Editor's Note

The era of modern capitalism is hallmarked by complex, esoteric financial products which are churned in and out of the portfolios of the investor masses by financial market speculators who steadily push such instruments into the marketplace. The speed at which these innovations are propelled into the financial markets consistently keeps market regulators at least two steps behind that of the speculators, and of course it's the investors who are left to pick up the proverbial "check" from such activities. In order to alleviate this problem, market regulators need to prioritize transparency and stability over institutional profits.

Uniquely, the Islamic financial system promotes a near one-to-one relation between real and financial sector activities. Thus, a well-designed regulatory institutional framework should be uniform and widespread enough to cover all Islamic financial instruments and innovations of the institutions operating within the system. The systematic risk of a failure of an Islamic institution, or instrument, is much greater for Islamic finance than under the conventional finance system largely due to the massive reputational damage for the entire Islamic system. Moreover, a satisfactory Islamic regulatory framework should also have the flexibility to minimize the risk of regulatory arbitrage given the profit-seeking motives of financial market participants pushing cutting-edge financial products. Similarly, regulations should be put in place to deter speculative activity, particularly with new financial innovations, to cushion Islamic banks from market risk. For instance, *Shariah* scholars should identify *gharar* to better understand the risk characteristics of all financial innovations and newly engineered products, such as Islamic hedge funds or CDOs.

Under Islamic finance, risk shifting (or transferring) and trading on debts should be completely prohibited. Risk shifting involves transferring risk to third parties who do not provide funds for production or organization; these third parties are generally avid users of derivatives and engage in speculative activity. The goals of speculators are in stark contrast to those of owners and intermediaries who profit through stability of the market and risk mitigation, whereas speculators'

interests come in the form of market instability. Risk shifting is relatively inefficient and inequitable as producers bear all of the losses and are still required to pay back borrowed capital with interest. The net effect is a negative impact on income and wealth as well as stressing social society. However, risk shifting propelled capitalism to unprecedented levels through a proliferation of interest-bearing debts and speculation, but this in turn lead to a decline of trust between dealing parties. Yet, the interest of society is founded on market stability and minimal risk, and not the speculators who attempt to amplify profits by engaging in anti-social activities. In the end, disenchantment with the economic philosophy of pursuing "greed for good" will inevitably lead to a more socially and ethically informed approach to finance. Contrastingly, a risk sharing framework, according to Islam, is a much more efficient and equitable distribution of wealth and income. If an owner (or entrepreneur) sustains any losses, the issuer of the funds bears the burden of the losses—this is in blatant contrast to capitalist societies where the owner bears the complete risk. This risk structure allows investable funds for projects to be allocated based on expected profitability and productivity and not merely the creditworthiness of the associated parties.

Islamic finance aims to support economies which sustain all the members of a society. The goals of such economies are disparate from profit-making activities and do not allow for market manipulations that create profits through information asymmetry, monopolistic practices, or outright exploitation/fraud. This ambition is strongly related to social justice, a paramount concept in Islam. Social justice hinges on three aspects: fair and equitable wealth distribution, provision of basic necessities of life, and protection for the weak in times of economic suffering. Social justice is so important that is one of the five pillars of Islam—*zakat*, meaning to purify in Arabic, which promotes equality by redistributing wealth. In fact, Islamic teachings preach that if creditors fail to lessen their debt burden, then the debtors are eligible for *zakat* where Muslims are encouraged to assist the meager.

Additionally, Islamic finance is distinctive in that it detests interest and applauds the sharing of risk. Such practices intend to avoid the concentration of wealth on (the generally wealthier) lenders and exploitation of (the generally weaker) borrowers. Capitalism considers money as a form of capital, while Islam sees

capital as a specific portion of wealth used to generate economic activity. Moreover, the core of Islam believes that money should not be an earning asset itself, as it is a measure of value and means of exchange. Thus, interest is proclaimed to be an unfair tool which is exploitative in nature, and its prohibition is a mechanism to establish justice. Islam is a practical religion which appreciates the human circumstance and recognizes that at times financial hardships can hinder people's lives. While Islam permits the use of debt within affordable means, its use in the case of luxury and extravagance is strongly condemned. However, when debt is assumed its prompt repayment is vitally important.

The first paper, in this issue, recognizes the stark distinctions between the spirits of Islam and capitalism and consequently examines the form taken by intuitions under each financial system. Zaman highlights that capitalist financial institutions are designed to support the process of the accumulation of wealth, while institutions central to the spirit of Islam are characterized by the radically divergent themes of diversity and service to others.

The second paper by Siddiqui focuses on Islamic economics and highlights a number of areas where Keynes' original ideas coincide with some of the basic principles and objectives of an Islamic economic system, despite the imposition that the channel of Islamic economics is rather unorthodox. It is suggested that Islamic economists who are interested in improving the distribution of income in the economy could benefit from studying Keynes and those who have proposed ideas coinciding with his original works.

