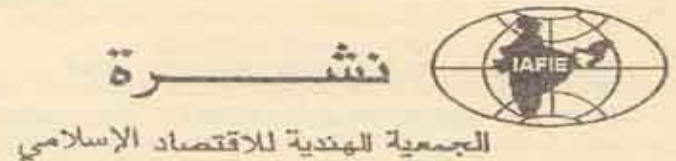


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Role of Sukuk (Islamic bonds) in Islamic Capital Markets

A *sukuk* has economic characteristics similar to those of a conventional bond, but is structured so as to be compliant with Shari'a law and can be sold to Islamic investors who are prohibited by Shari'a law from investing in conventional debt securities.

Sukuk, sometimes referred to as Islamic bonds, are better described as Islamic investment certificates. This distinction is as crucial as it is important; *Sukuk* should not simply be regarded as a substitute for conventional interest-based securities. The aim is not simply to engineer financial products that mimic fixed-rate bills and bonds and floating-rate notes as understood in the West, but rather to develop innovative types of assets that comply with *Shari'ah* Islamic law.

The essential underlying concepts of *Sukuk* are:

- transparency and clarity of rights and obligations;
- that income from securities must be related to the purpose for which the funding is used, and not simply comprise interest; and
- that securities should be backed by real underlying assets, rather than being simply paper derivatives.

Islamic fixed-income securities are already emerging as a significant class of asset, and are as potentially important for the Muslim investor as conventional bonds are for investors generally. In addition, for non-Muslims who already own conventional bonds, the acquisition of *Sukuk* introduces a new asset class into their portfolios, bringing further welcome diversity and possibly reducing risk.

Multinational corporations, sovereign bodies, state corporations and financial institutions use international *Sukuk* issuance as an alternative to a syndicated financing. *Sukuk* represents an undivided proportionate ownership interest in an asset with the corresponding right to the Islamically acceptable income streams generated by the asset. These current income streams are established and translated into tradable securities, which can be issued in the capital markets for investors' participation.

Sukuk allow investors to lock in either medium to long-term fixed income returns or variable rates of return, which are adjusted at periodic intervals and which, by virtue of being tradable, provide investors with the flexibility to exit the investment at any time prior to completion of the full investment holding period.

Benefits and features of *Sukuk*

- They are tradable *Shariah*-compliant capital market products providing medium to long-term fixed or variable rates of return.
- The credit quality of *Sukuk* instruments is assessed and rated by international rating agencies, which investors use as a guideline to assess risk/return parameters of a *Sukuk* issue.
- They are characterised by regular periodic income streams during the investment period with easy and efficient settlement and also provide the possibility of capital appreciation of the *Sukuk*.
- The existence of a secondary market provides liquidity to the *Sukuk* instruments.

Generally *Sukuk* are asset-backed, stable income, tradable and *Shari'ah* compatible trust certificates. The primary condition of issuance of *Sukuk* is the existence of assets on the balance sheet of the government, the monetary authority, the corporate body, the banking and financial institution or any other entity which wants to mobilise financial resources. The identification of suitable assets is the first, and arguably most integral, step in the process of issuing *Sukuk* certificates. *Shari'ah* considerations dictate that the pool of assets should not solely be comprised of debts from Islamic financial contracts (e.g. *Murabaha*, *Istisna*).

(Brian Kettell is a Trainer in Islamic banking. Details of his courses can be found on www.islamicbankingcourses.com)

Al-Madina launches India-dedicated fund

Al-Madina has launched an India Fund for West Asian investors, including NRI. This is a first such regional investment vehicle dedicated towards Indian equities. The subscription for the \$171-million fund would close December 21 and the maximum of subscription in the fund units would be in 1,000 units. Al-Madina, a Shariah-compliant investment intermediary located in the Persian Gulf region and is backed by Gulf Bank National Investment Company M S Holding and Gulfinvest International.

HSBC Amanah unveils Shariah-compliant funds

HSBC Amanah, the global banking giant's Islamic finance unit, announced the launch of three Shariah-compliant mutual funds, which it expects would provide long-term returns of 7 to 10 per cent a year. The three equity funds will invest separately in the Americas, Europe and Asia-Pacific and will be run using a 'manager of managers' model to ensure superior returns. The funds would open for subscription on December 13 with a threshold investment of \$10,000 and be available at all HSBC outlets. Investors will bear an entry cost of 3.25 per cent apart from a 1 per cent management fee. The bank intends to distribute at least 85 per cent of the returns annually.

