

Pricing Transactions Linked to Interest rate Benchmark

There are continuing debates on whether the spirit of Shari'ah is being violated by the practice of "benchmarking" linked interest rate benchmark such as London Interbank Offered rate (LIBOR) plus an agreed mark-up in also pricing returns on Islamic finance transactions . At a very fundamental level, the reason for the debates is the lack of understanding to clearly discern the difference between the use of LIBOR as a benchmark for pricing and the use of non-Shari'ah compliant assets as a determinant for returns.

However, benchmarking touches upon the integrity of Islamic Finance as a whole, and the concept of Shari'ah-compliance vs Shari'ah-based approach in particular. There are practical challenges delaying a switch to participation-based structures, such as Musharakah and Mudarabah, that require financiers to participate in the underlying asset in a financing transaction.

Islam's Approach to Ethical Investment

Given that many ethical funds have similar characteristics as Islamic funds, it is important for ethical investors attracted by the appeal of Islamic principles as well as the performance of Islamic investments to understand that there are additional prohibitions that must be applied on the products offered. These restrictions which are essentially self-imposed based on belief and conviction act a moral compass; the monitoring of the prohibitions by a Religious (Shari'ah) Supervisory Board may have prevented Islamic financial institutions to deviate from a faith-based system and absorb the shocks within the conventional financial system.

The important principles for Islamic financial instruments for participation and investments that require strict adherence, while providing good returns, are:

1. Investments must be free of interest, speculation and gambling, all are considered as forms of exploitation
2. Investments are made in permissible activities
3. Investments must be separately approved by an independent Shari'ah supervisory board to ensure Shari'ah principles are strictly adhered to and deviations and wayward business practice penalised, for example in Islamic finance requires penalties to be paid to charity

"The ethical principles on which Islamic finance is based may bring banks closer to their clients and to the true spirit which should mark every financial service," the Vatican's official newspaper Osservatore Romano said in an article its latest March 2009 issue.