DEVELOPMENT OF FINANCIAL INSTRUMENTS IN AN ISLAMIC FRAMEWORK

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.1BACKGROUND

Almost three decades have passed since the founding of the first modern Islamic bank in the small Egyptian delta town of Mit Ghamr. Islamic banking has developed so remarkably in the last quarter century, that it is hard to believe that the movement is so young.

The main expansion occurred in the 1970s, with the opening of the Islamic Development Bank in 1975, the first international aid agency to advance funds on an interest free basis. In the field of commercial banking, 1975 also witnessed the opening of the Dubai Islamic Bank, followed in 1977 by the Faisal Islamic Banks of Egypt and Sudan and the Kuwait Finance House. The following year saw the start of business of the Jordan Islamic Bank for Finance and Investment, the first venture of its kind by the Al Baraka group, though most of the shareholders were Jordanian. The Bahrain and Qatar Islamic Banks started slightly later, but were soon to establish themselves as significant forces in domestic retail banking.

.2RETAIL SUCCESS

These early institutions have now matured, and have achieved a considerable degree of success in terms of market penetration. This is all the more remarkable, given that the markets in which they were established already had well developed commercial banks, indeed some markets, especially in the Gulf, were viewed as overbanked. One of the most successful in terms of local market penetration was the Kuwait Finance House, with 14 branches. It accounted for almost one fifth of all bank deposits in Kuwait. Few would have believed in the 1970s that it would have overtaken well established local banks such as the Bank of Kuwait and the Middle East, the successor to the British Bank of the Middle East, the country's first modern bank. The Kuwait Finance House now ranks fourth in the market after the Commercial Bank of Kuwait, the Gulf Bank, and the Alahli Bank.

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The Bahrain Islamic Bank has been almost as successful, in an admittedly much smaller retail market. It operates with three branches, and accounts for around 16 per cent of total deposits. Though the National Bank of Bahrain and the Bank of Bahrain and Kuwait dominate in terms of local currency deposits and deposits from residents of the Island, the Bahrain Islamic Bank has overtaken Standard Chartered, the oldest commercial bank in the Gulf, first founded as the Eastern Bank in 1920. Interestingly, the Eastern Bank did not give interest on deposits during the first decade of its existence in Bahrain, as if, although a British bank, it was well aware of the feelings of local residents regarding *riba* .It did, however, levy charges for loans, and would certainly not be regarded by today's generation of Islamic bankers as being a legitimate Islamic financial institution.

Other notable success in markets where *riba* based commercial banks dominate have been accomplished in Egypt, Sudan and Jordan. In Egypt, the Faisal Islamic Bank has 12 branches which stretch throughout the country from Aswan to Alexandria. In addition, the Islamic International Bank for Investment and Development, which was founded in 1980 as a completely separate entity, has 7 branches, mainly in Cairo and the Delta. Together these institutions account for almost 17 per cent of private bank deposits in Egypt, and pose a real challenge to the big four Egyptian banks which resulted from Nasser's nationalization of the financial system, the National Bank of Egypt, Bank Misr, Banque du Caire and the Bank of Alexandria.

Sudan has the largest number of Islamic Banks in any Islamic country, with the Al Baraka Bank of Sudan, the Faisal Islamic Bank, the Islamic Bank for Western Sudan,the Islamic Cooperative Development Bank, the Islamic Northern Bank, the Sudanese Islamic Bank and the Tadamon Islamic Bank all providing *riba* free banking. The fortunes of the Islamic banks in Sudan have been largely influenced by political developments and government patronage. The share of the Islamic banks was almost 18 per cent in 1984, but then the Nimeiri regime suddenly acted against Islamic interests in the country. The well established Faisal Islamic Bank of Sudan, which accounted for 80 per cent of total Islamic deposits, was particularly badly affected .Its share of total deposits declined from 15 per cent to 7 per cent over the 1982-86 period. Prospects have improved, however, for the Islamic banks in Sudan, as the political turmoil which followed the departure of Nimeiri seems to be coming to an end, and the Islamic parties play a major role in the new Sudanese government.