IFSB calls for consolidation of Islamic Banking industry

There are some 300 Islamic banks and financial institutions worldwide but they account for only 1 per cent of global banking assets, said a statement of Islamic Financial Services Board, or IFSB. Islamic banking is largely concentrated in the Middle East and Southeast Asia but it is making inroads into Europe and the U.S. But only one Islamic bank in the world - Al-Rajhi Banking and Investment Corp. in Saudi Arabia -- has capital exceeding \$500 million, and 10 others with more than \$200 million. IFSB welcomed a proposal by the General Council for Islamic Banks and Financial Institutions to set up a \$1 billion Islamic mega bank, saying it will help boost the industry's market share in the global financial system. The council has said it hoped to launch the bank next year and is looking at Bahrain, Qatar, Dubai and Malaysia as possible host country. The Bahrain-based Albaraka Banking Group, the Islamic Development Bank and Malaysia's Islamic Bank are among key shareholders.

Islamic finance to double market share in 10 years

Islamic finance could more than double its share of the financial services market in many Muslim countries in the next decade, according to estimates from a key industry body. The expectations are that in the coming 10 years, 60 per cent of financial services in the GCC and perhaps some countries, but not all, in the Middle East will be in the form of Islamic finance, IFSB said in a statement. The absence of a money market, which conventionally has very liquid, short-term, interest-bearing debt, is seen as a major obstacle to the development of Islamic banking.

KFH, Deutsche Bank Launch \$50 m Equity Fund

Bahraini provider of Shariah-compliant financial and investment services Khaleej Finance and Investment Co (KFIC) and German banking group Deutsche Bank AG have launched a \$50 m five-year investment equity fund. The equity fund will be linked to the Dow Jones Islamic Market Index. The fund will be capital protected to help investors benefit from the strong performance of the index without any risk to their initial capital. The fund requires an initial subscription of a minimum sum, worth \$250,000 (213,800 euro). After reaching maturity, the fund will total \$100 m, with a minimum additional 8.0 pct return on investment, and not less than 90 pct participation of the average monthly performance.

GFH to Increase Capital by 30 pct

Bahrain-based Islamic investment bank Gulf Finance House (GFH) will increase its capital by 30 pct. The increase to \$195 m from \$149 m will be carried out via an issue of some 136.16 million shares, at a price of \$0.33 a share and a premium of \$1.03. The move is in line with the bank's strategy to expand its business activities and participate in investment opportunities.

Indonesia Shariah banking grew by 40% in 2005

Despite economic downturn and rising inflation, the Indonesian central bank remains optimistic that growth of Shariah banking will remain robust. Currently, growth has exceeded the 2005 target of 40 percent. According to the central bank's report, Shariah banking grew by 88.6 percent last year, with total assets of Rp 14 trillion and total financing of Rp 10.9 trillion. This year, the volume of Shariah banking assets is expected to reach Rp 24 trillion, or some 1.8 percent of the national banking sector.

HSBC Prepares Islamic Syndication Package

The Islamic unit of Hong Kong and Shanghai Banking Corporation Limited (HSBC) has been preparing three syndication packages at the value of US\$150 million to US\$900 m. The three syndication packages would be in addition to the previous syndication loans it had arranged for Pertamina early this year, at the total value of US\$322 million. Islamic Division of HSBC said that the bank was on negotiation process with three local corporate on the three syndication packages. On the syndication loan, HSBC has invited some investors from the Middle East to join on package scheme, with the value of US\$50 million to US\$300 million per package.

RHB unit to launch fourth Islamic fund

RHB Unit Trust Management Bhd, will launch its fourth Islamic fund before end of this year while emerging market funds are in the pipeline for next year. The proposed Islamic fund is a closed-ended fund with RM100 million in size. RHB Unit Trust's first Islamic fund is the RHB Mudharabah Fund, which was launched in 1996 with the current fund size of RM102.7 million. The second one is the RHB Islamic Bond Fund, which was launched in 2000 with the current size of RM150 million; while the RHB Islamic Growth Fund was launched last year with a current fund size of RM83.49 million.

