ISLAMIC FINANCE IN THE FACE OF ECONOMIC AND FINANCIAL CRISES

By

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I dedicate this modest work to the memory of my grandfather HAJ ABDELAH MOURTADI may God grant peace to his soul and to my mother AICHA BOUSHIB and my father OMAR MOURTADI who have always given me their support and who have believed in me. May they find here the fruit of their perseverance, patience and hope.

Contents

Lists of abbreviations

IS: Islamic Finance

PF: Participatory Financing

FC: Finance Classic

OIC: Organization of the Islamic Conference

DIB: Dubai Islamic Bank

RA: Riba-Annassia

IFSB: Islamic Financial Services Board

SB: Sharia Board

IDB: Islamic Development Bank

NGO: Non-Governmental Organization

SRI: Socially Responsible Investment

HSBC: Hong Kong & Shanghai Banking Corporation

BNP Paribas : Banque Nationale de Paris Paribas

IMF: International Monetary Fund

Abstract

This thesis investigates in order to carry out a research regarding Islamic finance in the face of economic and financial crises. In order to analyze the practical side of it we will be conducting a research and analysis the sources and origins of this finance. I explained the principles of Islamic economics which are the principle of dual ownership, the principle of economic freedom within a limited framework and the principle of social justice. I also defined the principles on which Islamic finance is based. Moreover, we have seen what Islamic finance currently weighs in the world thanks to its financing techniques. Finally, I mentioned the financial crisis that gave rise to the revolution in Islamic finance, which is the very subject of my report.

CHAPTER I: INTRODUCTION

The world has been in the grip of a financial crisis for years, the worst since 1929. Its effects have been felt in the real economy and globalization has accelerated its domino effect throughout the world. This crisis, initially centered on obsolete US financial securities, has continued to spread. As a result, international stock exchanges suffered colossal losses, pillars of world finance collapsed overnight. The real losses have yet to be identified by the world's political and monetary authorities. In order to limit the effects of this crisis, several developed countries have adopted austerity policies, but this has not prevented the collapse of some states that are reputed to be economically strong. On the other hand, this financial crisis has had the merit of highlighting the fragility of the capitalist system in the face of speculative excesses and the spiral of debt. The strong impact that the financial crisis has had on the economies of developed and emerging countries has prompted several economists and analysts to look into the reasons for the crisis, its consequences, and the means that must be put in place to prevent it from happening again. In this regard, the UN Commission of Experts, meeting in New York under the chairmanship of Joseph Stiglitz (one of the founders and best-known representatives of "New Keynesianism"), emphasizes the vital need to reform the principles governing monetary and financial systems to avoid new crises. Among the guidelines of this commission, a new door has been opened to draw inspiration from the principles specific to Islamic finance. Thus, thanks to its remarkable rise in recent years, the Islamic financial system has been of particular interest to economic analysts throughout the world.

Almost non-existent 30 years ago, The Islamic Finance has become a trillion-dollar industry. The sector, although modest on a global scale, seems to have weathered the crisis well. Indeed, the Asian Development Bank is showing annual growth of more than 15% over the next 5-10 years. Long concentrated on a potential global market of 1.5 billion Muslims, Islamic banks are now attracting the attention of players around the world. Today, large institutions such as Bank Al Rajhi of Saudi Arabia, Kuwait Finance House and Islamic Maybank of Malaysia compete with Western giants such as Barclays, HSBC and Deutsche Bank.

CHAPTER II: REVIEW OF LITERATURE

A) Generalities on Islamic Finance

1. The Sources of Islamic Finance:

Before getting to the heart of the matter, we must be careful not to confuse the term "PF (Participatory Finance)" used in the Western world with "Participatory Finance" which is used only in the Muslim world and which refers to "Islamic Finance". This confusion will be clarified as our analysis progresses. First of all, we will recall what participatory finance is, before moving on to Islamic finance, which is the very heart of this subject.

To learn more about participatory finance and to better understand the subject and its place in the Western world, let's talk about it in numbers.

First of all, what does this industry weigh today?

According to official figures, the so-called participatory banks weigh $2,000 million (twice as much as four years ago). It is estimated that their average annual growth rate is over 15%. This financial industry should weigh up to 4000 million Dollars by 2020: a real golden lawn especially with the world economic situation and the image of finance which has been tarnished by scandals and financial crises.

SHARIA LAW:

Islamic finance, on the other hand, is indeed a self-sufficient concept based on the notion of an independent economy. Indeed, it is the result of a philosophical reflection on a Muslim economy following the application of Sharia law. In order to highlight the sources of the Sharia and the principle of this Islamic economy, we will establish the different principles of Islamic finance. The term "Sharia", which literally means "the way forward" in Arabic, refers to a legal system based on Muslim ethics. This system serves as a legal point of reference and indicates the course of action in all areas of Muslim life, including the economic sphere. The two main sources of Sharia law are:

THE KORAN

The Koran: The holy book of Islam records the message of God as revealed to the Prophet Muhammad (SAWS) it is the primary source in terms of law. Any element from other legal sources must imperatively be in full conformity with the word of God in the Koran.

Sunnah: This term encompasses all the teachings transmitted by the Prophet Muhammad (SAWS) through his words, expressions, deeds, and tacit approval. These two sources constitute the essential basis for determining the conformity of any action with the rules and purpose of Sharia. However, the Sharia remains open to possible interpretations and developments. Thus, we can add two other sources of Sharia law.

L'ijmaa, in its technical dimension, I'ijmaa means the consensus of Muslim jurists on a point of law. In practice, I'ijmaa is used as evidence if there is nothing in the Coran or the Sunnah to decide a case.

2. The Origins of Islamic Finance

Islamic finance has its source in the Muslim religion: Islam. The latter would have been revealed to the Prophet Muhammad (born in 570 in Mecca and died in 532 in Medina) from the year 610. Islam provides in these texts (Coran and Hadiths), a set of precepts relating to economic exchanges between men. Thus, we can see the main principles of Islamic finance appear in the Shariah.

(All dates in this history refer to the Gregorian calendar.)

