Islamic Banking: Insulation against US Credit Crisis

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Abstract

During the last twenty years there has been an enormous increase in the global awareness and world-wide growth of Islamic banking governed by Islamic finance. In spite of severe aftershocks of recent global financial crisis stemming from subprime mortgage crisis of USA 2007-2008 that has threatened the stability of international finance, the Islamic banking system remained progressing at the uniform pace with growth rate of 8.85% and reaching assets worth USD 895 billion in 2010. This paper aims at highlighting the feasibility and reliability of Islamic banking as an interest free banking system with reference to its growth prospects, success factors and various sharia't complaint financing modes in light of subprime mortgage crisis of USA.

Key Words: Islamic banking, insulation, US credit crisis, Musharka, Ijara, Conventional banking.

Paper Type: Conceptual Paper

1. Introduction

The recent Credit crisisof USA, also known as subprime mortgage crisis as one of the main indicators of the 2007-2010 financial crisis,has wreaked havoc and extreme turbulence in the world financial markets. A credit crisis, also known as a credit crunch,is commonly referred to as "severe shortage of money or credit in the economy"(Farook, 2009). Against all odds, the Islamic banking has shown a remarkable increase in the growth rates of bank reserves and number of customers. Almost all of financial institutions have been affected by credit crisis but its negative effect on Islamic banking is almost insignificant as compared to conventional banks(Nijzink, 2009).

The fact lies in the key tenet of Islamic banking which includes the elimination of interest (Riba) in financial dealings. Riba is prohibited in four major religions: Christianity, Judaism, Islam, and Hinduism (Chapra & Umer, 1998).According to basic Islamic perception about money that it has no built-in value, money cannot be earned out of money directly.Anti-sharia't principle "selling a debt against a debt" has made credit crisis technically improbable in Islamic financial market.This paper uses terms of credit crisis, financial crisis, subprime mortgage crisis, credit crunchandeconomic turmoil interchangeably.

This paper answers following research questions:

RQ1. What is Islamic banking and its theoretical analysis as interest free banking system?
RQ2. What are the growth prospects of Islamic banking in the perspective of financial crisis?
RQ3. What are the underlying structural causes and consequences of credit crisis?

RQ4. What is Sharia't compliant financing and alternativeways of home financing practiced by Islamic banking?

RQ5. What is significance of Islamic finance in providing insulation to Islamic banking against severe global economic turmoil?

Islamic Banking asInterest Free Banking System: A Theoretical Analysis

Before defining the Islamic banking system it is useful to define some basic terminology. Riba is an Arabic word which means doubling or addition and it refers to the any excess amount paid for the use of money at the predetermined rate after a specified period(Khan, 1986). Whetherriba refers to the usury or interest, it has been under conflicts in the past but now there is consensus among Muslims scholars that it covers not only 'excessive interest' but all other forms of interestas well. Thus, riba, interest and financial interest will be used interchangeably in this study. According to contemporary interpretations the most significant element that the Islamic banking must possess is the elimination of interest in the financial transactions. TheQuranic injunction against financial interestis given asfollows:

"Allah has permitted sale and forbidden interest…. [T]hose who repeat (the offence of interest) are companion of the fire. They will abide there-in" (2: 273)

Thus, the Islamic banking system will be referred as a banking system in which the payment or receiptof interest is not allowed when compared to its conventional counterpart. Islamic banking aims at seeking the target of an Islamic economy working in accordance with the philosophy of the Islamic value system. In spite of the fact that the terms"Interest free banking" and "Islamic banking" have been used interchangeably, many scholars and writershave focused that the earlier is a more normative concept whereas the later is actual Islamicbanking practice or mode.Although the discussion regarding the reasons for the financial interest being forbidden have been varied among Muslim scholars; it is evident from the clearly stated Quranic injunctions that there is no space for difference in interpretation about whether interest can or cannot be charged in Islamic financial transactions. Basically it is the fair distribution of wealth and protection of the poor that is held behind the strong condemnation of interest based financial contracts.

Interest free banking system seems difficult to be imagined by many viewers. They often argue that such a bankingsystem cannot be effectively run and consequently it reduces savings and investments. Zaher& Hassan (2001) claimed that modern Muslim scholars have felt the need to redefine the theory of interest as its prohibition by Allah is related to some major concepts. Muslim scholars do not allow interest as savings' reward, capital productivity or difference of today's or tomorrow's worth of capital.They further claimed that the Muslim scholars argue that interest can be savings' reward only if it is produced by reinvesting or successive capital growth. For capital productivity, Muslims' scholars argue that it is not justified as interest doesn't depend on capital productivity rather it is paid on money regardless of capital productivity.

