

## Islamic Banking And Finance: Why The Global Down Turn Was Good For The Sector

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The global down turn it could be argued came as a blessing in disguise for the Islamic banking and finance sector (IBF). But may not for reason you might think.

The decline in western banking and finance, while it led to many opportunities for the expansion of IBF, actually saw a decline in growth. This decline though clearly not as catastrophic as the one experienced in western style banking was a decline none the less.

And here is the kicker - this was good news, in fact I would say very good news.

No, I have not taken temporary leave of my senses; there is reason behind this seeming madness. To my mind there are three reasons a dip in the fortunes of the IBF sector following the global down turn was good for the sector. The first of which is that it is proof positive that IBF is now fully integrated to the global financial system. That is to say that while IBF is not yet a prominent part of the global financial web it is none the less fully entrenched and vibrations in one part of the web will surely affect the whole.

While IBF has some inherent buffers that prevent it from going down the road and suffering the dire consequences of western style financials it is however not entirely immune from their reverberations. It is false, as some in the industry believed to their later detriment, that these buffers some how would insulate IBF from a global down turn.

The second reason for believing that the dip in IBF was good for the sector relates very closely to the first and that is it helped to dispel the myth that IBF was some how safer and thus superior to conventional banking/investing. The myth goes something like this: because part of the modus operandi of IBF is not to make money from money but rather putting money to productive use by profit/risk sharing in a way that avoids making wildly speculative investments akin to gambling (e.g. Credit default swaps and short selling) the sector is insulated from making the mistakes of western financials. Thus, by not allowing the moral hazards of western style banking IBF due to its very nature could never suffer the fate of western financials. Or could it?

If the dip is an indication, which I believe it is, IBF's total avoidance of moral hazard is clearly a myth, after all it is only logical that preventing some moral hazards does not prevent them all. Don't believe me; just take a look at Nakheel and its land developments in Dubai. For all its buffers IBF cannot prevent over exposure, bubble creation and the eventually bursting of bubbles. It must always be remembered that IBF like that of its western cousin is driven by the profit motive and with it the desire to keep up with the Jones (or copy what the other guy is doing) and with that comes all manners of human virtue and vice.

My third reason for believing that a dip in the fortunes of IBF following the global recession was good for the sector has to do with the law; more precisely legal precedents or the lack there of. Modern IBF is just that: modern; and as a relative newcomer to the global financial system it lacks the centuries old

refinement through litigation and precedent setting of its western cousin. In fact the lack of legal certainty/clarity/established precedents, call it what you will, is an oft cited criticism of IBF.

The aforementioned dip helped to reduce but sadly did not end the poverty in legal precedence that exists in the sector; think Investment Dar in England and East Cameron Partners in the US. With tongue ever so slightly in cheek it is safe to say that litigation by in large is good for lawyers, however, all joking aside litigation is also important to a 'young' sector such as IBF still defining its legal contours.