However, we cannot say that it is finance as we know it. Indeed, the Coran describes certain behaviors to be observed during commercial transactions, but does not define a system as complex as the one we know today.

The first traces of an organized accounting system in the land of Islam would be found in the time of the first Khoufala (from 634). This period was the beginning of the expansion of the Muslim religion. The Islamic institutions of this period were very strict in the management of state resources. The major challenge was to properly channel the Zakat. Already at that time the

Muslim religion wanted to be transparent in matters of finance. In 1969 Subhi LABIB described this period as the birth of Islamic capitalism.

Indeed, in an article in the journal of economic history, he pointed out that at that time a Muslim economic system would emerge. This system will be based on the dinar. It will be from this moment that we will see the appearance of new financial instruments (such as cheques, bills of exchange, international.... money transfer operations).

Modern Islamic Finance

Islamic finance as we know it will only see the light of day in the 1970s. Indeed, it was not until 1963 that the first Muslim savings bank was established. This event took place in the Egyptian village of Mit Ghamr and was triggered by the economist Ahmad EL NAGGAR. The local population, very religious, expressed mistrust of traditional banks. This is why they decided to found a tontine system of Muslim mutual aid (through microcredit), in order to provide for their needs. Initially, there was no question of an Islamic system as such. It was simply a gathering of farmers who wanted to pool their financial resources. This savings bank, which was the first initiative of its kind in the Muslim world, drained a large part of the villagers' income. True to their principles, the villagers did not make any distributions or take any interest. Rather, they favored equity investments and direct financing. In this sense, it can be said that modern Islamic finance was born at that time. Although this first experiment was a real success, it lasted only 4 years, and had to end for political reasons.

This initiative has inspired the creation of several Islamic levers:

- In 1969 Malaysia created an Islamic mutual aid fund called Tabung Hadji. This fund, still in operation, has as its mission to financially help pilgrims (going to Mecca). Today this fund still plays a very important economic role in Malaysia.

- The Dallah Albaraka Group was founded in 1969. A powerful business conglomerate of which the Albaraka Banking Group is a part. The latter has subsidiaries, "sharia compliant", specializing in retail and investment banking.

- In 1970, the first sharia board, "the sharia supervisory board", was created. It was independent, and was the initiator of the two-headed governance of Islamic banks (we will come back to this later in our study).

- In 1972, the Nasser Social Bank was established. It was the first bank for the modest people in Egypt. The concept was to offer conventional services and at the same time offer Islamic services such as the collection and redistribution of Zakat or the financing of Hajj.

Generally speaking, it can be said that it was in the 1970s that a set of financial practices in accordance with the precepts of Islam emerged. This was more

ladder. This movement will be born thanks to the OIC which decided in 1973 to create the Islamic Development Bank. It started its activity 2 years later, at the same time as the private bank DIB. This movement was called "Islamic Finance"

Islamic finance in the world

We have seen that Islamic finance was born in 1963 in Egypt (Mit Ghamr). It was then exported to Malaysia. In the 1970s, it just began its evolution, passing through the Gulf countries (Dubai, for example). It started its normalization in the early 1980s, reaching regions of the world such as sub-Saharan Africa (Niger, Senegal...) or Europe (Great Britain, Luxembourg).

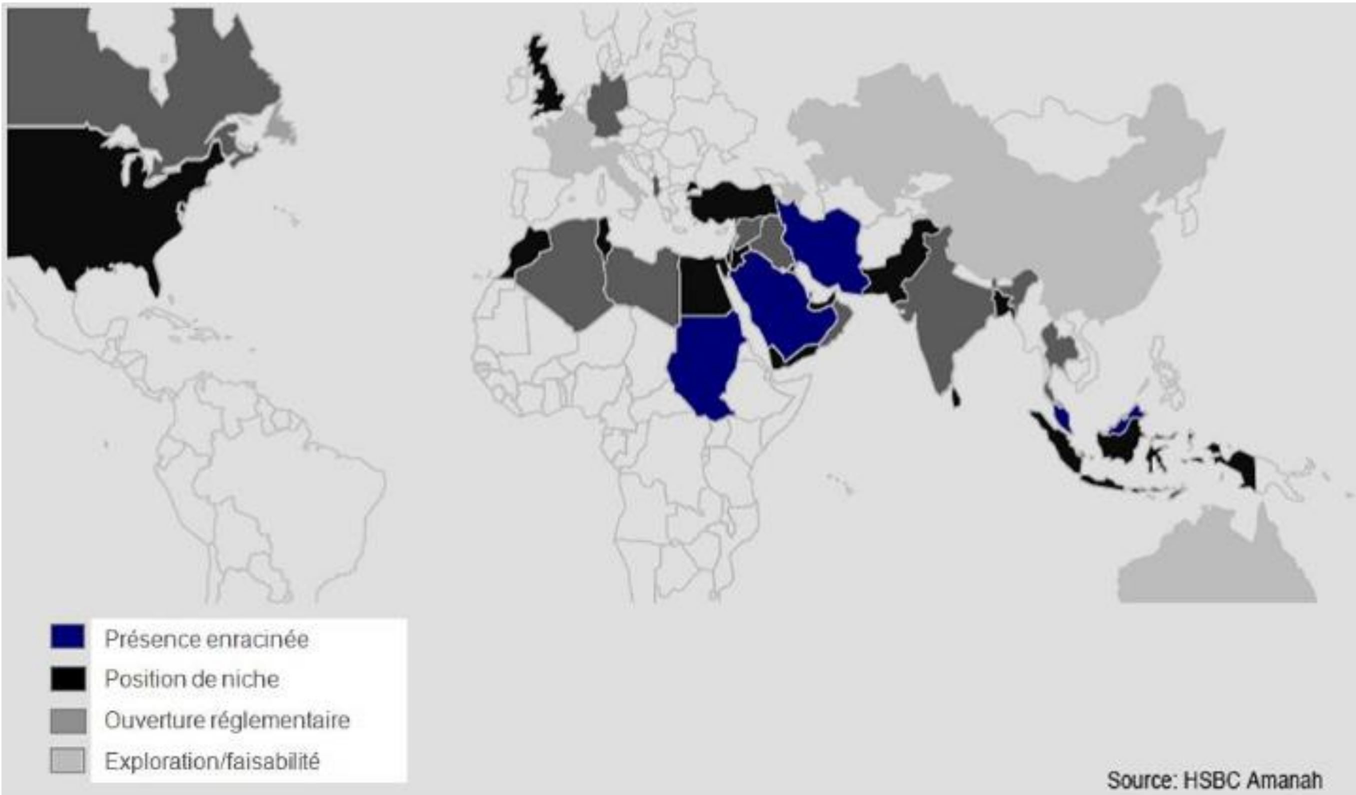
In forty years, this type of finance has experienced considerable growth. Indeed, it was born on the eve of the 1973 oil crisis and is now practiced in more than 60 countries. It has been exported well outside the Arab lands, traditionally Muslim.