The Jordan Islamic Bank for Finance and Investment is another well established retail Islamic bank with a successful track record. It has 24 branches in Jordan, from Irbid in the North to Aqaba in the South, and accounts for around 9 per cent of bank deposits in the Kingdom. The bank has over 75,000 deposits, mostly from those of modest means from the small business community, and is particularly strong outside Amman in the smaller centers. Unlike most Islamic banks, it is a publicly quoted company, whose shares are traded on the Amman stock exchange .Its shares have out-performed those of the other Jordanian banks throughout the 1980s, and it has withstood comparatively well the effects of the post 1983 recession in Jordan. Indeed, deposits have continued to grow healthily, while those of the *riba* based banks have stagnated or declined.

Jordan nevertheless represents a limited market, with its small population and lack of lending opportunities. Prospects would be much more promising in larger neighboring countries such as Syria or Iraq, but the Damascus government has refused to let any Islamic institution challenge the monopoly of the state owned Commercial Bank of Syria. In Lebanon, however, the Tehran based Bank Saderat Iran has been allowed to offer Islamic banking services to Hezbollah supporters in South Beirut, and through local financial intermediaries offers similar services to the citizens of Zahle and Baabek in the Bekaa Valley. The Iraqi government has been more sympathetic to the concept of Islamic banks recently, though its banking system has long been nationalized. There have been discussions with the Kuwait Finance House about the latter opening a Baghdad office to provide trade finance on an Islamic basis.

Turkey offers perhaps the best prospects for Islamic banking expansion in the Middle East. With a large population of over 50 million, an established industrial base, agricultural self-sufficiency, a flourishing tourist sector and a government committed to helping the private sector, prospects for the economy look very encouraging. Turkey enjoyed the fastest growth rate of any OECD country in the 1980s, yet it is the only Muslim country in this organization of developed nations. The arrival of the Islamic banks in Turkey has been very recent, as it was only in late 1983 that the government of Turgut Ozal passed the necessary legislation. In 1985, the two major Islamic financing groups entered the Turkish market, with the opening of the Al Baraka Turkish Special Finance Institution in Istanbul and FFK -the Faisal Institution, part of the *Dar-Al-Maal al-Islami* group. During 1985, Al Baraka attracted over 3000 accounts, while the Faisal institution had over 5000 clients after nine months of operation. The rapid growth has continued, but as both institutions still only account for less than one per cent of all Turkish bank deposits, the scope for expansion is clearly enormous. Besides Turkey, there is also scope for expansion in the Central Asian Republic, an opportunity the Al Baraka group has responded to, with a branch in Uzbekistan.

.3INTER-BANK RELATIONS

There is a well-known saying that imitation is the sincerest form of flattery. Certainly it is an excellent reflection on the success of Islamic banking that many conventional commercial banks are now offering their clients Islamic financial services. This trend is being encouraged by the demands of Muslim clients, who are increasingly letting their views be known in the marketplace of what is, and what is not acceptable financial practice. This trend is apparent both in the Islamic world, and in countries where Muslims are minorities, or merely temporary residents or visitors. Saudi Arabia's largest bank, the National Commercial Bank, for example, today offers specifically Islamic trade finance to its clients as one of its services. The largest chain of money changing establishments in Saudi Arabia, the Al Rajhi group, is now a designated Islamic financial institution which claims that all its transactions are conducted in accordance with the *shari'ah* law. When it was floated as a public company in the spring of 1988, its shares were five times oversubscribed. As a result of such developments, the distinction is becoming more blurred between specifically Islamic banks and finance houses on the one hand, and western style commercial banks on the other. It would nevertheless be premature, and perhaps objectionable to many, to over-exaggerate the extent of any convergence.

In international markets, the links between Islamic and non-Islamic institutions have been greatest, not least because Muslims need to do business in these markets given the current pattern of global economic relationships. Firstly, most trade of Muslim states is with non-Islamic rather than Islamic countries, a fact many may regret, but nevertheless a continuing reality. A major function of banks in the Muslim world, including Islamic banks, is the provision of trade finance, and much of this is to finance imports from the industrialized West. Secondly, Western financial markets provide both a breadth and depth for diversified portfolio investment which is simply unavailable in the Islamic World.