For the disagreement of paying interest as a difference in today's and tomorrow's worth of capital they think that if it is the only justification then a more reasonable way is to determine the rate of interest by the economic conditions of next year instead of predetermining it.Hence, certainty of interest is an issue and guaranteed interest is not allowed in Islamic financial law (Zaher & Hassan, 2001) A recent interpretation regarding financial interest is that interest may be earned only when the property or asset of a person is exposed to some risk otherwise any other payment made on investment bearing no investment risk (based on its pure time value) is not allowed(Hamwi & Aylward, 1999). In any case, the Islamic banking system has to work within the defined interest free context presented by Islamic financial law.

Growth Prospects of Global Islamic Banking

With the global financial markets experiencing extreme unrest due to existing credit crunch, the world Islamic banking sector has been progressing at the uniform pace. According to Financial Times (2008), the Islamic banking has gained a growth more than five folds by hitting $900bn from $15bn during the time period of 1990 to 2008 and prospering at the yearly pace of 15%-20%.As for most recent statistics revealed by Financial Times of November 2008, the global Islamic banking assets worth $800bn from around 50 countries accelerated at 27.6% over the past year. Nonetheless, when compared with top 1000 global conventional banks having assets worth $90,256bnthis amount is relatively small.

With world markets struggling hard to make their existence after the global economic turmoil the Islamic banking has been progressing at the uniform pace [Zeti, 2010]. The six Gulf Cooperation council (GCC) statesi.e. Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and UAE contribute the major fraction of the entire $800bn.global Islamic banking assets but the non-GCC states are also playing their role well. In the overall listing of $800bn. assets; the GCC foundations flourished mainly by an astounding 47.5% to reach 262.

7bn, whereas the non-GCC (MENA) establishments accelerated at 40.4% and made contribution in overall assets worth $248.3bn. Asian countries (including Pakistan, Thailand, Malaysia and others) account for the prime area to sharia't complaint financial instruments having a growth rate of 32.3% to 119.3bn. Following table shows the remarkable performance of Islamic banks of Gulf region in terms of aggregate size, in the midst of crisis, in comparison to conventional banks that further glorifies its efficiency and resilience.

Table 1: Islamic and Conventional Banks in the Gulf Region, 2008

Particulars	Conventional banks	Islamic banks
Assets (USD Billions)	1,135,669	232,189
Assets growth 2007-08	16.3%	38.2%
Profits (USD Billions)	22,008	7,666
Profits growth 2007-08	−6.1%	20.1%
Profits/Assets	1.9%	3.3%

Source: El-Jarhi, 2009. Islamic windows in conventional banks are not included in Islamic banks.

America, Europe and Australia contributed $35.1bn with growth rate of 60.6% in addition to sub-Saharan African establishments that accounted for $4.7bn of total. Recently, Britain's HSBC, Americans' Citi Group and Germany's Deutsche Bank that are being considered as global banking giants have also introduced sharia't compliant banking units (Farook, 2009). According to latest figures revealed by survey report made for Islamic Financial institutions for year 2010, the total sharia't complaint assets has reached $895bn in year 2010, growing at the rate of 8.85%, from $822bn in 2009 (Top 500 Islamic Financial Institutions, 2010).
Two new programs -founding of the International Islamic Liquidity Management Corporation (IILM) and the settlement of the Islamic Financial Stability Forum (IFSF)- undertaken in October 2010 will together make efforts towards the continued global flexibility (Zeti, 2010).

Moreover, it is to be noted that the US Treasury department conducted the first training seminar on Islamic banking for US government employees at the end of 2008. The Vatican newspaper,revealed that in the current economic turmoil the conventional banks should consider Islamic banks in order to rebuild trust among their clients. Whereas, the Islamic bank offers strikingly similar products to those of offered by conventional banks; their continued pliability in the financial crisis is based on more ethical and less risk bearing investment approach than conventional banks. It is further narrated that the French finance minister Christine Lagarde declaredParis to make "the capital of Islamic finance" in its most recent intentions(Tobin & U, 2009). The above discussion clearly states the growth prospects of Islamic banking and its glimpse of future progress.

