

Convergence between Socially Responsible Investment and Islamic Finance

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Abstract

Socially Responsible Investment (SRI) and Islamic finance are both categories of investment concepts which largely unknown, they have many things in common: they rely on extra-financial criteria, and considered as attractive areas for development.

This paper provides some clues on the complementarity of their mechanisms and how, the religious foundations of Islamic finance comparably to other ethical finance in countries where Christianity is the dominant religion, and the possibility of extension of Islamic finance in those countries. We begin by recalling what fundamental religious SRI and Islamic finance before describing their possible common mechanisms and all latest offers of financial products that converge for the first time the two concepts.

Keywords: Socially Responsible Investment, Islamic Finance

1. Introduction

We must go back to the XVIIth century to find the beginning of the emergence of ethical finance in the western financial sphere.

John Wesley, founder of the Methodist movement, declared that the use of money for ethical purposes is the second most important point that influenced the New Testament: its doctrine has greatly influenced the United States, home of the de-

velopment of Socially Responsible Investment (SRI) [1].

In France, the first initiatives related to ethical investment emerged in the 80s under the leadership of Sister Nicole Reille.

In charge of administration of the budget of the Congregation of Notre Dame, this nun was after the initiative of launching a mutual fund whose main objective was to manage ethically, the savings of nuns of about forty religious congregations.

To accomplish this undertaking, sister Nicole said, "we were inspired by the social encyclicals of the Church [2], (...) we arrived at the conclusion that our financial investments could and should be at the service of man and his development, with particular attention to the most disadvantaged."

How was structured this type of investment, and what could be instead of Islamic finance in this new environment whose growth has been multiplied by 6 in 10 years?

In late 2007, the French Association of Financial Management (AFG) counted 175 SRI funds outstanding for a total of approximately € 22.1 billion. [3]

Initially, the motivation of ethical investors was primarily religious motivations. At the French level, where the Sisters of the Congregation of Notre-Dame is a striking example.

2. SRI approaches

The first SRI resolutions were filed in the late 60's in the United States by church groups and student associations on the Vietnam War. Another favorite subject was apartheid in South Africa in this regard, the American Episcopal Church in 1971 filed a resolution at the general meeting of General Motors. All of these initiatives has led two years later to the creation of the Interfaith Center on Corporate Responsibility (ICCR), comprising 275 institutions now Protestant, Catholic and Jewish holding more than \$ 120 billion. This organization has since been at the forefront of shareholder activism on social issues in the United States.

Religious activists in the United Kingdom also participated in the campaign against apartheid during the period 1970-1984, particularly involving Barclays Bank and the oil company Royal Dutch / Shell. Their efforts include convince institutional investors to divest from these companies, which led Barclays to withdraw partially from South Africa in 1985. Moreover, the rise of this campaign on both sides of the Atlantic has resulted in the departure of more than two-thirds of U.S. companies operating in South Africa.

More recently, various phenomena have contributed to the growth of SRI:

- The many financial crises and other financial scandals (Enron, WorldCom) have prompted investors to look at criteria other than those related to the single yields race
- The many government initiatives and international on climate, water, pollution, sustainable development, micro credit, corporate social responsibility have prompted investors to rethink their strategies in a world in search of a more moralized [4]

- Finally, the growing desire of customers anxious to see their savings invested in supports with high ethical tendency has boosted the market. In April 2008, BNP Paribas issued a study that showed that more than one customer on two was ready to invest a portion of their savings on supports ISR [5].

3. Islamic finance Principles

Sharia, Islamic law is based mainly on the writings of the Koran and the Prophet sayings, provides a normative framework for different aspects of Muslims' life; it lays out key principles of the report Muslim/money

One of the principles of Sharia compliant investment is the prohibition of illicit assets: alcohol, tobacco (less systematic) arming (less systematic) gambling, pornography, the entertainment industry (music, cinema ...) the financial industry, the pig industry.