It is now necessary to understand how Islamic financial activity is distributed.

It is represented by 345 financial institutions or windows of financial institutions 2 Among the latter, it may be noted that only 105 are purely Islamic banks. Even in the Arab Gulf countries, the market share of purely Islamic activities will not exceed 26.5% of total banking activities in 2008. This figure is recorded by Kuwait. On the other hand, Iran and Bahrain recorded the best figure as regards the share of purely Islamic banks in the banking system of the Gulf countries in 2008. This figure is 86%. It may be noted that even though Iran is among the countries using Islamic finance the most, it is not often cited to speak of it. Indeed, this country is extremely protectionist. According to Dhafer SAIDANE, the process of establishing Islamic finance in this country was different from others. Indeed, this finance would have been born in this country, at the initiative of the public authorities, during the revolutions of 1979. It should also be noted that the Sultanate of Oman does not practice Islamic finance. (SACHAT Joseph (1953), sketch of a history of Muslim law)

Indeed, this country is issuing a rejection, which would be of a religious nature. The dogma that is mostly practiced there is Abadhite Islam. Thus, it can only express a rejection of the principles emanating from the Sunni trend: "...recent research has shown that ancient sects of Islam [including the Abadhites], when they are separated from the Orthodox [Sunni] community, could not share with the majority the essential principles of a right that did not exist.

Islamic finance around the world



AIT DAOUD Amine, in his dissertation Islamic finance & compliant sharia funds, University of Evry val d'Essonne, year 2007-2008

As shown on this map we can see that Islamic finance activity is concentrated in the Golf countries and Asia. However, this is not by chance as these two regions of the world regroups more than 85% of the world's Muslim population.

3. The Principles of Islamic Finance

What distinguishes the Islamic approach from conventional financial practices is a different conception of the value of capital and labor. Instead of a simple lender-borrower relationship, the Islamic financial system is based on a more equitable sharing of risk between the lender and the business owner (Haque Zia Ul, 1980). This practice derives from five main pillars on which the Islamic financial model is based: the prohibition of Riba (usury), the prohibition of Gharar (speculation) and Maysir (uncertainty), the requirement to invest in legal sectors, the obligation to share profits and losses (P3) and the principle of backing investments with tangible assets in the real economy.

The Pillars of Islamic Finance:

The Islamic economy is based on the prohibition of Riba. This Arabic word meaning increase covers the notion of usury and interest. This financial practice is totally prohibited whether it is low or high interest. Moreover, Martens (2001)8 indicates that this prohibition is also present in the other major religions, namely Judaism and Christianity through their Bibles (respectively the Torah and the Gospel). The Riba has two main forms:

- Riba-Al-fadl: This is any concrete surplus perceived during a direct exchange between two things of the same nature that are sold by weight or by measure. ("Islamic Finance: Fundamentals, Theory and Reality", Martens A., Lecture. President, 41st Congress of the Canadian Society for Economic Science, Quebec City 2001)

- Riba-Annassia: The surplus received on payment of a debt, the payment of which has been made a condition, explicitly or implicitly, in the contract, because of the time allowed for deferred payment. RA is the most widespread type in the company, particularly through credits, loans and investments offered by banks and traditional financing institutions.

What differentiates Riba from the sale of a good or service is that the consideration received is considered acceptable in Muslim law only if it is intended to compensate for something legitimate, such as:

- the loss of value related to the use of an object (in the case of the rental of an object), the effort made to achieve an object (in the case of the sale of an object produced by the seller),

- or the work done to obtain a material good and the risk involved in taking it over (in the case of the sale of goods purchased from others). According to the French orientalist Jacques Austruy the prohibition of Riba in all its forms seems to be one of the consequences of the egalitarianism sought in Muslim law. According to him, this prohibition is based on the double affirmation that time belongs to God alone and that money, in itself, is not productive. Thus, the Shariah prohibits the withdrawal by the lender of any benefit from his loan, unless that benefit is freely granted by the borrower after repayment of the loan and without constituting a tacit or explicit condition.

The banning of Gharar and Maysir:

Sharia law also requires, in business and commerce, that it is not permissible to enter into any transaction that contains Gharar.

Gharar can be defined as any material vagueness in any of the goods being traded and/or which is inherently hazardous and uncertain. This is the case, for example, of:

- when the sale is of goods that are not precisely determined.

- when the transaction is concluded without the price of the goods being clearly fixed.

- when the transaction relates to a specific good that the seller does not yet own.

- when the transfer of ownership is conditional on a hazardous event.

- when the transaction relates to a specific good that the seller does not yet own.

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In conventional finance, this corresponds to forward products or transactions characterized by an obvious uncertainty as to their realization, such as futures, swaps or other more complex financial products such as Subprimes.

Similarly, Sharia law prohibits transactions based on Maysir. Etymologically, Maysir was a game of chance, in the economic field it refers to any form of contract in which the law of the contracting parties depends on a random event. Thus, each contract must have all fundamental terms (such as the object, price, performance deadlines and identity of the parties) clearly defined on the day of its conclusion. Muslim lawyers also strongly encourage the fulfillment of all preconditions before the contract is signed. This clearly differentiates between

Islamic banks are interest bearing lending institutions, based on the principle that one can buy without paying and sell without holding, which constantly fuels speculation and damages the stability of the banking system.

