

# Ethical Finance and Islamic Finance: Particularities, Possible Convergence and Potential Development

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**Abstract**—Economics is not an exact science. It cannot be from the moment it is a social science that concerns society organization, a human science that depends on the behavior of the men and women who make a part of this society. Therefore, it cannot ignore morality, the instinctive sense of good and evil, the natural order which place us between certain values, and which religion often sheds light on. In terms of finance, the reference to ethics is becoming more popular than ever. This is naturally due to the growing financial crises. Finance is less and less ethical, but some financial practices have continued to do so. This is the case of ethical finance and Islamic finance. After attempting to define the concepts of ethical finance and Islamic finance, in a period when financial innovation seeks to encourage differentiation in order to create more profit margins, this article attempts to expose the particularities, the convergences and the potentialities of development of these two sensibilities.

**Keywords**—Convergences, ethical finance, Islamic finance, potential development.

## I. INTRODUCTION

NOWADAYS, Islamic finance is a rather successful example of an entanglement between religious principles and economics. Organizations need to adapt to an environment and context that is not devoid of religious principles. The Islamic economic doctrine reminds the Islamic bank of its ethical responsibility and its duty of economic participation. This will be one of the conditions for their effectiveness, as the theory of contingency has largely shown [1]. Ethics comes into the play in order to make the morality fully respected and the economy at the service of man. Therefore, it is essential to assess the "ethical" character of Islamic finance. It is the same in ethical finance, which today would be an exact science, welcoming to mathematics, but which will always remain an area of the economy, and consequently submitted to morality and to ethics. This reference to ethics is becoming more popular than ever because this requirement is becoming more and more important. Thus, the world is a changing geo-financial paradigm. The different financial crises throughout history highlight so-called "ethical" investments that resist well to the storm and market dysfunctions. And so, it seems interesting to dwell on it by trying to understand why they are less vulnerable and how they are structured. Socially Responsible Investment (SRI) and Islamic finance belong to this category of ethical finance. These two investment concepts are still largely unknown but they have at least two

points in common: they use extra-financial parameters and are considered by the main financial centers of the world as very attractive development axes.

Islamic finance integrates ethical components that can constitute points of convergence with the SRI in the societal goal and in the exclusion of activities deemed unethical. It aims to improve the human condition, establish social equity and prevent injustice in trade. These objectives are in line with those of SRI as it has developed in recent years, namely sustainable development in its economic and social pillars. Thus, insofar as the two approaches are not contradictory in their aim, they could be not only compatible but also complementary, since they had the characteristic of being a source of additional commitments, and eventually of additional responsibilities. They could not only be conceptual but also mutually enriching. The rise of Islamic finance and ethical finance do not seem to be correlated today, but it is up to local actors, financiers, research centers, rating agencies, NGOs or even regulators, to promote their development.

This article focuses on a central issue: how Islamic finance can be an alternative to conventional finance in the direction of more ethical finance? In other words, to what extent is Islamic finance an ethical finance and what are the strengths of this finance with regard to the possible establishment of capitalism better characterized by ethics?

We will try throughout this analysis to understand this complex problematic. First, we will begin our analytical work with a literary passage on the origin, evolution, trends, fundamentals and potential contributions of Islamic finance. And to better understand the ethical questions and issues of finance, we will discuss the genesis of ethical finance to study the ethical foundations of Islamic finance. Then, and after trying to define the concepts and actors of ethical finance and Islamic finance, we will try to expose the stakes, the challenges and, of course, the potential for development of these two approaches. At the end of this qualitative analysis, we will be able to provide answers to the problematic of our paper by examining the conjunction between ethical finance and Islamic finance, while trying to answer the following questions: - Are their mechanisms complementary and how? - Are the religious foundations of Islamic finance comparable to those that have led to ethical finance?

## II. GENESIS OF ETHICAL FINANCE AND ISLAMIC FINANCE

Islamic finance emerged with the creation of the first Islamic banks (the Islamic Development Bank, the Nasser Bank in Egypt, the Dubai Commercial Bank, etc.). Moreover, the abundant flow of oil rents, the phenomenon of over-

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liquidity accompanied by the development of the oil industry, which was accentuated by the "oil shock" of the 1970s, and the Pan-Islamist movement have highlighted the need to create financial institutions specially adapted for the region. These years were also years of growing demand from the faithful population, who no longer wanted to deposit their assets in banks with conventional financial instruments.

Just as Catholic doctrine proscribed interest, Islam rejected the trade of money, which must retain its role as a unit of value and currency. However, the return of an investment is envisaged in another way:

"Islamic finance remains a business that takes into account profitability. It comes to be grafted to conventional finance with a filtering that seeks to clean it up."

In addition, as in Christian ethical finance, exclusion criteria are applied to Islamic investments. The list is variable, but alcohol, weapons, gambling and the pig industry are compulsory. Therefore, these two concepts call for extra-financial parameters and are considered by the main financial centers of the world as very attractive areas of development. Accordingly, it is necessary to set out their origins and their basic principles.

#### *A. Origin, Evolution, Principles and Potential Contributions of Islamic Finance*

Islamic Finance has seen its first days in the 1960s. But its fundamentals arose long before, at the beginning of the 20<sup>th</sup> century, when Muslim scholars and practitioners sought an alternative to the dominant economic paradigms, namely liberal capitalism and communism. Thus, the Islamic economy becomes acceptable and adopted by several financial professionals including non-Muslims. Therefore, this concept (Islamic finance) is meant to remedy the demands of international finance based on the payment of credits by interest, and that by offering products legitimized by the reference to Islam. It has been able to integrate easily into the circuits of international finance through its spread in a large part of the Arab and Islamic countries.

##### 1) Overview of the Origin and the Evolution of Islamic Finance

The roots and principles of Islamic finance are as old as religion itself. Indeed, Fiqh Al Mouamalat has for centuries been a structured and determined framework for all financial transactions of Muslims. It was not until the end of the 20<sup>th</sup> century that the Islamic financial system developed enough to be considered as a distinct model. It provides answers to the failures of existing conventional systems.

In order to reduce bank exclusion and promote the social development of the most deprived populations, financial institutions have been set up, but their perimeter has remained limited to local affairs.

It was necessary to wait the 60s, to testify to the true birth of modern Islamic finance. The creation of the Organization of the Islamic Conference (OIC) was at the origin of the emergence of this rebirth. The challenge at the time was

twofold: on the one hand, to design a financial system that should respect the teachings of Islam, and on the other hand to be compatible with the existing economic model characterized by modernity.

In 1972, at the Islamic Conference held in Jeddah, a comprehensive plan to reform conventional monetary and financial systems in accordance with the rules of Islam was launched. In the same period, at the OIC Summit in Lahore, the Islamic Development Bank (IDB) was established. This intergovernmental institution has become the building block of the Islamic system. Its objectives are to:

- Participate in injecting and lending capital for productive business projects; and,
- Provide financial assistance to member countries for economic and social development.

The mission of this Islamic bank is to:

- Establish and manage special funds for specific purposes; and,
- Accept deposits and mobilize the necessary financial resources in accordance with the Shariah.