An over view of pre and post crisis performance of Islamic Banks: Report on top ten Islamic banks

Islamic banking is a broad emergent financial concept that is becoming more popular and strong globally. Islamic banking in many aspects is different from conventional banking. The sustained flexibility of Islamic financial institutions during the currentfinancial crisisgives deep insight in the built-in strength of Islamic finance. The core values and principles of Islamic finance are sourced from Quran and Sunna'h. The basic philosophy of the Islamic finance is to give protection to the property of people and to eliminate widespread injustice in the society.Itis aimed at serving the society that is based on ethical and religious standards.A study on the performance of the top 10 conventional banks with the top 10 Islamic banks indicates the following

- During the time period December 2006 to May 2009, in comparison to top 10 conventional banks showing a decline in combined market capitalization with 42.8%, the Islamic banks suffered a decrease of 8.5% only.
- As for conventional banks a vivid turndown in aggregate net profits occurred and it reached to net loss of USD 42 billion in 2008 from USD 116 billion in 2006, whereas during the same periodthe Islamic banks experienced an increase in net gain and hit USD 4.6 billion from USD 4.2 billion. Moreover the number of conventional banks that experienced losses is four where as for Islamic banks it is nil.
- The total assets of conventional banks' reserves accelerated at 36% and reached USD 17.4 trillion but on the other side Islamic banksgrew at 55% to reach at USD 147 billion from USD 94 billion during the period 2006 to 2008. Similarly, during this period an increase in total equity for conventional banks and Islamic banks was 24% and 36% respectively
- The leverage ratio (Assets/Equity) of conventional banks was 16.6 times in 2006 that increased further in 2008 to 18.2 times. This leverage ratio was nearly three times of Islamic banks that was 5.8 times and 6.6 times in 2006 and 2008 respectively.

- Five out of top ten conventional banks gained financial assistance upto USD 163 billion in total or 26% of affected banks combined equity from government. In comparison to that, only one Islamic financial institution needed government support to restructure and trading of its shares, was suspended. Towards end of 2009, none of Islamic banks required any government rescue financial support.(Ali & Aziz, 2010).

Figure 1: Pre and post crisis changes in net profit, market capitalization, assets and equity

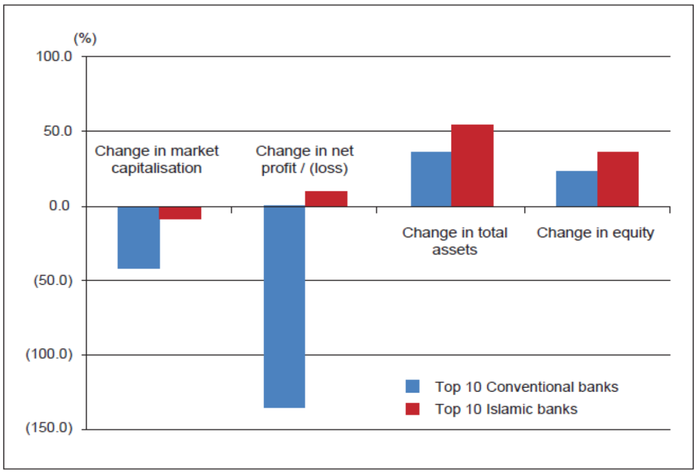


Figure 2: Pre and post crisis Market capitalization of top 10 conventional banks and Islamic banks

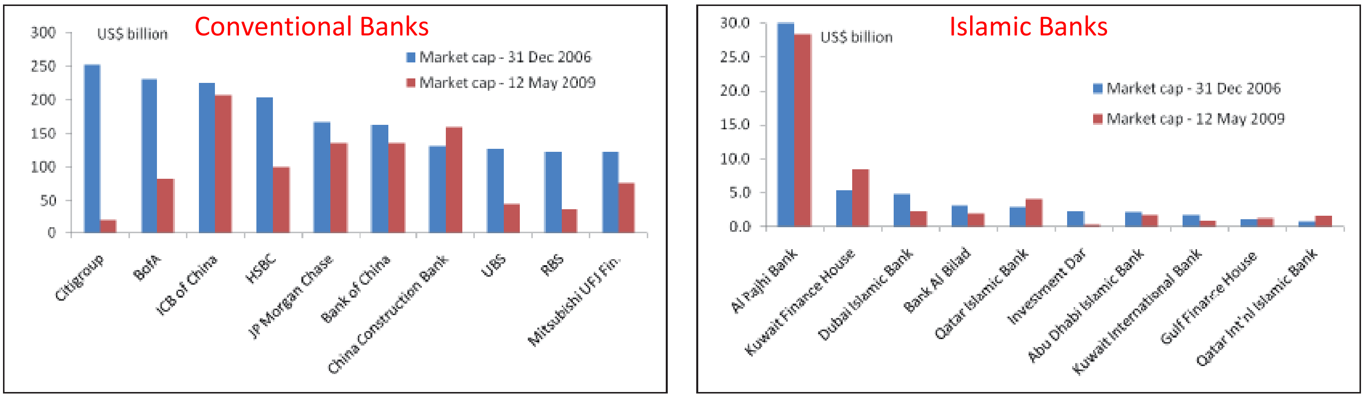


Figure3: Pre and post crisis net profit/net loss of top 10 conventional banks and Islamic banks

