

The Federal Reserve Bank Of New York

## Alternative Financing

By

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**11/21/2002**

# Islamic Financing

- Alternative financing for Muslims and all those who are averse to interest.

# ● Islam & Muslims

- Islam = Peace through Submission to Allah (God)
- Eternal Universal Message
- Revelation-Based [ The Quran, Hadith]
- Complete way of life
- Muslim = One who submit to Allah (God)
- Anyone can be a Muslim, regardless of race, ethnicity, color, or language

# Muslim Population

- 1.5 Billion Muslims World Wide
- More than 10 million in USA
- Demographics of American Muslims:
  - African American 42%
  - South & Southeast Asian 26%
  - Arab 12%
  - African 6%
  - Iranian 4%
  - Turk 3%
  - European & Others 7%

# Allah (God) & The Human

## Allah (God)

- Creator, Owner
- Infinite wisdom
- Love/concern
- Ultimate Judge

## The Human

Trustee on earth  
Submits to Allah  
Trust/guidance  
Responsibility

# Economy & Wealth In Islam

- Wealth is a favor and bounty from God.
- The human being is only a trustee for the wealth.
- Work and good earnings are a form of worship and strife.
- Prohibits earnings from evil sources.
- Recognition of the individual ownership and its protection
- Individuals can't take possession of natural resources important to society.
- Forbids the owner of doing harm to others.
- The investment of wealth should not be at the expense of morals, values and public interest.
- The achievement of self-sufficiency for the nation
- Moderation in expenditure
- Establishment of mutual responsibility in the society
- Narrows the gap between social classes

# Money & Wealth

- Not evil in itself
- Obedience to Allah
- Ethical framework/Moral filter
- Social commitment
- Maintain justice
- Shared equity, Profit/Loss

# Incompatible Businesses

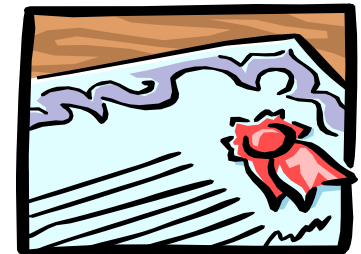
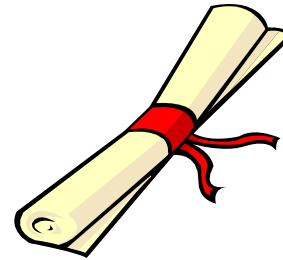
Certain businesses are incompatible with Islamic law such as:

- • Alcohol
- • Pork and pork products
- • Gambling
- • Lottery
- • Pornography
- • Adult entertainment
- • Prostitution
- • Illegal drugs
- • Illegal activities
- • Interest

Muslim scholars also do not advise investments in companies that deal with tobacco and weapons.



# Why Alternative Financing



# Trade vs. Interest

- { That is because they say, [Trade is just like Interest.] but Allah has permitted trade and has forbidden interest. }

The Quran 2:275

# Prohibition of Interest

- {O you who believe, observe your duty to Allah (God) and give up what remains from Reba (interest, usury) from now onward, if you are truly believers}

The Quran: 2-278

# Interest Is Unlawful

- Usury / Interest = Riba / Reba
  - Taking
  - Paying
- Loans & Interest
  - Fixed rate
  - Adjustable rate
  - Low rate

# Interest in Islamic Financing

- ❖ All forms of financing involving interest or usury (Reba/Riba), directly or indirectly, are not allowed according to Islamic law (Share'a).

# Lawful Financing Models

- Murabaha: Buy-Sell with Deferred Payment
- Leasing ( Ijarah)
- Lease Purchase (Ijarah Wa-Iqtina')
- Royalty Investment (Mudaraba Mahdoda)
- Trust Financing (Mudarabah)
- Equity participation (Musharakah)
- Decreasing Partnership (Ash-Sharikah Al-Mutanaquisah)
- General Partnership (Sharikah)
- Stock Investment (As-hum)
- Interest-Free Loan (Qard Hasan)!

## **Murabaha: Trade-Based Financing Buy-Sell with deferred payment (Bai al-ajal)**

- Sale of goods on installment or deferred payment basis. Financing Co. purchases the equipment or goods (assets) on behalf of a person or a business. Then it sells the equipment or goods to the entrepreneur or the client at an agreed upon price, which includes Financier's mark-up (profit). The business owner makes payments by installment within a pre-arranged period, or in a lump sum.

# Royalty Investment (Limited Mudarabah)

This is an agreement between an investor and an entrepreneur. In this case, the entrepreneur is in business and needs to expand his/her current business or has a special project that needs financing. The investor provides either 100% or a portion of the needed capital for the expansion or project. The Mudarib (the entrepreneur) manages the project using his/her entrepreneurial skills. Both parties agree on the profit/ loss share from the project. At the end of the project, the investor gets his/her principle along with the agreed upon Profit. In the case of a loss, the investor gets back his/her principle less his/ her portion of the loss. The profit or the loss can be determined or shared from the gross profit/loss.



# Decreasing Partnership (Ash-Sharikah Al-Mutanaqisah)

Another form of limited partnership, (Mudarabah or Musharakah) where the entrepreneur gradually purchases the financier's shares. Similar to the permanent partnership. However, because the financier wishes not to remain a permanent partner, he/she agrees to sell their shares to the entrepreneur, either within an agreed-upon term or on full payment when the individual is financially capable. Subsequently, the entrepreneur retains full ownership of the said initiative.

# Trust financing (Mudarabah)

This is an agreement between two parties. One party, the investor, provides 100% of the needed capital for the given project. The other party, known as the Mudarib (the entrepreneur), manages the project using his/her entrepreneurial skills. Profits from the project are distributed according to a pre-determined ratio. Any losses are borne only by the provider of the capital. The provider of the capital does not run the daily affairs of the project; it is the responsibility of the entrepreneur.

# Banking & Personal Financing

- Checking Account
- Saving Account
- Credit Card
- Debt Card
- Certificate of deposit CD's
- Mortgage
- Leasing
- Others

# Most Needed Financial Services

- Housing
- Saving accounts
- Investment
- Cars
- Business financing
- Equipment leasing
- Rent-to-own businesses/homes
- Money orders
- International wire transfer

# Non-Traditional Saving Account

- Based on partnership concept
  - Both parties share the risk and the reward
  - Bank invest in the need of the community
  - Annual performance.
  - Retirement plan
  - Cooperative Insurance (Takafu) for cars, Housing and businesses....etc

# Existing Organizations & Programs

- MN Neighborhood Development Center/Reba Free LLC.
  - = Small Business Financing
  - Reba Free LLC. = Working on housing
  - ICM = working on a credit Union
  - Hennepin County = Housing (Bai Al-ajal)
- CA La Riba ( American Housing Finance)
  - = Housing/businesses
- TX MSI, = Housing
- WA Amana/Saturna Capital,
  - = Saving, Investment and Retirement plan
- DC Samad Group, =Real Estate, Working on community bank
- NY/NJ HSBC Mortgage Corporation (USA) = Housing
- Others

# Alternative Financing, Challenges & Opportunities

- New concept
- Regulators
- Implementation
- Further development
- Test the market

# Conclusion

- Untapped market ( \$100 billion)
- Lack of information on both sides
- Viable alternatives
- Need for legislative action
  - \* **Banking regulation**
  - \* **Taxes**
  - \* **State/Local rules**

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