New Books and Articles

Books:

1. MUNAWAR Iqbal, & WILSON, Rodney (eds.), *Islamic Perspective on Wealth Creation*, Edinburgh: Edinburg University Press, 2005, 294pp.
2. MAURER, Bill, *Mutual Life, Limited, Islamic Banking, Alternative Currencies, Later Reason*, Oxfordshire: Princeton University Press, 2005, 256pp.
3. RAPOPORT, Yossef and MORGAN David (eds.), *Marriage, Money and Divorce in Medieval Islamic Society*, Cambridge: Cambridge University Press, 2005, 152pp.
4. ROY, Oliver, *Globalized Islam: The Search for a New Ummah*, London: C. Hurst & Co. 2004, 349pp.
5. SCHAEBLER, B. & Stenbeerg, L., (ed.), *Globalization and the Muslim World: Culture, Religion and Modernity*, New York: Syracuse University Press, 2004, 400pp.
6. YANAGIHASHI, Hisoyuki, *A History of the Early Islamic Law of Property: Reconstructing the Legal Development, 7th-9th Centuries*, Leiden: Brill 2004, 329pp.
7. ZAYAD, Nasr Abu, *Rethinking the Quran: Towards a Humanistic Hermeneutics*, The Netherlands: University of Humanistic Press, 2004, 63pp.

Articles:

1. PEERZADE, Sayed Afzal, "Towards Self-Enforcing Islamic, Tax System: An Alternative to Current Approaches" *JKAU: Islamic Econ.* Vol. 18, No. 1, pp. 1-3
2. HASSAN, Abul "Islamic Economics and the Environment: Material Flow Analysis in Society-Nature Interrelationships", *JKAU: Islamic Econ.* Vol. 18, No. 1, pp. 4-17.
3. CHACHI, Abdelkader "Origin and Development of Commercial and Islamic Banking Operations", *JKAU: Islamic Econ.* Vol. 18, No. 2, pp. 1-3.
4. HASAN, Zubair "Treatment of Consumption in Islamic Economics: An Appraisal", *JKAU: Islamic Econ.* Vol. 18, No. 2. pp. 4-29.
5. NISAR, Shariq, "Islamic Banking in India: Need of the Hour", *Islamic Business & Finance*, Issue 1, November, 2005, Dubai, UAE.
6. NISAR, Shariq, "Islamic Banking: Potential for Growth", *Chartered Financial Analyst*, Hyderabad, India, December 2005, pp. 66-71.

Current Researches

Islamic Banking and Finance in Theory and Practice: The Experience of Malaysia and Bahrain

Abdus Samd, Norman D. Gardener, and Cook Bardley, J., *American Journal of Islamic Social Sciences* (Herndon, VA), Vol.22, Np.2, 2005, pp.69-86

The paper identifies the relative importance of various Islamic financial products, in theory and in practice, by examining the financing records of the Bank Islam Malaysia (Berhad) and the Bahrain Islamic Bank.

The seven Islamic financing products considered alternatives to interest-based conventional contracts are included in this analysis. These include; *mudharabah* (trust financing) *murabaha* (equity financing), *ijarah* (lease financing), *murabaha* (trade financing), *qard al-hasan* (welfare loan) *bay bi al-thaman al ajil* (deferred payment financing), and *istisna* (progressive payments). Among these financial products, *mudharabah* and *musharakah* are the most distinct. However, the paper shows that the use of these two products are quite minimal compared to *murabaha*. For example, the average *mudharabah* is 5 per cent of total financing, and the average *musharakah* for the two Islamic banks is less than 4 per cent of the total finance and advance. The average *qard hassan* is about 4 per cent, while *istisna* does not yet exist in practice. *Murabaha* is most popular and dominates all other models of Islamic financing. The average use of *murabaha* is over 54 per cent. When the *bay bi al-thaman al-ajil* is added to the *murabaha*, the percentage of total financing is shown to be 82 per cent.

Authors explore some possible reasons why these two Islamic banks appear to prefer *murabaha* to *mudharabah* and *musharakah*. They conclude that during the initial development of the Islamic banking system, *musharakah* and *mudharabah* financing should be de-emphasized due to the increased risk associated with them. They further argue that these Islamic financial instruments will increase in importance as the Islamic banking system continues to mature.