The calculated risk of an investment is authorized by the Sharia, on the other hand the prohibition of futures contracts involving Gharar and Maysir comes from the fact that the risk of false anticipation of market developments could jeopardize the carrying out of transactions based on uncertainty, speculation, or even the criminal possession of privileged and prior information. Muslim jurists also justify the prohibition of such transactions by the need to direct the available funds to the financing of the real economy, instead of allowing them to fuel financial bubbles devoid of any productivity and useful wealth. (Zerouali, 2009)

(L'islam face au développement économique ", collection économie et humanisme, les éditions ouvrières. Paris 2006, p.52. 10)

The prohibition of illicit investments:

Shariaa also requires that no Muslim may deal with property deemed illicit or Haram. Indeed, there are requirements as to the nature of the activity in which an investment remains in accordance with moral and religious imperatives as dictated by Islam. For example, gambling, activities related to alcohol, pig farming or arms, the film industry that provokes or suggests debauchery and activities related to pornography in particular are prohibited investment sectors in Islam. This principle of exclusion can be found in ethical finance for sustainable development and socially responsible investment.

From a financial point of view, the underlying of all types of contracts must also be Sharia-compliant. Typically, in the context of equity investments, a number of sectors whose activities are considered illegal are to be excluded from the investment universe.

The principle of Profit and Loss Sharing: (3P)

The notion of profit and loss sharing is one of the key elements in the concept of Islamic finance because it reflects the values that Islam transmits to its followers, namely justice, social equality and fraternity. This system is defined by KHAN (1984) as "a financial mechanism that links financial capital to industry and trade without using a

interest". It is therefore a process that allows Islamic financing techniques

to establish commercial exchanges by preventing the interest and this under the rules of the

Sharia law. This technique also allows risk sharing between entrepreneur and investor. Indeed, the latter is directly linked to the smooth running of business during the transaction based on the 3Ps principle, whereas in the case of an interest loan the risk is partly transferred to the applicant.

The principle of profit and loss sharing is used in several Islamic financing techniques such as Mudharaba where the bank will fully finance the project and the contractor will provide his work in order to make the invested amount grow. Profits are shared while losses are fully borne by the bank. Or the Musharaka, a transaction that allows the bank and the entrepreneur to join forces for a project and share the profits and losses. These financing methods are similar to venture capital, where the investor will finance the post-seed phase of the business. They promote the development of businesses and thus economic growth. We quickly understand that this system implies higher risks because, unlike conventional banks, the remuneration of a type of financing depends directly on the return on the operation and therefore on the management of the project by the entrepreneur. Islamic financing can therefore only be viable with strict contractual clauses that allow the bank to ensure that the business runs smoothly. Otherwise, the management of the partner company could disguise its financial results in order to reduce the bank's remuneration. Moreover, in such a system, the criteria for the bank's selection of a project are no longer based on solvency issues but rather on anticipated profitability, which is very difficult to estimate.

« Asset Backing »

Any financial transaction must be implied by an asset to be valid under Sharia. The tangibility of the asset means that any transaction must necessarily be backed by a tangible, real, material and, above all, owned asset.

This principle of "Asset Backing" strengthens the potential in terms of stability and risk control and reassures in particular with regard to the problems of disconnection between the financial sphere and the real world.

The principle of asset tangibility is also a way for Islamic finance to participate in the development of the real economy by creating economic activity in other areas.

The role of the Sharia Board:

Every Islamic financial institution has a two-headed government structure. On the one hand, there are the traditional management structures that look after the day-to-day running of the company. On the other hand, there is an entity specific to Islamic financial institutions, the Sharia Board. This institution, made up of members who are both competent to interpret Islamic jurisprudence and with sufficient knowledge of finance and financial engineering, ensures that the products offered to clients and the way in which the company itself operates comply with Sharia standards.

It would be wrong, however, to consider that the Sharia Board is exclusively concerned with

Religious considerations, to the detriment of any commercial or financial objectives. The Sharia Board makes its decisions based on three concerns:

- Are the terms of the financial contract compatible with Sharia principles?

- Is this investment optimal for the customer?

- Does this investment create value for the client but also for the community?

The Sharia Boards are in no way passive entities. On the contrary, they can have a strong influence on the development of the Islamic financial institutions they advise.

As already mentioned, the Muslim sacred texts provide only the general principles for the organization of the economic and financial life of Muslim society. It is therefore necessary to transpose these ethical norms into concrete, sometimes unprecedented situations. Jurisprudence therefore plays a preponderant role in Islamic Finance. It also explains, to a large extent, the heterogeneity of the universe of Islamic products. Although all specialists in Muslim law agree on the main fundamental principles, there are many differences of opinion on certain points of detail.

Indeed, the opinions and interpretations put forward by the different shariah scholars may differ greatly, thus preventing the harmonization of Islamic financial products or procedures.

This diversity of opinion among the shariah scholars who make up these religious committees could prove to be one of the greatest challenges facing Islamic Finance.

The two-current major centers of Islamic finance - the Persian Gulf and Malaysia - have approached this situation differently, which could in the long term raise major difficulties but which is also a source of great opportunities:

- In Malaysia: creation of a central Sharia Board - attached to the Central Bank - which decides on the conformity of financial products - each institution can have its own Sharia Board, but it must first of all comply with the standards laid down by this central Sharia Board.

- Golf countries: each establishment has its own Sharia Board which decides on the conformity of the products it offers. A certain homogeneity is however ensured by the fact that most Shariah scholars sit on several Sharia Boards at the same time.

Finally, with regard to the Shariah Board, Islamic financial institutions face another major problem: the scarcity of human capital. There are less than a hundred Sharia scholars in the world who are sufficiently trained and competent to serve on a Shariah Board. To get around this difficulty, these specialists in Islamic law are multiplying the mandates in various Shariah Boards. This does, of course, indirectly ensure greater homogeneity in the decisions of the various Islamic committees.

However, this can only be a temporary solution and, moreover, it can lead to situations of conflict of interest.