In the third paper, Bidabad explores the issue of low returns of social security and retirement pension funds and how such performance does not lead insureds to obtain the real power of their accumulated capital from their premium payments. Consequently, establishments of private multi-pillar pension funds and thrifts have been considered as a solution. These types of plans work better than governmental pensions and security organizations, but suffer from inefficiency due to weak supervisions and concentration of activities. In order to remove such shortfalls, Rastin Personal Security (RPS) introduced Rastin Profit and Loss Sharing (PLS) banking which is designed so that banks make contracts among third parties and serves as an intermediary which provides necessary financing.

The infrastructure of PLS is both practical and provides new conditions for insureds to fulfill the goals of social security and pension fund systems.

The fourth paper by Arshad, Rizvi, and Wardhany examines the trend of financial institutions outsourcing their non-core business functions due to the rapid growth of Islamic finance. The benefits of outsourcing are heavily documented in prior literature; however, such actions serve as a concern when it comes to outsourcing Shariah compliancy. This paper addresses both the issues and challenges in outsourcing Shariah approval for banks which do not have their own advisory board—focusing primarily on Shariah risks, governance, and arbitraging. Additionally, it is established and discussed that reducing conflicts of interest between banks and consultancy firms, which contract out Shariah scholars, can be reduced through a collaboration of Shariah opinions by private sector, government, and regulatory bodies.

In the fifth paper, Asadov and Gazikhanov investigate the subject matter of Ijarah via the operations of the TAIBA Leasing Company—the only Islamic leasing company in Uzbekistan. The primary role of this paper is to show the potential benefits of broad implementation of Ijarah in the leasing industry and generalize the industry findings across all Central Asian countries. Moreover, recommendation and policy implications which could improve the prospects of Ijarah in the Central Asian region are discussed.

The sixth paper, by Mahmood, Fatima, Khan, and Qamar examines the emerging manner in which to empower the impoverished by means of Islamic Microfinance (IMF). Utilizing a pre- and post-study sampling questionnaire to observe the impact of microfinance on the respondents, this paper observes the implications of IMF on the assets and poverty status (as measured by Foster, Greer, and Thorbecke) of households who borrowed from three major organizations: the Akhuwat Foundation, the Farz Foundation, and the NAYMAT Foundation. The results of this paper indicate that IMF imparts a positive impact on the lives of the poor which utilize such financing.

In the seventh paper, Altwijry and Htay analyze the role of corporate governance on unconventional bond ratings of corporations listed in Bursa Malaysia. The

results of the study indicate that the corporate governance mechanisms: separate board structure, independent non-executive directors, and smaller board size contribute to higher unconventional bond ratings. Moreover, ownership variables indicate that a lower proportion of director ownership and a higher proportion of institutional ownership lead to higher unconventional bond ratings. Pertaining to control variables, firm size, proportion of leverage, and smaller net income are all positively related to higher unconventional bond ratings. The results of this paper are largely in line with prior theoretical literature, with the exception of the net income variable, which is likely due to the nature of unconventional bonds as a partnership and debt-based element.

The eighth paper, by Ihsan and Ayedh explores the Islamic concepts and values which are the underpinnings of the governance framework for awaqf institutions— consequently, such an analysis demonstrates the Islamic accountability of the mutawalli. Given the increasing demand for the revival of the waqf, much more attention has recently been accorded to the governance practices of awaqf institutions; this upsurge in interest of governance issues is largely due to the fact that the utilization of good governance is critical to the success (and revitalization) of the awqaf institutions.

In the ninth paper, Yusuf and Babalola examine the subject of Takaful in the nation of Nigeria. Despite the decade old birth of Takaful in Nigeria, observers quickly point out that the increase and growth of the sector's contribution to the nation's GDP has been relatively sluggish. Thus, in Nigeria, Takaful is considered a somewhat new phenomenon due to its virtual absence in insurance legislation and overall minute appearance of Takaful companies in the country—even in spite of a population that is chiefly Muslim. This paper assesses the level of performance of the small group (i.e. three in total) of Takaful companies which do exist in the Nigerian insurance market. Utilizing a case study approach, based on an interview methodology, the experiences, lessons, challenges, and contributions of these companies to the overall economy are explored in detail.

The tenth, and last paper, by Hidayat and Abdulla comparatively analyzes the financial performance (in terms of solvency, liquidity, profitability, underwriting performance, and efficiency) of Takaful and conventional insurance companies in

Bahrain. Utilizing data collected from the Central Bank of Bahrain (CBB) Insurance Decennial Report, this paper finds that—in contrast to the theoretical arguments that Islamic finance should outperform conventional finance—conventional insurance companies in Bahrain are more profitable and efficient than their Takaful counterparts, over the time period examined.

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