The Al Baraka group opened their own outlet in London through Al Baraka Investment Company in 1983. An advisory office for Islamic Investments is also maintained in London by the Saudi Arabian Al Rajhi group through a United Kingdom registered company, the Al Rajhi Company for Islamic Investments .*Dar-al-Maal al-Islami* in Geneva serves as a European outlet for the Faisal Islamic Banks, though its main activity is the promotion of commercial investments in developing countries, rather than investment in European capital markets.

.4THE ROLE OF NON-ISLAMIC INSTITUTIONS

For payments and remittances abroad, the Islamic banks often rely on conventional commercial banks with branches in the country in which the payment is to be made. These can either be overseas branches of commercial banks based in the Arab World, or Western banks, or joint venture banks with Western and Arab capital. For example, the Faisal Islamic Banks of Egypt and Sudan mostly use UBAF (l'Union de Banques Arabes et Francaises) as a correspondent in London, Paris and other European centers, while the Kuwait Finance House uses the United Bank of Kuwait in London, which is owned by the major Kuwaiti banks and investment companies, but not the Kuwait Finance House itself.

Although these conventional commercial banks are engaged in *riba* transactions, in their dealings as correspondents for the Islamic banks ,*riba* is not involved. For the provision of payments and remittance services a fee is charged for each transaction, as is the normal practice. With foreign exchange dealings spot transactions are considered legitimate but there are no transactions carried out in forward or futures markets on behalf of Islamic institutions. In the long term, many Islamic institutions wish to open branches in Western markets, but given the current regulatory environment, and the economies of scale associated with activities such as portfolio investment, the need to continue dealing with conventional *riba* based institutions will perhaps continue through the 1990s.

Some banks based in London and other European centers are in any case responding to the needs of both their own Muslim clients and Islamic banks with which they have dealings. Most of the Euro-Arab joint venture banks, for example, offer Islamic trade finance on *murabahah* basis. An increasing amount of trade financing involving Muslim countries is likely to be provided on this basis in the 1990s. Some wholly Western banks have been marketing Islamic investment instruments. Kleinworth Benson, for example, marketed an Islamic Unit Trust in 1986, which used the principles of ethical investment to construct a portfolio which would be considered *halal* by some Muslim clients. The Union Bank of Switzerland adopted a similar approach in the choice of investments for its Islamic Investment Fund. Not all Muslim investors have been happy with such developments however, especially where the funds involved are not subject to an audit or even supervision by a *shari'ah* committee.

Despite such worries, there is undoubtedly scope for non-Islamic financial institutions to deal with both Islamic banks and Muslim clients wanting *halal* financing.

Al Baraka deals extensively with Western financial institutions and companies, and First Path Financial Services, which is run by American and Canadian Muslims, does likewise. The reality of Western financial market strength is recognized ,and Islamic investors who want a balanced portfolio have to look to institutions with the experience of dealing in such markets.

The Islamic Banking Unit of the United Bank of Kuwait has become one of the most important providers of *riba* free services in London. Saudi International Bank maintains a similar unit, and the ANZ, the Australia and New Zealand Bank, has also extended its Islamic financial services from London.

.5HARMONIZATION OF ISLAMIC FINANCIAL PRACTICE

There is a healthy debate amongst Muslim scholars about the application of *shari'ah* in the financial field. Although the law itself is clear, its translation into modern rapidly evolving financial practice is inevitably open to different interpretations. Islamic banks have attempted to build up a common code of practice, and the emergence of bodies such as the Heliopolis based International Association of Islamic Banks has helped. Most Islamic Banks belong to this organization, which has branches in London, Jeddah, Karachi and Dubai. There are significant institutions outside the associations, including the banks and investment companies which form part of the Al Baraka Group, and the commercial banks in Iran, whose operations were Islamized in August 1983 under the mistranslated "Law for Usury Free Banking."