Currently, the IDB is home to 56 member countries, but the majority of the shares are held by a minority of countries: Saudi Arabia: 26.5%; Libya: 10.6%; United Arab Emirates: 7.5%. Subsequently, Islamic banks were born in the majority of Gulf countries (Dubai Islamic Bank in Qatar, Kuwait Finance House, Bank Faisal in Egypt, Islamic Bank of Jordan, etc.).

To accompany this movement, to further structure the Islamic Financial Institutions (IFIs) and to refine and harmonize their rules of operation, the Organization of Accounting and Auditing of Islamic Financial Institutions (AAOIFI) was created in 1991. But it was only in the 21<sup>st</sup> century that the rise of Islamic finance began to attract interest and mark the history of world finance. Indeed, the number of financial institutions has exploded to reach more than 300 institutions operating mainly in 75 countries around the world. The dynamism and rapid evolution of this young industry, especially in the traditional centers, generated a great interest on the part of the global players of Conventional Finance, especially in the developed countries where the classic financial systems are going through unprecedented crises. With increased liberalization, the Islamic financial system has become more diverse and has gained more and more depth. As a result, Islamic finance appears to be currently one of the most dynamic segments of the international financial services industry.

In recent years, the Islamic financial landscape has been remarkably transformed. Thus, we are witnessing a high number and a wide range of products and services, a growing importance for Islamic assets in Muslim and non-Muslim countries. Behind this unprecedented boom, the spiritual and religious renewal that has created a growing appetite for products that conforms to the precepts of Islam.

##### 2) Principals of Islamic Finance

Islamic finance aims to develop a financial offer in conformity with the rules of Islamic religion: Shariah (Sharia).

The financial product purported to be Shariah compliant bears the "fatwa" certification. These laws are based on the scriptures of the Quran and the precepts of the Prophet (Haddith) and represent a code of moral principles and rules of behavior for Muslims in their private and social life, including commercial relations and economic.

Too often, Islamic finance is defined by a series of prohibitions such as the Riba, speculation, uncertainty, etc. [2]. This restrictive definition does not account for the reality of the financial system in Islam, which is built around a much broader field than that of "Islamic law" in its repressive dimension. Islamic finance falls within the framework of the law of human and social affairs (fiqh moamalat), of which the principle of the original permission (or lawfulness) is the foundation. This principle stipulates that everything is lawful as long as an argument does not prove prohibition. Only that which has been prohibited by an authentic and explicit text of the Legislator is prohibited. In this area, the scope of the prohibitions is very limited whereas the scope of possibilities is infinite. This shows us that the horizon of economic activities in Islam is very broad and that, in principle, any financial instrument is compatible with the precept of Islam, except in the case of non-conformity clearly established by the texts.

The search for financial solutions in conformity with the values of Islam encourages the juriconsult or the Muslim researcher to draw on all the economic and financial models without a priori nor discrimination. This process requires continuous and open intellectual work. The researcher interested in the nature and modes of financing in Islam must bear in mind a few specificities that underlie this system in relation to the conventional financial system.

Islamic finance is based on a number of considerations:

- i) The joint prohibition of interest and usury. Unlike conventional finance that distinguishes the interest rate that represents the rent of money lent and the usury which is the maximum rate of interest beyond which it is prohibited to lend a sum of money; Islamic finance does not make this distinction because the two notions are associated with Riba.
- ii) Transfer of ownership: in Muslim law, any financing contract must relate to a productive project of goods or services or to the transfer of goods from the seller to the buyer. In other words, the concept of financing in Islam reflects both a transfer of ownership and the actual existence of the thing transferred in the context of credit sales financing and the concordance of any movement of capital with an economic activity in so-called participatory financing. The legitimate profit is realized from a real production of wealth and not fictitious. In short, all financing must be backed by a tangible asset.
- iii) The Prohibition of Uncertainty or Uncertainty in Contracts (Gharar): The term Gharar defines a transaction in which there is uncertainty or deception about the subject matter of the contract. Gharar can therefore be defined as "the sale of objects whose existence and characteristics are not certain, given the risk that

accompanies this probability, and which subjects the validity of the transaction to conjunctures, future events and uncertain". A contract struck by Gharar is a contract of which one or more fundamental elements are indeterminate or uncertain: impossibility of delivery, ignorance of the price of the object sold, ignorance of its nature, ignorance of the delay, failure to determine the exact price).

- iv) The prohibition of speculation or gambling (Mayssir): it is forbidden to buy without paying and to sell without holding. It is "purely speculative" activities that have no productive or wealth-creating purpose in companies.
- v) The ban on investing in illegal activities such as gambling, alcohol and tobacco, the pork industry, armaments, and the traditional banking sector based on interest.
- vi) Sharing of profits and losses: the relationship between the provider of capital and the entrepreneur is a relationship of association and sharing of risk and profit. The prohibition of interest takes its ethical meaning when it is associated with the principles of sharing of losses and profits and connection to a real asset. The return on an investment corresponds to the remuneration of the bank intermediation service associated with a real economic activity, the risk of which is shared between the lender and the borrower; The Islamic financial system is based, therefore, on ethical and religious principles to support a certain economic and social prosperity.

Once these fundamental principles are respected, Islamic finance opens up to all the tools of modern finance. Any financing technique that does not violate Islamic rules is acceptable.

### 3) Current Trends

In some countries, banks have "converted" into Islamic banks and in others, the two financial systems may coexist. The majority of international banks that chose to take advantage of this market opted for the opening of Islamic counters. Banking products make up the bulk of the assets, with the remainder consisting of investment products, Sukuks, Investment Funds and Takaful products.

The Islamic finance industry has enjoyed remarkable average annual growth over the past decade, and is reported to be twice as fast as conventional finance, at around 15% per year. The trend should continue to accelerate over the next few years, depending on the efforts and regulations that would be put in place and adopted by countries. The rapid expansion of Islamic finance reflects its degree of competitiveness and its ability to:

- Responding to structural changes in consumer and business demand; and,
- Resist the vagaries of a challenging and ever-changing environment.

### 4) Potential Contributions of Islamic Finance

In the midst of an international financial crisis that is sweeping away all the signs of growth in its path, Islamic

finance has demonstrated a particularly strong resilience. Indeed, thanks to a genuine traceability of its transactions and its belonging to the family of finance, which preaches moral and ethical values, the Islamic financial system has been able to juggle the risk of speculation and systematic risk linked to the vagaries of the international financial market by playing the security card. In this wake, the Islamic financial system with Islamic banking as a nucleus presents itself as a modern and operational alternative for all operators: businesses, individuals, etc. This industry, despite its young age, is starting to gain space and the confidence to alternate with the current system by presenting resilience against the drifts observed before and during the crisis that threatens global financial stability. Thus, far from any ideological or political considerations, and in a logical and objective analysis, we can safely go astray that Islamic finance could provide solutions to the burdens and problems that hinder the development of countries: unemployment, housing, degradation purchasing power, infrastructure, etc.

