DEBUNKING SOME COMMON MYTHS OF ISLAMIC FINANCE

Islamic finance is one of the fastest-growing sectors in the world, which should in theory target a vast portion of the global population. However, the sector has largely been untapped, by believers (and non believers) of the faith. Despite this, Islamic finance is expected to reach $3.4 trillion in assets globally by 2024, up from $2.5 trillion in 2018. UK's profile as a leading western center for Islamic finance has continued to grow in recent years, withthe Islamic Finance Country Index ranking it 17th out of 48 countries, placing it first in Europe & first among non-Muslim-majority nations, ahead of US. So where is the sector going wrong? In this blog, I share some common myths about Islamic finance that must be debunked.

1450+ ISLAMIC FINANCE INSTITUTIONS GLOBALLY

THE ISLAMIC FINANCE INDUSTRY'S ASSETS IN 2018

=$2.5 TRILLION

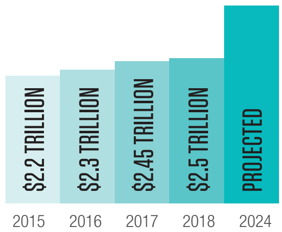
AVERAGE ANNUAL GROWTH RATE 7.1%

1 OUT OF 4

PEOPLE IN THE WORLD

ARE MUSLIM

=1.8 BILLION



TOTAL ISLAMIC FINANCE ASSETS FORECASTED TO GLOBALLY GROW TO

$3.4 TRILLION BY 2024

46% OF UK MUSLIM CONSUMERS HAVE NOT USED ISLAMIC FINANCE

120+ ISLAMIC FIN-TECH FIRMS GLOBALLY COVERING A RANGE OF SOLUTIONS

For people new to the space or hearing for the first time about it, Islamic finance (IF) is formed on the principles of Shariah, i.e. Islamic law, which outlines acceptable risks, details profit-sharing, prohibits interest payments, and encourages ethical investments for the greater good of society.

A few months ago, Muslims all over the world celebrated Eid al-Fitr, a religious holiday marking the end of the holy month of Ramadan. Throughout the month-long period (in 2020 it was 23 April to 23 May), Muslims across the globe observe a strict fast from dawn to dusk, accompanied by prayers throughout the day. I have very fond memories of these celebrations growing up and visiting my friends to exchange greetings and eating the world-famous biryani (a meat and rice dish), often accompanied by seviyan, a quintessential Eid desert containing sweet roasted vermicelli made in milk and sugar. But besides the food, the focus on socialising and closer connection with our faith, there is something else about Ramadan, that is less well known by outsiders.

Ramadan is also a time for Muslims to donate to charity or contribute to the community. One of the central tenets of Islam focuses on contribution to social justice through redistribution of wealth. On Eid, there is an even stronger focus on charity and Muslims are expected to pay their annual zakat – a religious tax equivalent to 2.5 percent of a person's wealth each year. The Muslim Charities Forum (MCF) estimates that every year in Britain during Ramadan, Muslims donate an estimated £100 million to charities. Yet strangely, 46 percent of Muslim consumers in the UK have never used an Islamic finance provider before.

5 CORE PRINCIPLES OF ISLAMIC FINANCE

ETHICAL
NO INVESTMENTS ARE PERMITTED IN FORBIDDEN INDUSTRY'S ('HARAM') – ALCOHOL, GAMBLING, PORNOGRAPHY, WEAPONS.

JUST
NO SPECULATIVE EXPLOITATION FROM (LEGAL) UNCERTAINTY OR ABUSE OF UNFAIR ADVANTAGES.

CERTAINTY
THERE CAN BE NO ELEMENTS OF UNCERTAINTY IN ASSET QUALITY, PRICE OR DELIVERY.

RIBA
'INTEREST' IS NOT PERMITTED TO BE PAID OR RECEIVED.

TANGIBLE
ALL FINANCIAL PRODUCTS MUST BE TANGIBLE OR ASSET-BACKED.

Despite the tremendous growth of this sector, even in this era of information and awareness, there are many misconceptions about Islamic finance, hampering its growth and adoption in today's exciting financial services ecosystem. Let us look at some of the common fallacies:

MYTHS OF ISLAMIC FINANCE

Islamic Finance is only available to Muslims

This is not true, and IF products have been available to everyone irrespective of religion, caste & creed since inception. This has been observed over the last millennium across some of the system i.e. Islamic finance often leads to this fallacy but, there is no limitation to type of consumers that can avail these products.

No underlying differences between Islamic finance and conventional finance

Another common misconception since there exist many differences between the 2 types of finances. There are instances where Islamic finance is more market efficient and ethical; significant amounts of debt and risk trading in financial markets expose economies to instability, and this can lead to unsavoury economic implications.

Islamic finance is purely focused on charity

Charity is one of the core tenets of Islam but that does not mean that IF products are not meant to make a profit. In some areas, IF products have been performing better than their Conventional Finance counterparts in terms of returns. For instance, Shariah-compliant funds usually scope out investment in companies that are high on debt and risk.

Only invests in Equities

Shariah-compliant funds invest heavily in equity as this is most readily available. However, there are many other financial asset classes that are available like real estate, commodity funds and Sukuk, which are Islamic bonds that provide a certificate of ownership allowing the investor to receive profit generated by the underlying asset.

More expensive than conventional finance

The cost of Financing is typically linked to the risk exposure or 'credit' involved, and this is no different for Islamic Banking transaction. Initially, Islamic finance has seen operating in a 'niche' market and this meant that prices were marginally higher, but now as the availability of these products in the market is increasing both in size and scope, the prices are very competitive.

The last decade has seen an increase in the number of institutions in the UK offering IF services. In my opinion, Islamic finance industry needs to raise awareness and actively manage these myths in order for the industry will be able to attract customers for either its Shariah-compliant ethos and/or for its ESG (environmental, social and corporate governance) inclusive principles.

For more information about Islamic Finance, read our report, or reach out to the author of this blog, Rahul Lalwani.

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