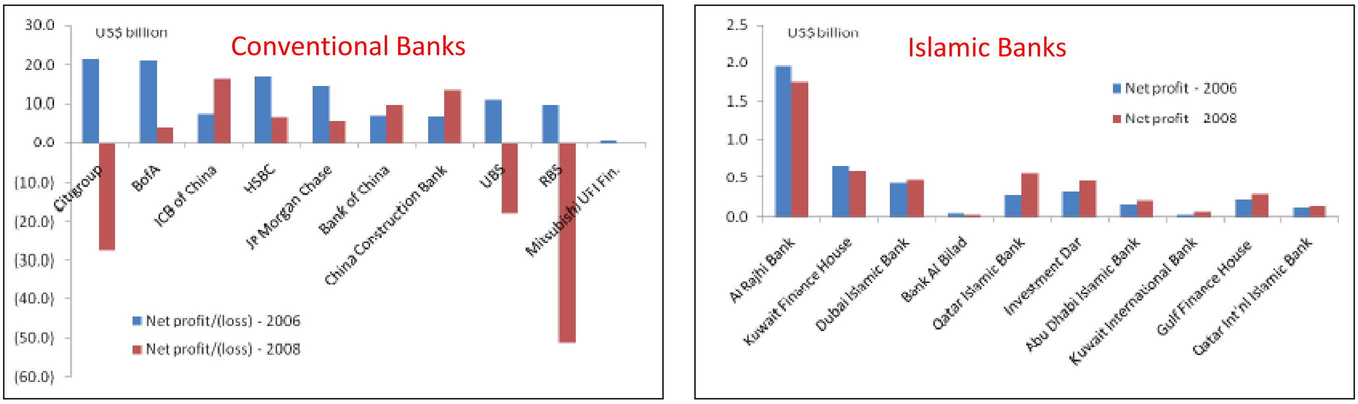


Figure 4: pre and post crisis total assets of top 10 conventional banks and Islamic banks

Conventional Banks Islamic Banks

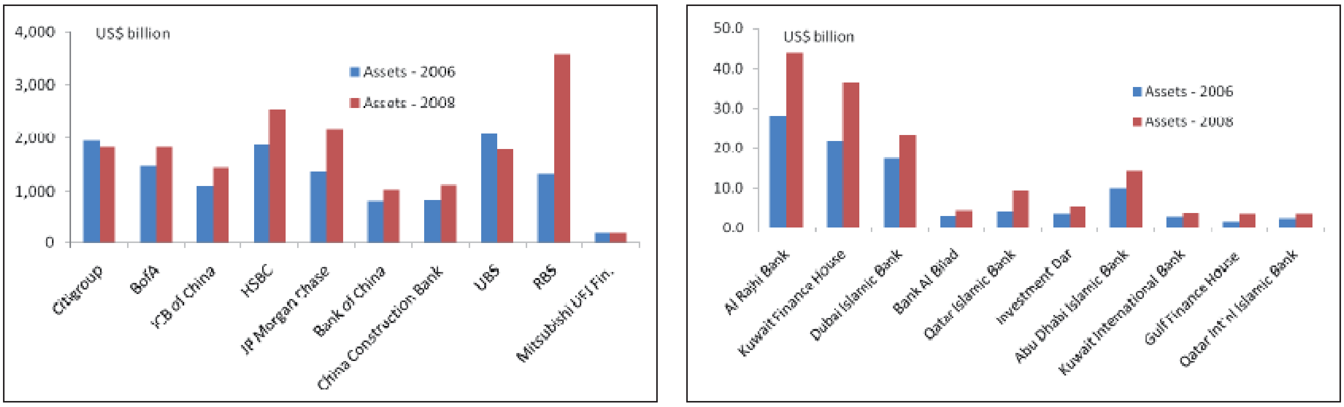
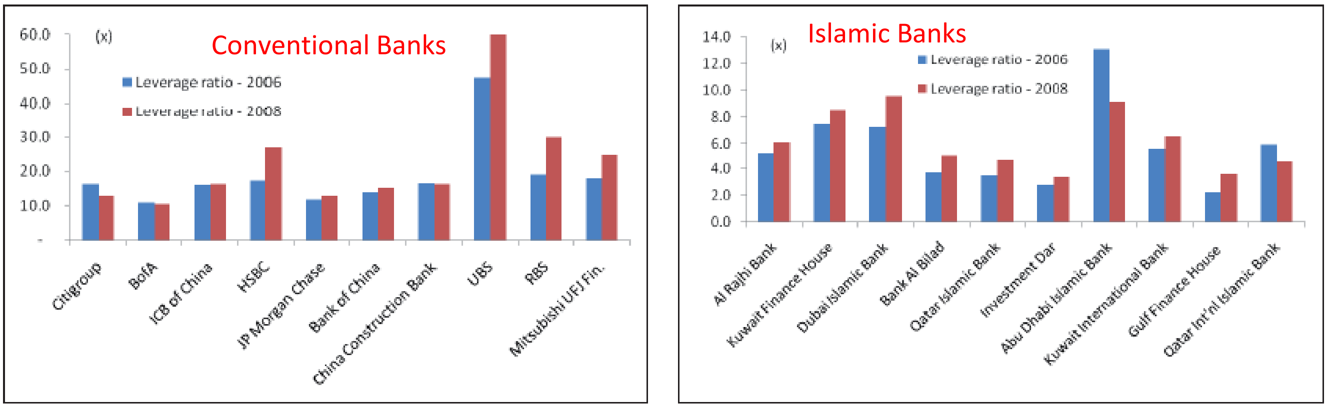