The growth and diversification of Islamic finance and the environment in which it operates has prompted international financial institutions to take an interest in it. In this context Islamic windows and outright Islamic banking institutions have opened up. In addition, "investment formulas based on participatory techniques, such as *"Moudaraba"* or *"Moucharaka"* are much more profitable than traditional bank investments, especially in periods of falling interest rates. Sukuk "with a serious issuer" could guarantee profitability far from that offered through monetary investments. On the other hand, this same "Sukuk" mechanism could be used to mobilize resources for the State, banks, and thus finance large-scale projects and mega projects: infrastructure projects, refineries, steel works, car manufacturers, etc.)

Islamic investment funds are also an attractive framework for attracting resources, especially from external investors, particularly from petrodollars. Another important aspect is that of the insurance market, which has not reached the desired level of development (barely 8% of total Islamic assets). This market could be boosted by the "Takaful" solution.

In summary, Islamic financial institutions could be a source of financing and a lever for growth and growth, given the opportunities they offer.

### *B. The Genesis of Ethical Finance*

It is recognized that ethical finance and, more specifically, SRI as it is practiced today has its origins in approaches motivated by the Christian religion, whether Catholic or Protestant. Naturally, religious congregations wanted to put their investments in line with their principles. Two types of strategy dominated the beginnings of Responsible Investment: sectoral exclusions and active shareholding. Christian religious groups have, however, initiated other SRI approaches, although other large institutional institutions have taken over.

#### 1) Finance and Ethics, Two Inseparable Concepts?

Finance is probably easier to define: it groups transactions

on the currency itself. It has all the ingredients that make it a world apart in the economy, permanently submitted to the choices made by the agents and the decisions they make. If it is in the economy a more social and more human domain than all the others, it is this one. Hence, finance is inseparable from ethics, the two forms of ethics that are usually distinguished [3].

#### *i) The Ethics of Conviction*

It consists in giving oneself a goal that respects certain values, most often stated by religion, if not by natural law. It is fidelity to a certain order, the will to do good, the obligation one is given to achieve it at all costs. It calls into question the consciousness which dictates to each one his conduct by allowing him to discern the good and the evil and which leads him to choose the good. It is based on the well-known categorical imperative of Emmanuel Kant and, on the other hand, on moral standards which many of us regard as natural.

#### *ii) The Ethics of Responsibility*

It is analyzed by Max Weber, which is rather a behavior, an attitude that would like to be exemplary. "You have to set an example, you have to set an example," the children once said. To behave ethically is to strive to do as well as possible in the context in which we find ourselves, in the midst of constraints that cannot all be avoided. It is also not to make excesses, to remain master of oneself, to preserve the sense of the measure. It is an ethic that we prefer to call behavior.

Ethics depends on the type of activity concerned, there is not one but as many sectors as there are ethics are "sectoral" [4]. In this respect, they approximate laws and rules of all kinds. But ethical behavior presupposes more than just respect for laws, it takes into account their minds, and it adapts more quickly than new laws are promulgated or new rules defined. Ethics naturally applies to finance. In a field where everything is based on trust, where the actors become creditors and debtors for a period of time, where operations become more and more sophisticated, where their impact becomes more and more difficult to master, where currency itself seems to become purely virtual, it is quite obvious that people cannot do anything, and institutions do not. And it is not enough, for the institutions especially and for those who direct them, to respect the rules, to be open to controls, and to be transparent. It is necessary that all agents, whatever they may be, act not only by respecting the law, but by listening to what their conscience says. This is so true that the current crisis is probably due to the fact that finance has moved away from ethics. There are, however, very specific sectors where finance has remained or has become ethical again: first and foremost, the so-called "ethical" finance.

#### 2) Ethics at The Heart of Finance: Ethical Finance

Ethical finance, the one that really is, is defined by its purpose: to whom will money be loaned, and, what will it serve? When this concept first appeared, in the early 1980s, it meant that the money was not going to be invested in companies that carried out activities that might appear reprehensible, such as armaments, tobacco, alcohol, play, etc.

This purely negative definition, and thus exaggeratedly broad, was quickly clarified. Ethical finance is now that which is oriented towards certain companies, certain activities. Their list is not fixed, but it most often refers to three criteria, which are not financial criteria:

*i) The First Criterion is Social*

It concerns the attitude of companies towards their employees. What is its recruitment policy? Are employees involved in the life of the company, and are they well treated by their employer?

*ii) The second Criterion is Economic*

It is about governance. What is the attitude of the companies towards the "stakeholders", not only of its employees, but of its customers, suppliers, the local communities where it is located, and all its partners in civil society?

*iii) The third Criterion is more Political*

It concerns respect for the environment. Do companies have a concern to respect nature and to exercise their activity in the long term without compromising the ability of future generations to meet their needs? These three criteria are the same ones that characterize sustainable development. They also correspond to what is now called SRI, which is based both on financial criteria and on extra-financial criteria. The two concepts do not fit perfectly, but one can say that the decision to invest in a "socially responsible" way characterizes ethical behavior. Once the choices and the decisions made, how will things happen? How will the money be borrowed? The most common solution is the intervention of an agency that will borrow from some agents and lend to others. It may be a bank, a stockbroker, a financial institution which, most often on the margins of its normal business, will issue SICAV shares to invest the funds raised in companies that meet the criteria we have just set out. But there is also a form of direct funding without intermediaries. Sometimes people come together in an investment club and invest their money in companies that respect, for example, the following criteria: "no use of subcontractors employing children, preservation of the environment and heritage, transparency of information, action in favor of job creation, satisfactory wage relations in the company, etc.". It is always about ethical finance. In fact, indirect financing is by far the most important. All banks and insurance companies offer one or more "SRI funds" to their clientele, in particular to companies that can place the employee savings plan in this way. They can manage these funds themselves, or they can also use management companies which, in turn, can also be offered to a particular clientele. Both can be assisted in the choice of securities - usually quoted on a market - by the specialized rating agencies Vigeo, Deminor, Innovest Novethic, etc.

Which of these criteria is the most significant? The answer may vary from one company, or even one country, to another, and it may also vary over time. As well, the methods of these agencies are not infallible. How do they weigh the factors they decide to take into consideration? What about a company that

pollutes a lot but treats its employees well? The ethical character is not easy to measure. Some investments still seem to be more so than others. This is why there is not really a definition of ethical finance. It is possible to define "a common core" of the purposes to which ethical finance refers, and characterize from there, the products and practices or the organizations that claim them [5].

The most important for a bank is not to appear as an ethical bank, but not to appear as a bank that is not. We even talk about "greenwashing"! What is true for banks is also true for companies. The intervention of the agencies facilitates the orientation of available funds towards investments or ethical investments. Another factor may be corporate social responsibility (CSR). This is an ethical approach, since it is mainly the result of taking into account the interests of all stakeholders as well as the consequences of the company's activities on the environment.

### 3) The Christian Roots of Ethical Finance

*i) Emergence through Sectoral Exclusions*

As early as 1760, John Wesley, the founder of Methodism (current evangelical Protestantism), emphasized the link between ethics and the use of money. For him, the investor must act not as owner, but as property manager, and must not create wealth by harming his neighbor.

