RESPONDING TO A QUARANTINED ECONOMY

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Islamic Fintech
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Managing Risk
Norhafiza Nordin

Riba and Mortgages
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Islamic Finance Today (IFT) is a much sought after source of information on Islamic Banking & Finance because of its rich and varied content, reader-friendly style of presentation & design.

The Magazine delivers a mix of scholarly articles, exclusive interviews, view points, news, events, tips & hints, industry trends and profiles relating to the Islamic Banking & Finance Industry. Our objective is to provide readers with the latest up-to-date information on the developments and growth potential of this very happening industry.
EDITORIAL

Islamic Finance: Testing Times

The COVID Pandemic has shown more than ever before that the world is not a perpetually perfect place to operate, even for the biggest bank with plenty of capital and resources at its disposal.

Just as innovative ideas can lead to unparalleled progress, black swan events such as this could force even the most developed parts of the world to a lockdown as recent events have shown. Needless to say in such a situation where the economy comes to a near standstill, the demand for goods and services drops drastically and affects all sectors across the board including Banking and Finance.

In such a context, how can the banking and finance industry survive and contribute meaningfully to uplifting affected nations and peoples? This question is particularly important for Islamic Banking & Finance whose purpose and scope goes even beyond that of conventional bankers and financial institutions. It needs no gainsaying that unlike conventional players whose bottomline is profit, profit and profit, Islamic bankers and financiers have an added responsibility in being socially responsible and in putting funds to good use.

As such, how does the IB & F Sector fulfill its role and purpose in these trying times? This is exactly what our lead story by Dr.Hazik Mohamed COVID 19 Crisis - Responding to a Quarantined Economy attempts to address. As Hazik points out, the best way Shariah-based lenders can support businesses in this scenario, would be to adopt fintech which can ensure strict social distancing while providing fast, convenient and secure transactions online even to remotest of places in dire need of funds.

Once established, Fintech can continue its inroads into non-pandemic territory and beyond into non-pandemic times. And what better time to adapt to fintech than the present?

The supporting article by Mufti Ismail Ebrahim Desai - Islamic Fintech – The Global Digitization of The Islamic Economy gives our readers an idea of how Fintech works, key trends in the industry and what he chooses to call ‘the lucrative future of Islamic Fintech’.

As Mufti Desai points out, the Islamic Fintech Industry will enable an entire digitization of Islamic financial products including Shariah home finance, vehicle finance, trade finance and project financing.

However, at the same time, we need to be realistic and take a macro view of the situation as well. Can Islamic finance as we understand it with its principles of profit and loss sharing, provide the much needed relief to all affected communities within this short space of time when it is most needed? The answer is obvious.

This is where individual and corporate social responsibility come into play. It is this aspect that Syaammon Jaffar focuses on in her article COVID Pandemic - The Rise of Islamic Social Finance. As Jaffar points out, the economic downturn is likely to take its toll on the already economically underprivileged sections of society.

As such, persons and corporates that follow Islamic principles are at the crossroads of a time where they can demonstrate that Islamic ideals of social welfare can be applied for the greater good, so that its trickle down affects will leave a lasting economic legacy on the world. Thus there is a need for more and more CSR projects on the part of Islamic banking and financial institutions.

To the believer, the life of this world is but a test, and this is the testing time for Islamic Finance.

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COVID-19 CRISIS:
RESPONDING TO A QUARANTINED ECONOMY

Dr. Hazik Mohamed

Dr Hazik Mohamed is the Managing Director of Stellar Consulting Group and the author of Belief and Rule-compliance and Blockchain, Fintech, and Islamic Finance
For most people, the pandemic lockdown measures have come quickly and as they adjust to working from home and social distancing, there are those who resist or are slow to adapt to the new normal.

Hence, as in all new regulations, enforcement plays a critical role to regulate new behaviors in every citizen. Like all rules and laws, containment measures to “keep the curve flat” to prevent a second wave will be ineffective if none of them are complied to, so enforcement has to come into play for the greater good.

In successful societies, the effectiveness of policies and laws are in its administration and adherence. At the beginning of the pandemic, non-essential services struggled to improve their remote capacity to allow employees to work safely from home. Commercial bankers and trade financiers had to wrestle with an extra level of complexity: helping large multinational corporations and their vendors within the supply chain to adapt to the massive disruption caused by the COVID-19 crisis. Governments and corporations had to ensure the seamless flow of goods, services and payments to cope with infection positive-tests, post-travel quarantine orders and work-from-home measures.

**E-COMMERCE, GIG ECONOMY AND DIGITALIZATION OF BUSINESSES**

If there are people who are not convinced with the benefits of the digitalization of businesses, this pandemic period has clearly demonstrated it so. Online businesses have been impacted less (or even grown in some sectors) as compared to traditional physical retail establishments which are heavily impacted by restricted movement orders and stay-at-home advisories.

E-commerce have eased the transactions between businesses, such as a manufacturer and a wholesaler (business to business or B2B), and enabled wider reach between businesses and new customers (B2C), even beyond borders. Although B2C e-commerce tends to receive significant attention, B2B transactions actually exceed B2C transactions. In the current lockdowns, e-commerce has enabled businesses to continue as logistics and delivery services are regarded as essential services that cannot stop.

Firms that have relied on traditional non-digital commerce become stalled and are unable to operate in quarantined conditions. Even without the pandemic restrictions, firms that have embraced e-commerce have higher productivity and have generated a larger share of their revenues from exports than other firms. Moving forward, besides expanded markets and reach, businesses with e-commerce and mobile accessible platforms will be better off and pandemic-ready.
Gig economy workers, approximately 150 million workers in North America and Western Europe, are another proof of the successful digitization of the economy. Yet, given their irregular income streams, gig workers characteristically have distinctive financial, insurance, and tax requirements which make them difficult to profile under standard measures. For this particular reason, they are likely to be excluded by traditional banks, but creating opportunities for much spryer digital financial services or fintech startups.

It is still unclear how COVID-19 might impact the growth trajectory of the gig economy, but one outcome may be that nimbler digital service startups end up pursuing these individuals directly. In the challenger bank space, a number of digital financial services already serve the gig economy, such as Cogni, Green Dot, Joust, Qwil, Salaryo, and Steady. Some provide features such as advances against unpaid invoices and the facility to find gig work on the app itself.

Likewise, a few fintechs in the United Kingdom—Capital on Tap, Coconut, Credit Kudos, 11:FS, Fronted, Mazuma, SeedLegals, and TrueLayer—have formed a consortium and created a new concept called ‘Covid Credit’ to cater to freelancers affected by the COVID-19 crisis. Another area is Internet of Things (IoT)–enabled contactless payments, such as connected cars that allow consumers to pay for gas or food without handling cash or other potentially infected surfaces. In fact, it is possible that COVID-19 will accelerate the adoption of IoT-enabled contactless payments or transactions.
HOW FINTECH HAS RESPONDED TO THE LOCKDOWNS

During the global lockdown, MSMEs needed Financial Technology (fintech) to keep business operations going.

FinTech companies also provided an intrinsic relief to business owners that were at risk of getting sick by continuing to operate manually. It was not simply the delivery convenience that brought technology into the limelight but that it simply eliminated the risk of COVID-19 exposure for many people.

For governments, their massive fiscal stimulus packages were announced but one of the main roadblocks hindering the impact of stimulus packages for small businesses has been challenges to their implementation. Delivering incentives to all sectors of the economy was a nightmare. Imagine disbursing money to millions of eligible businesses and individuals claiming cash benefits while safeguarding your health and trying to avoid the contagion.

