

Challenges and opportunities for Halal financing in fintech

Across the Middle East, innovative financial technology (fintech) is evolving rapidly with demand expected to further increase due to the region's demographics. With more than one-fifth of the population being between the ages of 15 and 24, there is a growing determination to develop and access more technology-driven services. DR MURAD M DAGHLES writes.



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Halal financing and Islamic finance transactions are based on two fundamental principles: (i) each transaction must be related to a real underlying economic transaction, and (ii) all parties entering into a financial transaction must share the profits, losses and risks associated with such a transaction.

In the context of fintech, certain legal structures may be deployed in order to safeguard Halal financing. Among them is Murabahah, a cost-plus sales contract, which is a financial structure that enables immediate asset purchase with a pre-agreed profit against a deferred payment. Mudarabah is a partnership comprising a financier and a contributor of expertise or management, allowing the parties to participate in the profits and losses according to their prior agreement.

Further, Sukuk are asset-based certificates representing undivided shares in the ownership of certain tangible assets, property rights and services that act as financial securities comparable to conventional bonds but differing in the relation to the asset they are based on. Istisnah is a common option for construction and manufacturing agreements, allowing deferred payments linked to the completion of the project.

Blockchain

Blockchain is a distributed ledger technology which records and shares data and allows the authentication of transactions online without a central counterparty, such as a central bank, for securities. By reducing the number of parties required for a transaction, blockchain reduces the transaction costs and other rent extracted by centralized



third parties, and has the potential to facilitate the Tawarruq process through ledgering and enabling the automated sale of commodities. Blockchain also has the potential to provide for increased standards of security and transparency, with the caveat that at the same time it may also create new potential legal and practical risks leading to more insecurity and uncertainty.

The Saudi Arabian Monetary Authority, a regulatory authority involved in fintech, has signed an agreement with Ripple, a leading supplier of blockchain payment solutions, to implement and trial blockchain-based transactions. In February 2020, Egypt also made its first venture into the blockchain sector. The National Bank of Egypt executed a cooperation agreement with Ripple to establish new channels for inward remittances. The UAE also instituted Blockchain Strategy 2021, aiming for blockchain technology to be used in 50% of the government's transactions by 2021.

Cryptocurrency

Cryptocurrencies are digital currencies secured via cryptography, a technique of protecting information by encrypting it and ensuring that only those with a respective secret digital key are able to

decrypt it, according to the article titled 'The Evolution of Digital Currencies: Bitcoin, A Cryptocurrency Causing a Monetary Revolution' by Chris Rose and published in the International Business & Economics Research Journal.

Cryptocurrencies are easily tradeable against goods and other currencies. However, Islamic law does not accept currency as a subject matter of trade; instead, it is considered merely a medium of exchange resulting in no further utility except where the intrinsic utility of the exchange is sold for money, according to the article titled 'Blockchain Technologies and the Prospects of Smart Contracts in Islamic Finance' by Volker Nienhaus and published in the book, 'Fintech in Islamic Finance'. In its current form, it is questionable whether cryptocurrency allows for strict compliance with Islamic finance.

In fact, Egyptian Grand Mufti Sheikh Shawki Allam has endorsed a ban on cryptocurrencies in Egypt citing concerns of fraudulence and cheating, and the subsequent harm arising therefrom, ultimately forbidding them under Shariah law.

However, innovative solutions such as creating cryptocurrencies with values

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linked to real assets such as gold are promising developments.

Nonetheless, in May 2019, the Central Bank of Egypt announced that it is drafting a law for crypto-related activities, obliging financial institutions to obtain licenses in advance for cryptocurrency activities such as creating, advertising or operating platforms that issue or facilitate the trading of cryptocurrency.

Crowdfunding

Crowdfunding allows the raising of funds through contributions through an intermediary, typically in the form of a web-based platform for a particular purpose, as explained by Muhammad Al-Bashir Muhammad Al-Amine in the article titled 'Crowdfunding in Islamic Finance: Ensuring proper Shariah oversight' in the book, 'Fintech in Islamic Finance'. Contributors may benefit from a material prize, interest, profit share or a 'warm glow', while the platform receives registration fees or commissions on the contributions. Crowdfunding in the Middle East may serve as a simpler and swifter solution to the complexities of conventional financing methods, avoiding prohibited elements of interest and encouraging innovation and cooperation.

In Egypt, the concept of crowdfunding is already well-established. In 2014, the Egyptian government raised funds to expand the Suez Canal by selling investment certifications to millions of Egyptians. In February 2019, the Technology Innovation and Entrepreneurship Center, the United Nations Development Programme in Egypt (UNDP Egypt) and the UNDP Alternative Finance Lab partnered together to foster crowdfunding in Egypt by providing training to 10 start-ups, introducing crowdfunding as an impact investment tool.

Summary

Fintech is a rapidly evolving industry with wide-ranging implications and potential for not only Islamic finance but for all industries. These technological developments already have a significant impact on businesses and will continue to gain more prominence. However, for Halal financing, it will take considerable regulatory developments to integrate into the growing fintech industry. ☺

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