

Experts have urged the Islamic finance industry to seek new areas of business to develop its portfolio and increase earnings in the current challenging economic environment. What new areas should be considered, what impact will they have on the Islamic finance industry in general and what contribution will they make to the global financial stability?



Although the global financial crisis did not adversely affect Islamic banks because of their conservative business model, the subsequent recession has had a negative impact on earnings. Clearly, in the present circumstances Islamic banks should remain focused on their core retail and commercial business.

As most retail customers continue to be employed and have their salaries paid into Islamic banks, this provides captive business. Clients may be more hesitant to take car or housing finance as they deleverage and rebuild their savings balances, but there are opportunities to cross sell new products.

Shariah compliant equity funds performed badly in the last two years reflecting the dismal fall in stock prices, but many companies now look attractively valued, and company earnings are showing some signs of recovery. This is an excellent time for Islamic banks to review their fund provision and introduce further monthly savings plans that channel clients' money into funds.

Restricted investment accounts, which enable clients to place funds in specific projects, could also be promoted, perhaps as a device to enable clients to gain access to private equity financing opportunities. Islamic banks can also sell third party Takaful, or provide Takaful plans themselves. There are enormous earnings potential in Family, medical and vehicle Takaful.

In short, recessions are a good time to focus on product offerings and decide what should be promoted for the inevitable recovery. It will be those Islamic financial institutions which plan ahead that will emerge the strongest. Now is the time to envisage the future, not regret the past.

PROFESSOR RODNEY WILSON: Director of postgraduate studies, Durham University



As one of my fellow speakers at a recent conference in Tehran said in relation to the credit crunch, "21st century problems cannot be solved by 20th century solutions".

I agree and observe that the use of a partnership-based risk-sharing protocol as a Guarantee Society framework of trust, for direct "peer to peer" trade credit, is essentially a 21st century approach to Takaful, while the use of, say, LLPs or LLCs as Capital Partnership production/revenue sharing protocols for direct "peer to peer" investment in productive assets is a 21st century approach to Musharakah.

I discussed these concepts at length in Qom not long ago with perhaps the leading Iranian scholar in the field, and his view was that the Shariah compliance of such partnership-based agreements is "self evident". I suspect that not all those advising on applying an Islamic veneer to our fundamentally unIslamic, and demonstrably unsustainable, financial system will agree.

Be that as it may, to share risk and reward equitably – and consistently with Islam – throughout the "peer to peer" system will clearly make it more stable than to press the reset button and once again repeat the debt cycle and the accompanying privatization of profits and socialization of losses.

CHRIS COOK: Principal, Partnerships Consulting



There are many areas which the Islamic finance industry can expand into, and the economic environment and the challenges facing the banking and financial systems in the US and other western countries are more likely to be receptive now.

Expanding into these regions provides a way for the Islamic finance industry to penetrate a customer base that is currently not involved with the Islamic finance industry.

The Islamic finance industry may have to change some aspects of how it markets itself to take advantage of a general distrust of the banking system to reach customers who are concerned more than usual about the solvency of the banks with which they do business.

Because this market is not motivated by religious considerations, the Islamic finance industry should focus on two aspects that differentiate it from the conventional financial system: its natural conservativeness and its focus on fairness in dealings between the parties.

continued...

As the current financial crisis has demonstrated, the regulatory system particularly in the US is focused on allowing innovation even where it can create systemic risk. In the absence of a tight regulatory system, consumers are more likely to favor banks that are not heavily involved in innovative business and are more focused on being intermediaries between savers and borrowers.

In addition, banks are seen as creating a situation where bankers benefit at the expense of depositors, taxpayers and the economy as a whole, and Islamic finance should continue to emphasize the ethical underpinnings of the industry that stress a sharing of risk and reward.

BLAKE GOUD: Principal, SharingRisk.org



products universe.

Islamic financial institutions should expand their businesses further into private equity, joint ventures, asset securitization, REITs and such. In order to effectively position these business themes in the global financial market, Islamic product specialists and scholars need to further develop the Islamic

These kinds of businesses should ultimately result in more effective customer reach and product offerings to both Islamic and conventional financial markets, and also facilitate secondary trading. It should also result in better transparency and remove market speculation.

