opportunistic niche that Islamic financial products can exploit to gain popularity and adoption, especially in the case of a normal rising yield curve or a volatile interest rate environment.

Breadth and depth of products

Islamic financial products are still nascent in their development. Islamic scholars need to increase the breadth and depth of Islamic products to make them attractive to investors globally. The fact that interest is not chargeable is itself an "Achilles' heel" that will prevent mass adoption, as interest rate is a very important tool to structure financial products and to reflect the risks of the business ventures seeking financing.

Over the years, Islamic scholars and financial institutions have increased the breadth of Islamic financial products, to include, among others:

- Mudarabah: a profit-sharing contract akin to a conventional partnership, where one partner gives money to another for investing in a commercial enterprise;
- Musharakah: a joint-venture relationship between two or more parties that contribute capital to a business, with net profit and loss being distributed pro rata;
- Diminishing Musharaka: a financing method for major capital purchases;

- Asset-backed financing: this takes the form of a sales contract that allows for the transfer of (a) a commodity for another commodity, (b) a commodity for money, or (c) money for money;
- Murâbahah: an Islamic contract for a sale where the buyer and seller agree on the mark-up (profit) or “cost-plus” price for the asset being sold;
- Bai’ Muajjal or Bai’-Bithaman Ajil: a credit sale or deferred payment sale (i.e., the sale of goods on a deferred payment basis), where the financier buys the asset requested by the client, then sells it to the client for an agreed price, which includes a mark-up (profit) for the financier;
- Bai’ al ‘Inah: a financing arrangement where the financier buys an asset from the client on spot basis, with the price paid by the financier constituting the “loan,” and the asset is sold back to the client subsequently;
- Istisna and Bai Salam: these are akin to forward contracts in conventional finance;
- Ijarah: an Islamic product akin to rent-to-own arrangements in conventional finance;
- Ijarah Thumma al Bai’: this is akin to hire purchase contracts in conventional finance;
- Ijarah Wa-iqtina: an Islamic lease which gives the lessee the right to acquire the asset;
- Ijara Mawsoofa bi al Dhimma: this is akin to a lease in conventional finance;
- Tawarruq: a contract where a client raises immediate cash to be paid back later by buying an asset that is easily saleable, paying a marked-up price with deferred payment and then quickly selling the asset to raise cash;
- Hawala: a widely used, informal method for transferring funds from one geographical area to another, based not on movement of cash or computer network wire transfers between banks, but on a large network of money brokers (known as “Hawaladars”) located throughout the Muslim world;

- Kafala: this is akin to a guarantee in conventional finance;
- Rahn: a collateral or pledge contract where property is pledged against an obligation;
- Islamic demand deposit accounts: this provides little or no return, but allows for withdrawal on demand;
- Qard: a deposit whose repayment in full on demand is guaranteed by the bank;
- Wadiah and Amanah: contracts used by Islamic financial institutions for pay-back-on-demand accounts;
- Takaful: Islamic insurance policies;
- Islamic funds: professionally managed investment funds that pool money from a group of investors to purchase securities that have been screened for Sharia compliance; and
- Wa'd: Shariah-compliant hedging instruments or derivatives.

Clarity and ease of applicability of rules

The biggest problem in transforming from conventional banking to Islamic banking is the fact that Islamic banks and financial institutions were, and still are, facing difficulties due to the lack of a comprehensive framework of regulations for Islamic products.

One of the key issues is the lack of general awareness among various stakeholders, including users and investors in Islamic financing products. Within Islamic banking, many rules and regulations are not set in stone and can be interpreted differently between the many stakeholders, and across different jurisdictions.

There are also many different Islamic councils (staffed by Islamic scholars and clerics) with differing opinions on the rules and regulations governing Islamic financing products. The existence of different schools of thought within Islam makes a single set of guiding principles impossible to achieve. Until such reconciliation is achieved, globalisation of Islamic financing products would face considerable challenges.

Inadequacies and inconsistencies in the rules and regulations governing Islamic financing products create significant uncertainties. For example, a product sanctioned by the Malaysian Islamic Council may not be acceptable in full by its UAE counterpart, and such products may not be able to be sold in the UAE.

All of the above could however be resolved over time, as long as Islamic scholars and clerics are willing to work together across borders. Active intervention, in the form of initiatives undertaken by leading supranationals and financial institutions focused on the development of new and universally accepted frameworks to incorporate the teachings of Islam in commercial and financial activities, may speed up the process. A comprehensive review and gazetting of Shariah-compliant laws as they are applied to Islamic financial products will go a long way toward achieving uniformity across the world.