(P. Moore, « Islamic Finance: partnership for growth”, Euromoney publications, Londres 1997)

CHAPTER III: DATA AND METHODOLOGY

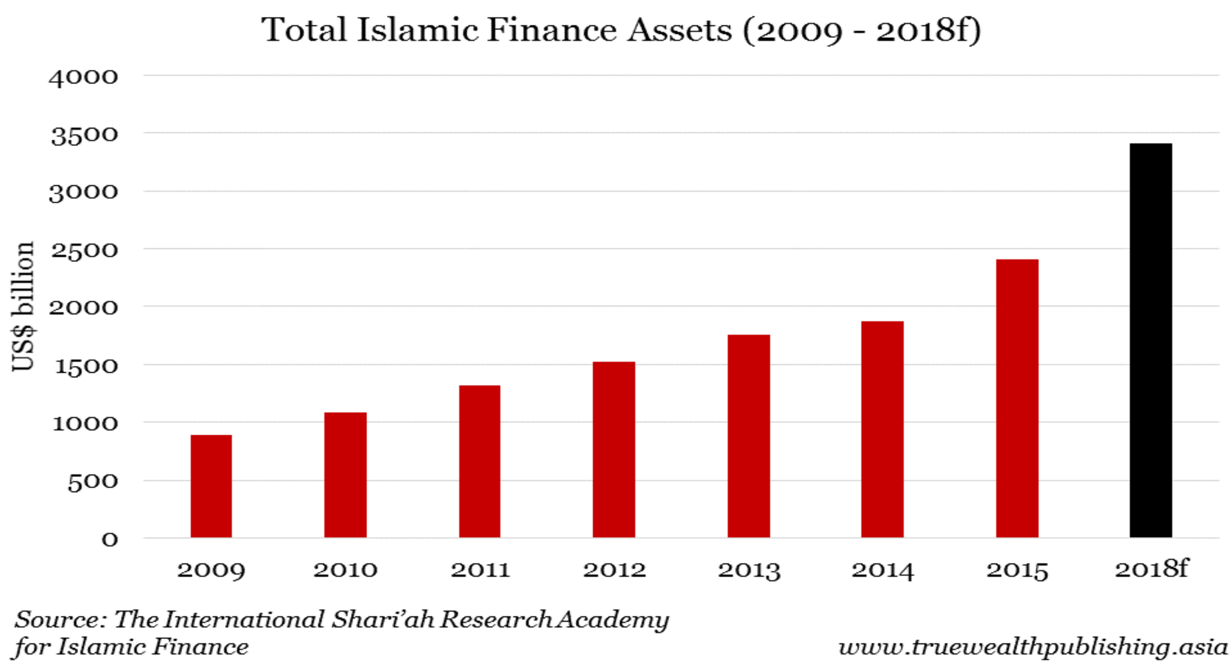
B) The Growth and Products of Finance Islamic

1. The Value of Eastern and Western Islamic Finance

What does this finance value?

Since its inception, Islamic finance has grown steadily and has been able to develop throughout the world. It has experienced massive growth over the last 20 years. The International Monetary Fund, the World Bank and other international financial institutions estimate that the assets of Islamic banks have increased considerably to reach 1800 billion dollars in 2013 with an increase of 16% per year between 2003 and 2013. Today Islamic finance is worth more than 2000 billion dollars worldwide. Islamic banks are home to more than 40 million customers worldwide. According to in-depth studies carried out by experts, this sector will further double in volume to reach 4000 billion dollars in 2020.

Islamic finance is not only for Muslims, it is based on universal moral principles of responsibility and an absence of speculation. However, it is Muslims who are the primary target group.



As can be seen, Islamic finance has experienced massive growth over the last nine years and has almost tripled in volume with a continuously increasing growth rate. According to studies conducted by experts, Islamic finance will exceed 4500 billion by the year 2022.

Islamic finance products

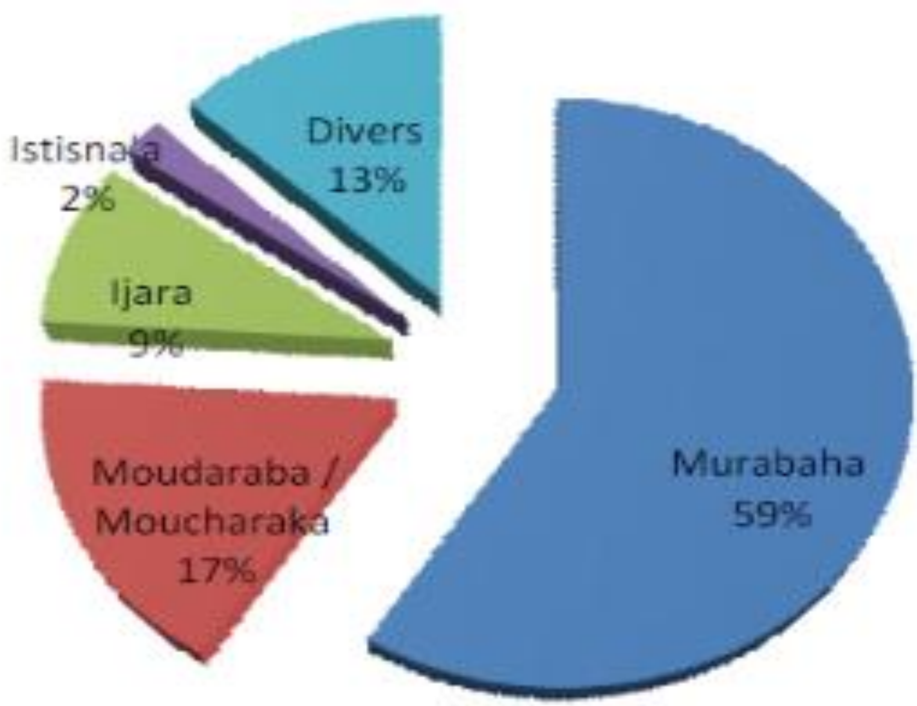
In the course of its development, Islamic finance has created several products or instruments to meet the needs of their clients. Some of these instruments are pre-Islamic Arab constructions originally developed for the needs of the aforementioned city-states.