Since many FinTech firms are start-ups, their grit and agility to pivot their operations to provide specialized services as customers needed them strengthened the industry. Banking, digital payments and loan-financing services greatly propelled the economic wheel forward throughout the lockdown.
They are doing their part to provide relief to individuals and businesses coping with the effects of COVID-19 in some of the following ways:

- PayPal has waived fees on chargebacks and instant funds transfers from PayPal business accounts to bank accounts.

- Lending Club has added new hardship plans, including waiving late fees and allowing eligible borrowers to make interest-only payments or skip up to two monthly payments.

- Stripe is fast-tracking support for telemedicine platforms.

- Flock, a drone insurance provider, is allowing its commercial customers to pause their policies when no work is being conducted.

- Kabbage worked with other fintechs like Lendio, Finix, and Fundera to launch a platform that allows consumers to buy gift certificates to support local small businesses during the coronavirus crisis. The gift certificates can be redeemed at any time, but small businesses receive the revenue within one business day of purchase.

- Nomo, a platform that assists freelancers in managing their accounting, taxes, and invoices, is providing free temporary access to its new customers.

- Revolut, which launched recently in the United States, and a number of other fintechs have introduced a charitable-giving feature within their apps so that their customers can donate funds to those affected by COVID-19.

Looking forward into the uncertain months ahead post-lockdown, many small businesses without financial muscle to sustain them will likely face tough times as government ease stimulus packages. Here, fintechs can play a critical supporting role, and many are innovating to create new products that address the rapidly evolving economic environment, for example in the UK;

- Trade Ledger, Wiserfunding, Nimbla, and NorthRow have formed a business-lending taskforce to provide a turnkey origination and underwriting platform that allows banks, alternative lenders, and private debt lenders to virtually and digitally deploy funds to businesses during the COVID-19 outbreak.
• iwoca, an online lender, announced OpenLending, a platform that allows fintechs and banks to extend iwoca’s lending capabilities to more than two million UK businesses

While in the US;

• Lendio is enabling small businesses to apply for loans.

• Unqork developed a small business digital lending platform.

• Numerated, another digital lending platform, is seeing an increase in banks’ fascination in using its technology to handle the rise in loan demand.

Similarly, Shariah-based lenders need to think in these terms to support businesses within the Islamic economy. It may have taken time for many to shift to digital financing as individuals tend to repel complexities and choose to remain with familiar processes, but fintech has proven why it will continue to play a big role in strengthening and rebuilding our global economy. There is not many industries that can ensure strict social distancing while providing fast, convenient and secure transactions online or remotely.

**IMPORTANCE OF HALAL TOYYIBAN SUPPLY CHAIN**

At the other end of the spectrum, we need to tackle the root cause of the pandemic, and take measures to prevent it from reoccurring. Previous investigations into the root causes of pandemics have proved to be inconclusive. The challenge of preventing outbreaks requires deeper understanding of zoonotic disease (i.e. disease that passes between animals and humans, and vice versa) so that it does not happen again. Research have found that the potential of viral outbreaks is higher in denser populations combined with active wildlife markets.

If the origination of the virus did involve the consumption of exotic animals such as bats, pangolins, civet cats, etc., governments need to work together across jurisdictions to prevent the trade and consumption of protected species and exotic animals that have become exclusive food for the rich and wealthy or deemed as cultural delicacies. Governments can help those who depend on such trades as their livelihood to explore other forms of safer more ecologically-friendly activity.
Globalization can (and has) accentuated global interconnectedness and accelerated contagion transmission from niche communities to the common citizens of the world.

By extension, the concept of ‘halalan toyyiban’ broadens the safeguarding of purity beyond the mere consumption of products. It is meant to underline the commitment to the Shariah law, to ensure that the consumers are provided with the assurance that such purity from ‘farm to fork’ or ‘beginning-to-end’. So, a truly halal approach is a holistic concept that have come to include the slaughtering, procurement, production, packaging, labelling, logistics, retailing and dispensation of goods and services.

The assurance of halal integrity to the end customer in the global Islamic market has become increasingly important for its consumers. The requirement of pure, quality, safe and free from unlawful practices along the supply chain—from farm to fork, that goes beyond proper slaughtering and preparation procedures.

Following a strict Islamic dietary of “do’s and don’ts” would likely help in keeping new corona viruses at bay. Products such as those tracked by strict supply chain and origin assessments, as is required in toyyiban halal supply chains, would be preferable. Ingested food also needs to be properly cooked to prevent harm for the eater.

Foodborne illnesses are usually infectious or toxic in nature and caused by bacteria, viruses, parasites or hazardous chemical substances entering the body through contaminated food or water. Food safety, nutrition and food security are inextricably linked. Unsafe food creates a vicious cycle of disease and malnutrition, particularly affecting infants, young children, elderly and the sick.
ISLAMIC FINTECH
THE GLOBAL DIGITIZATION OF THE ISLAMIC ECONOMY

Mufti Ismail Ebrahim Desai,
CEO, Global Islamic Financial Services Firm
Islamic FinTech is a rapidly growing sector spurring great economic activity and presenting serious business opportunities within the Islamic Economy in the Middle East and elsewhere. The Islamic Economy can truly scale and expand with fintech and cater to Muslims wishing to use Shariah compliant financing options, whilst adhering to their faith.

With growth set to reach 3.8T USD in Assets by 2022 according to Reuters, Islamic Finance is set to grow even faster with the advent of digitization and technology. This presents a unique opportunity for Muslims globally to harness and latch onto business opportunities while adhering to their Faith.

The combination of a young tech-savvy population seeking products and solutions aligned to their faith provides an opportunity for FinTech as an enabler, to provide products that not only strictly complies with the Sharīʿah, but also the spirit of the law in a manner that reflects their lifestyles and objectives. The fintech industry currently consists of over 8500 firms that have raised over 140 Billion USD from 2010.

**What is Islamic FinTech?**

The definition of Islamic FinTech is essentially financial technology which complies with Islamic financial regulations and principles governed by Shariah law. Financial technology or FinTech as it is widely known as, is the service of software applications and technology that can serve to deliver financial services.

The industry is made up of businesses and organisations that use technology to create financial solutions. There are many tools that have been developed for the FinTech industry ranging from smartphones that enable mobile banking to online international money transfers and AI – Artificial Intelligence software that can pick up sensitive data points for banks and financial institutions.

Islamic Finance and the Islamic Economy on the whole presents unique opportunities with many countries tapping into the potential of an economy with over 1.6 Billion people. From a performance and track record perspective, Islamic financial products have a solid track record. Research from the International Monetary Fund (IMF) shows that “Islamic banks, on average, showed stronger resilience during the global financial crisis”.

**How does Islamic FinTech work?**

There have been many countries who are promoting Islamic FinTech solutions with the major demand coming from the MENA and South East Asia Regions including Malaysia and Indonesia. Islamic FinTech generally works by the delivery of a digital product or service which complies to Islamic financial principles.
The usage of a variety of FinTech solutions such as blockchain, payments and AI for FinTech are spurring the sector forward. There are many ways to promote Islamic Fintech including the establishment of Venture capital funds for Islamic Fintech.

Islamic Fintech can be used to provide solutions and products in predominantly Muslim countries to cover the strategic pillars of the Islamic Economy including Halal travel, Halal fashion, Halal tourism, Halal pharmaceuticals, Islamic Finance and Banking, etc. Many Islamic fintech companies have found tremendous success and have scaled considerably attracting high valuations in their peer groups.