Prudential standards for the supervision of activities involving Islamic financial products will also be a move in the right direction. Accredited and internationally-recognised regulators will play a major role to ensure consistency of standards and ethical practices. Disclosure requirements for financial statements should be implemented along with corporate governance and transparency requirements for reporting entities involved in Islamic financial products.

The above would hasten resolution and the continued positive development of Islamic finance, while at the same time, reducing the risk to all stakeholders and ensuring compliance and enforceability of Islamic contracts.

Ability to provide hedging

Instability of interest-bearing debt finance has caused, or at least contributed to, many financial crises. Islamic finance could be an effective alternative.

Financial crises have mostly been debt-related, but no less than 75% of global securities (worth US\$200 trillion) represent interest-based debt. Islamic finance is a risk-sharing and rule-based system which seeks to promote sustained growth and full employment, thus contributing positively to poverty alleviation and economic and social justice.

The Qur'an (the Holy scripture of Islam), in Chapter 2 verse 275, states that all economic and financial transactions are to be conducted via contracts of exchange, and not through interest-based contracts. The rules include the following:

- Full and transparent observance of property rights;
- Faithful adherence to terms and conditions of contracts;
- Shariah-approved sources of factors and products before they enter the market;
- Provision of full information regarding qualities, quantities and prices of factors of production;
- No misrepresentation;
- No speculative activities;
- Full and transparent flow of information; and
- The need for distribution and redistribution rules to be stated.

This will reduce problems such as moral hazard, as there is now symmetry of information, as well as clearly stated property rights. The cost of monitoring will also be lower, as there will be collaterals whose value approximates the amount borrowed. The ability to hedge interest exposure can be achieved in a limited way with more transparent (albeit non-interest-bearing) instruments, and Islamic financial products can play a role here.

Liquidity

Liquidity is paramount in any financial system or for any financial product. Many studies have looked at the creation and implications on financial stability of Islamic products.

The “Liquidity Creation and Financial Stability Implications of Islamic Banking” study in 2017 by four academics from University of South Carolina and American University of Sharjah looked at banking activities across 22 countries, with a sample of 431 banks (55 of which are Islamic banks) over a 14-year period. In that study, banking activities were classified under three categories: (a) liquid; (b) semi-liquid; and (c) illiquid. Assets were also classified based on ease, cost, as well as the time taken for banks to dispose of their obligations to satisfy liquidity demands.

The study found that Islamic banks create more liquidity per unit of assets compared to conventional banks and this occurs on the asset side. This result holds true during crisis as well as non-crisis times.

Popularity

There is a certain perceived “negative” connotation in some quarters with respect to the word “Islam” due to the fact that the Middle East (where Islam is the dominant religion) is a volatile region, both politically and militarily. It is also a known fact that Islamic teachings may have differences with Western culture and law, and are perceived to be authoritarian, undemocratic, archaic and somewhat fundamentalist (some go further to call it “extremist”).

This is largely a perception problem. The effectiveness of a banking or financial system, and of financial and investment products, depend more on economic efficacy rather than political or religious considerations. That said, more effective marketing efforts are required to remove (or at least, reduce) any negative perception that would cause Islamic banking or Islamic products to be still-born or shun.

Islamic investment has financed significant parts of the City of London’s infrastructure, including the Shard skyscraper and the Olympic Village. South Africa and Luxembourg joined the sukuk bond rush soon after, becoming respectively the third and fourth non-Muslim countries to sell government debt that adheres to Islamic law.

Flexibility in terms of structuring

There is no evidence to suggest that Islamic products are any less flexible in terms of structuring. An issue that needs to be addressed is the timing and extent of profit share in any lending or investment instruments. In fact, in reality, Islamic financial institutions have structured or worked around the non-interest issue by varying the levels of profit required in any given situation.

The reality is that Islamic financing products need to be competitive in the world markets, and while the teaching of Islam is sacrosanct, there is no restriction on the terms governing the pricing of Islamic financing products to ensure that they are viable alternatives to, and priced at a level that is comparable with, conventional financial products.

Ease of adoption

There is no evidence to suggest that Islamic banking principles or rules governing Islamic products are any more difficult in terms of adoption. However, inconsistencies in interpretation of the regulatory framework, discussed above, are hindering a more widespread adoption, in light of governance, marketability, enforceability and legitimacy risks.

Conclusion and The Way Forward for Islamic Finance

Is there a future for Islamic finance? Economies or firms seeking financing that do not think so may be missing out, as Islamic financing products are already actively traded in more than 60 countries worldwide, not to mention the ever-increasing wealth of the peoples of the Middle East.

