

Why the merger of Innovation and Social Responsibility needs to be the niche for Islamic Finance

By Sayd Farook, Dar Al-Istithmar

It is a well known, but rarely admitted fact amongst Islamic bankers and experts that Islamic Finance is not really innovative. Innovation is defined by most dictionaries as something new, a new method or practice or the act or process of inventing or introducing something new. In economic terms it is defined as something that increases value, customer value or producer value. What innovation there is in Islamic Finance was developed 1400 years back and that was the core fundamentals of Islamic commercial law. Hence, the 'innovative' value we perceive in Islamic finance exists only as a result of the fundamental governance and compliance constraints imposed on individuals and institutions, including rules prohibiting usury, gambling and ambiguity. These rules articulate very important sub-rules which form the basis of a solid contractual governance framework, including rules permitting only a first degree of separation from assets, not selling what you do not own and not trading in debt etc. Hence, this perception that there can be innovative Islamic finance products needs to be critically dissected.

By far, the majority of 'innovations' in Islamic finance have been directed towards building what the rest of the world has already developed within the boundaries of Islamic law. Whether it be structured products, derivatives or sukuk, more efficient forms have existed at least 10 years before we came to the market with an innovative "copycat" version twisted around Islamic nominate contracts producing exactly the same outcome. As a result, Islamic Finance is not really an innovative field where value is added through creative inputs to make life better for individuals. The fact that every one nowadays markets themselves as innovative is really shying from the truth. Off the top of my head, I can name two Islamic financial Institutions that utilise derivations of the word innovation in their brand name, with many more who flagrantly abuse the terms at each and every opportunity. While I personally have no issues with presenting new Islamic products to the market that attempt to replicate conventional products, (which may be crucial to the growth of Islamic finance), I have an issue with individuals and organizations trying to pass them off as "innovative".

If we are to claim we are innovative, we must start reflecting on where we can really add value and this requires us to look at what our forefathers have handed down to us as a divine message and work around that to see how that message might add value to our lives. We certainly have not added value in terms of financial innovation, nor have we come with a new asset class.

Going back to the original innovation that is Islamic Finance, our value was added as a result of our unique contractual governance and ethics requirements. The requirements to avoid usury, misrepresentations, ambiguity, zero-sum games all emanate from a broader set of principles that is conceived in Islam as a way of life to be practiced by all human beings. These include conceptions of vicegerency, commending good and forbidding wrongs and developing a spirit of brotherhood and trust. What this means for the innovation agenda in Islamic finance is a fundamental paradigm shift. Innovation in Islamic finance should be directed towards finding solutions to contemporary challenges while wearing the 'Islamic' hat and assessing how the Islamic perspective could add value. More so than everything else, it is the conception of social responsibility that is inherent in a Muslim's responsibility to his creator that can really add value to the financial system. Our research at Dar Al Istithmar and Oxford Islamic Finance is geared towards this agenda. While we acknowledge that our research may not derive immediate benefits, we are firmly of the opinion that the long term value for us and the Islamic industry can only be derived from an Islamic perspective of innovation, rather than innovation driven by the need to mimic mainstream products.

Sayd Farook is Senior Consultant (Structuring and Legal) with Dar Al-Istithmar, based in London. The opinions expressed herein are those of Sayd, and are not reflective of the views or policies of Dar Al-Istithmar.