**Key trends in the industry**

There are many emerging trends that are developing within the Islamic financial industry spurred by a great demand from a young and tech savvy Muslim generation of millennials. The number of platforms that allow investment directly from an app or web browser has exploded in recent years, and so has the opportunity for similar Sharīʿah-compliant products and solutions.

Recent government regulatory activity in the UK, US, and EU permit the marketing of investment products to accredited and non-accredited investors alike, spurring a wave of innovation in the marketing and availability of Islamic financial and investment opportunities. There are currently 93 Islamic Fintech firms globally with 65 of them focusing on peer to peer lending. Indonesia currently tops the list with over 31 Islamic fintech providers. In terms of adoption, 33% of consumers in 20 major markets are estimated to use Fintech services (EY). This rate is higher at 46% across the emerging markets of Brazil, China, India, Mexico and South Africa.
The lucrative future of Islamic FinTech

There are many opportunities for companies and start-ups in the Islamic Fintech space as the demand grows in key Muslim Markets such as the Middle East and Asia. The Islamic Fintech Industry will enable an entire digitization of Islamic financial products including Shariah home finance, vehicle finance, trade finance and project financing.

Takaful or Islamic Indemnification will also be digitized and sold globally via fintech platforms. Currency and cryptocurrency backed by assets such as gold using the blockchain technology will enhance the Islamic Economic ecosystem and enable asset backed transactions. Sukuk issued via the blockchain and traded globally in the primary and secondary capital markets via a digitized platform will further enhance efficiencies in the system.

Islamic Trade finance or Murabaha can be digitized through the blockchain to verify specific requirements and data points while also ensuring speed and efficiency in promoting global trade. Bahrain and Dubai has been spearheading the Islamic FinTech sector and has created incubators and ecosystems with a full sandbox to support the growth of the sector.

Among the many interesting Islamic Fintech companies:

ALGO Bahrain also opened up the world’s first FinTech consortium of Islamic banks. The banks which make up the consortium include Kuwait Finance House Bahrain, Al Baraka Banking Group and Bahrain Development Bank.
In 2018, New York–based Wahed Invest, a digital wealth-management firm that follows Islamic Shariah-law tenets, raised $8 million from MENA investors to expand in Arab countries including the UAE and Saudi Arabia. Its robo-advisers help clients make halal investments in global portfolios that include stocks, gold and sukuk (Islamic bonds).

Yielders is a property crowdfunding platform that is Sharīʿah-compliant and FCA authorised. They have successfully taken a simple model and enhanced it for the digital age. Again, they have a low starting investment amount, but also cater for the more sophisticated investor too. Their equity-based model forgoes involvement with debt, interest, banks, or mortgages, whilst still being competitive and investing in tangible physical assets that everyone understands.

EthisCrowd is the world’s first real estate Islamic crowdfunding platform, investing in entrepreneurial, business, trade and real estate activities in ‘Emerging Asia’. Based in Singapore, and with a presence in Indonesia, Malaysia and Australia, the company crowdfunds the construction of affordable and commercial housing, mostly in Indonesia, through private and institutional investors, as well as Islamic banks.

Adab Solutions, is UAE-based cryptocurrency startup that has announced the launch of the First Islamic Cryptocurrency Exchange (FICE), the only crypto currency exchange globally that is designed to adhere to shariah-compliant law.
COVID PANDEMIC: 
THE RISE OF ISLAMIC SOCIAL FINANCE

Syammon Jaffar

Syammon Jaffar holds an M.A. in Science of Finance from the International Islamic University Malaysia (IIUM) and has taught at various universities including IIUM International Islamic College and University Teknology Malaysia (UTM).
The Covid-19 outbreak has led to a steep drop in economic activity around the world. In order to avoid the contagious, people have been urged to stay at home and keep their distance from others. This global effort to contain the virus through a succession of lockdowns across countries has impacted almost every sector, including Islamic banking and finance.

The Impact of the Covid-19 pandemic is not directly due to the disease, but rather due to the impact of the lock-down. From an economic perspective, the lockdown severely reduced the demand for goods and services in the market; thus declining the prices of goods and services. One of the obvious examples is the dwindling demand for petrol in the market due to declining usage of transportation.

For example, the average oil price in the year 2019 was around USD 55 per barrel. In the middle of the lockdown period, between March to April in year 2020, the oil price was around USD 20 per barrel. Surprisingly, the future price of petrol in the derivatives market in the middle of pandemic slumped to USD 37 due to oversupply of future oil market and storage area being almost full.

**Economic Impact**

Even though the objective of the lockdown is to flatten covid-19 cases, the impact of the lockdown has been quite severe to the economy.

The initial impact was the declining of demand and supply in almost all sectors of the economy; thus reducing the amount of money supply in the market. This will directly reduce individual and institutions’ incomes. The rise of unemployment and reduced amount of capital are bound to be burning issues in an anticipated upcoming recessionary period.

Therefore, as the money circulation decreases and future economics looks bleak, it is expected that financial institutions and especially banking institutions including Islamic banking will reduce the amount of lending money (or trading by Islamic Institutions) in the market. It is expected that most buyers will reduce the amount of investment and buying assets such as houses as income declines.

In the midst of the current pandemic period, the role of Islamic banking and finance as a middle person between the surplus and deficit could be expected to deteriorate.
As such, we surmise that during this downturn period, the flow of money will depend more on charitable activities such as sadaqah (Charity), Zakah (Alms Tax) and Waqf (Charitable Endowment). Islam encourages the concept of brotherhood by helping each other especially in time of crises when the amount of income & money supply reduces. The difference is that the benefits are not of this world but rather in the hereafter.

In Surah al-Baqarah verse 261, we read:

“The example of those who spend their wealth in the way of Allah is like a seed [of grain] which grows seven spikes; in each spike is a hundred grains. And Allah multiplies [His reward] for whom He wills. And Allah is all-Encompassing and Knowing.”

Therefore, in order to encourage the consistency of the economy to sustain itself in the current economic downturn, it is important for Shariah scholars to encourage the Islamic social finance concepts of sadaqah, zakah and waqf in society

**Role of Sadaqah**

The word sadaqah is derived from the word sidq that means sincerity or truth. Sadaqah is a voluntarily act of giving something for the sake of God. There is a misconception that sadaqah should be in the form of money; however, sadaqah can be in any form. Even spreading knowledge, visiting the sick, giving advice and smiling at people could be counted as sadaqah.

However, sadaqah in the shape of material form such as money, food and proving places of shelter are encouraged in Islam. In these times of economic recession due to the pandemic covid-19, the act of giving sadaqah to needy people who have lost their jobs and income is particularly encouraged.

**Importance of Zakah**

Zakah is derived from an Arabic word meaning ‘purification’. Zakah can be considered as a purification of one’s wealth. Unlike sadaqah, the act of zakah is compulsory. As the third pillar of Islam; it is an obligation for each individual to donate a certain percentage of wealth each year for charitable purposes.

It basically consists of 2.5 % of one’s saved or invested wealth that will be calculated at the end of each year and given to the deserving sections of society.
The recipients of zakah are the poor and needy, muallaf (struggling Muslim converts), slaves, people in debt and wayfarers or travellers stranded during their journeyings.

**Waqf Endowments**

Waqf, is an Arabic word that literally means stop or confinement or causing a thing to stop or stand still. In Islamic finance, Waqf basically refers to a permanent endowment by a Muslim of a valuable property of his or hers in trust for a particular social benefit.

