FINAL EXAM
FIRST SEMESTER SESSION 2012/2013

COURSE CODE / NAME : BWFS 3093 SEMINAR IN ISLAMIC FINANCE AND BANKING
DATE : 13 JANUARY 2013 (SUNDAY)
TIME : 9.00 – 11.30 AM (2 ½ HOURS)
VENUE : DMS

INSTRUCTION :

1. This examination paper contains FOUR (4) questions in THREE (3) printed pages excluding the cover page.
2. Answer ALL questions in the answer BOOKLET provided.

MATRIC NO : _____________________________

( with word )

( with number )

IDENTIFICATION CARD NO. :

LECTURER : ______________________________

GROUP : _______ TABLE NO. : _____________

DO NOT OPEN THIS EXAMINATION PAPER UNTIL INSTRUCTED

CONFIDENTIAL
QUESTION ONE (24 MARKS)

1. An important principle in Islamic finance is the requirement that all financing transactions must be backed by an underlying real economic activity.

   (i) Explain the asset-backed requirement in Islamic finance. (2 marks)
   (ii) Explain TWO (2) important implications of the asset-backing requirement in Islamic finance. (4 marks)
   (iii) List THREE (3) financial assets that do not qualify to be used as the underlying asset. (3 marks)

2. An important distinction between conventional and Islamic finance is the perception towards risk and return. While interest-based financing transfers the business risk to the borrower, Islamic finance requires the financier to assume certain risk as a condition for earning a return.

   (i) Describe THREE (3) types of risk-bearing contracts that are currently used in the Islamic financial services industry. Give ONE (1) example for each category. (9 marks)
   (ii) Contrary to its theoretical proposition that Islamic finance promotes risk-sharing contracts, an observation of the contemporary practice indicates a widespread use of low-risk contracts. Discuss TWO (2) reasons that contribute to the phenomenon. (6 marks)

QUESTION TWO (27 MARKS)

1. Islamic banks were initially established to provide banking products and services that are free from unlawful elements that exist in conventional banks. In other words, Islamic banks offer Shariah-compliant alternatives to the existing products currently provided by conventional banks.

   (i) Explain how the following conventional products violate the Shariah principles.
      (a) Home financing (2 marks)
      (b) Personal financing (2 marks)
      (c) Fixed deposit (2 marks)

   (ii) Describe how Shariah-compliant contracts are used to eliminate unlawful elements in the following products:
      (a) Home financing (3 marks)
      (b) Personal financing (3 marks)
      (c) Fixed deposit (3 marks)
2. *Takaful* is the Shariah-compliant alternative to conventional insurance. In other words, *takaful* operators around the world offer *takaful* products that are free of *riba*, *gharar* and *maysir*. Currently, there are three operational models that are adopted by *takaful* operators around the world.

(i) Explain how *takaful* products eliminate the existence of these unlawful elements: *riba*, *gharar*, and *maysir*. (6 marks)

(ii) Describe the evolution of *takaful* operating models in Malaysia. Support your answer with an example from the industry. (2 marks)

(iii) Discuss TWO (2) reasons for the evolution of operating models in the *takaful* industry. (4 marks)

QUESTION THREE (24 MARKS)

Shariah-compliant financial instrument is a crucial component in determining the continued survival and competitiveness of the Islamic financial services industry. Indeed, the prohibition of interest in Islam emphasizes the crucial role of an Islamic equity and asset-backed instruments.

(i) Since the Shariah views financial instruments as representative of assets, there is no separation between financial instruments and their underlying real economic activity. Briefly describe the Shariah guidance pertaining to negotiability and tradability of these THREE (3) types of financial instruments.

(a) Debt-based financial instruments (2 marks)

(b) Asset-based financial instruments (2 marks)

(c) Partnership-based financial instruments (2 marks)

(ii) Equity instruments are generally permissible due to their risk-sharing feature. However, there exist certain practices in the operations of conventional stock market which clearly violate certain Shariah principles. Describe how the following operational aspects of conventional stock market violate the Shariah principles.

(a) short-selling (2 marks)

(b) margin trading (2 marks)

(c) speculative trading (2 marks)
(iii) Distinguish between conventional asset-backed securities and sukuk based on the following aspects:

(a) Ownership (2 marks)
(b) Principal protection (2 marks)
(c) Linkage with asset value (2 marks)

(iv) Discuss how TWO (2) of the above features of Islamic securitization prevent the occurrence of the subprime mortgage crisis. (6 marks)

QUESTION FOUR (25 MARKS)

Financial engineering is crucial to ensure the survival of the Islamic financial services industry. While innovation in the conventional financial system is motivated by the desire to evade certain regulations or tax requirements, innovation in Islamic finance must comply with the Shariah precepts. Thus, product development in Islamic finance is more challenging because of the needs to comply to the Shariah requirements as well as fulfilling the existing legal, regulatory, accounting and taxation requirements of the existing financial services industry. As a result, the practice of Islamic finance is not much different from its conventional counterpart. The failure to fully adhere to the Shariah ideals has raised concerns relating to authenticity of the Islamic financial services industry.

(i) Describe TWO (2) approaches that have been taken in developing Islamic products and services. (4 marks)

(ii) Discuss TWO (2) reasons why one approach is more prevalent during the initial stage of the development of the industry. (5 marks)

(iii) Support your answer in (ii) above by providing ONE (1) example from the following segment of the Islamic financial services industry:

(a) Islamic banking (2 marks)
(b) Sukuk market (2 marks)

(iv) Discuss THREE (3) challenges which hinder the product development effort in the Islamic financial services industry. (12 marks)

END OF QUESTIONS