



# ARTICLE

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## Basics of the Islamic financial system

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Islamic finance, just like politics and daily life, try to follow the rules written in the Qur'an (governed by the *Sharia*, or the code of conduct for Islamic life) as faithfully as possible. For the Muslim world this financial model assumes a more ethical form, as it is an integral part of a way of life, another area regulated by Islam.

This model of Islamic finance was born in order to reconcile the *Sharia* with the global business world, so it is important to mention that it does not necessarily mean an alternative to conventional finances, rather an integral part of global finance. Currently Islamic finance is currently booming with an annual growth above 15%.

The beginnings of Islamic finance can be traced back to the end of the 19<sup>th</sup> Century, when the British bank Barclays established an office in Cairo. The cultural and financial crash which the establishment of a European banking entity with a Western financial model involved led to criticism due to, amongst other reasons, the charging of interest, as it is considered usury and is punishable under Islam's *Sharia* law. Ever since this initial approach, the development of alternative financial instruments began so that the laws established by the *Sharia* would be respected at all times. Subsequently, Islamic financial institutions focused on the Muslim population and operating under the *Sharia* have been emerging.

Such is the growing importance of Islamic finances in recent times that international entities in the world of finance such as *Dow Jones*, *Financial Times* and *Standard & Poors* have created special stock exchange indexes for Islamic finance, which exclude companies whose activities clash with the principles of Islam.

Due to the economic growth of Islamic countries in recent decades, the Western world has begun to show interest in the financial products of these countries. Yet today there are still large differences that exist between conventional and Islamic finance, which are making certain international banking entities comply with the regulatory framework that Islamic finance requires.

The Islamic financial system is based on religious and cultural pillars, as mentioned above, which give it this special and distinct tenor in comparison to our financial system. These distinguishing pillars are as follows:

- *Riba*: a ban on interest rates. It is prohibited to carry out transactions with default interest rates, as is done in conventional finance. Therefore, not paying interest does not mean profits are not generated.
- *Gharar* or *maysir*: prohibition of carrying out extremely speculative transactions. The motivation behind such speculation is the aim promoted by the Qu'ran of benefitting both

parties, such as pursuing a correlation between expected benefits and sought benefits (avoiding the phenomenon of the *gharar*, or speculation). Excessive risk is prohibited by the *Sharia* “Law of Conduct”. In any case, operating under the suspicion of *gharar* or *maysir* renders the contract or transaction invalid.

- *Haram*: a ban on doing business involving pornography, weapons, alcohol, pork products or gambling.
- As well as the impossibility of the listed activities, it is required that the world of finance does not distance itself from physical reality and is backed by real assets.

In relation to Islamic finance in Spain, its development seems to be more than possible given the real opportunities that exist, as, from a banking point of view, the economic development of Northern African countries, their neighbours and tight economic ties with

Spain could be a flow of business and diversification for companies in the region given the low correlation these markets have with the rest of the world. The other interesting point would be the Islamic population living in our country’s access to saving through the issuance of *Sukuk* by Spanish banks, which would serve for its own financing as well as that of its clients.

Ultimately, the Islamic financial system should be considered outside the borders of the territories where it has been developing for religious and cultural issues, as the economic growth of these countries, as well as the growth of the Islamic population in Western countries, means this financial market has grown exponentially; even more so when taking into account the particularities of Spain as a nexus for both cultural and geographical union between Arab and European countries, meaning this type of finance could have a very positive impact upon Spanish banks

## FOR MORE INFORMATION

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