Although the principles of Islamic finance are well known, and there is a substantial literature on the methods of financing involved, the documentation on actual practice is meager, and usually unpublished. There have been a number of studies in recent years on the working of particular Islamic financial institutions, but most concentrate on the broad development of the banks concerned, and examine their deposit and lending policies in general terms. There is no practical guide to Islamic financial instruments, and no universally acknowledged standard reference manual for Islamic bankers to follow. Indeed there appears to be considerable divergence in Islamic financial practice between institutions in the same line of business. No Islamic institutions can guarantee a depositor's return, but how far does the uncertainty go? Most Islamic banks, for example, do not guarantee the value of deposits which can be adjusted according to the institution's financial performance. There are, however, some institutions which provide such a guarantee. Is this practice Islamic? Western banks seeking to offer Islamic banking services are confused by the variations in practice.

There is no international Islamic accounting standard, and most Islamic banks are subject to conventional audits, as well as specifically religious audits. Despite some discussion of the issue of Islamic accounting standards, and a seminar on the topic arranged by the Islamic Development Bank, there is no consensus over detail ,though the idea of a standard is widely welcomed. The conventional audits are sometimes carried out by Western firms of accountants. Ernst and Whinney, for example, audit the accounts of the Al Baraka Islamic Investment Bank in Bahrain, an institution which draws much of its business from Saudi Arabia. Usually established local accounting firms are involved with professionally qualified staff. Such audits are normally required by law for all registered companies, and the central banks of the countries in which the Islamic institutions operate will expect to receive a copy of the audited accounts each year. The *shari'ah* audit is usually conducted by the banks' own religious supervisory board of *shari'ah* advisors. They examine the banks' balance sheets and profit and loss accounts, and review the financial and investment activities of the banks to ensure that they comply with the *shari'ah*.

It is argued in some quarters that the *shari'ah* advisors are too closely associated with the banks' management .*Shari'ah* advisors usually have legal rather than accountancy qualifications, and may not be able to fully understand the accounting procedures. Furthermore, they are paid a fee for their services, and have an interest in being retained. Some argue that this practice could undermine their impartiality. One alternative would be for a body such as the International Association of Islamic banks to have its own *shari'ah* auditors, who could audit the accounts and review the activities of the association's members. The *shari'ah* committees or religious advisors would then be paid by the Association rather than by the banks themselves. The banks' subscriptions to the Association would presumably be increased.

Those non-Islamic institutions which offer Islamic finance to Muslim clients seldom use either a *shari'ah* advisor or have a religious supervisory committee. Some argue that there is not enough business to justify the appointment of an Islamic auditor. If the International Association of Islamic Banks could offer auditing services, should these be extended to non-Muslim institutions offering Islamic finance? This is another topic which would have to be addressed in the context of any future developments towards the standardization of practice.

It would also be useful if there was more discussion of operational standards with respect to Islamic financial practice. What, for example, are the criteria for deciding when *mudarabah*) equity sharing) is preferable to *musharakah*) profit sharing)? Each

Islamic bank has its own criteria, but there are no internationally accepted guidelines. What considerations should be taken into account in decisions about the scale and timing of *musharakah* finance? How are the profit shares determined? Should there be standard methods for assessing the contribution of entrepreneurship viz-a-viz that of risk capital? With *murabahah* trade credit, how long should the period be? Is a relationship between time and mark up permissible, or should the mark up be solely determined by risk? The calculation of the mark up is also a matter to be settled. Should it be calculated on a cost-plus basis, or demand related so that a pricing mechanism is used to determine who gets access to *murabahah* ?These kind of basic economic issues are seldom explored, yet they are much more than mere technicalities.