Islamic Banking and Finance: Theory and Practice

Muhammad Ayub; The State Bank of Pakistan

December 2002

This book has been designed to serve as a compendium of Islamic banking & finance covering both theoretical and practical aspects described by the authorities on the subject. The book specially focuses on alternatives to interest and their contemporary application; progress made so far, obstacles faced and the issues yet unresolved. Distinct features of Islamic finance have been discussed with reference to resolutions of the OIC Islamic Fiqh Academy, observations made by the Council of Islamic Ideology and Shariah Courts of Pakistan and views of Shariah scholars. The author has also deliberated upon concepts like reference rates/bench marks, time value, *ijarah* and Salam based securities etc that till recent past were ignored by majority of authors or the subject. Besides providing an overview of the judgments of Pakistan's Shariah Courts, the book also discusses arguments given during Review Hearing of the Riba Case by Pakistan's apex court. The chapter on Analytical Framework and Unresolved Issues could particularly be helpful in understanding the emerging challenges. It also includes an explanation of Acronyms used in the book, Glossary of important terms of Islamic finance, a Select Bibliography and Further Readings, and Subject and Author Indices. It can serve as a reference book to all those interested in knowing about the nature of Islamic finance.

Al-Jamia Al-Islamia Launched Second Batch of PG Diploma in Islamic Economics and Banking

By: Nabeel K.N.

Al-Jamia Al-Islamia established in 1951 is one of the oldest and most reputed Islamic institution in Kerala. Last year in association with the Indian Association for Islamic Economics Al-Jamia started one year PG Diploma Course in Islamic Economics, and Banking. After great response of the first batch the second batch of the course was formally inaugurated by Dr Shariq Nisar, Joint Editor, Islamic Economics Bulletin on November 20th 2005. Other dignitaries present on the occasion were Mr. Ashraf Mohamedy, Managing Director, Idafa Investment Pvt. Ltd., Prof. P.P. Abdul Rasheed, Vice President Indian Association for Islamic Economics, Kerala Chapter, Mr. T.K. Hussein, Secretary Forum for Democracy and Communal Amity and Mr. M.V. Salim Maulvi, Director Islamic Research Centre, Al-Jamia. Mr. Shaheed Ramzan CP, Assistant Director, PG Diploma Course welcomed the speakers on behalf of the Jamia.

In his inaugural address Dr Shariq spoke at length about the current challenges facing Islamic financial industry. He admitted that most of the challenges related to Islamic banking are related to the age and size of the institutions comprising this sector. However, he emphasized that the biggest and most important challenge for Islamic banking is its regulation.

Dr Shariq highlighted the pioneering role played by Indian scholars in the development of Islamic economics and finance and exhorted the students to carry forward the work done by the previous generation. He also spoke about the prospects of Islamic banking and finance in the country in the era of liberalization, privatization and globalization.

He contended that the prospectus of Islamic finance in India can be seen from two angles. One the internal demand which consists of huge Muslim population and their high rate of savings and secondly the possibility of petro-dollars switching from US and Europe to the emerging economy like India. He also highlighted some of the imminent challenges faced by the Islamic finance in the country.

Managing Director of Idafa Investments Private Limited Mr. Ashraf Mohamedy delivered a his talk on Shariah Compliant Investment opportunities in Indian Stock Markets i.e. BSE and NSE'. He also outlined how his company is engaged in screening of the shariah compliant companies. The first and foremost of which is the economic activity. If the economic activity of the company is not against the shariyah then the company qualifies of this. However, there are certain quantitative parameters also applied before a company is finally declared a shariyah complaint. These includes (a) a company should not have interest based borrowing more than 33% of its total market capitalization, (b) interest earnings of the company should not be more than 5% of its total income and (c) receivables of the company should not be more than 45% of its total assets.

Mr. Ashraf Mohamedy promised to give three months comprehensive training to four students of the Jamia at his Bombay office. At the end Prof. P. P. Abdul Rasheed gave vote of thanks.

Call for Papers

The Journal of Muamalat and Islamic Finance Research (JMIFR) is a fully refereed journal published annually in July by the Faculty of Economics and Muamalat, Islamic University College of Malaysia. Its main objective is to provide a platform for publication in Muamalat, Islamic Economics, Finance and Banking of research-based articles locally or internationally. The first issue of JMIFR was published in July 2004. The journal's editorial board now calls for paper contributions for the next issue of JMIFR. For more information, please contact, Abdullaah Jalil, Executive Editor of JMIFR at: nasihunamin@yahoo.co.uk

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