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# Sound bites in Islamic finance


*"Interest equals disinterest because the lender has nothing to do with the borrower and his business. Islamic finance aims at creating an economy in which one financial dollar equals one real economy dollar."* **Yusuf Talal DeLorenzo, syariah scholar**

TODAY'S attention span can be described by a seven letter word "TWITTER". The amount of seconds in a minute, minutes in an hour and hours in a day is the same as far as one can remember, yet we seem to be busier than ever in an information overload world.

It seems the typical time for processing, analysing and drawing conclusions of, say, news headlines is confined to the first few paragraphs of a story and we must act fast in scrolling headlines in real time.

In a world of "hyper-trading" and "flash crashes", information is the new currency of choice for the informed. John Naisbitt, a futurist and best-selling author, stated it eloquently, "… the new source of power is not money in the hands of a few, but information in the hands of many".

However, it seems we have also reached the point of being "efficiently destructive" as the US subprime and eurozone debt crises may be examples of "over-reaction" to data points.

The attention span in Islamic finance also seems shorter. In the course of the last few years, I've tried to explain aspects of the industry in catch phrases and sound bites. It is not meant to be a gimmick or attributed to laziness, but reflects the financial world landscape we operate in today. It's well accepted that Islamic finance is a subset of conventional financial, and today, a better understanding may just require sound bites that conjure up a mental picture of what the user has already encountered.

Thus, financial industry participants have heard or read phrases like "efficiency, intermediation, 1.0 or 2.0, eurobond and shelf registration", etc, and such words produce a mental picture of what is being described. It then becomes an easier task in describing parts of Islamic finance, from work in progress to existing offerings, to open minded interested parties.

**SOUND BITES**

**Boring finance is vogue:** Several years ago, I was presenting on structuring, screening and product offerings in Islamic finance. After the polite "golf clap", an audience member, probably a trader or hedge fund manager commented "this stuff is boring, how do you juice returns?" I replied, "boring finance" meaning lack of use of excessive leverage and turbocharged derivatives, has (typically) a narrower bandwidth of returns, but a global target market. He replied, "what is the point when financial engineering is not allowed to lead your industry?"

**Well, the subprime and sovereign debt crises have flushed out one important takeaway:** Investors had more risk than they thought they had. The transparency associated with "boring finance" seems to be vogue today as "risk" is better understood.

**Islamic Finance 2.0:** We need to speak in the language of the worldwide web (www), as it's the "lingua franca" of the community seeking connectivity to undertake collaborations for the benefit of Islamic finance contributions. It took the Islamic finance industry nearly 40 years to reach the magical US$1 trillion (RM3.07 trillion) size, i.e., 1.0. Now, the consensus is that it should take five years to reach US$2 trillion (RM6.14 trillion), hence, 2.0.

**Information intermediation:** To get to Islamic finance 2.0, information intermediation (prerequisite for financial intermediation) needs to be conventionally efficient. In certain quarters, the western financial model or system may be discredited, however, it is difficult to deny the information side of the model is discredited.

Today, information about Islamic finance, from news to data to structures to fatwas, is fragmented, scattered and (oftentime) stale. For example, today Islamic finance news is not time sensitive. Hence, there may be 10 stories on, say conventional funds in one hour globally on the wire service, but only 10 Islamic fund stories in a month.

For an effective output, one needs to have an informed input. The information intermediation must be to the standards of a western/conventional terminal user.

**Conventionally efficient:** It is assumed that the financial sector is the lubricant of any well functioning G-20 economy, which includes three Muslim countries — Turkey, Saudi Arabia and Indonesia — where Islamic finance exists.

Today, Islamic finance is best categorised as an emerging market phenomenon and national/domestic in nature. Therefore, Islamic finance information as part of pre-trade work flows for various existing asset classes, from treasury to sukuk to compliant investing, needs to become conventionally efficient.

**The conventional efficiency of Islamic information can be seen as:**
**q MORE** precisely measuring, mitigating and monitoring risk, including capital charges for compliant participatory instruments,

**q CROSS** selling Islamic finance to non-Islamic community, including joint ventures, and

**q REACHING** the non-bankable and disenfranchised customers. Put differently, such information efficiency will act as growth factors and facilitators.

**A.I.R. (Authenticity, Innovation & Reach):** One of the battle cries in Islamic finance is (indigenous) authenticity as it goes to:

**q DELINKING** or decoupling from the law necessity and conventional finance, and

**q ADDRESSING** the question for the man on the street, "what's the difference?" The authenticity (A), less standardisation, will typically set the foundation of innovation (I), and where there is "A and I", reach (R) generally follows.

However, some in Islamic finance have commented it may be just "hot air". An example of indigenous authenticity that has been classified as innovation is the alternative Libor, Islamic Interbank benchmark Rate (IIBR) launched in November 2011. It has been an ongoing industry issue, delinking from Libor and it was addressed by industry institutions and market participants. IIBR is now reaching the early acceptance stage whereby its being discussed by lawyers for inclusion into modalities of contracts as reference price.

**Malaysia is nearing Shelf Registration Efficiency for sukuk:** The sukuk has become the poster-child for Islamic finance and no one country has done more sukuk growth and development than Malaysia and its stakeholders, from Bank Negara Malaysia to the Securities Commission to the Association of Islamic Banks Malaysia (AIBM) to the Bond Pricing Agency of Malaysia (BPAM) and so on. Thus, the time to market is measured in weeks and not months. Hence, Malaysia sukuk market development seems to be following the early growth patterns of the eurobond market.

**Furthermore, the sukuk development flushes an important point about debt capital markets (DCM):** It is about liquidity and not just listings. Thus, jurisdictions that issue press releases about number of sukuk listed or the total size (dollar amount) of listed sukuk are missing the bigger point — DCM development is about liquidity as liquidity begets liquidity and listings.

**Islamically over-leveraged:** As one can be conventionally over-leveraged, one can be Islamically over-leveraged. Thus, there is no "divine put" in Islamic finance as the "syariah" will not save someone from bad business decisions, bad documentation or be "lender of last resort". Thus, there have been sukuk defaults and bankruptcies, Islamic investments banks (really real estate project banks) changing the business model, etc.

**Islamic finance (today) is about personalities:** When Christine Lagarde was the French Minister of Economic Affairs, Islamic finance was moving forward in France and now seems to have been put on hold after she left for the IMF. When Gordon Brown was the UK Prime Minister and Chancellor of Exchequer, Islamic finance was also moving, and upon his leave, Islamic financial seems to have taken a sabbatical in the country.

Thus, it seems there may be “key-person” risks in Islamic finance, and more so in Muslim countries where it is flourishing; Malaysian central bank governor Tan Sri Dr Zeti Akhtar Aziz, Securities Commission chairman Tan Sri Zarinah Anwar (she is to leave at the end of the month and there is much confidence in her successor Datuk Ranjit Ajit Singh), Islamic Financial Services Board (IFSB) secretary general Rifaat Abdul Karim (his successor Jaseem Ahmed has carried on the work to the next level) and others.

As with any new industry, personalities will give way to institutions, and institution like Malaysia’s AIBM is a good case study on how to formalise a movement.

**Islamic finance is a sunrise industry:** The US$1 trillion industry has moved from viability (an alternative to conventional finance) to credibility (establishment of Islamic windows/subsidiaries) and has arrived at durability (global financial crisis). It is now beginning the journey to sustainability and scalability, with the hope of A.I.R. for mankind.

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