Islamic Finance scholars currently promote waqf as part of sustainable development that reduces the dependency of Muslim society on others. The waqf endowment, although little known is one of the most profound economic institutions Islam has promulgated. It is a long-term investment for the whole community with continuing benefits. Through waqf, long-term assets that generate income flows can be created and preserved. These assets obviously help the process of production and creation of wealth in society.

In modern Islamic finance, an asset of waqf can be divided into 3 categories- property, corporate and cash waqf. The first waqf is the property waqf- real estate waqf- such as shop lots and houses that can generate rental as income. Second is the corporate waqf that are in the form of corporate shares of company that are issued and managed by a corporate body such as Islamic banks, takaful companies and Shariah-compliant investment companies that generate wealth for the greater good. Lastly there is the cash waqf which is originally in a form of capital consisting purely or partially, of cash or even currently in the form of crypto currency.

**Going Forward - The Larger Good**

Islamic financial analysts estimate that each year around USD 200 billion is spent in zakah and 1 trillion spent in charitable acts of sadaqah and waqf. Let us remember that these are not only considered as an investment for the hereafter, but can also reduce inequality and disparity of income and wealth in society. As a result, wealth will be circulated and ultimately help establish social equality. As the lower income sections spend more in the market for their basic needs, the economy itself could grow and sustain itself.

The implementation of such activities must however continue beyond the downturn period and cover the long-term period. These activities and especially waqf can be used as a complement to fiscal or monetary policy of governments as well.
Financial intermediation can be defined as the process of transferring funds from a sector with surplus towards a deficit sector by a financial intermediary.

However, financial intermediation creates huge amounts of debt that may cause numerous harms, especially home-financing debts, which constitute the highest proportion of the debts created by financial institutions.

The high volume of debt, especially mortgage debt, triggered the 2008 crisis that began in the United States. Recently, the size of debt in the United States is five times the debt in 2008. The debt of China, the world’s second-largest economy, has far surpassed it level in 2008.

The Basic Problem

The risk of mortgage financing is higher in poor and unstable countries. Long-term financing does not function in turbulent economies with job insecurity, or weak government oversight of financial institutions, as in the United States before the recent crisis. The abundance of liquidity, which is mostly the money of depositors in banks, and the fact that banks earn a profit from financing, make banks rush to compete in financing clients without regard to the effects and the future economic risks.

In fact, the problem with debt creation lies in the ghabn (unfair advantage) for the creditor (the bank) as the client incurs a debt that he or she may be unable to repay, especially if it is a large debt for an extended period, such as in home financing. If debtors cannot afford to pay and default on repayments in large numbers, this leads to financial institutions going bankrupt, which has serious adverse effects on the economy that could lead to an economic crisis. Collective default is not something that is unthinkable, as historically, it has occurred numerous times, most recently in 2008, because of the slowdown in the economy and the weak government oversight.

Whether the bank lends or sells on credit as the Islamic banks do, there exists the problem that the client may not be able to repay his debts that spans two or three decades. There is no guarantee of the client’s ability to retain their job or maintain his income, and be able to keep up with the instalment payments. If the creditor seeks to repossess the financed property in the event that the debtor defaults due to losing his job, this would inflict great harm on the debtor, who might find himself and his family without a shelter.

On the other hand, a large number of defaults on real estate mortgages causing homes to be repossessed may lead to a real estate crisis that affects other sectors of the economy.
The process of debt creation by banks is worsened when banks provide additional loans to the client if the price of the mortgaged house increases with time, with the reassurance that house prices are increasing, so the client’s debt increases.

In addition, banks lend the depositors’ money, and therefore if a bank goes bankrupt it affects all the depositors. If one bank goes bankrupt, panic spreads to depositors in other banks, who would rush to withdraw their money. As this occurs at the same time, banks become unable to pay depositors simultaneously and the crisis exacerbates.

Furthermore, if the debt created domestically is traded internationally, the crisis becomes more severe. In fact, due to the trade of debts both domestically and internationally, the debt crisis in the United States in 2008 became a global crisis.

Therefore, the problem with mortgage debt, regardless of the underlying financing modes be they loan or sale-based, relates to the concentration of debt creation and the lengthy financing period. When more than half of a country’s population are in such debt, the debt carries the seeds of a crisis that may erupt at any moment with the slightest economic turmoil. Indeed, the spirit and wisdom of the Islam economic system would never tolerate such conditions.

**The Way Forward**

The current modes of Islamic real estate finance carry most of the economic caveats of conventional real estate finance. Therefore, there is a need to explore other options and the proposed solution must not lead to the creation of a long-term debt relationship between the bank and the client.
By presenting the structures of Islamic home financing, from the conceptual perspective (not the current application) we can, from the outset, rule out sales contracts, such as *murābaha* and *istisnā*, because they convert the price of the property into a long-term debt that is borne by the clients. As for the remaining structures - *ijāra* and *Mushāraka mutanāqisa* - the latter is the fairer and the more appropriate of the two.

**Financing through a modified form of *Mushāraka Mutanāqisa***

We shall review this financing mode based on two considerations: firstly, justice for the parties - the bank and the client, and secondly, the issue of debt creation.

**First consideration: justice for both parties**

When the instalments paid by the client for a property extends over many years, whether it occurs by financing directly through a loan or indirectly through an intermediary, then the principle of justice, which is at the core of any Shariah transaction, requires that the rights of both parties are guaranteed. The bank that pays the full price of the property in cash, and the client who pays in instalments to the bank in order for the property to eventually be in his name.

In reality, *Ijāra muntahiya bit-tamlīk* in a financial sense is not fair for the client, as he pays instalments to the bank without owning anything against those instalments even though his aim is obtaining ownership, not leasing. This is especially so as the instalments for *Ijāra muntahiya bit-tamlīk* are usually higher than normal *ijāra*. 
As the Islamic bank practically evades the ownership liabilities associated with being “the landlord” by transferring them to the client, this makes the *Ijāra muntahiya bit-tamlīk* more like a sale rather than a lease contract.

Rather, it makes a sale in this case fairer than leasing as in the latter case ownership is not transferred to the client, although the liabilities of the leased asset are borne by the client, which is usually the responsibility of the owner (i.e. the bank). Thus, the partnership in the ownership of the real estate according to the proportion of contributions is achieved in the *Mushāraka mutanāqisa*.

**Second consideration: debt creation**

Obliging the customer to repay on instalments, in whatever form, produces a debt-based contract and home financing is no exception.

The problem with debts in home financing, in particular, is that they last for many years and contain gharar (high risk) which may cause an economic crisis in the future. If the client is not obliged to pay for the financing of the *Ijāra muntahiya bit-tamlīk* and *Mushāraka mutanāqisa*, it is possible to say that it is then different from financing by sale on instalments), or a loan, in terms of debt creation.

However, due to the obligation, the so-called lease is in fact a debt that the client must pay throughout the financing (*ijara*) period. This is also the case with *Mushāraka mutanāqisa* as the client must repay the instalments.
The client practically buys the whole house since the day the contract is signed and has to pay the remaining debt in instalments; especially if the house is officially registered in the name of the customer, as it is practically the case in all Islamic financing contracts.

Furthermore, the bank practically evades the liabilities of the full ownership in the *Ijāra muntahiya bit-tamlīk*, and the liabilities of the partial ownership in *Mushāraka mutanāqisa*. This shows that although the contract appears to be *ijāra or mushāraka*, it is actually a sale that creates debt.