Figure 5: Pre and post crisis Leverage ratio (Asset/Equity) of top 10 conventional banks and Islamic banks



Sources:

• Company annual reports and websites; financial database websites (Thomson Reuters etc.)
• The Banker, November 2008 report on top 500 Islamic financial institutions
• Ernst & Young Analysis

Note:

• All financial figures have been converted to USD on current exchange rates.
• All figures are for December year-end, except Mitsubishi UFJ Financial which has March year-end. Its 2006 numbers are actually for 12 months ended March 2007. Its 2008 numbers are as of September 30, 2008, the last reported figures. Net profit for 2008 is for six months.
• The 2008 numbers for Investment Dar are for 9 months – up to 30 September 2008.
• As of 1 April 2009, the Kuwait Stock Exchange suspended trading in Investment Dar's shares until further notice as a result of the postponement of the release of its full year financial results for the year ended 31 December 2008.
• The list of top 10 Islamic banks in terms of 2006 market cap does not include some large Iranian banks which claim to be Shari'ah compliant but their market data is not easily available.

2. Background and Underlying Causes of Credit Crisis

The credit crisis of 2007 to the present is a crisis triggered by a liquidity shortfall in the United States banking system. Among the various causes that contributed toward the crisis, one is the failure of governmental institutions of USA in various aspects. At first, through the government sponsored enterprise Fannie Mae and Freddie Mac, the USgovernment implicitly subsidized the credit expansion in the US housing market. In context of meeting certain housing objectives by the department of housing and urban development, the senior management deliberately continued to buy large amount of subprime loans in spite of the emerging risk felt by the risk managers(Calomiris, 2008). After the market for mortgage loan had been shaped, the private investors were also encouraged to enter. With rise in interest rates in 2004 the tendency to meet obligations of bank by many home owners declined and resultantly the home prices plunged. The monetary policy made by US policy makers also got failed. The Federal Reserve systematically lowered the price of money to keep the economic growth at its normal pace. As a result surplus liquidity caused the housing bubble when invested in housing. Another drawback concerns the lack of proper regulation and supervisory framework of financial markets. It failed to rectify the market imperfection in the trade. The individual firms especially banks were focused by Europe as well as on global level. Sufficient measures had not been taken at observation of significant risks (De LarosiereGroup, 2009).