In the United States, the Pioneer Fund, the first socially responsible fund, was launched in 1928 at the initiative of the Federal Council of the American Churches. Its investment policy excluded companies whose activities were related to alcohol, tobacco and pornography, sectors that are still on the black list of so-called ethical SRI funds. However, access to this fund is limited, and it was not until 1971 that the first ethical investment fund available to individual investors, the Pax World Fund, was opened. In addition to the traditional exclusion of tobacco or gambling, the fund was intended to allow investors to avoid investing in companies likely to benefit from the Vietnam War; "Pax" meaning peace in Latin.

In Europe, the first ethical investment product was launched by a Swedish temperance society in the form of a fund called Ansvar. Like the Pioneer fund, it was reserved for sympathizers of the movement. In the United Kingdom, ethical exclusions were part of the investment rules of the Anglican Church in 1948 and the creation of the Church Commissioners. A similar body was created by the Methodist Church in 1960.

In France, the first two ethical funds were launched for Christian religious investors. In 1983, the financial company Meeschaert and the Ethics and Investment Association (initiated by a group of general confessional nuns of their congregation) launched the New Strategy 50 fund, which excludes the tobacco, armaments, alcohol, pornography and gambling. The management company, very oriented towards a Christian clientele, will retain these exclusion criteria for its other SRI funds.

*ii) Activism and Evolution*

The first resolutions on SRI were marked in the United

States in the late 1960s by activism of church groups and student associations on the Vietnam War. Another subject of preference was apartheid in South Africa: religious activists in the United Kingdom have implicated Barclays Bank and the Royal Dutch/ Shell oil company. Their efforts included convincing institutional investors to divest themselves of these companies, which led Barclays to partially withdraw from South Africa in 1985.

Today, SRI holdings held by churches and religious congregations are very marginal compared to those of institutional investors such as insurers, provident organizations or pension institutions. The latter do not really share, particularly in France, their vision of what the inclusion of extra-financial criteria should be. Paradoxically, responsible investment, as it has been developed over the last 10 years by most management companies in France, even displays a certain aversion to ethical approaches. This aversion responds to two factors: the financial management problems posed by the exclusion of certain titles or sectors and the difficulty of finding a common ethic when one addresses oneself to investors who are not united by the same religious conviction. Suppliers have largely preferred to focus on a sustainable development approach focused on environmental, social and governance (ESG) issues. That said, the demand from some investors, rather in northern Europe, and campaigns by NGOs like Amnesty International, have even led to the generalization of at least one ethical exclusion, which applies controversial weapons (antipersonnel mines and cluster bombs).

### III. CHALLENGES, CONSTRAINTS AND POTENTIAL DEVELOPMENT OF ETHICAL FINANCE AND ISLAMIC FINANCE

The potential development of Islamic finance is very important. Indeed, France has a very high Muslim population of more than 6 million people, or nearly 10% of the total population. On the other hand, Islamic finance is placed in a much more innovative framework, even if it remains a niche activity. It is mainly developed in Anglo-Saxon countries, especially in the United Kingdom.

With regard to ethical finance, the ever-increasing demand for investment responsibility is a fertile ground for the development of these so-called ethical financial products. Nevertheless, it currently covers less than 2% of financial assets. Indeed, despite the fact that these subjects find an increasingly favorable echo in a large part of the population, speeches have difficulty in taking action. Ultimately, saving and investment behavior remains very traditional. It is unlikely that ethical finance can claim a much larger role without government support. Moreover, ethical finance is not a profound change in functioning because it is in fact a branch of traditional finance where it is the investment criteria that differ, rather than the general philosophy.

#### *A. Challenges and Operating Mechanisms of Islamic and Ethical Financial Institutions*

Like the conventional banking system, Islamic and ethical finance have undergone profound changes in terms of financial products and the nature of institutions. Indeed, at the

institutional level, Islamic and ethical financial institutions have entered a dynamic of permanent change in the face of a changing and increasingly difficult context on the one hand and a situation of backwardness accumulated for centuries, on the other hand. Thus, the development of these finances has taken place with and through the diversification of financial institutions: Islamic commercial banks, Islamic investment banks, Islamic insurance companies (Takaful), Islamic mutual investment funds, ethical banks, solidarity financial institution, socially responsible investing institutions, etc. The Islamic and ethical banking system has also undergone a significant change from the point of view of financial products.

#### *1) Challenges and Choice of Positioning of Modern Islamic Banks*

During the first centuries of Islam, the financing contracts used were mainly those of Mudaraba and Musharka [6]. In other words, participatory financing with shared outcomes was the cornerstone of the Islamic financial system of the day. Today, the situation is quite different, as this type of financing has given way to other Islamic contractual instruments such as Murabaha, Ijara, Istisna and Salam, which now represent the core of Islamic banking. These instruments are short-term instruments. Because, unlike conventional banks that can refinance themselves by re-borrowing liquidity, Islamic banks can only rely on their own assets. In principle, they cannot call on the central bank or other banks to find the capital they need. Faced with this risk, Islamic banks direct mobilized savings towards low-risk activities and immediate gains.

This financing is essentially secured by successive purchase and sale transactions with a profit margin negotiated in advance. Sales transactions such as Murabaha or Ijara are widely used by Islamic banks, accounting for up to 90% of all their transactions. The exaggerated use of these methods of financing distorts the primary spirit of Islamic banks, namely participatory financing through the capital-labor association. Let us recall that in Islamic economic theory, the banking enterprise must play the role of providing capital to the various economic sectors. It must not be satisfied with commercial financing for immediate gains, but must invest in productive projects that create jobs and wealth.

By making short-term instruments the bulk of banking activity, banks are gradually losing their peculiarities and coming closer to the logic of conventional banks. Moreover, it is this shift towards a commercial logic at the expense of participatory financing that is the main criticism addressed to Islamic banks. The financial engineering that has seized this sector has enabled Islamic banks to offer a range of financial products called "Islamic" but which have the same objectives and above all respond to the same logic as conventional finance. Thus, for each prohibition, equivalents have been found: *Arbun* for speculation, futures for short sale, *Murabaha* or *Sukuk* for interest, etc.

Obviously, this process was carried out with the assistance of the committees of jurists and under the impulse of bankers' eager to offer Islamic financial products equivalent to those of conventional finance but with an ethical dimension. Here it is

necessary to highlight the primordial role of religious scholars in the current process of financial innovation within Islamic banks. Interpretations have always been made by lawyers throughout the history of Islamic finance, but contemporary financial issues have mobilized these committees more than ever.