In fact, debt creation is prevented if the customer can choose, in principale, whether to continue paying instalments or stop paying them in both *Ijāra muntahiya bit-tamlīk* and *Mushāraka mutanāqisa*. However, *Ijāra muntahiya bit-tamlīk* has an unjust element because the client does not receive ownership in proportion to the amount of instalments he pays, which are usually higher than the rental amounts of a regular lease contract that does not end in ownership.

Hence, in essence, the *Mushāraka mutanāqisa* formula is fairer and most appropriate. If, however, the customer in this formula is not forced to gradually acquire the bank’s share, then the price of the house paid by the bank shall not be transferred into a debt for the client. Thus, home finance will not then result in the creation of long-term debts with all its potential harms.
MANAGING RISK: ROLE OF INSURANCE/TAKAFUL

Norhafiza Nordin
“Life is like a box of chocolates. You never know what you’re gonna get,” is a famous quote from the 1994 film, Forrest Gump. The statement is so true because we can never predict our future. Indeed, life is full of uncertainties and risks. We may try to avoid them or reduce their impact, but we will not be able to completely abolish them.

For that reason, we need insurance. Insurance is a financial tool that gives financial buffer in case unfortunate events such as death, illness, fire and accidents happen to us. Insurance provides protection and could help us to minimize financial loss. The most common risk is unexpected illness. If we do not have an insurance, we need to pay out-of-pocket for the treatment. Medical expenses nowadays are prohibitive. Thus Health Insurance helps to cover the cost of hospitalization and medical expenses.

Not only risk of health, we also face the risk of our properties or belongings being damaged by a natural disaster or other reasons such as accident and robbery. If the belongings are not insured, it may be costly to replace them. On top of that we also yearn to protect our loved ones. For that reason, life insurance policy may provide succor to our loved ones when we pass away. It may help to pay off the outstanding loans, utility bills, education fees, and funeral costs.

What is Insurance?

What is an insurance? Insurance provides protection in return of fees or premium paid. We will be compensated for our loss if the incident happens during the insurance coverage period and the amount paid is limited to the sum insured. So how does insurance operate? An insurance company gets fees (premium) from people who want to be protected from various types of unfortunate events. The purchaser of an insurance policy is known as the policy holder.

Not all policy holders will be involved in unfortunate incidents at the same time. Therefore, premium collected can be used to help those who experience the misfortunes. In general, there are two types of insurance, general and life. General insurance protects us against losses related to personal assets while life insurance protects our loved ones or dependants once we are no longer around to take care of them. Examples of general insurance include motor insurance, fire/houseowner/householder insurance, health insurance, and travel insurance.

Two broad classifications of life insurance are term and whole life. Term provides protection for a specified period where the beneficiaries will get the payment in the event we die. This type of insurance is usually cheaper compared to whole life insurance. Whole life provides protection for the lifetime of the insured.
Why Insurance?

Why do we need a life insurance? The answer lies in the fact that we do not know when we are going to die. Life is uncertain and no one knows what the future holds. Many people die young even though average life expectancy has increased. Imagine this happens to us and we are the sole breadwinner in the family.

What will happen to our family or our dependants? It will be a devastating situation for our loved ones. Will they be able to survive? This is why life insurance is important. In general, it helps to secure our family’s financial situation when we are not around. Specifically:

1. Maintaining lifestyle and financial position: This is the most important reason why we need life insurance. Life insurance provides or replaces the lost income. Thus, ensuring the survival of the family.

2. Paying off debt: Life insurance like Mortgage Reducing Term Assurance (MRTA) will help our loved ones to settle housing loans if we die. Since any outstanding debt will be settled, the family is not burdened to continue paying the debt.

3. Achieving long-term goals: There are insurance products that combine protection and investment. This kind of insurance provides protection and at the same time gives us the opportunity to achieve our long-term goals such as retirement fund and children’s education.

Undeniably, life insurance is an important financial tool, but does everyone need to purchase life insurance? It depends on our personal situations. For example, if we are not married and both parents have passed away, we may not need life insurance because we do not have any dependant. Another example is a dual-income couple without children. In this case, a survivor’s lifestyle may not be affected much upon the spouse’s death.
Enter Takaful

Insurance gives us peace of mind. The advantage of obtaining insurance is it helps alleviate financial loss and gives us the support we need when mishaps happen. The main objective of having an insurance is to offset the burden of financial loss.

Purchasing insurance at young age will give advantage in term of premium paid. Nevertheless, we should only buy the one that we need. Do not get influenced by an agent who might try to persuade us to buy a policy that we do not need. We must determine what type of policy we need and how much coverage is needed.

For Muslims, Takaful offers an alternative insurance protection based on Shariah principles. Specifically, Takaful is an Islamic insurance wherein each participant contributes money with agreement to protect each other against loss or damage. Takaful requires the participants to undertake a contract (aqad) by agreeing to cooperate and mutually help each other. Similar to conventional insurance,

Takaful policies cover both life and general insurance needs. The key difference between a conventional insurance and Takaful is that Takaful is based on Shariah foundation. Thus, its operations do not involve elements which are outlawed in Shariah such as riba (interest), maisir (gambling), and gharar (uncertainty).
RIBA AND MORTGAGES: 21 COMMONLY ASKED QUESTIONS

By Ethica Institute of Islamic Finance (https://ethica.institute)

We speak to bankers, both Islamic and conventional, and laymen, both sincere and cynical, and compile twenty-one of the most commonly asked questions about riba and mortgages.
He’s a good Muslim. He prays, he fasts, he pays zakat. He regularly performs voluntary acts of obedience. He’s a caring family man and a respected member of the community. By every outward measure, he appears to be leading the life of an exemplary Muslim.

But, somewhere along the line, he reconciled his views on interest-based finance, particularly in relation to conventional mortgages, with his religious beliefs. He became convinced, like countless other Muslims, that Islam permits one to take a conventional mortgage to finance the purchase of a home.

The question is not whether riba is impermissible; the verses in the Quran are clear enough. The question for many is: “Is the riba in the Quran the same as the interest on my home loan?” We spoke to bankers, both Islamic and conventional, and laymen, both sincere and skeptical, and compiled twenty-one of the most commonly asked questions related to conventional mortgages.

We confirmed the answers with qualified scholars who referred back to the Quran; sunna of the Prophet (Allah bless him and give him peace); the scholarly consensus of the traditional schools of jurisprudence; and the Shariah standards of the world’s largest regulatory body governing Islamic banks, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). The following are actual questions posed by genuine Muslim homebuyers and industry practitioners:

1. How is the riba Allah has forbidden the same as ordinary interest? I thought riba refers only to usury.

The Quranic verses and hadith are clear on the prohibition of riba. What is not clear to some is the meaning of the word “riba.”

Understanding this is particularly relevant to understanding the impermissibility of conventional mortgages. The present answer seeks to show that differences in interpretation do not originate from a substantive change in the nature of the circumstances since the time of the Prophet (Allah bless him and give him peace), as some claim, but rather from a change in the common usages of the words “usury” and “interest.” So while the original meaning of the word “usury” referred to any charge over the principal according to Old English Law, the modern meaning of the word underwent a process of evolution.
Essentially, a change in language, not a change in commerce. Allah deems only two sins worthy of a war from Him: enmity with His friends and dealing in riba. Few Muslims doubt the enormity of dealing in riba, clear in Allah’s words in the following verse:

“Those who eat of riba shall not rise (on Judgment Day) except as those arise who are smitten by the Devil with madness—which is because they say that trade is but like riba, though Allah has made trade lawful and has forbidden riba. So whoever is reached by a warning from his Lord and desists may keep what was before (Allah forbade it), and his affair is with his Lord. But whosoever returns, those are the denizens of hell, abiding therein forever”

“Allah extirpates (all benefit from) riba, but makes charity bounteous, and Allah loves no sinful ingrate.