Severe competition among countries also contributed to this disaster. In fear of losing national competitive position the tighter supervision was denounced by the most controllers (Tabellini, 2008) The second main contributor to this economic turmoil was the conventional banking sector's involvement in the reckless subprime mortgage lending. The proper checking of credit histories, income and other relevant parameters of borrowers were ignored by the bankers. These subprime loans were sold within the year in the secondary market.Thus, the holder of these secured mortgages wasfacing the credit risk (Mian&Sufi, 2008) The third main group of players concerns the investment banks that have transformed the mortgages into mortgage backs securities and collateralized debt obligations.These evolved instruments can be beneficial for risk sharing till they also account for more chances for asymmetric information that is used to hide risk toward the respective buyers (Skreta&Veldkamp, 2009) The credit rating agencies were among the fourth major contributor. Rating inflation has resulted due to competition in rating agencies. It is revealed by empirical evidence that the higher ratio bias is produced by ratio agencies. More complex securities resulted in higher rating biasness produced by rating agencies.

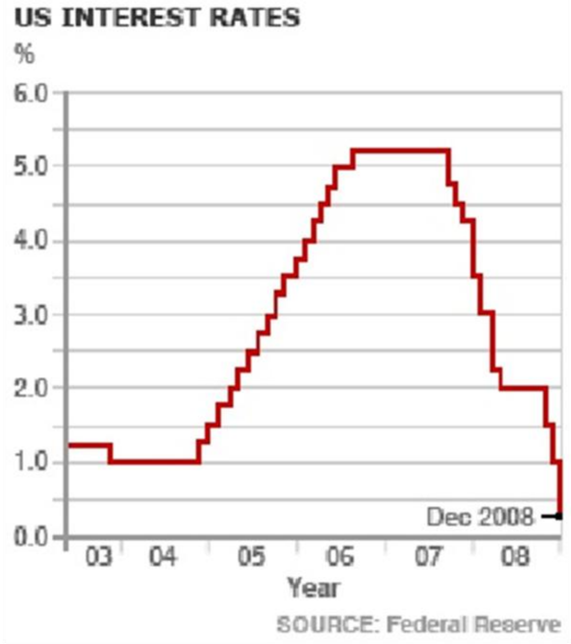
The buyers of derivatives have also shown to have concern in this regard. Too much risk was allocated to the portfolios and the poor evaluation tools were used (Brevas, 2006). Finally, it can be concluded that the shareholder of banks settled the short time horizon and focused on short term profitability. The average stock holding period was reduced to less than one year from about seven years in mid 1960's (Rapport, 2005).
If we analyze the whole scenario we will be able to find following main reasons behind the credit crunch; global imbalances, flaws in conventional banking i.e. easy lending practices, over leveraging, subprime lending, deregulation, spike in capital cost and weak liquidity. The excessive investment in mortgage bond market and highly easy lending practices with its effect on credit risk were the two main catalyst triggering credit crisis. Yet, the above mentioned contributing factors are fundamentally associated with makeup of instruments and financial measures. When discussing from the paradigm of Islamic financial law these contain two contributing factors that is Riba or financial interest and the activity of buying and selling of debts refers to as *al kali bil kali* in its Arabic formulation.

In October2007, major collapses became prominent in world financial market. Giant Swiss UBS bank declared the subprime losses worth USD 3.4bn. American banking giant Citi Group announced USD 40bn loss linked to subprime investment. US investment bank posted a USD 7.9bn to unpaid debts. One of the chief bond issuers, MBIA revealed a total failure of USD 2.3bn. The present credit crunch is stated as "probably a once in a century type of event" (says Former Federal Reserve Chief Alan Greenspan) and warned that this may result in failure of major firms (Farook, 2009).

3. Consequences of Financial crises

As the credit crunch has hit the wealthiest nations, it has caused acute unrest in financial markets declining the overall world economy. Since 11 September 2001, world stock markets together with FTSE 100 Index of London have undergone severe fall downs and accompanied with lowest world economic growth rate of 0.5% ever since world war II. Different countries announced several financial rescue packages to gain stability against credit crunch. Due to extreme market volatility the French Saving Bank (Caisse'dEpargne) suffered the crash of 600million Euros during this period. The government of South Korea and Dutch declared USD130bn and 20bn Euros (USD 26.8bn) financial rescue packages, respectively, to defend their financial market from the economic turmoil. Similarly, Sweden's government rescue plan included the credit guarantees to the mortgage providers and banks for 1.5 trillion Kroner (USD 205bn).