ASIM M BASHARULLAH: Director, corporate and investment banking, Al Rajhi Bank (Malaysia)



rather than being speculative instruments.

The Islamic financial industry has historically developed products to mimic the economic function of conventional financial products, including some of the derivative type products. The current crisis in the financial markets provides a strong opportunity for Islamic banks to promote and further develop products that are based on underlying assets

As long as new instruments have a high level of transparency, these will likely have a positive impact on the Islamic finance industry's development.

However, the contribution they will make to the global financial stability will mainly depend on the underlying assets invested in. After all, even a badly performing asset is still an asset, and concentration risk still needs to be considered.

DR NATALIE SCHOON: Head of product management, Bank of London and the Middle East



The Islamic finance industry needs to look at innovative investment avenues to expand their product mix that will enable them to manage risks profitably. Generally speaking, the industry needs financial inclusion, deepening and integration among Islamic financial institutions and their conventional counterparts.

More specifically, the industry needs to look at alternative investment avenues which will broaden the horizon of Islamic finance into various industries and this will make them a more active and vital part of the economy.

One such area is real estate, where I-REITs have yet to be introduced in most developing markets. Prudently managed I-REITs can provide regular income to investors like widows, the aged and the disabled.

Furthermore, I-REITs provide a lucrative investment option for Islamic income funds. The Islamic finance industry should also focus on micro equity funds and venture capital funds on the basis of Mudarabah in developed markets where the economy is well documented and issues regarding availability of collateral, taxation and legal services are favorable.

During these times, the Islamic finance industry can explore the potential in the SME sector, microfinance and agricultural financing. These sectors can provide a stable earning potential to the sector and be a step towards global financial stability.

Government backed Sukuk can also become a good alternative to conventional T-bills as central banks in the last few years have started to reach out to global markets for deficit financing. Such global issuance of Sukuk can provide access for central banks to the excess liquidity with Islamic banks.

continued...

A word of caution, however: The Islamic finance industry needs to ensure that in the search for new investment options it will not go for artificial financial structures and speculative transactions, the culprits in the global financial crisis.

AHMED ALI SIDDIQUI: Executive vice-president, product development and Shariah compliance, Meezan Bank



The crux of the problem is that the Islamic banking and finance industry has relied on transaction income to support its growth. As a young industry, it has yet to develop a multi-line approach to sourcing revenue streams. One obvious omission is in the private banking area.

Both advisory and fund management activities ensure recurring sources of income. The challenge is that these areas require aggressive investment at the front end without the benefit of an immediate return.

The Islamic banking community should use its relative balance sheet stability to foster private banking initiatives, especially since the conventional industry is sloughing off talent in ways that would have been unfathomable two years ago.

Certainly, prospective clients will listen and engage in newfound ways now that the easy returns of the last liquidity cycle are behind us. As a sign of the times, our own work in creating innovative but not controversial products seems to be finding a more assertive footing worldwide.

Certainly, the notion of “distressed” or “opportunistic” products is fashionable. But it also responds to the market opportunity created by the deleveraging of the conventional financial services business. Islamic banks may be able to benefit their institutional and individual clients by focusing on developing and distributing products in these areas.

DOUGLAS CLARK JOHNSON: CEO, Codexa Capital

Next Forum Question

The Malaysian Court of Appeal recently ruled that Bai Bithaman Ajil (BBA) contracts are valid and binding. However, over recent years the industry has witnessed a diminishing interest in this product. What role, if any, will BBA play in the future of Islamic finance?

If you would like to air your views on the next Islamic Finance Forum Question, please email your response of between 50 and 300 words to Christina Morgan, Forum Editor, at: Christina.Morgan@REDmoneygroup.com before Wednesday, 29th April 2009.

Islamic Finance *training*

Requires

FREELANCE FINANCIAL TRAINERS

To conduct public training courses in Malaysia and GCC countries. Practical experience of working within the Islamic financial services is required, as is some experience of delivering training to the banking sector.

If you would like to know more about this opportunity, please contact Andrew Tebbutt at

Andrew.Tebbutt@REDmoneygroup.com

or by telephone on: **+603 2162 7802**