

ISLAMIC FINANCE IN THE SPOTLIGHT

Hussain Najadi, a senior figure in Arab and Asian investment banking, wonders whether many Islamic financial products really are Shariah compliant. He tells *ABF* why he feels Islamic institutions need to rethink their product development strategies

Hussain Najadi has seen a lot during a career spanning more than thirty years in Europe, the Gulf and Asia. In the early 1970s, he was one of the first Middle Eastern investment bankers to urge Arabs to start diverting petrodollars from Western markets to emerging opportunities in Asia.

In an example of practising what he preached, he then moved to Malaysia where he established the Arab Malaysian Banking Group in 1975. Najadi helped turn it into one of the country's major merchant banks before selling it seven years later.

A decade in his native Bahrain was followed by a long stint in Switzerland where he ran his own firm, AIAK Group, working to bring Arab and Western money into Asia. Now back in Malaysia, Najadi is still active with AIAK and is the founding president of Davos Management Institute, an executive development company. He is also a member of the advisory board of Global Finance Forum (GFF), an annual gathering of senior industry figures.

During his career, the Bahraini native has witnessed at first hand the growth of Malaysia's Islamic banking sector, widely considered the world's most advanced. These days, it is the development of the Islamic financial industry that is a subject of growing concern to him.

His view is that the market is currently seeing a proliferation of Islamic products whose Shariah compliance is, in his view, highly questionable. "What I am critical of is banking products that you rebrand as 'Islamic', but are not actually Islamic," he says.

What also concerns Najadi is a lack of individual participation in Islamic capital

markets. The vast majority of existing sukuk deals, he says, are 'bought deals', where one institution buys debt from another. There is very little listing of corporate sukuk and therefore very little opportunity for the ordinary man to buy into them.

"So far, sukuk have been issued by big corporations, the super rich, and bought by another corporation, also super rich. The transaction is between a triple A company and a triple A bank," he explains. "The public, the Mohammed, Hussein, Ali in the street, how much is he affected

"An Islamic credit card with interest is not Islamic."

by buying these papers or receiving these payments? If you ask me, very little."

Najadi is keen to state that he is not out to criticise any person or institution. What plays on his mind is a worry that consumers, for the reasons outlined above, may simply turn off to the idea of Islamic finance. On a retail banking level, his view is that Islamic financial providers need to refocus on the basics.

"Sooner or later, we have go back to the root of Islamic finance, profit sharing and risk sharing on an equal basis," Najadi says. "I should not mortgage my assets to you."

Could it not be the case though that Najadi's view is too narrow, and that

Islamic banks are in fact innovators, creatively coming up with products that match modern consumer's needs? As an example, this interviewer asks him how any bank can possibly come up with a home loan that does not use the property as collateral.

Najadi says he is glad to be asked the question and explains that any transaction where one individual or institution benefits at the expense of another is riba'a (translated into English as 'usury'), which is forbidden. Repossession of a person's home, as a result of financial misfortune, therefore constitutes riba'a, he says.

To solve the problem of how to cover losses, home loan providers should operate on a co-operative model. Under such a system, the co-operative's excess funds are made available to help those who suffer financial misfortune and are unable to make their repayments on their home.

Another product that has attracted Najadi's concern is the so-called Islamic credit card. "An Islamic credit card with interest is not Islamic," he says.

"The ones I've examined are simply adding a management fee or operating fee and removing the word 'interest'. That's what I call rebranding."

On the other hand, a pre-paid store value card is something that Najadi sees as perfectly acceptable because it does not involve interest. "You have not received interest or paid interest to anybody," he says.

According to current estimates, the Islamic finance industry is now worth around US \$500 billion, with around \$250 billion of that in banks and the other \$250 billion invested in various funds.

That kind of growth has attracted more and more players, which would





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help explain the 'rebranding' that Najadi talks about. Amongst the newcomers are conventional banks, which have opened Islamic units, known in the industry as 'windows'. Such windows have been criticised because whilst they may offer Islamic products, they are still a part of institutions that make money from interest bearing products.

Najadi does not directly criticise banks that operate windows, or banks that convert from conventional to Islamic operations. Instead, he says that there is a danger of "mixing everything in one pot", which could lead to confusion on the part of consumers and eventually disillusionment. "Consumers will get clever. They will ask how Islamic you really are," Najadi says bluntly.

He also returns to the theme of rebranding. "A lot of money wants to be 'Islamic', so people do what is necessary to get that money. If that is the purpose, in my view, you should not be licensed to do that."

Development of a product set that is truly Islamic at the retail level is undoubtedly a key challenge, but that is not the only one that he feels the industry faces. Another step that Najadi sees as essential is the development of a much broader capital market, with wider public participation.

He uses the Islamic sukuk phenomenon to illustrate his point. Currently, most sukuk transactions involve a very limited

number of buyers, almost invariably large institutions. The sukuk is not listed on a market and the man in the street has no opportunity to buy into it.

"In London, you have traditional bonds that are sold to pension funds, mutual funds and insurers, and there is an active secondary market," explains Najadi. "You can be a holder of any bond, call your broker and it is instantly bought or sold. This does not exist in the Islamic capital



market. 95% of sukuk are bought and kept. There is no active secondary market, or in banking jargon, 'liquidity'."

The net outcome of all this, in Najadi's view, is that Islamic banking & finance exists more in theory than in reality for the everyday Muslim consumer. "The average man in the street is going to an Islamic bank and putting his deposits there. That is Islamic banking," he argues. "You go to the street in any Muslim economy and ask if anyone has bought compliant Islamic shares, or bonds, and he will not

know what are you talking about."

One development that could help boost the Islamic capital market would be tie-ups between stock markets in different Islamic countries. Shares could then be listed on major exchanges such as Malaysia, Bahrain, Dubai, Saudi Arabia and Kuwait and bought and sold across borders. "There would be a link that will allow a person elsewhere to buy any share in Malaysia approved as Shariah-compliant," Najadi explains.

"He can go to his broker in Bahrain or Dubai and buy that share, and vice versa. Cross-listing is absolutely necessary to evolve the Islamic capital market into a sizeable force. I foresee within five years that we will have cross-listing capability."

Moves by Malaysia to state that certain stocks listed on its exchange are Shariah compliant are seen as a positive move. Najadi also welcomes Dow Jones' and Financial Times' launches of Shariah Islamic indexes. That still does not solve the problems of questionable Shariah compliance and 'bought deals' at an institutional level. Najadi feels that consumers and the media will play key roles in applying pressure and forcing change.

"Sooner or later, people will become more aware," he concludes. "Currently, there is a lot of confusion in the market and people are not quite knowledgeable enough to say which product is Islamic and which one is not. Change will be dictated from the street." ❖