There seems to be a high demand for Islamic financial products; with a fast-growing Muslim population making up 24% of the world's population, and a concentration of wealth in the Gulf Cooperation Council ("GCC") nations, there is major demand for Shariah-compliant products. Globalisation will force banks to have more diversity in the products sold across the world.

In Islamic finance, the PLS concept takes centre-stage. One can argue, however, that this makes little fundamental difference. The PLS concept between creditor and debtor is meant to align the interests of both parties, and their shared values and morality, to the extent this is possible, are the elements that ultimately ensure trust between the two and make collateral unnecessary. In reality, in the real world, profit sharing ratios are often “adjusted” to align the costs of Islamic financing products with that of conventional financing products. This shows the ease of adoption of Islamic financing products, as their returns are often “adjusted” to match those from conventional financial products in order to be competitive.

Islamic banks are theoretically more resilient to external shocks since losses can be passed on to depositors of a banking institution to some extent. This enables Islamic banks to engage in more long-term lending with higher risk-return profiles typical for growth promoting investments such as infrastructure.

Islamic scholars claim that the fundamental difference between conventional and Islamic economics is the morality of the “homo Islamicus” in contrast to the rationality of the “homo economicus”. Islamic finance and banking are meant to function based on this fundamental morality and derive their claim towards more stability from it; that said, there is no evidence that morality and trust is higher in Islamic finance.

The International Monetary Fund (“IMF”) and the United Nations Development Programme (“UNDP”) are also contributing to the growth of Islamic finance by taking initiatives to develop rules and regulations in this area. Islamic finance is not here to replace conventional finance as it fits in a dual-product system. The main focus of Shariah laws is social justice, which does not threaten the Western world or seek to undermine the conventional financial system. Given that socially responsible investing is thriving globally, the dual-product system may, in fact, benefit nations that have not yet embraced Islamic finance.

With financial technology (or “FinTech”) companies taking on conventional banking institutions, Islamic FinTech is also a prominent feature in the new economy. There are already over 120 players in the Islamic finance FinTech landscape.

Examples include:

- Wahed Corporation: launched an Islamic RoboAdvice service with access to Shariah-compliant exchange-traded funds;
- Ovamba Group: launching a Shariah-compliant initial coin offering (“ICO”) allowing fee- and risk-sharing backed by halal instruments using a token; and
- Ethis Crowd: uses e-Wakalah (agency contract) and Istisna (contract to construct an asset) that allow new real estate developments in Indonesia to receive crowdfunding.

The increasing use of Blockchain technology will also revolutionise Islamic banking by adapting standard Islamic finance contracts into smart contracts. Like the use of Blockchain technology in conventional finance and business arrangements, this will reduce service costs by up to 95% as well as ensuring a perpetual record of ownership and assets that is immutable, tamper-proof and which ensures a high level of integrity.

In conclusion, as Islamic finance is not, in reality and in practice, fundamentally different from conventional finance, its adoption and popularity will continue to increase, and it will one day be part of mainstream financing in the global capital markets. Stakeholders, including regulators, users, investors, intermediaries, etc., will need to work on the product positioning and marketing messages of Islamic financing products to ensure global acceptance. Islamic financial products have an important role to play in promoting a higher level of stability in global financial markets, and these instruments should not be ignored as the world sees the continuing growth in the wealth and prosperity of investors, both institutional and retail, in the Islamic world.

Bibliography

- Abdullahi, N.A., 2016. ISLAMIC BANKING IN NIGERIA: ISSUES AND PROSPECTS. *Journal of Emerging Economies & Islamic Research*, 4(2). (Reviewed: 4th March 2019)
- Abedifar, P., Ebrahim, S.M., Molyneux, P. and Tarazi, A., 2015. Islamic banking and finance: Recent empirical literature and directions for future research. *Journal of Economic Surveys*, 29(4), pp.637-670. (Reviewed: 16th February 2019) (Revisited: 16th March 2019)
- Abedifar, P., Hasan, I. and Tarazi, A., 2016. Finance-growth nexus and dual-banking systems: Relative importance of Islamic banks. *Journal of Economic Behavior & Organization*, 132, pp.198-215. (Reviewed: 9th April 2019)
- Ali, S.S. and Hasan, H., 2011. Towards a maqasid al-shariah based development index. *Measurement*, 95(7/8). (Reviewed: 2nd January 2019) (Revisited: 8th January 2019)
- Berger, A.N., Boubakri, N., Guedhami, O. and Li, X., 2017. Liquidity Creation and Financial Stability Implications of Islamic Banking: Evidence from a Multinational Study. In *KFUPM Islamic Banking and Finance Research Conference, Dhahran*. (Reviewed: 11th January 2019)
- Cho, O. 2019. Interviewed by Chong Charles Edward Ho Kit, 24th March, 2019.
- Chong, P. 2019. Interviewed by Chong Charles Edward Ho Kit, 12th January, 3rd March and 17th April, 2019.
- Choudhury, M.A., 2007. Islamic Economics and Finance Where Do They Stand?. *ISLAMIC ECONOMICS AND FINANCE*, p.75. (Reviewed: 16th January 2019)
- Diaw, A., Bacha, O.I. and Lahsasna, A., 2014. Public Sector Funding and Debt Management: A Case for GDP-Linked Şukūk. *Islamic Economic Studies*, 130(1155), pp.1-33.9th (Reviewed: 2nd April 2019)
- Dusuki, A.W., 2010. Do equity-based Sukuk structures in Islamic capital markets manifest the objectives of Shariah??. *Journal of Financial Services Marketing*, 15(3), pp.203-214. (Reviewed: 17th January 2019)
- Lahsasna, A. and Lin, L.S., 2012, March. Issues in Islamic capital markets: Islamic bond/Sukuk. In *3rd International Conference on Business and Economic Research (3rd ICBER 2012) Proceeding* (pp. 495-512). (Reviewed: 18th March 2019)
- Mirakhor, A. and Zaidi, I., 1988. Stabilization and Growth in an open Islamic Economy. (Reviewed: 8th January 2019)