“Verily, those who believe and do righteous works, who perform the prayer and give zakat, they possess their wage with their Lord: no fear shall be upon them, nor shall they grieve.

“O you who believe, fear Allah, and give up whatever remains of riba, if you be believers.

“But if they do not, then be apprised of war from Allah and His messenger, though if you repent, you may keep your principal, neither wronging nor being wronged” (Quran 2:275-79)

And the words of the Prophet (Allah bless him and give him peace) found in this and other rigorously authenticated (sahih) hadith:

“The Messenger of Allah (Allah bless him and give him peace) cursed whoever eats of riba, feeds another with it, writes an agreement involving it, or acts as a witness to it.” (Sahih Muslim).

And the expert legal opinion (fatwa) of one of the world’s leading Islamic finance scholars, Justice Mufti Muhammad Taqi Usmani, defining riba:

“The concept of riba was widely recognized among the addressees of the Holy Quran, and it is that concept which is reflected in the legal definition provided for riba either in the hadith or in the later literature of Islamic jurisprudence. According to this definition, any transaction of loan where the payment of an additional amount on the principal is made conditional to the advance of such a loan is called riba.”
Confusion, spread primarily by the more modernist readings of the Islamic Sacred Law in the first half of the 20th century, arose on whether riba refers to usurious levels of interest alone, or refers to commercial interest as well, the kind found in conventional mortgages. Two issues are involved here: 1) the incorrect and widely-held belief that interest was, in previous times, only usuriously excessive by nature; and, 2) the popular notion that pre-modern forms of finance served primarily consumptive, not commercial, needs.

A brief look at history is instructive.

Commercial interest, as practiced today even at single digit rates, was well-known and widely practiced among Abrahamic societies, even over four thousand years ago, mostly as a form of institutionalized agricultural finance, not just as a form of usurious consumption finance, borne out by substantial historical proof.³

Later, even the concept of credit risk became well understood, with Byzantine traders contemporary to the Prophet (Allah bless him and give him peace) borrowing on standardized rates of interest, rates that varied by profession.⁴

The Prophet (Allah bless him and give him peace), his Companions, among whom many were previously moneylenders, and all those trading in the Arabian peninsula during the 7th century were thoroughly familiar with the widespread practice of commercial interest-based lending: charging for the use of money with an additional sum over the principal amount.

Modernist Islamic discourse on the inadequacies of an interest-free economy is highly reminiscent of the arguments favoring interest given by medieval Christian theologians. Three centuries before prointerest Calvinism reached its full stride, the slippery-slope justifications that marked the beginning of the end of the Church’s interest prohibitions began, most openly, in the 13th century with the introduction of a time-based penalty charge on an interest-free loan.

The charge was called “interesse.”

About a hundred years later, this charge evolved into one that could be incorporated into the contract itself as part of the loan, not just as a penalty for late payment, but as a charge just for the use of the funds.⁵
The last stage of this recidivism came in 1920 when the Church itself issued the following statement: “…in lending a fungible thing, it is not itself illicit to contract for the payment of the profit allocated by law, unless it is clear that this is excessive, or even for a higher profit, if a just and adequate title be present…” 6

Even the modern dictionary attests to the true origins of the word “usury”: “1. the practice of lending `money at an exorbitant interest rate. 2. an exorbitant amount or rate of interest. 3.Obs. Interest paid for the use of money…” 7 The first two definitions are the norm, the third, the point. That it became obsolete (“Obs.”) is testament to the fact that usury was once regarded as none other than nonexorbitant interest.

From the beginning of Islam to the present day, the overwhelming majority of Muslims, both scholars and laymen, have regarded riba, usury, and interest as but one in meaning. To follow this is to follow the words of the Prophet (Allah bless him and give him peace) to “adhere to the jama’a (overwhelming majority of Muslims).” (Ahmad)

2. How does interest harm society? Isn’t it a necessary part of every economy?

Muslim societies are a living example of the debilitating effects of interest-based finance. Most sadly reflected in just about every Muslim country in the world, with daily-ballooning interest payments to the World Bank, International Monetary Fund, and other industrialized nations’ agencies; notably, at low rates of interest.

Interest payments that, quite unproductively, draw valuable funds away from healthcare, education, sanitation, infrastructure, and any number of other governmental responsibilities. Debt creates dependence, and dependence provides the opportunity for control. The following two passages are particularly relevant for those who claim that interest-based development actually works:

“According to UNICEF, over 500,000 children under the age of five died each year in Africa and Latin America in the late 1980s as a direct result of the debt crisis and its management under the International Monetary Fund’s structural adjustment programs. These programs required the abolition of price supports on essential food-stuffs, steep reductions in spending on health, education, and other social services, and increases in taxes”.

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The debt crisis has never been resolved for much of sub-Saharan Africa. Extrapolating from the UNICEF data, as many as 5,000,000 children and vulnerable adults may have lost their lives in this blighted continent as a result of the debt crunch.”

“Debt is an efficient tool. It ensures access to other peoples’ raw materials and infrastructure on the cheapest possible terms. Dozens of countries must compete for shrinking export markets and can export only a limited range of products because of Northern protectionism and their lack of cash to invest in diversification. Market saturation ensues, reducing exporters’ income to a bare minimum while the North enjoys huge savings.

The IMF cannot seem to understand that investing in...(a) healthy, well-fed, literate population...is the most intelligent economic choice a country can make.” Further, price inflation and increased market volatility, the usual concomitants of a highly leveraged economy, affect poor and rich countries alike. To add to this, poorer, debtor countries typically find their currencies devaluing as they struggle to repay loans in their creditor’s currency. The realistic alternative to debt is the one already employed to good use in successful Western economies: equity, upon which most Islamic finance products are based. In comparison to debt, equity provides the most resilient and least damaging source of capital for individuals, businesses, and economies. Besides the ravaging macroeconomic effects of debt, problems also appear at the level of the individual.

A 2001 study at Bath and Exeter reveals that students who fear they may fall into debt are four times more likely to suffer from depression. For those students who are actually in debt, the numbers may be worse. The correlation between indebtedness and ill health is particularly alarming given the widespread use and social acceptability of interest-based consumer finance, including home financing, which also offers the all too convenient option of multiple mortgages.

Debt finance expands the range of possibilities available to us, and for some, to unsustainable levels, making it possible to own things one cannot afford with money one may never have. Allah’s command, after all, is not intended for His benefit, but for our own. Islam recognizes that the choices we make as individuals affect all society, and that to support an interest-based institution, even with a seemingly benign conventional home loan, is to support the broader framework of banking institutions largely responsible for today’s widespread global poverty.
3. Does Islam permit conventional mortgages?

A conventional mortgage is a loan of money on which interest is charged. It constitutes a cash loan advanced by a bank or mortgage agency to finance the purchase of a property. The homebuyer agrees to repay the principal in addition to making an interest payment, while nonpayment of either entitles the bank to seize title.