.6AN ISLAMIC FINANCIAL MARKET

In most Islamic countries, financial markets are either non-existent or have developed to only a limited extent. Government securities are traded to only a small degree, and those instruments which are marketed often carry *riba* .Equity markets are also under-developed, though from the point of view of Islamic financial institutions such investments are of potentially greater interest than conventional government securities. The shares of specifically Islamic companies are quoted on the Cairo, Amman and Kuwait stock markets, and many of the other shares on offer could be considered as legitimate Islamic investment. Stock market development in many Islamic countries has, however, been impeded by nationalization measures, although this type of state economic involvement is now less emphasized, and in some Muslim states privatizations are being implemented, as in Turkey or Bangladesh, or are being considered, as in Egypt.

Many family businesses in Muslim countries are reluctant to seek public quotation, as they fear, probably correctly, that family control might be lost. Often finance for expansion is sacrificed, and businesses remain small, because of such worries. There is clearly a venture capital gap, which the Islamic banks could help meet through *mudarabah* financing. Under these arrangements, where a separate company is set up by the bank and its client ,there is no risk of the client loosing control of his original business. Indeed *mudarabah* finance seems the ideal financial vehicle in such circumstances. Even under *musharakah* arrangements, however, an Islamic bank is merely interested in obtaining a return, not in company control. Hence, small business clients should have much less apprehension about dealing with Islamic banks than with private or corporate investors who might ultimately take them over.

The absence of marketable Islamic financial instruments impedes the flexibility of Islamic financial institutions, and reduces their profitability. Many Islamic banks hold large cash reserves, which earn no return, largely because they cannot hold *riba* based inter-bank deposits, or government securities which yield interest. Even trade financing through *murabahah* ,though ultimately self liquidating, is too long term for immediate cash calls. Two developments could clearly aid Islamic financial institutions, and transform the Muslim financial scene in the 1990s, but both seem a long way off. The first would be the creation of Islamic certificates of deposit which could be traded amongst the Islamic banks themselves. The second would be the issue of debt instruments by the governments of Muslim states which could be legally held and traded under the *shari'ah* law.

For both instruments to be traded, there would clearly have to be sufficient buyers and sellers in the market, Islamic institutions prepared to act as market makers, and central banks conversant with and sympathetic to the principles of Islamic finance which could provide an appropriate regulatory framework. The markets in government debt instruments would have to be at the national level, with the instruments denominated in particular Muslim currencies. The market in Islamic certificates of deposit would perhaps best function internationally, with the certificates denominated in either a Western currency such as the dollar, mark or yen, or in terms of Islamic dinars. The latter might be particularly attractive given the instability of the US dollar, and its increasing inadequacy as a store of value.

The Islamic Development Bank could perhaps play a crucial role in any market for Islamic certificates of deposit. At present, this Jeddah based institution acts largely as an aid agency, assisting projects and advancing foreign trade finance to Muslim countries. However, it is not active in financial markets, nor does it function as a kind of supernational Islamic central bank. What is proposed is a much more modest but perhaps realizable goal. If the Islamic Development Bank issued its own certificates of deposit in the first instance, these could be purchased by Islamic banks and other commercial institutions. This would enable the Islamic Development Bank to increase its own liquidity. The Islamic Development Bank would play the role of ultimate market guarantor, which would be prepared to offer cash for any certificates of deposit sold back to it. In practice, however, Islamic Banks would usually sell the certificates of deposit to another commercial Islamic bank. The Islamic Development Bank would only need to act as ultimate paymaster if there was market failure.

Islamic certificates of deposit would not yield a fixed return, nor could their value be guaranteed. They would, however, be attractive to their holders, as they could always be converted into cash on demand, and they would (usually) be profitable. The return could be a function of the profits which the Islamic Development Bank makes on all its activities, or alternatively related to a multiple of the return which the Bank made on the activities financed from the deposit proceeds. The multiple might be necessary to make the instruments attractive, this being financed by the Muslim governments which are the shareholders in the Bank in relation to their shares of the paid up capital. The governments themselves could regard their modest subscriptions as a way of promoting Islamic solidarity through co-financing with private Islamic capital.

