

ISLAMIC FINANCIAL

ISLAMIC FINANCIAL

A financial system is based on Islamic principal and values, which eliminates Riba and ensure a profit sharing mechanism in the financial system

Fundamental principles of Islamic finance

- ***Prohibition of interest***

The prohibition of interest is founded on the prohibition of *riba*, a term literally meaning “an excess” and interpreted as “any unjustifiable increase of capital whether in loans or sales”;

Fundamental principles of Islamic finance

- ***Risk sharing***
- Because interest is prohibited, suppliers of funds become investors instead of creditors. The provider of financial capital and the entrepreneur share business risks in return for shares of the profits.
- Money as “potential” capital. Money is treated as “potential” capital - that is, it becomes actual capital only when it joins hands with other resources to undertake a productive activity. Islam recognises the time value of money, but only when it acts as capital, not when it is “potential” capital

Fundamental principles of Islamic finance

- ***Prohibition of speculative behaviour***

Islamic finance prohibits transactions featuring speculation including extreme uncertainties, gambling, and risks.

Therefore, transactions in Islamic finance should be backed by real assets.

Islamic financing system

1. Equity & Justice

Islam provides every individual with some basic socio-economic rights, such as the right to access factors of production – land, labour and capital (economic justice), the right to be heard and redress of grievances (legal justice), and the right to safety, education, satisfaction of basic needs, access to public property, etc. (social justice). It is incumbent upon the rulers of the time to ensure that the socio-economic rights of individuals are respected and fulfilled.

Islamic financing system

2. Property Rights & Concept of Ownership

As Muslims, we firmly believe that God Almighty is the real and ultimate owner of all property on this planet and man as His vicegerent is entrusted with this property, which man must use according to His instructions. Thus, ownership of private property (land, commodities and capital) by man is subject to the sovereignty of God Almighty, and man will be accountable for its use on the day of judgement

Islamic financing system

3. Zakat

In the context of fulfillment of their social obligations, Muslims are strongly encouraged to participate in charitable giving and philanthropic acts aimed at reducing the gap between the “haves” and the “have-nots”. Hence, the notion of Zakat was introduced whereby every Muslim must allocate 2.5% of their net wealth (wealth in excess of their consumption needs) to be distributed among the poor and needy (Surah al-Taubah, Ch.9: V.60).

But the Islamic concept of charitable giving goes beyond Zakat where Muslims are encouraged to help the poor

IMPORTANCE OF ZAKAT

- **Purification**

Zakat purifies the possessions and the spirituality of one who gives it. It creates a sense of self-discipline and shows your obedience to Allah s.w.t.

- **Become Prosperous Muslims**

By giving Zakat a person shows that he obeying the rules set by Allah s.w.t. His obedience brings him prosperity in both this world and the hereafter.

- **Closer to Allah s.w.t**

Giving Zakat brings you closer to your God and increases your faith in Him.

IMPORTANCE OF ZAKAT

- **Rewarded by Allah s.w.t**

The Prophet (pbuh) said: “Whoever gives away charity the size of a date, which is earned lawfully, since Allah only accepts the good lawful things, Allah will indeed take it with His right hand and cause it to grow for its owner, just as one of you raises up his colt, to the point that the charity will become like the size of a mountain.” [Reported by Al-Bukhari and Muslim]

- **Sins are Wiped away.**

The Prophet (pbuh) said: “Giving charity wipes away sins just as water extinguishes fire.” The word charity (sadaqah) here refers to the Zakat as well as the supererogatory form of charity.

Islamic financing system

4. Sanctity of contracts

Islam teachings upholds contractual obligations and the disclosure of information as a sacred duty. This feature is intended to reduce the risk of symmetric information and moral hazard.

Principles of Islamic Finance

- Islamic finance strictly complies with Sharia law. Contemporary Islamic finance is based on a number of prohibitions that are not always illegal in the countries where Islamic financial institutions are operating:

Principles of Islamic Finance

1. Paying or charging an interest

- Islam considers lending with interest payments as an exploitative practice that favors the lender at the expense of the borrower. According to Sharia law, interest is usury (riba), which is strictly prohibited.

2. Investing in businesses involved in prohibited activities

- Some activities, such as producing and selling alcohol or pork, are prohibited in Islam. The activities are considered haram or forbidden. Therefore, investing in such activities is likewise forbidden.

Principles of Islamic Finance

3. Speculation (maisir)

Sharia strictly prohibits any form of speculation or gambling, which is called maisir. Thus, Islamic financial institutions cannot be involved in contracts where the ownership of good depends on an uncertain event in the future.

4. Uncertainty and risk (gharar)

The rules of Islamic finance ban participation in contracts with the excessive risk and/or uncertainty. The term gharar measures the legitimacy of risk or uncertain in nature investments. Gharar is observed with derivative contracts and short-selling, which are forbidden in Islamic finance.

Types of property

1. Private Possession

Islam gives the right to individual to own different means of production of any kin and size

Provided that:

- This property doesn't cause damage to the interest of the public
- Islam bans of monopoly
- There are in islam of 'Halal' & 'Haram' for earning & production

Types of property

2. Collective possession

-The facilities important to the (water, fuel, mines) must remain in state ownership or under supervision to provide the basic need of people's lives & interest of the community.

Riba & Interest Rate

Riba is a concept in Islam that refers broadly to the concept of, growth, increasing or exceeding. It has also been roughly translated as illegal, exploitative gains made in business or trade, under Islamic law.

Derivatives in Islamic Finance

- A derivative security is a financial asset whose value is dependent on the value of an underlying asset. The underlying asset could be a basic financial asset like common stocks, bonds.

Why do we need derivatives?

As with any other financial product, derivatives were the result of financial innovation.

Innovation that responded to the existing need to help manage risk in increasingly sophisticated business environments.

Risk, from a Finance viewpoint, refers to the uncertainties associated with returns from an investment. These uncertainties would translate into volatility or fluctuation of returns from an investment.

- ***Risk-Management;*** refers to the process/techniques of reducing the risks faced in an investment.
- It generally involves three broad steps;
 - Identifying the source and type of risk.
 - Measuring the extent of the risk.
 - Determining the appropriate response (Balance Sheet) methods.

Monetary Policy in Islamic

Monetary policy consists of management of money supply and interest rates, aimed at achieving macroeconomic objectives such as controlling inflation, consumption, growth

The Role of Monetary Policy

- Economic well-being with full employment and optimum rate of economic growth;
- Socio-economic justice and equitable distribution of income and wealth; and
- Stability in the value of money to enable the medium of exchange to be a reliable unit of account, a just standard of deferred payments and a stable store of value.