In order to legitimize new banking operations, Islamic banks rely on the judicial production of their own committee of jurists, who, having examined the case of cash, rule by confirming or reversing the lawfulness of the contract or transaction. Because of the ideological independence of each committee, interpretations can multiply and produce divergent conclusions on the same issue, all of which are based on Islamic texts. The diversity of interpretations in general reflects the theological tendencies of jurisconsults. Indeed, the deductive reflection effort that the Muslim scholar provides is consubstantial to his mind and his way of perceiving the Shariah's dispositions as well as the spatio-temporal conditions to be taken into account. In general, when examining Muslim law, Muslim theologians are divided into two categories: those who have a narrow reading of the texts (scholars of the texts), and those who propose an extensive approach to the Islamic precepts. In the particular case of the committees of jurisconsults attached to Islamic banks, the general trend is not conservatism but rather a very open approach, deeply influenced by the flexibility of Muslim law of transactions. This branch of Muslim law, whose founding principle is "original permission", is endowed with a great predisposition to evolve. This principle allows innovations compatible with modern finance. In order to meet the modern needs of Islamic banks, in terms of financial innovation and integration into global finance, lawyers gradually succeed in exploiting the subtleties and freedom of interpretation offered by Muslim law to arrive at financial solutions audacious but supposed to be in conformity with religious texts. Without going so far as to call into question the fundamental principles governing Islamic finance, they have developed, so to speak, legal tricks (*Hyal*) to thwart the prohibition of interest and/ or circumvent other prohibitions such as speculation, chance, and so on.

Although legitimate as such, this ingenuity of jurisconsults has, however, produced a number of financial techniques and banking operations that are, to say the least, controversial and in a way reflect the evolution of the interpretative approach of jurisconsults, who is more concerned with questions of technical modalities than with the higher objectives of the Shariah. Motivated by the principles of "necessity" and "facilitation", several authorizations of case-law have aroused much controversy and questioned by many authors.

## 2) Challenges, SRI Strategies and Building an Ethical Fund

An ethical fund or SRI combines the financial process of a conventional product with an extra-financial strategy based on environmental, social and governance (ESG) criteria.

### i) The Different SRI Strategies

The extra-financial strategy of a fund can take several

forms, which can be combined.

#### ■ ESG Selection (Environment/Social/ Governance)

The ESG selection consists in analyzing the ESG practices of the issuers concerned, based on various sources of information: non-financial rating agencies, which analyze issuers on a set of ESG criteria, NGOs, brokers, information watch, and of the analysis in-house by a dedicated team, which can conduct meetings with issuers. The qualitative notations or analyzes that are produced can be used in several ways:

- The selection of the best rated issuers according to defined inclusion thresholds ("best in class" approach);
- Overweight of the highest rated issuers in the final portfolio; and,
- The selection of issuers with potential and a desire to improve their ESG practices (best effort approach).

#### ■ Normative Exclusion

The normative exclusion is to exclude issuers guilty of violations of certain international standards and conventions. The most cited repositories are:

- The 10 principles of the UN Global Compact, divided into four categories:
  - o Human rights
  - o Labor law (according to ILO core Conventions)
  - o Environment
  - o Fight against corruption
- The fundamental Conventions of the International Labor Organization (ILO)
- The Universal Declaration of Human Rights (UDHR)

As well as certain practices such as child labor, racial discrimination, animal experimentation or liability in environmental disasters. The perimeter of analysis of practices can include suppliers and subcontractors, insofar as the company chooses these actors and can influence their practices.

#### ■ Sectoral Exclusion

The sectoral exclusion is to exclude companies deriving a share of their turnover from controversial activities, which are generally included in this list: Armaments and defense (all, or weapons prohibited by international conventions (BASM, MAP)); Tobacco; Alcohol; Gambling; Pornography; Fur; Environmental exclusions (Nuclear, Petroleum, GMO, Genetic engineering in natural environment, Genetically modified agriculture, Agrochemistry and chlorinated products, Chemistry, Thermalism, swimming pools, and bottled water). The threshold, which is often around 5% of the turnover, may vary, as can the scope, which may extend to the subsidiaries. Sectoral exclusions are often subject to cultural specificities; they are, for example, rather rare in France and even non-existent in the case of nuclear power. This approach alone is not, according to Novethic, comparable to SRI *stricto sensu*, insofar as issuers are not analyzed on their ESG practices. Therefore, it must be combined with other systematic approaches such as ESG selection, normative exclusions or active shareholding.

#### ▪ Thematic or Sectoral ESG Selection

The thematic or sectoral ESG selection consists of selecting companies active on themes or sectors related to sustainable development:

- The sectoral approach, more specific, selects companies active in one or more sectors, for example: Renewable energies, Water, Health, Waste.
- The thematic approach is broader and can combine sectoral choices with a selection of certain environmental or social practices. Examples of themes:
  - Climate change: the manager can retain companies in the renewable energy sector, but also exemplary companies with regard to CO<sub>2</sub> emissions;
  - Eco-efficiency, consumption of natural resources; and,
  - The aging population.

Enterprises may be eligible if their share of turnover from the sector of activity is above a certain threshold or if they are in a dominant position in the market in question.

The thematic or sectoral ESG approach may concern the whole of a fund or be limited to a pocket of total assets. It can also lead, when combined with an ESG selection approach, to an overweighting of a pillar (generally the environment or the social according to the selected theme) compared to the other two. Like sectoral exclusions, this approach must be combined with other approaches that analyze issuer practices, not just their sector of activity.

#### ▪ Active Shareholding

Active shareholding is not limited to the simple exercise of the right to vote in a general meeting, but involves entering into dialogue with an issuer on certain ESG issues with a view to pushing it to improve its practices. If this dialogue is unsuccessful, it may evolve towards public communication, or even lead to the tabling of a resolution at a general meeting. The manager may also decide to disinvest from a company that has refused to improve its practices.

##### *ii) The Construction of SRI Fund*

The ESG analysis of issuers can be carried out upstream, downstream or iteratively in relation to financial selection. To simplify, we will take the example of a fund combining all of these approaches, and performing ESG selection upstream of financial selection.

#### ▪ Financial Characteristics

The manager starts by choosing the financial characteristics of his fund:

- asset classes: equities, bonds, etc.
- the type of issuer of these assets: companies, states, local authorities, etc.
- the investment zone: Euro zone, world, emerging markets, etc.

Thus, he defines a starting universe, in which he will make his selections.

#### ▪ Thematic Pocket

It can also define an ESG thematic pocket, which will

follow the same selection process, but will be limited to the selected sectors or themes.

#### – Extra-Financial Selection

Initially, it will carry out the extra-financial selection, based on the analysis of the practices Of the issuers. It will select the best students (ESG selection) and eliminate those with unacceptable practices (normative exclusions) or active in proscribed sectors (sectoral exclusions). This will lead to a universe of values that are allowed from an extra-financial point of view, which will be called a socially responsible universe.

#### – Financial Selection and Portfolio Construction

In this universe, financial analysis will choose financially investable securities, which will lead to a new, more restricted universe in which the manager will make his choices to make up the final portfolio, both satisfactory in one financial and extrafinancial.

#### – Monitoring of the Portfolio and Active Shareholding

Finally, downstream of the construction of the fund, a follow-up of the issuers' practices is carried out by a renewal of the analyzes and ratings and by an information watch. This can lead to a dialogue with some issuers on areas for improvement, which may evolve towards a more robust approach, in particular by filing or supporting a resolution at a general meeting or by choosing to divest itself.