There are five main principles:

- Prohibiting The interest (riba)
- The sharing of profits and losses between the lender and the borrower
- Prohibition of uncertainty and chance (gharar), including speculation
- The existence of an underlying asset or obligation of any investment to lean a real asset
- The prohibition of illicit assets (haram), determined as such by the industry and the financial situation of the company

For the five principles mentioned above, Islamic finance has developed a number of sometimes complex mechanisms. The Islamic financial system did not simply ask and moral rules and principles of non-financial, but beautiful and well designed tools to implement them. And, in addition to any investment based

on underlying real and financial conditions have set very specific about investable companies, which therefore require special financial analysis. The following ratios are those taken into account by the Dow Jones Islamic Market, even if the thresholds may vary depending on the institution:

- The debt ratio of the average market capitalization over the last 12 months should not exceed 33%.
- Cash and interest bearing securities held by the company must not exceed 33% of the average market capitalization over the last 12 months.
- Ratio of claims on the average market capitalization over the last 12 months should not exceed 33%.

These ratios correspond to the logic of the existence of an underlying the cash flow and the proscription of interest: for example, if it is mechanically inevitable that the company is indebted, and key interest hold cash, the majority of its value must come from real activity.

4. Common criteria to both standards

The presentation so far of the principles of Islamic finance suggests several points of convergence with ethical finance and SRI. However, important gaps may appear between theory and practice. If certain rules relating to financial practices are clearly formalized, other moral principles of Sharia occur only marginally in Islamic finance as conveyed today.

The purpose is similar to that of SRI as it has developed in recent years, namely sustainable development in its economic and social pillars: creating wealth for society and improving the quality of human life. The environmental pillar is not absent either in Islamic finance: a cornerstone of Islam is that man fulfills a stewardship of God's creation

If Islamic finance is not particularly close to the Best-in-Class, however it is quite in line with the ethical finance. The sectoral exclusions, originally of SRI as we know it today, are in fact from religious considerations, Protestant and Catholic in this case. It is therefore not surprising that the list of prohibited areas is substantially the same as in the case of Islamic finance: alcohol, pornography, gambling, tobacco and weapons are fairly widely condemned activities, are deemed harmful to the man and society. However, certain exclusions are specific to Islamic finance, such as the financial industry or the entertainment industry (music, movies ...). These sectors are also not always an output of the investable universe. Regarding the pig industry, it is prohibited to the extent that Islam prohibits the consumption of pork.

Contrary to what can be done in the case of SRI, Islamic finance does not explicitly exclude issuers guilty of the worst social and environmental practices. However, a publication of OWW Consulting [6], consultancy CSR and SRI established in South East Asia highlights the similarities between Islamic principles and those of the Global Compact. As a reminder, Global Compact [7] is a UN initiative which calls on signatory companies to comply with ten principles in four categories: human rights, labor, environment and the fight against corruption. These principles are based on reference texts such as the Universal Declaration of Human Rights, the Declaration of the International Labour Organization on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development and the United Nations Convention against Corruption. It should be noted that the Global Compact not binding and is of no is not monitored practices of signatories. OWW Consulting report shows compliance with the principles of Islam to each of these principles, noting

motivations sometimes different and sometimes further requirements. It does not look so far put into practice, much less effective, these principles in Islamic finance.

5. Conclusion

For ten years now, the market for socially responsible investment and ethical finance is broadly growing. Today the fund managers diversify their management strategies and now offer a range of funds particularly oriented towards environmental, social and corporate governance has become a major topic during this crisis.

In this environment, investment according to the Islamic label would find a prominent place, a strong set of principles that seem to jurisprudence in these times of challenging financial system as a whole.

The evolution of demand in terms of social and environmental implications of financial players will be an area for improvement of Shari'a compliant for funds structurers.

Some tools such as funds under the category of "Ouooud tabarou'at" (Qard al hassane, Waqf, etc.) will be excellent vehicles to meet this demand and meet consumer expectations SRI.

Finally, it will require Islamic financial players (Shari'a Boards, management companies, structurers, etc.). Reflect integration in their corpus of rules, some SRI criteria (pollution, corporate governance, etc..).

The issue related to the inclusion of these new criteria will allow Islamic finance to demonstrate its ability to adapt but also to prove the good faith of its deeply ethical dimension.

Accordingly, to the extent that the two approaches are not contradictory in their

purpose, they could be not only compatible but also complementary consideration of ESG issues providing both value and financial ethics, including limiting risks. The rise of Islamic finance and that of the SRI does not seem correlated today, but it is up to the players, financial research, credit rating agencies, NGOs or even regulators, to promote their reconciliation. This would jointly develop these approaches aim to encourage more ethical, accountable and transparent, and find new customers, especially for SRI in countries where it is now absent.

6. References

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