Book Review

Islāmic Finance: A Practical Guide
(Second Edition)

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Islāmic finance that has seen unprecedented growth during last two decades is attracting sovereigns, financial institutions, universities and business colleges, multinationals, corporates and customers across the world. In this perspective, importance of incoming literature on practice of Islāmic finance institutions cannot be overemphasized.

The book under review is a welcome addition to the valuable reading material on Islāmic finance and as its title indicates, comprises a series of articles. It features fully updated and insightful chapters by leading practitioners in Islāmic financing and analyses market trends, key developments and structures for *ṣukūk*, syndications, Islāmic funds, *takāful*, project financing and Islāmic liquidity management. New to the second edition are chapters on the regulation of Islāmic finance and an overview of the *ṣukūk* market.

In the first article entitled "*Islāmic finance: introduction to the market and key principles*", Rahail Ali defines some terminology, concepts and principles of Islāmic economics as well as some main principles of Islām.

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The article is very useful to anyone wishing to learn more about the main principles of Islām in general and specifically about Islāmic finance. However, two main concepts are missed. First, it should be noted that no trade in Islām is acceptable if there is asymmetric information in that trade. This is based on verse 29 of chapter 4 of the Qur'ān. According to this verse, complete disclosure with good intention (symmetric information) is a must in any trade. The second fact which should have been mentioned is that both the Qur'ān and the actions/sayings of the Prophet of Islām (pbuh) are subject to interpretation. A newspaper is good only for the day it is published and is not subject to interpretation as the following day the news is old. But, because the Qur'ān and the sayings of the Prophet of Islām (pbuh) are symbolic and as technology improves, and knowledge of human beings grows, these interpretations may change over time. This makes Islām dynamic and everlasting. Consequently, one would expect many different schools of thought in Islām. In fact, there are currently five main schools of thought. However, on p. 10, the author did not mention the *Ja'farī* school of thought. I hope that, in the next edition of this book, he will incorporate these two important factors.

The second article entitled "*Legal issues and standards in Islāmic finance*" also written by Rahail Ali, discusses the legal issues in Islāmic finance. The only point which the author has not discussed, as in his previous article, is *Ja'farī's* school of thought. Perhaps in the next edition of the book in Section (a) of 6.1, the author would include this school. It is also more valid to mention the source of the sayings of the Prophet of Islām in the last paragraph of p. 26.

Imtiaz Shah, in the third article of the book entitled "*Overview of Islāmic Asset Management*", defines the contracts and *Sharī'ah* compliance concepts of funds, investments and leverage, including *ijārah*, *mushārakah*, *muḍārabah*, *murābaḥah* and *istiṣnā'*. The definitions are not very technical.

The fourth article, entitled "*Sharī'ah screening and Islāmic equity indexes*", written by Kamal MA Mian, defines and explains *Sharī'ah* compliant firms, equity and products. The author explains carefully the Malaysian Securities Commission's *Sharī'ah* screening methodology, including business activity screens and financial ratio screens. Very interesting sections include those which define and explain the characteristics of Islāmic indexes, including the Bursa Malaysia Sharī'ah indexes, the Financial Times Stock Exchange Sharī'ah Global Equity indexes, the Dow Jones Islāmic Market index, the Standard and Poor's

Sharī‘ah indexes, the Morgan Stanley Capital International Islāmic index series and Thomson Reuters/Ideal Ratings indexes.

The fifth article, entitled "*Islāmic Finance in the Syndicated Bank Markets*", is written by Rahail Ali. In this paper, the author explains important Islāmic finance tools including *murābaḥah* and *ijārah*. Therefore, the paper is very informative. However, I would suggest for the next edition explaining why there are disagreements among scholars on some of these issues and what these disagreements are[1]. The author notes on p. 68 "*Sharī‘ah* scholars prefer *ijārah* rather than *murābaḥah* transactions". It would be useful to add some convincing arguments regarding these disagreements in the next edition of the book.

The sixth article, entitled "*Islāmic Project Finance*", is written by Shibeer Ahmed and Sajjad Khoshroo. The authors define and describe step-by-step *istiṣnā‘-ijārah* and *wakālah-ijārah* for financing of the projects. Furthermore, they define and describe step-by-step *ṣukūk*, *mushārakah*, *murābaḥah* and *tawarruq*. There are some repetitions from the previous article. A few points may be mentioned. It would be useful in the next edition to mention that there are four kinds of transactions in Islām: *musāwamah*, *murābaḥah*, *waḍi‘ah* and *tawlīyah* transactions. In *musāwamah* transactions, the seller does not need to say how much is his profit, but in *murābaḥah* transactions, he should. In *waḍi‘ah* transaction, the seller sells the goods at a price lower than his cost while in *tawlīyah* transactions the goods are transacted at the same price as its cost to the seller, but depending on the percentage of the goods the buyer has bought, the profit will be shared, see Maki Alameli (1948). In all of these transactions, with the instantaneous or time lagged payments (i.e., instalments, ballooned or bullet payments), the payment is at real zero interest rate. The buyer will pay in six months the amount that would be used to buy the same good irrespective of the change in price. Namely, the payment is indexed to the actual inflation rate. For example, for 100 grams of gold, including the profit in a *murābaḥah* transaction, the buyer must pay in such a way that the seller could buy 100 grams of gold at the time of payment. Otherwise, it is usury (*ribā*). In other words, a predetermined

[1] Some scholars believe that if the profit is predetermined in a transaction conducted on a deferred payment basis either by instalments, ballooned or bullet payments, the financiers are charging interest. Such a transaction cannot be Sharī‘ah compliant. The main reason is that there is no risk for the financier and all risks and benefits, excluding the predetermined profit, are borne by the borrowers. This is simply a "renting" of money. The only difference is extra activities, i.e., so called artificial buying and selling.

profit, because of the time involved in the amortization of the debt, is simply usury.