#### *B. Constraints on Islamic and Ethical Finance*

Islamic and ethical finance face two constraints related to each other. The first constraint is to reconcile ethics and profitability. In addition to technical constraints, the structuring of Islamic and ethical products must integrate the ethical and moral dimension in order to impose itself on the market, for example, the confidence of the Muslim client is not based solely on the financial reliability of a product or the financial strength of an institution, but it is also and above all dependent on the degree of compliance of the product or the bank with the principles of Shariah. The issue of trust plays a major role in Islamic and ethical finance, and is even more persistent when it comes to creating a new product. For example, the process of innovation in Islamic banks sometimes comes up against a certain wait-and-see attitude of a suspicious customer who is awaiting the legitimating of the products in question by recognized or accepted institutions or personalities. For example, in 2008, at the Islamic Finance Summit in Paris, the President of AAOIFI ruled that a large part of financial instruments are in contradiction with the principles of Shariah. This resulted in a significant decline in Sukuk emissions. However, while attentive to ethical parameters, Islamic banking clients are also driven by a financial logic, that is, profit maximization. It can be said that "the religious sensitivity of clients of Islamic financial institutions is not indefinitely elastic in relation to the evolution of the products that are offered to this clientele". In this regard, the additional costs generated by the ethical certification of Islamic banking impose an additional

challenge on them. The possibility of price competition and services reduces the scope of Islamic banks considerably, as not only do customers make choices according to their religious convictions, but they also take into account other constraints: price, profitability, risk, etc. In order to cope with competition, the Islamic bank must, on the one hand, pay its depositors a dividend higher than the average interest rate charged by conventional banks and, on the other hand, it must provide the entrepreneur with a rate of profit above the rate of interest, under penalty of seeing all turn to the capitalist banks. This leads to a second constraint and one of the main problems of Islamic finance, namely the lack of liquidity suffered by the Islamic markets. The fact that Islamic banks cannot refinance themselves through traditional means (money market, rediscount, etc.) for reasons of Shariah compliance, leads to an increase in the risk of liquidity shortages and puts them in situations very delicate. The negotiation of Islamic financial products on the secondary market is in fact encountering several specific constraints which make the operation difficult to achieve. The sale and purchase of an existing financial product is not inherently unlawful from the religious point of view, provided that certain fundamental Islamic principles governing commercial and financial transactions are respected: the absolute necessity of backing any financial transaction to a tangible asset, the prohibition of speculative behavior on the market. These constraints lead to a paradox of Islamic finance. In an international context characterized by a strong standardization of conventional financial products, Islamic finance is marked by heterogeneity of financial products. In the current state of affairs, it can be said that there is no Islamic finance but Islamic finance "tailored". The fragmentation of national markets, the heterogeneity and diversity of financial products of Islamic banks have undoubtedly contributed to the emergence of Islamic finance offering relatively more expensive products than conventional institutions and, above all, have led to an unprecedented situation in which, despite globalization, Islamic financial products tend to be localized [7]. From this point of view, Islamic banks operating in a dualistic financial system appear to have more room to develop their own financial practices than in a fully Islamized context such as Iran or Pakistan. Financial intermediation practices are imposed by the State. The State's influence hampers financial innovation and involves additional transaction and information costs for Islamic banks. On the other hand, it is not always very distinct from the concepts that are close to it. Solidarity finance, ethical finance, and microfinance, we do not always know very well the borders of each one, the more so as savings transferred from one institution to another change in nature. While it is normal for solidarity-based savings to be invested in an ethical way, it can also finance microfinance; but, it remains to ask the question: Is solidarity finance ethical too? It is first of all by its destination: social surplus value, social well-being, that of society at the same time as of every person, in a word, the common good.

Solidarity finance is then ethical by its modalities. Institutions, and even more the associations involved in

solidarity finance, are almost all on a human scale; they offer support services that bring people closer together and contribute to the social bond. It is difficult to imagine that these organizations are often not well managed, that their governance is deficient, and that the people concerned do not do their best, each in its place, so that this money can improve the welfare of the most disadvantaged. Lastly, since solidarity-based savings are invested in neighborhood associations or solidarity-based organizations, and not in shares of listed companies, there is little risk that solidarity-based finance will be diverted from its vocation and be used to improve the image of a bank or a company. Ultimately, solidarity finance cannot be understood without reference to the ethical framework in which its operations take place [8]. It is necessarily ethical. If it was not ethical, it would not be in solidarity. As solidarity finance progresses rapidly to the point of appearing - modestly of course - as an alternative to finance, ethics is, thanks to it, on the margins of finance.

Ethics is always present at the heart of finance, when operations respect the principles. Indeed, it is always credit, therefore debts and receivables, but special institutions intervene, customers are not the usual customers of banks, credit is not granted on the same conditions (the rate of interest, etc.) or in the same way (guarantees, etc.). And ethics is no longer present, at least in a systematic way, in all the rest of finance, in the so-called traditional finance. It is even less so, in other words, virtually no more, in international finance. Institutions, customers, operations... nothing is really different this time... except of course the amounts and the fact that the creditors and the debtors no longer live in the same country, so they are no longer in the same currency. It follows that the risks are considerably greater, that there is also the risk of contagion; whereas there is no authority over the States, and not really effective regulation or control. It can be said, and it is often said, that the problem of finance today is that it is no longer ethical enough. Beyond the laws that here and there impose themselves, choices are no longer always dictated by consciousness, there are only always moral behaviors. Nevertheless, in some sectors or in some countries, financial practices are more ethical in need to remain. Despite rapid growth, we cannot speak of alternatives to traditional finance, as volumes of operations remain moderate. But the existence of such practices can help us seek to restore more ethics in finance and even encourage us to do so.

### *C. Prospects and Potential of Development*

Among the common questions about Islamic finance and ethical finance is the issue of ethical compliance. Actors such as Novethic or rating agencies (Moody's, Standard and Poor's) have of course a great role to play: they allow the dissemination of transparent information. We were also given the opportunity to reflect on the legal consequences of non-compliance with ethical criteria. Thus, we have seen that, in this respect, ethical finance and Islamic finance have the characteristic of being the source of additional commitments, and therefore possibly of additional responsibilities.

Representatives of (*Finequity*) and (*J'épargne utile*) have

testified to their field experience, particularly regarding the expectations of consumers of banking products, savers or investors. They reiterated that Islamic finance and ethical finance not only coincide conceptually but above all that they could and should enrich each other.

Certainly, ethical finance is a relatively recent concept but it is constantly evolving. Nevertheless, it is possible to identify constitutive elements: fight against inequalities, respect for the environment and sustainability. In this context, the goal of ethical finance is to combine the financing of the economy on the basis of criteria considered ethical and within a framework of sustainable development. In practice, ethical finance corresponds to financial products that are still unknown, such as microcredit, SRI or solidarity-based savings.