Such financing, by harnessing counterpart private funds, would be much more beneficial than mere official aid. This type of scheme might be attractive in the more difficult financial climate which currently prevails in the Islamic World, and which is likely to continue into the 1990s. It also captures the mood of the late 1980s in the Arab world in particular, which favors a greater role for private capital, and making use of markets rather than trying to regulate them out of existence. Though the value of the certificates of deposit could not be guaranteed, it would only be devalued if there was any writing down in the capital of the Islamic Development Bank. This would be an extremely unlikely occurrence, given the stability and size of the institution. If the paid-up capital of the bank was increased, then there could be a revisionary bonus for the holders of Islamic certificates of deposit, though not necessarily proportional to the increase in capital.

Were such an Islamic financial instrument successfully introduced and marketed, then it could set a precedent for other Islamic financial institutions to issue their own certificates of deposit. The returns on these might be higher on average than those issued by the Islamic Development Bank, but the variability, and hence the risk, greater. Caution would need to be exercised, as it would be undesirable, and certainly un-Islamic to have speculative instruments. Only the instruments issued by well established Islamic banks and financial institutions could be traded for the certificates of deposit issued by the Islamic Development Bank. The Islamic Development Bank, as principal market maker and ultimate payments guarantor, could ensure that this was the case.

At the same time the possibility of arbitrage between the certificates of deposits issued by the Islamic Development Bank and those issued by the Islamic commercial banks would prevent the rates getting out of line. Arbitrage, unlike speculation, is permissible under the *shari'ah* law, provided it does not involve interest, futures, or forward transactions. Much arbitrage involves these elements of course, but that between Islamic financial certificates of deposit would not as there is a degree of risk associated with the instruments themselves.

.7FIRST STEPS TOWARDS AN ISLAMIC INTER-BANK MARKET

Two schemes were initiated by the Islamic Development Bank in 1987, both of which indicate a growing recognition that this intergovernmental agency has some role to play viz-a-viz the Islamic commercial banks. One is the Islamic Banks' Investment Portfolio Fund and the other is the Islamic Development Bank Unit Trust. The first was immediately implemented, with a considerable degree of success, while the second started its operations in January 1990 after undergoing further refinements. Under the Islamic Banks' Portfolio scheme the leading Islamic commercial banks were invited to subscribe to a fund which is administered by the Islamic Development Bank. It is designed to be used for export and import finance of trade amongst Islamic countries, and between Islamic countries and the rest of the world. The subscriptions are in dollars, and share certificates are issued to the participating institutions worth $100 each. The certificates are valid for an initial 25 years but this period may be extended for subsequent periods of 25 years at the discretion of the Islamic Development Bank.

The share certificates are tradable instruments which can be bought and sold amongst the Islamic Banks themselves. In the absence of a regular market in the certificates, however, the prices are announced at least every three months by the Islamic Development Bank, which itself trades at the announced price. The price is determined in the light of the financial position of the portfolio, as attested by two external auditors, and by the supply of and demand for certificates in the market. In practice, this is likely to be determined by the profits on the certificates, as holders receive a 90 per cent share of the profits, distributed annually. The Islamic Development Bank receives a 5 per cent share of the profit as the portfolio manager or the *mudarib* ,and 5 per cent is retained to support the financial position of the fund.

.8THE ISLAMIC BANKS PORTFOLIO IN PRACTICE

The initial capital of US $65 million was 75 per cent subscribed by the end of 1987, with the Islamic Development Bank itself contributing $25 million. The Al Baraka Investment Bank in Bahrain, subscribed $9.25 million, but the group's total holding is $17.75 million, as its associates in Sudan, Bangladesh, Mauritania, Turkey, Tunisia, Jordan and London have all taken up subscriptions. Prince Mohamed bin

Faisal's group of Islamic banks has also been supportive, with the Faisal Offshore Bank in Bahrain subscribing $5 million, the Faisal Islamic Bank of Egypt $5 million, and the Faisal Islamic Bank of Sudan $0.25 million. The Kuwait Finance House also subscribed $5 million. In total, 21 individual Islamic banks supported the issue. In 1991, the capital was increased to $80 million.