Moreover a financial crisis has caused a severe unemployment crisis with about 51 million jobless people worldwide. The severe financial turmoil had caused huge negative effect on the economic growth of USA with 11 million American unemployed. To overcome the country's recession the US Federal Reserve has cut the key financial interest rates to 0.00%-0.25 percent in 2008 from 5.25% in September 2007. Similarly the Bank of England in its 315 years history has slashed its key interest rates to a record low to 1%. According to officially announced figure by Bank of England in its financial stability report, it is revealed that financial institutions have already suffered a loss of $2.8 trillion from the current credit crunch (Farook, 2009 and Wade, 2009)



4. *Bailout plans-Two views*

a. **Proppnents' View:** Supporters of the bailout plan argued that the financial rescue plans should necessarily be carried out to gain the confidence of the investors in the credit markets of USA otherwise its failure could result in severe economic turmoil (Usman, 2010).

b. **Opponent's View:** Opponents of the bail out plan argued that plan must not be carried out since surplus of credit and debts caused the economic crises in the USA. The crisis will even enhance and accelerate further due to this increased addition of credit to the economy so some other better feasible solutions should be found out**(**Usman, 2010)

However while the global conventional bank have been in loss of more than $400 billion, the Islamic banks are virtually zero. The next portion of this paper will highlight the success factors behind this prominent survival of Islamic banking and alternative financing modes presented by Islamic Financial Law.

5. *Shari'a Compliant Financing*

Essentially Islamic finance stands for all shari'a complaint features, procedures and dealings in the financial system. It is based on Divine rules and is sourced from Quran and Sunnah. It has a clear and prominent lay down of product arrangements and contractual modes for business finance.These financing procedures, however, have common goal of obtaining corresponding financial benefit as that enjoyed by its counter, conventional economic system. Sheikh Yusuf TalalDelorenzo, a leading shari'a board member said:

"While these product and services may appear similar to conventional financial products and services, particularly from an economic perspective, the contractual and structural underpinnings of these products and services comply with shari'a. Thus, while a shari'a complaint home finance contract may resemble a conventional mortgage in many ways, the underlying structure is quite different. Simply stated, while the economics are the same, the mechanics are different"

The Islamic bank-customer relationship that exists in Islamic financial transactions is one of the unique aspects that make it different from its counter banking system. In Islamic banking nature of contract is of significant importance that governs the dealing between the client and the bank. In the conventional system this relationship is mainly of borrower-lender relationship for financing and of a lender-borrower relationship for deposit purposes. This study intends to analyze the current approach of financing that have resulted in the present economic turmoil and the prospective immunity framework provided by shari'a complaint financing.

Islamic financial contracts cover the areas of investment, trading, loan or agency. In Islamic financial transaction, the financial element of interest that is prevailing in the conventional financing modes, known as riba, is prohibited. The reason of credit crunch is adhered to the financial interest factor present in conventional home financing models which is characterized mainly by targeting the subprime consumers and further securitization of such kinds of loans to be dealt in secondary market. Moreover it is claimed by Hamid Yunis, the head of the law firm Taylor Wessing's Islamic finance practicethat Islamic Finance allows trade or investment in only visible-tangible assets.

An asset must be visible for it to be sharia't complaint. While shari'a allows certain options, structures and futures for example*salaam* (sale contract with deferred delivery) and *arboun*(sale contract with non-refundable deposit), it forbids highly complex derivativeinstruments(Wade, 2009).EmadYousef Al monayea, Chairman and Managing Director of Liquidiy House, a KFH subsidiary, reported that Islamic finance encourages the need of asset back trade to make the contract more sound and transparent. One of the fundamental elements which provided insulation to Islamic banking against credit crunch was the existence of assets behind the shari'a complaint models. Thus assets must be real, with a value and possess some sort of marketable features into them (Al-Monayea, 2010). Although shari'a complaint home financing is similar to its conventional counterpart with same economic objective yet they do so with ensuring the strict check on demand-supply relation along with the prohibition of any element of unnecessary ambiguity or speculation.

6. Islamic financing models for home financing

Shari'a complaint financing models for home financing can be divided into three areas. These categories are characterized by distinct kind of relationships that exist between the parties and exhibit various modes of contracts. Among these categories, the asset based financing is the first division. It basically represents the sale-purchase contracts made between the customer and Islamic bank. In this mode the bank acts as middleman or buyer thus purchases the required asset as requested by the customer and then transfer its ownership back to customer at the acquisition cost plus a profit. The contract is agreed on the base of delayed payment made for a stated extent of time. Here the variation in prices of buying and selling provides the only profit that the bank enjoys. This structure exhibits the seller-buyer bond that connects the Islamic bank and the client and *murahba* contract (financing on cost-plus basis) is the type of contract usually used. A key feature of the *murahba* contract is that the ownership of the asset is actually possessed by the bank before transferring its title to the other party. Thus the bank bears some risk to justify its profit. *Murahba* home financing is an example of this type of financing.