- Mirakhor, A., 1987. Analysis of short-term asset concentration in Islamic banking. (Reviewed: 8th January 2019) (Revisited 26th March 2019)
- Mokhtar, M. 2019. Interviewed by Chong Charles Edward Ho Kit, 7th April, 2019.
- Mokhtar, M. and Ismail, A., 2013. Shariah issues in managing household debt: The case of Malaysia. *Jurnal Pengurusan*, 37, pp.63-76. (Reviewed: 19th March 2019)
- Mokhtar, M. and Masih, M., 2014. Are diversification benefits obtainable within the same asset class? New evidence from Malaysian Islamic REITs. (Reviewed: 19th January 2019)
- Nafith, A.H., Dealing, A.C.I. and Market, C.C., 2014. The advancement of Islamic banking and Finance in Global Markets. *International Journal of Interdisciplinary and Multidisciplinary Studies (IJIMS)*, 1(8), pp.11-18. (Reviewed: 16th March 2019)
- Ong, J. 2019. Interviewed by Chong Charles Edward Ho Kit, 17th April, 2019.
- Rafay, A. and Sadiq, R., 2015. Problems and issues in transformation from conventional banking to Islamic banking: Literature review for the need of a comprehensive framework for a smooth change. *City University Research Journal*, 5(2), pp.315-326. (Reviewed: 18th March 2019) (Revisited: 22nd March 2019)
- Razak, D.A., Mohammed, M.O. and Taib, F.M., 2008, June. Consumers' acceptance on Islamic home financing: empirical evidence on Bai Bithaman Ajil (BBA) in Malaysia. In *IUM International Accounting Conference IV (INTAV)*. (Reviewed: 10th January 2019)
- Rehman, S.S. and Askari, H., 2010. An Economic Islamicity Index (EI2). *Global Economy Journal*, 10(3). (Reviewed: 11th January 2019)
- Rod, M., ALHussan, F.B. and Beal, T., 2015. Conventional and Islamic banking: perspectives from Malaysian Islamic bank managers. *International Journal of Islamic Marketing and Branding*, 1(1), pp.36-54. (Reviewed: 17th January 2019)
- Shaukat, M. and Alhabshi, D.O., 2015. Instability of Interest Bearing Debt Finance and the Islamic Finance Alternative. *Islamic Economic Studies*, 130(2223), pp.1-56. (Reviewed: 26th March 2019)
- Sundararajan, V. and Errico, L., 2002. *Islamic financial institutions and products in the global financial system: key issues in risk management and challenges ahead* (Vol. 2). International Monetary Fund. (Reviewed: 16th April 2019)
- Teo, W. 2019. Interviewed by Chong Charles Edward Ho Kit, 14th January and 11th March, 2019.
- Ul Haque, N. and Mirakhor, A., 1986. Optimal profit-sharing contracts and investment in an interest-free Islamic economy. (Reviewed: 21st January 2019)

- Waemustafa, W. and Sukri, S., 2016. Syari'ah compliance and lawful profit making dilemma in Malaysian Islamic banks. *Available at SSRN 2824903*. (Reviewed: 21st January 2019)
- Wilson, R., 2003. Regulatory challenges posed by Islamic capital market products and services. *Centre for Middle Eastern and Islamic Studies, University of Durham, UK*. (Reviewed: 11th February 2019)