There is little doubt that the banks' enthusiasm reflects not only the potential profitability of the certificates, but also their desire to cooperate with the Islamic Development Bank, which is a potentially important business partner, as the largest Islamic financial institution. No less than four Sudanese Islamic banks subscribed, despite the financially difficult conditions in Sudan, and the severe shortage of dollars available. The share certificates should nevertheless prove a sound long term investment, as well as a useful divisible means of liquidity management. The Islamic Development Bank hopes to make further issues, and bring in other institutional investors, but these issues will not exceed 10 times the initial capital at any point of time. Therefore, there is no risk of the market being flooded by paper, and the price being driven down. Indeed with a wider spread of institutional investors, and the proven interest in the first issue, price prospects appear favorable.

Profits should be reasonable, as by the end of 1987 nine short term trade financing and one leasing operations had already been mounted by the fund. The value of these deals amounted to $23.5 million representing almost half of the paid up capital in the Portfolio. The periods of credit ranged from 6 to 18 months, with goods purchased on the Islamic resale basis on behalf of private companies in Saudi Arabia, Egypt, Turkey, Algeria, Tunisia, Iraq, Kuwait and Pakistan. There is a little risk involved in any of the ventures, and the link with the Islamic commercial banks has enabled the Islamic Development Bank to identify a new client base which would not otherwise have been reached. From the point of view of the Islamic commercial banks, the scheme has the merit that it enables them to indirectly participate in international trade finance with minimum risk. At the same time, the Portfolio represents a useful channel in which to place surplus liquidity which will yield a return. Furthermore ,the Islamic commercial banks can introduce their more important corporate clients to a new type of financing widening the product choice available to those in need of funding.

.9AN ISLAMIC UNIT TRUST

The Islamic Development Bank launched the Unit Investment Fund on December 2, 1989. The Fund started its operations on January 1, 1990, with an issue of US $100 million. The Unit Trust is managed by the Islamic Development Bank, which acts as trustee. Certificates are issued to subscribers at a par value of US $1.0, these being negotiable and transferable. It is hoped to list the certificates in regular securities markets, but the Islamic Development Bank would in any case be ready to periodically repurchase the certificates on request at prices to be determined.

Establishment of the Unit Trust raises many issues, not least whether the fund should actually be called a unit trust or whether it is some type of investment pool or investment trust. Unit trust certificates are always repurchasable on demand rather than periodically, there being no specified time element. Prices are determined on the basis of the prices of the underlying stock in which the funds are invested, which is usually stock quoted on the listed or unlisted securities market. The problem in the case of the Islamic Development Bank is that it is intended to transfer some of the bank's existing asset portfolio to the unit management, thereby releasing resources for new ventures. These assets are usually not tradable, however, and do not have a price. They are basically equity stakes in projects, or machinery or equipment being leased on a long term basis. Valuation is likely to be far from easy, as it is debatable whether this should be done on the basis of historical cost, resale value if there is a market replacement cost, etc. The handling of depreciation is a large enough issue, but this is only one complexity. If unit prices are revised then the whole question arises whether a complete revaluation is necessary, and on what basis.

.10THE FUTURE

Although the Islamic banking movement has been tremendously successful, it is important not to be complacent, and merely review the encouraging progress of the 1970s, 1980s and early 1990s. There has already been much imaginative thinking in the field of Islamic finance, and some of the ideas have given non-Muslim observers considerable food for thought. Indeed many of the economic problems of the Western world may stem from an excessive reliance on *riba* finance, and the narrow and unhealthy obsessions which that seems to bring. Now that Islamic banks have proved themselves to be viable retail financial institutions within individual Muslim countries, there is a need to look to the broader horizons of international finance. Some Islamic institutions with Western basis have already moved in that direction. An effective Islamic interbank market will, however, require tradable instruments. This is one area where further thinking is needed. Islamic certificates of deposit may be one possibility, and it is hoped the scheme suggested here will contribute to the debate. The creation of other instruments may well be feasible and Islamically permissible. The Islamic Development Bank has already taken the first steps. Debate on such matters may be one way of moving Islamic finance forward and of providing a welcome alternative for Muslim financial dealings to the *riba* based international status quo .

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