Given the number of contracts in existence today, we have decided to mention the most used and well-known contracts in the Islamic finance sector. These have played a leading role in the growing development of Islamic finance. The majority of Islamic finance experts agree that there are two types of Islamic financial instruments: financing instruments and participatory instruments.

- Financing instruments: Murabaha, Ijara, Al Salam and Istisna.

- Participatory instruments: Moudaraba and Mousharaka.

This graph gives us an overview of the trend in contracts used in this sector:



Moral report on money in the world (2005), Association of Financial Economy.

Financing instruments:

Murabaha

The Murabaha is a contract of sale, between a seller and a buyer, whereby the latter buys the goods required by a buyer and sells them back to the buyer at a premium price. The profit (profit margin) and the repayment period (usually instalments) are specified in an initial contract. This allows a customer to acquire a property without taking out a loan with interest. Sales conditions such as the profit margin for the vendor or repayment details are predefined between the different parties.

I'ijara

I'ijara is a medium-term financing method whereby the bank purchases machinery and equipment and then transfers the usufruct to the beneficiary for a period during which it retains title to the property. I'ijara is the equivalent of a leasing contract. However, there are some differences that should be pointed out. What makes it different from financial leasing is the absence of penalties in case of non-payment or late payment, as the penalties that would arise for these reasons would be considered as interest, and Islamic finance refutes this procedure. The conditions of the contract are predefined, in case of modification of one of the conditions, even with the agreement of both parties, a new contract has to be made with the new conditions.

Al Salam

This technique consists of paying in advance for predetermined goods. It can, for example, be used to finance a company's cash requirements. In this way, the financier pays the full price of the asset in advance, for a deferred delivery date. In order for this technique to be Sharia-compliant, full payment for the asset must be made upon signature of the contract and the delivery date must be clearly determined.

A full prepayment often allows the financier to acquire the asset at a reduced price. The price is calculated on the basis of a reference index (such as LIBOR) plus a margin. At the time of delivery, the financier may sell the asset to its customer for a higher price or, at the same time, enter into a bai al Salam contract with a third party (under a separate contract) to resell the asset at a higher price.

Istisna

Istisna is a progressive means of financing. It is a manufacturing (or construction) contract in which the participant (seller) agrees to supply the buyer, within a certain period of time and at an agreed price, with specified goods after their manufacture (construction) in accordance with the specifications. Indeed, the seller agrees to supply the property within a certain period and at a previously agreed price according to the conditions issued when the specifications were drawn up. In return, the buyer undertakes to pay the seller according to the progress of the work.

Participatory instruments:

Mudaraba

Mudaraba is a financing technique used by Islamic banks. The bank plays the role of the investor (Rab el Mal). It undertakes to fully finance the project. In return, the contractor (Mudarib) must manage the project. Remuneration is based on a percentage of the entrepreneur's profits fixed in advance. Any losses must be borne by the capital provider alone. The entrepreneur renounces variable remuneration for his work. Today, Mudaraba can be applied to various economic activities.

Mousharaka

The Musharaka is a contract between the bank and the client under which the bank and the client each contribute capital for a specific project. The partners contribute the funds, but only one of them is in charge of managing the project.

The profit-sharing conditions are predefined. The distribution of the profits made is on a pro rata basis. Repayment is made according to a depreciation schedule which includes, in addition to the principal capital, the profits earned by the bank for this operation. Losses are shared according to the capital invested.

Sukuk

Sukuk is the Islamic equivalent of a bond where the interest becomes a prearranged profit with virtually no risk. This form of bond is particularly used for real estate financing.

Sukuk allows you to earn a return on an investment by avoiding the use of interest. The investor owns a share of ownership in an underlying asset. In exchange, this share provides the investor with income. To do this, the issuing company must identify assets for sale in order to offer them to Sukuk investors. This operation is carried out with the intervention of an ad hoc company. The investors will then receive the usufruct of these assets in proportion to their investment. The risks of this operation are shared. The investors bear the credit risks of the issuer and the risks related to the assets are borne by the ad hoc company. The particularity of Sukuk is that they can be listed and rated according to the target market.

Arbun

Amount taken as security for the performance of any future contract. The buyer pays the seller a security deposit for the right to conclude or cancel the sale. In case of non-performance of the contract the seller has the right to keep the deposit as compensation. If the sale is indeed concluded the amount of the deposit is included in the purchase price.

However, this type of transaction is not accepted by all the different Muslim schools of thought. On the one hand, the Hanafite school believes that the Arbun is a form of corruption and the Shafiite and Malikite schools argue that this kind of contract because it increases the risk of deception.

C) Islamic finance in the face of economic and financial crises

The origins of economic and financial crises

The history of the crisis

The crisis of capitalism is the situation where we find ourselves at the present time, we can use it to define the state of our financial system. In order to understand why and how it has become so questionable, we will navigate through the past back to the very beginning of its evolution.

- From 1815 to 1914 gold or silver coins were the currency of merchant transactions. Their weight represented their value. The law of August 12, 1870, will put in place the banknotes "having legal tender". They could be exchanged for their value in coins (gold or silver). Moreover, the use of real money allowed to avoid inflation, to stabilize wages and to control prices. Indeed, the existence of real money (coins) as a counterpart limited the issuance of bank notes.

- At the end of World War II. Allied nations sign the Bretton Woods Agreement. From then on, the dollar becomes the standard currency. Indeed, it will be the only currency indexed to gold and will serve as a reference for the others. This is how the international monetary system was created. On the other hand, these agreements led to the creation of the World Bank and the IMF.

- On August 15, 1971 President NIXON under the "New Economic Policy" will suspend the convertibility of the dollar into gold, John Connally Secretary of the Treasury, will declare: "the dollar is our currency and your problem".

- On 3 January 1973 Valéry GISCARD D'ESTAING, then Minister of Finance, introduced the "POMPIDOU-GISCARD" law. This law removed the Banque de France from its public service role. Thus, the Treasury will no longer be able to discount its bills with the Banque de France. From now on, government bonds will be issued on the financial markets.