Despite the explosion of Islamic finance, its representation is still very low compared to the huge socially responsible industry. Beyond the principles which clearly state the necessary responsibility of man for his actions, it will be crucial for the players in this new finance to put in place, in a practical way, measures to quantify the quality of the Islamic approach to human rights, respect for the environment, good corporate governance, the fight against corruption, etc. Therefore, the most important challenges will not be to rewrite existing principles, but to clarify their application and measurement in a context where confidence in the players in the financial sphere is heavily tainted by scandals linked to deception on the commercial promise. It will be irreproachable, firm on principles but innovative in the way to implement them. Thus, from the Islamic perspective, the concept of development is intrinsically linked to Islamic principles, inasmuch as God has invested man with lieutenancy on earth. Lieutenancy supposes that man, endowed with all the necessary resources, transforms his existence and establishes a decent life. This is for Muslim men to undertake economically profitable activities but also to diversify production into socially beneficial works, investments must cover all sectors of activity and all social strata, they must extend health and social sectors to meet the collective needs of populations. Thus, any economic development strategy must be based on a wide range of productive activities. This development must also be balanced. A development is described as balanced when it is multidimensional, that is, it covers the material, human and spiritual aspects. Development cannot be limited to quantitative variables alone, it must also allow an equitable redistribution of wealth, pursue goals of social justice, spiritual well-being and improve the human condition as a whole. Any economic activity, whether undertaken individually or collectively, must always be based on a social and spiritual dimension and cannot be accomplished at the expense of eternal life. The balance between economic objectives and moral objectives therefore characterizes the concept of economic development in Islam.

Despite the diversity of financial arrangements proposed by the two Islamic and ethical finance, financing methods for large companies are not strongly developed by halal and ethical financial institutions. This is due in part to the fact that

these companies are less concerned with the religious or ethical nature of financing than SMEs or individuals: "The target of Islamic banks is rather that of small and medium-sized enterprises (SMEs) to the legal structure of their financing" [9]. Thus, Islamic banks can constitute an essential financing alternative for SMEs and, in return, benefit from a large number of strategic opportunities of attractive quality and attractiveness. However, because of all the specificities and constraints associated with Islamic finance, this collaboration is not as simple. Indeed, Islamic finance, as described above, has very restrictive selection criteria, including the need for 100% halal financing of projects at all levels. The project must be halal, of course, but all the projects resulting from it must be halal, which is not easy to verify or prove. It is generally difficult to know in advance the consequences and implications of a project. Thus, it is difficult for an "Islamic" investor to make a choice that is perfectly just with regard to Shariah. This is why, often, the projects financed are in a narrow sphere of intercognition and control. Moreover, we may note a risk of interference by the bank in the affairs of the SME. This is the case, for example, with the operations of *mudhârabah* and *mushâarakah*, in which the promoter can hardly make changes to the conduct of the project without first obtaining the authorization of the bank to do so. Indeed, sharing the risk of loss, the bank becomes a full partner of the entrepreneur. The latter is no longer the sole master of his affairs and conflicts can break out between the two protagonists.

Marginal and widely unknown, ethical finance and Islamic finance continue to develop in a storm and resist the spectacular outperformance of certain categories of investments.

#### IV. ISLAMIC FINANCE: A NEW STEP TOWARDS ETHICAL FINANCE?

First of all, let us recall that religions are not incompatible with finance, far from it. Long before us, Max Weber had demonstrated that Protestantism could influence the economy and give it a new impetus. Weber shows in his book, *Economy and Society* that it is indeed a religious ethic, in this case the Protestant ethos, which is at the origin of the spirit of capitalism. In other words, it is a matter for the Protestants to make fruitful what God has entrusted to them, for the goods present on Earth come from the latter and do not belong to the believers. In fact, "the resources entrusted by God to the Protestant manager are natural, human and financial. It is up to him to combine them optimally in order to maximize their products". More generally, authors such as Joannides, highlighted the links between religions and the economy and recalled how the religions of the Book (Judaism, Christianity and Islam) have borne the spirit of modern capitalism, management and finance, since the Middle Ages.

Islamic finance is a rather successful example of an entanglement between religious principles and economics. In this case, organizations must adapt to an environment and context that is not devoid of religious principles. This will be one of the conditions for their effectiveness, as the theory of

contingency has largely shown. Organizations linked to Islamic finance are subject, in addition to the components of their environment, to the influence of elements of Islamic laws, principles and customs. But beyond this data, what interests us here is to show to what extent Islamic finance is ethical finance and what are the strengths of this finance with regard to the possible establishment of a better tempered capitalism by ethics.

#### *A. Islamic Banks: An Alternative Ethical Model?*

Islamic ethics applied to economics dates from the advent of Islam, the first texts of Islam already referring to the ethical principles that must manage the material activity of man: prohibition of the Riba (interest), Zakat (solidarity tax to be paid by each Muslim), private property, etc. Although its founding principles are distant, Islamic finance as it exists today is a recent construction. It is also a concrete institutional application of the economic doctrine of Islam. It ensures the mobilization of funds and their injection into the economic circuit. However, Islamic banks should not be content with a mere monetary approach but should move towards an Islamic perspective of "managing on earth", that is to say, an effective economic and social involvement in the development of the Muslim community.

The gradual shift of Islamic banking practices towards short-term instruments in fact reflects a major evolution in the very conception of the Islamic bank's purpose. The initial idea of the Islamic bank was linked to a global vision of an Islamic economy aimed at a new alternative economic and social order, the key to which was the combination of capital-capital and capital-labor. However, the prohibition of interest takes its ethical meaning when it is associated with the principles of sharing of losses and profits and connection to a real asset. Then, the return on an investment is not a matter of simple time passing, but corresponds to the remuneration of the bank intermediation service associated with a real economic activity whose risk is shared between the lender and the borrower. This connection to the real economy makes it possible to argue that "Islamic finance did not participate in the causes of the financial crisis. Because risky mortgage credit is prohibited and derivatives (subprime, securitization) are subject to uncertainty, as the underlying asset is a package of credits resold on the market. Now a principle of Islam says: "You do not sell what you do not have".

As in Christian ethical finance, exclusion criteria are applied to Islamic investments. The list is variable, but alcohol, weapons, games of chance and the pig industry are compulsory. In addition, Islamic finance organizes the control of products called "compatible shariah". Each Islamic bank is endowed with a Shariah council composed of independent personalities (lawyers, specialized economists) who advise on the products put on the market. Regular internal and external audits are responsible for validating respect for Islamic principles. In cases where a presumption of genesis of interest is detected, "purification" schemes are organized in the form of a donation to the poor. But it should be pointed out that Islamic finance is not ethical with regard to its destination, it is

by its inspiration, which is none other than Shariah, the law of the Muslim religion, based essentially on the Koran. The most well-known precept is the prohibition of usury - the riba - which is normally an excessive interest rate, but which results in a prohibition of loans at interest. This prohibition is also found in the Old Testament, as in the Politics of Aristotle.

Interest is not replaced in Islamic finance. The creditor who lends money does not receive interest fixed in advance and guaranteed, he shares with his debtor, the profit that he will make with the money he lends him or he takes his share in the loss that may occur. There are no longer any claims and debts, no creditors and no debtor, there are two actors engaged in a joint venture, there is an association of two persons to carry out a joint project.

Financial transactions must be related to the real economy, they cannot produce anything by themselves. The financial cycle must be a productive cycle of goods or services. It follows that, in Islamic finance, financial speculation is prohibited, as is "excessive uncertainty" in contracts [10]. It also follows that this relation to the real must appear, and that all these operations must be sufficiently transparent.