Some money today for more money tomorrow. The lender takes no equity position in the property. The lender provides no service. There is no usufruct of the lender’s assets. The lender provides only some cash today for more cash tomorrow. Riba, no less, and forbidden

4. Aren’t Islamic home financiers simply changing labels, replacing “interest” with “rent”? What’s the difference between a conventional mortgage and an Islamic home financing?

Shariah-compliant Islamic banks, which certainly does not represent all of them, use one of three forms of home financing: 1) Diminishing Musharakah (also called “declining partnership” or “declining balance”); 2) Ijarah; and, 3) Murabaha. Very briefly, in a Diminishing Musharakah, the Islamic bank and the client purchase the property jointly.

The client moves into the property and begins acquiring the bank’s equity in the property while paying rent in proportion to the bank’s remaining equity, with each successive rental payment “diminishing” to the extent of the bank’s reduction in its share of the property. In an Ijarah, or Islamic lease, the bank, acting as lessor, acquires a property and rents it out to the lessee client.

Much later, as part of a separate agreement, the bank offers to sell the property to the client. In a Murabaha, or cost-plus financing, the client selects a property and the bank acquires it. The bank adds its profit and sells the asset to the client at an agreed upon price on a deferred, usually installment, basis. No different from the shopkeeper who sells goods (not money) on credit. For the purposes of facilitating execution, it is permissible for the client to act as the bank’s agent, provided the risk of ownership resulting from this agency role devolves back to the bank.

The key difference between a conventional mortgage and an Islamic home financing is that a conventional mortgage involves the loan of cash on interest, whereas an Islamic home financing is strictly the exchange of an asset. Each of the above transactions involves an asset and actual ownership by the bank. Ultimately, the bank must own some (Diminishing Musharakah) or all (Ijarah and Murabaha) of the asset for
it to be Islamically acceptable. Exacting conditions related to timing, usufruct, and the proper allocation of potential penalty charges (to a designated charity), among other things, govern these Islamic products. When things go wrong, the fact of the Islamic bank having undertaken the liabilities associated with asset ownership makes all the difference.

So while “changing labels” is, alas, true in the case of some “Islamic” banks, to make a blanket statement condemning the entire Islamic banking industry as fraudulent is simply inaccurate. If only to earn the reward for having tried, one should probe a bit further into a bank’s dealings, at the very least, by asking a relied upon traditional scholar about the qualifications of the bank’s Shariah board.

5. Isn’t home ownership an important step in establishing Muslim minorities in the West? Surely, that should make conventional mortgages permissible.

As a general Shariah principle, avoiding harm takes precedence over seeking benefit. Establishing Muslim communities is important, but not at the level of the obligation of avoiding the enormity of dealing in interest. With Islamic home finance options readily available in most areas where large Muslim populations reside, there is no need to resort to conventional mortgaging to build communities of Muslim homeowners.

6. What about necessity (dharura)? Are there any situations in which conventional mortgages are permissible?

In the words of the respected Damascene scholar Sheikh Muhammad Sa’id Ramadan al-Buti: “The necessity which allows usurious loans is the same necessity which allows eating the meat of a dead animal, pig and the like, in which case the one necessitated is exposed to perish from hunger, nakedness or losing lodging.

Such is the necessity, which makes such prohibitions lawful.” 11 And in the words of another leading scholar, Sheikh Wahba Zuhayli: “… only when there is absolute distress (dharura qaswa) in which all the conditions of genuine distress are fulfilled.

In such situations, it would only be permitted to the extent of the distress, such as someone being unable to find a house through rental, for example, and if they don’t take a mortgage they’ll actually end up sleeping on the street or end up hungry such that they’ll have genuine fear of death. This is the criteria for the genuine distress that would entail an exception.” 12
7. Imam Abu Hanifa said that there is no riba in Dar al-Harb (lands where the rules of Islam do not exist), basing his opinion on a hadith\textsuperscript{13}. Doesn’t this entitle me to take a conventional mortgage?

The traditional schools of Islamic jurisprudence consist of rulings and methodologies that rely on the expertise of a body of scholars who base these rulings and methodologies on a specific socioeconomic context. It is not simply a matter of lifting an opinion from a classical jurist and inserting it, decontextualized, into a modern framework. The job of today’s scholars is to apply the interpretive tools of their respective schools within this framework. The position of the Hanafi school and the Hanafi scholars with whom we spoke, including several leading muftis specializing in Islamic finance, is that one is not permitted to deal in riba, whether in Muslims lands or non-Muslim lands, and whether with Muslims or non-Muslims.

8. I don’t qualify for an Islamic home financing and I can’t afford to rent. But I do qualify for a conventional mortgage. Can I then enter into a conventional mortgage since this is my only reasonable option?

As Sheikh Muhammad Sa`id Ramadan al-Buti’s states, quoted from above, “the necessity which allows usurious loans is the same necessity which allows eating the meat of a dead animal, pig and the like, in which case the one necessitated is exposed to perish from hunger, nakedness or losing lodging.” In such a case one is expected to explore all possible alternatives, including the inconvenience of a longer commute, the prospect of a less desirable neighborhood (provided it is not clearly dangerous or harmful), or, in the longer term, seeking work in another city. The monthly payments on a conventional mortgage, after adding principal and interest, property taxes, and the usual expenditures that go with home ownership, come to an amount similar to renting property, and in many localities, an amount greater. Often we impose a pre-conceived limit on the kinds of options available to us before we fully explore all of these options.

9. Can I live in a conventionally mortgaged house that somebody else bought for me as a gift and is currently making payments on?

Scholars have permitted one to live in such a house, though it is still best avoided. Of course, one is not permitted to assist in the decision-making process or transaction of obtaining the property through unlawful means.
10. Why do Islamic banks charge more for a home financing than a conventional bank? How is that Islamic?

Rates are a function of market dynamics. Not sincerity. In more mature Islamic finance markets, it is cheaper to purchase property using Islamic finance than it is to borrow funds through a conventional bank.¹⁴

Growing market competitiveness, and the resulting growth in volumes, ensures that financing rates will continue to fall. Islamic banks in the West are catching up. On the supply side rates continue to fall as more Islamic home finance providers enter the market, while on the demand side a rapidly growing and increasingly sophisticated customer base asks for greater Shariah compliancy at competitive rates.

In relation to conventional mortgage transactions, which number in the millions each year in the US and UK, Islamic home finance transactions are but a fraction. But within only a few years, Islamic banks in the West have made considerable strides in lowering financing rates, with one Islamic home finance provider stating that their product is “no more expensive than a 30-year fixed-rate (conventional) product…” ¹⁵

11. Islamic banking is inherently less competitive because extra paperwork for Shariah-compliancy means higher costs.

This returns to the above point about scale, and the need for greater volumes to bring rates down. Shariah compliance is less a matter of additional paperwork, though additional paperwork is often necessary, than a matter of properly executing existing paperwork. Even so, demonstrable costs associated with collapsing conventional banks and their associated products, most tellingly seen in the global financial crise, far outweigh any perceived or real costs associated with Islamic finance and the additional steps necessary to legitimize a contract.

12. What about the moral hazard of Islamic banks using their own paid for Shariah boards?

Shariah advisors are paid a fee for their services regardless of their legal opinions. These opinions are not commission-based, volume-based, or linked to the success of any given transaction. The Shariah advisor plays an auditory role, not a marketing role, so there is no financial incentive for the advisor to win hearts. And given the relative simplicity of Islamic banking products, and the fact that industry-wide Shariah standards¹⁶ are accessible to everyone, including customers, central bank regulators,
and independent auditors, means that there is little room for advisors to exercise personal agendas. Notwithstanding the handful of scholars whose fringe positions are well known to the industry, if there is a worldly motive that a Shariah advisor might aspire to, it is the need to preserve his reputation.