- In 1994 Blythe MASTERS perfected credit derivatives by "inventing" CDS, which Warren Buffet called "financial weapons of mass destruction". She also developed a new hedging instrument: the CDO (collagenized debt obligation). This will allow companies to securitize their debts. It consists of the transformation of debts (divided into tranches) into bonds. This process will be carried out via a special purpose vehicle (SPV).

- On November 12, 1999, the Americans will pass the Gramm-Leach-Bliley Act. It will replace the Glass-Steagall Act passed in June 1933 under Roosevelt's presidency. This measure will put an end to the separation between deposit banks and merchant banks. In addition, it will allow merchant banks to merge with insurance companies. Europe will follow suit by regulating as well.

- In 2007, CDS (Credit Default Swaps), in which, among other things, "subprime" loans granted to Americans in order to access home ownership, were used and distributed on a massive scale. This will lead to mistrust between banks. Indeed, they will no longer lend on the interbank money market. They will grant less credit to companies and individuals.

- In 2012, Greece is almost bankrupt. Most European Union countries are too indebted.

The gradual decorrelation of the value of money and its underlying asset (gold) has allowed financial players to take risks without due consideration. Indeed, the merger of deposit banks and merchant banks, as well as the construction of 23 risk transfer instruments have had very serious consequences on our economic system. We will try to explain this later in our study.

The subprime crisis

This crisis began in July 2007 and continued to grow until the fall of 2008. This crisis is largely due to the willingness to give mortgages to small, high-risk households to face possible losses. These bankers had securitized a large number of these "doubtful" loans. The main problem was that the real value of the foreclosed assets was less than their purchase value. Indeed, the multiplication of these defaults led to too much supply in the face of too little demand on the real estate market. The banks found themselves owners of low-value, unprofitable real estate that cost them billions and billions.

There is a difference between the French mortgage and the American mortgage is that in the United States the bank owns the property until the loan is repaid, whereas in France the bank only has a preferential right on the property which will be granted to it in case of non-payment by customers.

Some American banks held assets that were largely based on securities and bonds issued in the subprime market, but as a result of the financial crisis these banks had to resign themselves to bankruptcy like the giant Lehmann brothers. Although it was an American crisis, it caused contagion in most other banking markets because of the banks that held subprime bonds.

The debt crisis

The debt crisis is the least complex form of the debt crisis in relation to its spread. Indeed, although much is unknown about this crisis, one thing can be confirmed: most states are over-indebted and the majority of them will never be able to repay their debt (Greece in particular). Debts, it should be remembered, are held by other states, banks, insurance companies and individuals through life insurance policies taken out in euros.

Indeed, the majority of the European Union states have gone into debt. The main concern raised by this information is that some nations have gone into debt beyond their means. If we take the case of Spain, we can see that its public debt has risen from 54% to 62% of GDP between 2009 and 201013. Moreover, its trade balance was negative by 52 billion euros. This crisis is different from those we have known. Indeed, it is not the result of the bursting of a speculative bubble, but rather of a failure of management on the part of governments. That is why he describes this crisis as a financial crisis in its early stages, which has now turned into an economic crisis.

Islamic Finance a topical issue in the light of the Global Financial Crisis

As we have observed, Islamic finance allows for the strengthening of equity financing. It also makes it possible to return to an economic system that is closer to reality.

We will see what are its potential and limitations

Islamic Finance to conquer the world.

Although only a grain of sand in traditional financial transactions, Islamic finance is gaining momentum as its practices extend beyond the confines of countries where Islam is the official religion.

Islamic finance in its modern sense is extremely young. It emerged in the 1960s almost simultaneously in Egypt with the local bank Mit Ghamr and in Malaysia with the first pilgrimage savings fund. It therefore only took a little over half a century for it to cross the symbolic trillion-dollar mark. The comparison made by the International Monetary Fund of the post-crisis performance (2008) of this niche market is even more interesting. According to this study published in 2010, while the conventional sector grew by 4% in 2009, minus 1% in 2010 and 6% in 2011, the Islamic finance sector grew by 9%, 10% and 22% respectively during the same period. In 2016, Islamic financial institutions-controlled assets worth more than $1.6 trillion. This sum, which is believed to be considerable, represents only a small fraction of the total value of global financial assets. In these circumstances, it is not surprising that Islamic finance is attracting the attention of the largest financial operators. As early as 2005, HSBC, BNP Paribas and other major banks opened subsidiaries using Islamic financing products

Socially responsible investment

The contemporary resurgence of Islamic finance - after an initial emergence in medieval times - on a global scale can challenge socially responsible investment (SRI) in its original ethical foundations and thus contribute to finding in this "dialogue of cultures" the inspiration that will help to overcome the excesses of a failing financial system.

However, the lack of legibility of the ethical criteria used by investors underlines the complexity of taking into account the ethical question in financial choices. Let us look, for example, at the way ethical investors treated the case of the multinational Chevron. In 2013, a report by the NGO Human Rights Watch condemned the "ethnic cleansing" carried out by a fringe of the Burmese population against its Muslim minority, the Rohingyas. This report denounced the massive human rights violations perpetrated by the Burmese military government over the past decade. Chevron, like other multinationals in the oil industry, has been subject to legal proceedings for its involvement in these state crimes. In response to these violations, some fund managers and index providers, the Dow Jones Sustainability Indexes, have chosen to exclude the Chevron group from their investment universe.

Islamic Finance a Relevant System for a World in Crisis

Islamic finance in the face of the crisis

The international financial system is now suffering, with its umpteenth crisis, from the excesses of indebtedness and the exuberance of global financial engineering. Faced with this critical situation, Islamic finance has stood out for its resilience to the crisis of autumn 2008, which has drawn the attention of specialists and researchers, who have questioned the reasons for its immunity, as well as the possibility of considering it as a potential alternative to the current system. This work essentially aims to position Islamic finance at the heart of this crisis, to explain its contributions to the international financial system and to analyses the various difficulties that still hinder it. This study is a synthesis of the work carried out on Islamic finance and a compilation of the opinions of bank managers and specialists in Islamic finance.

The need for reform of the international financial system is obvious so that crises such as the current one does not recur. In the United States, various plans have followed one another, some of which soon showed their limits and were abandoned.