The seventh article, entitled “Islāmic finance and documentation” written by Rahail Ali, explains documentation involved in Islāmic contracts and how a contract can be accepted from the *Sharī‘ah* point of view. The article is quite informative.

The eighth article, entitled “*The global ṣukūk market and legal structuring considerations*”, is written by Rahail Ali and Imran Mufti. This paper as well as the ninth article entitled “*The ṣukūk market: resilience and resurgence - the foundations for future growth*” written by David Testa give an elaborate explanation on the global *ṣukūk* markets and their historical developments, respectively. They cover in their articles all kinds of *ṣukūk* also including the *Nakheel ṣukūk*, and the GACA *ṣukūk.* The historical data of Testa’s paper is very informative, especially for the prediction of *ṣukūk’s* future growth. His paper is a good complement to Ali and Mufti’s paper and earlier papers on this issue in this book.

The tenth article, entitled “*Takāful and conventional insurance: a comparative overview*”, is written by Mamoon Ashraf, Michael Kortbawi and Rima Mrad. In this paper, the authors explain the meanings and concept of *takāful*. In *takāful* participants contribute to be used for the administration cost and the cost of the potential damage to the members as well as investment in *Sharī‘ah* compliant activities. The profit as well as the loss will be distributed to the members. So every member is subject to the profit as well as the loss of the *takāful*. The history of this Islāmic way of mutual assurance, its basic concept and its guidelines have been explained elegantly. Furthermore, the regulation of *takāful*, the Malaysian model and its development as well as the *takāful* regulations in the Gulf Cooperation Council (GCC) countries have been discussed. The paper also covers general requirements for setting up a *takāful* company, its operating challenges as well as key areas for the growth of *takāful*. It nicely compares and contrasts the conventional insurance and *takāful*. I would suggest to the authors, for the next edition of the book, to clarify two important facts: (i) The risk and uncertainty exist when the outcomes of an event (investment) are subject to probability. There is risk if there is historical data to estimate the probability associated with each outcome. If such a historical data is not available, uncertainty exists. (ii) Clearly, Islām is not against business risk or business related uncertainty. So the statement in the introduction that Islām condemns uncertainty is vague and needs further explanations. Islām encourages profit-risk, which is uncertain, and sharing activities/investments, but condemns gambling and excessive one-way uncertainty taking which results in a wasteful outcome. The insurance, in contrast to *takāful*, is subject to adverse selection and moral hazard and so one way risk/uncertainty taking.

The eleventh article, entitled "*Islāmic insurance products: a case study*", has been written by Omar Clark Fisher. The author provides a comprehensive historical overview of *takāful.* The operation of this system is compared to conventional insurance and very useful data on premium, growth profile, number of employees, productivity, assets, income and operational efficiency of *takāful* are provided. In many cases, the author compares and contrasts these items with those of conventional insurance. Interestingly, the author provides the profile of *takāful* in different regions in the world mostly concentrating on G CC countries. I would suggest updating, in the next edition of this book, a ll the charts using the additional observations since 2006.

The twelfth article, entitled "Malaysia and GCC regulation: comparisons and contrasts", is written by Mustafa Kamal. The author analyzes the reasons for the success of Malaysia and GCC financial centers and describes how different these two regions are from a *fiqh* (Islāmic jurisprudence) point of view.

The last article, entitled "*Regulating Islāmic Finance*", has been written by Hari Bhambra. The paper explains the role of regulators in banking and other Islāmic financial institutions. The regulatory requirements which should be imposed in the appointment of Sharī'ah scholars are also discussed in the paper. The issue of transparency, how the organization follows the rules of Sharī'ah and the accountability of the scholars who approve or disapprove a rule or mandate (their *fatāwá*) are reviewed and discussed in-depth. The study also suggests regular control and audit of the organization in complying with the Sharī'ah. This also includes the investigation of the expertise and experience of personnel, both domestic and international, within the institutions. The author summarizes with four interesting questions and their answers. He may note and include in the next edition that Islām is not against speculation *per se*, but clearly prohibits gambling and *gharar*, i.e., the excess and wasteful speculation which creates uncertainty.

As this reviewer mentioned earlier (Kia 2001), uncertainty is a fact of life. Furthermore, according to Samuelson (1972) a successful investor is a speculator while a speculator is merely an investor who may lose his money. An arbitrage activity is when an investor buys from a market with a lower price and sells it in another market with a higher price, but a speculative activity is when an investor buys an asset or produces a commodity with the hope to sell it at a higher price in the future. Neither activity in its original form is prohibited in Islām. However, trading activities by resorting to short selling and creating or selling the risk are the prohibited speculative activities. Note that when North American markets close, Far East and later Middle East, and then European markets open and operate. During these 24 hours, there are many speculators who buy and sell, e.g., equities for speculative profits. These noise traders do not add to the value of the existing firms or add any information to markets. Their actions are a pure waste of resources. These excessive and wasteful speculative activities are prohibited in Islām.

In conclusion, any researcher who is interested in Islāmic finance would do quite well to read carefully this excellent book. The authors offer an interesting analysis and also present a more intuitive approach to Islāmic finance to non-experts.

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