And in an industry in which the number of institutions entering the market far outpaces the number of qualified scholars available to serve them, reputations are paramount. The way that one ensures that an Islamic product is Shariah-compliant is to speak directly to the Islamic bank and then check their responses against the opinions of a qualified scholar.17

13. In an Islamic home financing, the rent follows the rate of interest and is always a certain percentage above the base rate. Does this mean that the rent is simply replacing the interest to make it sound permissible?

Interest is forbidden on the basis of it representing “rent” on the use of cash. The concept of benchmarking, on the other hand, in which rental rates are measured against a well-known benchmark, like the US Federal Funds Rate or LIBOR (London Inter-Bank Offered Rate), constitutes a measurement, not an actual interest charge. Scholars cite the example of selling wine: a Muslim vendor selling juice would be perfectly entitled to measure the price of his product against those of his wine-selling competitors in order to remain competitive.

The variation in rental rates after the contract is signed could be a potential source of uncertainty leading to dispute (gharar), but scholars provide two mitigants: 1) mutual agreement by both parties to benchmark against a well-known measure; and 2) flooring and capping of rate levels. While scholars permit benchmarking, they acknowledge that it is the less ideal (though still no less permissible) alternative to a truly Islamic measure such as an asset-based benchmark.

14. Islamic banks use the word “interest” in their documentation. Is this permissible?

In the absence of government documentation specific to Islamic home financing in most countries, Islamic banks are required by law to use conventional home mortgage contracts, including those that use the word “interest” in their documentation. Scholars state that this does not compromise the permissibility of the transaction, saying that the legal substance—and reality—of an Islamic home financing contract is not affected in this case by a third party’s terminological usages.
15. Islamic home financiers require clients to engage in insurance. Is this permissible?

Given that property insurance is a legal requirement in most, if not all, localities in the West, and given that properly capitalized Islamic cooperative insurance (takaful) options do not exist in the West, scholars have allowed the use of conventional property insurance for homebuyers.

16. Islamic banks use credit scores similar to the ones conventional banks use to check on the eligibility of a potential homebuyer. Is this permissible?

Credit scoring, among other risk assessment measures, is only a measure. Just as one would check on the credentials of a business partner before entering into a partnership, so too, an Islamic bank checks on the customer before entering into what amounts to an actual partnership. Credit scores provide institutions with a clearer understanding of a prospective customer’s credit worthiness. In order to be sustainable and continue to provide Muslims with Shariah-compliant financial alternatives, Islamic banks must remain financially stable, and credit scores are an indispensable tool for promoting this stability.

17. If I am not allowed to take a conventional mortgage, am I permitted to work in the conventional real estate business?

The Prophet (Allah bless him and give him peace) said in a rigorously authenticated (sahih) hadith, reprinted from above: “The Messenger of Allah (Allah bless him and give him peace) cursed whoever eats of riba, feeds another with it, writes an agreement involving it, or acts as a witness to it.” (Sahih Muslim) Assisting in an act of disobedience is an act of disobedience. As it relates to the real estate business, one should not be involved in the solicitation, execution, or any form of assistance, of an interest-based conventional mortgage, though scholars have permitted accountants and others to make post-transaction records in financial statements and the like.

Growing globally at an annual rate of 15-20% 18, and considerably faster in some countries, career opportunities in Islamic banking abound, particularly for those already familiar with conventional finance, as many real estate professionals are.

18. How do some banks, claiming to be “Islamic” trick me?

While there is no end to the possibility of indiscretion on the part of insincere “Islamic” bankers and lawyers, the customer’s final line of defense, amid the paper shuffling, is a quiet read of the actual contract.
Whether in a Diminishing Musharakah, Ijarah, or Murabaha contract, if the financier never owns the property, one is not engaged in an Islamic home financing transaction. One “Islamic” home finance provider in North America claims to “conceptually own the shares in its name as expressed as a lien on the property,” while another provider, this time in Australia, “assumes an interest in the property (‘rights’) other than a right to possession.” According to scholarly consensus, neither of these represents actual ownership.

These banks effectively charge rent on a claim or a right (as opposed to the valid rent on an asset, service, or usufruct), a practice not acceptable to regulatory bodies. In the absence of a governing regulatory body that unifies and imposes global Shariah standards, customers are on their own.

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) is widely regarded as the industry’s leading standard-setting body, and may one day provide the criteria for global licensing and auditing, but it currently only serves as a guide, not as a watchdog. Even so, as one bank learned when it was stripped of its “Islamic” label by its government regulators, word gets around.

19. The concept of ownership has changed since the classical jurists first formulated their rulings.

Some have argued for a new theory of ownership, stating that, among other financial innovations, a lien represents a new form of conceptual ownership that did not exist when the classical jurists declared all forms of riba forbidden. First, secured lending was not foreign to classical jurists. Second, a conventional mortgage is a lien against a property, not an interest in it.

The liabilities associated with the property never return to the lender. Not convinced? Light a bonfire in your front lawn this weekend and see who the authorities fine, you or the lender. On the other hand, look at the assets side of an Islamic bank’s balance sheet and you will find actual home ownership19, unimaginable to a conventional bank.

20. Interest is now a customary practice in most parts of the world. Don’t rulings change in the Shariah when something becomes customarily acceptable?

Customary practice (‘urf) affects rulings related to the permissible, not the decisively prohibited. As always, changes in rulings are subject to the agreement of qualified scholars, who must possess the following-
a highly sophisticated understanding of the primary texts, classical Arabic, the rulings and methodologies of previous scholars, a thorough understanding of the needs of our time, and deep familiarity with the specific topic the ruling relates to, in this case, finance and economics.

21. After much thought, I have decided to leave interest-based finance. What should I do now? What happens to the mortgage and the property?

Allah says: “And those who, when they do an evil thing or wrong themselves, remember Allah and implore forgiveness for their sins - Who forgives sins save Allah only? - and will not knowingly repeat (the wrong) they did.” (Quran 3:135).

The Prophet (Allah bless him and give him peace) said in a rigorously authenticated (sahih) hadith: “There is no one who commits a sin, goes and performs ritual ablutions, and then prays two rakats after which they seek Allah’s forgiveness except that He forgives them.” (Tirmidhi)

Imam Nawawi says in Riyad al-Salihin: “Sincere repentance consists of abstaining from the sin instantly, having a firm intention not to be involved in that sin again and being remorseful and regretful of one’s actions.”

One takes the means to extricate oneself from the mortgage: one would be religiously obligated to remove oneself from the situation, and when not reasonably possible, to repay the loan as quickly as possible by the most effective means available to one; most readily by reducing one’s expenditure and, if possible, taking interest-free loans from friends and family.

Ownership in the house itself and proceeds from its eventual sale are both considered lawful. A number of Islamic banks now offer refinancing options that convert one’s conventional mortgage into its Shariah-compliant equivalent. And

Allah knows best.
END NOTES:


13 For a complete discussion, see section w43.0: Al-Misri, Ahmad ibn Naqib. Reliance of the Traveller. Maryland: Amana Publications, 1999.

14 Based on a survey of rates at Meezan Bank (Islamic) and Prime Bank (conventional), conducted by Fareed Agha (Pakistan, Summer 2005).


17 See: www.sunnipath.com for detailed and reliable answers to commonly asked questions answered by qualified scholars and those able to contact them directly.


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