In the midst of this crisis, we hear a lot about Islamic finance, and it is credited with being able to withstand the crisis of autumn 2008. Several symposiums, seminars and round tables have been organized, some major institutions of higher education have even created training courses on the discipline, and all this to understand the philosopher's stone of this troubling mystery. This appetite for knowledge is not always devoid of ulterior motives, such as that of attracting capital from the Middle East, although some are interested in it as part of a much broader, serene and disinterested reflection on responsible money and in order to examine an original way of responding to a more ethical sense of money.

In order to compete with conventional finance, Islamic finance has to meet the challenges of performance at an acceptable level. Its implementation generates non-negligible costs stemming from the application of its principles and its restricted universe of action due to the application of exclusion criteria.

Islamic financing means first and foremost any provision of financial resources governed by Shariah law. With regard to the nature and methods of financing, in principle, any financing technique that respects the prohibition of interest and speculation is acceptable. These rules lay the foundations for the Islamic financial system, the alternative being participatory financing based on profit and risk sharing. However, it can be observed that Muslim economists, lawyers and financiers, after a century of breaking with their legal heritage, have had to face the need to devise Islamic alternatives to interest financing. Islamic banks and the Islamic subsidiaries of conventional banks have thus designed legal-financial mechanisms based on concepts called Mudaraba, Mousharaka, Mourabaha, *L'ijara*...

Theoretically, there are a large number of Islamic modes of financing, and the door remains open for the creation of new formulas, provided they comply with the rules of Sharia law. In the same framework, we cite sukuk, which is the Islamic equivalent of a bond where the interest becomes an expected profit. This form of bond is particularly used for the financing of real estate and infrastructure projects. The sukuk market has grown dramatically in recent years, from less than US$5 billion in 2002 to more than US$40 billion in 2007 (Soumaré, 2009). Despite its strong growth in recent years, sukuk remains a complex financing instrument that can be based on any of the forms of financing described above.

Undoubtedly, one of the biggest challenges is to create a framework for the management, supervision and regulation of Islamic banks. First of all, not all countries where Islamic banks exist have the same approach. One of the two main approaches - applied by the authorities in Malaysia and Yemen, for example - is that Islamic banks should be subject to an entirely different regime of supervision and regulation by the central bank from that applied to conventional banks. The latter recognizes the special nature of Islamic banking activities, but prefers to place them under the same central bank supervision and regulation regime as for conventional banks, with slight modifications and special guidelines that are usually formalized through central bank circulars. Bahrain and Qatar are examples of countries that apply this form of supervision and regulation.

However, since the late 1990s, the Islamic banking world has intensified its efforts to standardize regulation and supervision. The Islamic Development Bank (IDB) plays a key role in developing internationally acceptable standards and procedures and in strengthening the architecture of the sector in various countries.

Is Islamic finance an alternative to the current financial system?

The current economic situation is so unbalanced that we need to be aware of the failure of the current financial system, both rationally and morally. The official financial and monetary dogma apparently defends "liberal" ideas, but in reality, we see that it justifies a huge system for the benefit of the wealthy.

The profit-sharing system can be a viable model and an alternative to the usurious system. It is both an opportunity for sustainable development and a responsibility for all.

Several research studies have shown the feasibility and viability of the Islamic financial system. This has also been evidenced by the successful activities of Islamic institutions in several countries. Nevertheless, Islamic finance faces a number of internal and external challenges.

Although the basic principles of Islamic finance may promote ethics in banking practice, this does not mean that the Islamic financial system is immune from the abuses to which the conventional system is exposed. It is therefore necessary to establish appropriate governance, regulatory and risk management arrangements.

Financial globalization represents a major challenge for Islamic finance since Islamic financial institutions are required to comply with certain Islamic rules while conventional financial institutions are not subject to any restrictions, which has a negative impact on the competitiveness of Islamic banking institutions.

The establishment of Islamic finance requires changes in banking law, which is not to the liking of some monetary and regulatory authorities within Muslim countries.

Finally, among the major challenges facing the Islamic system are the establishment of effective regulation and supervision that can enable better risk management, safeguard depositors' interests, promote market stability and make a significant contribution to the international financial system as a whole (Boudjellal, 2010).

Although Islamic finance has not yet experienced serious crises, good governance and effective risk management remain imperatives as financial globalization intensifies and funds diversify their investment instruments and vehicles.

CHAPTER IV: CONCLUSION

Throughout my work, I have focused on the different aspects of Islamic finance, its sources, origins and the different products offered to deal with all financial crises.

To begin with I looked at the sources, origins and principles of Islamic finance.

First of all, I began my report with an overview of the sources and origins of this finance. These are mainly based on the Koran, the Sharia and the Sunna, which are among the pillars of Muslim religion and ethics. Then I explained the principles of Islamic economics which are the principle of dual ownership, the principle of economic freedom within a limited framework and the principle of social justice. And finally, I defined the principles on which Islamic finance is based.

I have drawn up my plan in such a way as to introduce the emergence of the financial crises which were the reason for thinking of creating a modern Islamic finance in order to meet the needs and requirements of the economy which conventional finance has not been able to satisfy for some time.

Then we have seen what Islamic finance currently weighs in the world thanks to its financing techniques. I mentioned the financing instruments (Murabaha, Ijara, Al Salam and Istisna). And participatory instruments (Mudaraba and Mousharaka), as well as other instruments.

Finally, there was mention of the financial crisis that gave rise to the revolution in Islamic finance, which is the very subject of my report. The crisis of capitalism is the very origin of the modernization of Islamic finance, and in order to deal with it and with potential future crises a new system had to be put in place.

Islamic finance seems a suitable alternative to the current system. However, it has a responsibility to learn the lessons of the crisis and not to repeat them. It is therefore necessary to foresee future dysfunctions in this system so as not to suffer the same failures. Nothing can be more fatal to it than blind mimicry.

In addition, the solution to the challenges encountered is the adoption of best practices in control and accounting for the development of the sector. This involves solving two major problems:

understanding the sector and striking a balance between effective control on the one hand and legitimate market aspirations on the other. This dilemma can only be resolved if the central bank and the targeted institutions intensify their cooperation and create a favorable context.

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