Next, there is second division called as equity based financing. It typically refers to the business operation where the Islamic bank contributes the percentage of capital as capital injection and the customer contributes some money injection or no money at all along with sweat equity that represents its management efforts and knowhow thus acting as an entrepreneur borrower. The parties to the contract proportionately share in gain and losses arising there from according to some pre agreed formula linked to the certain transaction. This undertaking comes to an exit either when the customer repurchase the shares after the span of time thus redeeming the equity of the bank or the case in which the set gain percentage is reached by the bank over the time length. In this arrangement entrepreneur-investor relationship or equity partners exist between bank and its customer. The *musharka* (partnership agreement) and *mudarba* contract are considered under this arrangement. *Musharkamutanaqisa* or diminishing musharka models is the paradigm of equity based financing.

The last division refers to the financing of work or service. It represents the financial activity where by the Islamic bank purchases machinery or equipment according to the requested needs of client and leases it back to client under installment plan over agreed period of time. The customer at its own discretion may own the asset after the leasing duration ends. This resembles to conventional hire purchase financing in structure. The continued inflow of hiring payment represents the gain enjoyed by the bank until the leasing duration expires. This model is based on lesser-lessee relationship and the *ijarawaiqtina* contract or the *ijaramuntahiyabiltamlik* contracts are the type of contracts being used. The *ijarawaiqtina* home financing model is the exact demonstration for this type of category. However, absence of interest and the kind of relationships that exist between parties to the contract are the glaring differences between the shari'a complaint home financing models and its counter part. (Aziz &Gintzburger, 2009)

7. Conclusions

In the current economic and financial global scenario, the Islamic banking gives a deep insight into Islamic economics and provides a practicable, systematic and sustainable financial alternative to the world economic system that requires reevaluation and reorientation after the severe aftershock of financial crisis. The credit crisis of 2007-2010 originating from subprime mortgage crisis 2007 of USAwas a test for both Islamic banking and its conventional counterpart in which Islamic banking has proven its worth. While over the world, the conventional banks have suffered losses of more than $400 billion, the losses of Islamic banks are virtually zero. Along with disclosing the flaws in the global financial system it depicts a final conclusion that Islamic finance provides a far better ethical and religious ways of financing that is purely based on divine rules rather than manly intellect. This paper clearly demonstrates Islamic banking as interest free banking system. Aside from narrating the underlying structural causes and consequences of financial crises, this paper has presented the alternativesharia't compliant financial modes for home financing based on asset based, equity based financing or financing of work or service.

Due to inherent factors within Islamic banking it is largely protected against financial crises. The very primary among such contributory elements is that the buying and selling of debts is prohibited and sufficient precautions are taken against money laundering(Al-Hamzani, 2008). Noninvolvement of interest factor and non-application of selling debts against debts these models provide a safer and more ethical financing approach toitsclients than its conventional counterpart in which these elements are excessively practiced. The Islamic finance has basic perception regarding money that it has no intrinsic value so money cannot be earned out of money directly instead Islam proposes certain other legitimate ways of earning wealth through investment or trade.This paper further concludes that the nature of contract and the type of relationship that exist between Islamic banks and its clients is what that makes it different from its conventional counterpart and accounts for its success as well. This paper provided the perspectives of the Islamic finance governing Islamic banking system that have contributed toward the insulation of Islamic banking financial institutions against the wide spread global credit crunch.

It is acknowledged that the scope of this paper has been fairly limited, as several interesting questions regarding Islamic banking are yet unanswered. The generalized approach regarding interest free banking system should be studied in detail to evaluate its effect on investment, saving and level of financial development if such system would have been adopted globally.The alternative securitization model practiced by Islamic banking system has not been discussed in this study. Further, the level of product diversification possessed by Islamic banking and its developing role in financial infrastructure is needed to be addressed in detail. Moreover, the current and future challenges to Islamic banking should also be considered and the ways to withstand such challenges must be explored.Despite these limitations, this study is helpful to provide a guideline for framing certain policy implication for the world threatened financial stability due to credit crisis, in light of Islamic finance. Although Islamic banking remained insulated from recent credit crisis still it has to equip itself from further ornaments to keep its growth in the world financial market and to preempt challenges. A Chinese proverb will suffice to say; “A crisis is an opportunity riding the dangerous winds”
The global financial crisis is an ongoing issue and has to be addressed in a unique, diversified and reoriented ways as a significant risk remains there for the global economy over coming period.

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