Islamic finance is indeed ethical finance. This is all the more true given that investments are not allowed in certain sectors such as the gambling industry, tobacco, alcohol, armaments, etc., as in companies that exceed certain percentages of indebtedness. This Islamic finance can even be seen as serving people, with the aim of protecting the human being, the family, social harmony and even the environment [11]. This respect for the environment, coupled with respect for future generations, brings Islamic finance closer to the objectives of sustainable development, as well as corporate social responsibility practices [12].

Other provisions of the Koran help to make Islamic finance a genuine ethical finance: it concerns the Zaqat, a religious tax imposed on all the believers on all their property and which is generally recovered by the banks, but which can be paid directly to associations. In fact, the Koran always speaks of alms. But the most important thing is that alms is constantly linked to prayer. Almsgiving, which is one of the five religious commandments of Islam, appears to be the tax of the poor or "purification tax" when an interest has been illegally collected. It becomes a means of circulating goods to the poorest and, beyond that, a means of achieving equilibrium and social justice. However, these principles, whether they are always respected or only partially respected, perfectly characterize ethical finance as it is usually defined. For the Muslim stake, Islamic banks represent a real alternative to the banking system with interest considered to be contrary to the injunctions of Islam. It is difficult for us to question the achievements of Islamic banks in terms of ethical financing. But the reality of the Islamic banks imposes us some reservations as to the overall application of an Islamic banking system in accordance with the ideal-type as conveyed by the great Islamic principles. Indeed, from a macroeconomic point of view, the work of the Islamic banks did not lead to the expected development and thus the overall well-being of the community (Umma). Most often, Islamic finance comes down

to a partial Islamization of the economy by adapting existing capitalist practices to Islamic norms.

### *B. Ethical Finance and Islamic Finance: Possible Convergence*

These two investment concepts have at least three points in common: they use extra-financial parameters; they are considered, by the financial centers (London and Paris), as attractive axes of development; they originate in an application to transcribe to the financial universe religious convictions of investors, private or institutional. Thus, to try to show the conjunctions that can exist between ethical finance and Islamic finance, we will try to answer the following questions:

- Are their mechanisms complementary and in what ways?
- Are the religious foundations of Islamic finance comparable to those that gave rise to finance?

#### 1) Islamic Sustainable Development in Ethical Finance and Islamic Finance

Sustainable development is now at the center of many reflections (policy, environment, finance ...). However, the very concept of sustainable development is often poorly understood because it is incompletely understood. The aim is to produce more, in the service of the greatest number, to distribute wealth more efficiently and to combat poverty, while preserving nature. Finally, in each of the economic, social and environmental dimensions, there is a transversal demand for solidarity between the generations.

Companies are indeed actors of sustainable development. They can participate in three main ways:

- Economic development through investment.
- The reduction of social inequalities (working conditions, wages, etc.).
- Sustainable consumption of natural resources, and reduction of pollution.

Sustainable development is defined as corporate social responsibility (CSR). It means that companies, on their own initiative, voluntarily integrate social and ecological concerns into their business their relationships with stakeholders.

In examining the conjunction between ethical finance and Islamic finance, we will ask ourselves whether the latter embodies many themes of sustainable development and social responsibility.

Indeed Islamic finance inspired by Islamic law (Shariah) aims to promote the well-being of all men in order to be able to meet essential needs without excessive expense. It also insists on the preservation of future generations (offspring), resources and the environment. Thus, achieving these objectives requires dynamic interactions between socio-economic processes and environmental priorities. Consequently, Islamic finance offers many guidelines that meet what is now called sustainable development. It also proposes a model of corporate social responsibility based on more sustainable moral and ethical principles taking on a broader meaning based on a moral and religious initiative. The entrepreneur is no longer only guided by the maximization of

profits, but also, and above all, by the pursuit of supreme happiness, in this life and beyond.

#### 2) Ethical Finance, Islamic Finance: What Convergence?

Having examined the religious fundamentals of ethical finance and Islamic finance as well as their common mechanisms and their recent offerings of financial products, there was a certain convergence of the two concepts. Islamic finance integrates ethical and extra-financial components that can constitute points of convergence with ethical finance. Focusing on the extra-financial aspects of this approach shows that there is a convergence in the societal purpose and exclusion of activities deemed unethical, but that Islamic finance is a financial system in its own right. Another point of convergence is the existence of a certification body. In the case of ethical finance, this certification will take the form of an annual review carried out by an SRI certification body. The players in Islamic finance will rely on "Shariah boards" for the review of the conformity of the operations according to the principles of Shariah.

##### i) Purposes and Moral Principles

Islamic finance aims to improve the condition of man, to establish social equity and to prevent injustice in trade. This is the origin of the prohibition of interest and its replacement by a system of sharing of profits and risks. These objectives are in line with those of ethical finance as it has developed in recent years, namely sustainable development in its economic and social pillars. The environmental pillar is also not absent from Islamic finance: one of the foundations of Islam is that man fulfills a role of stewardship of the divine creation. Thus, the creation of God, which is not limited to nature and the environment but also encompasses men and society, belongs to God and is entrusted to man; therefore, he has a duty of administration and preservation towards him. As a result, waste and unnecessary and unnecessary consumption are unacceptable.

The link between religion and business ethics was more widely studied by an interreligious grouping of representatives of the three major monotheistic religions (Christianity, Islam, Judaism) at the initiative of the British and Jordanian royal families and under the patronage of Prince Philip, the Duke of Edinburgh, Prince Hassan of Jordan and Sir Evelyn of Rothschild.

Four broad themes of convergence between these three religions have been drawn:

- Justice,
- Mutual respect,
- The concept of stewardship entrusted by God, and
- Honesty.

The declaration (An Interfaith Declaration: A Code of Ethics for International Business for Christians, Muslims and Jews) issued by this working group, which is a code of business ethics common to all three religions, develops good practices to be adopted in each of these themes, particularly in relation to stakeholders.

### ii) Sectoral Exclusions

The sectoral exclusions, at the origin of the ethical finance or the SRI, as we know it today, are indeed derived from religious, Protestant and Catholic foundations in this case. Therefore, it is quite normal that the list of prohibited sectors should be substantially the same as in the case of Islamic finance: alcohol, pornography, gambling, tobacco and armaments, are fairly widely condemned as being detrimental to the man and society. Islamic finance does not specifically adopt the ESG (Best-in-Class "Besteffort") selection approach, but it is entirely in line with ethical finance.

It should be noted that certain exclusions are specific to Islamic finance, such as that of the financial industry or that of the entertainment industry (music, cinema, etc.). As far as the pig industry is concerned, it is outlawed insofar as Muslim religion forbids the consumption of pork.

### iii) Normative Exclusions and Global Compact

The convergences between the principles of Islam and those of the Global Compact are highlighted in the report of "OWW consulting", consultancy firm in CSR and SRI. He notes sometimes different motivations as well as more demanding requirements. It does not, however, concern the much less effective implementation of its principles in Islamic finance. But 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.

Global Compact is a pact proposed by the United Nations, an international initiative where large companies are asked to join civil society and UN agencies to support ten principles in the field of the environment, human rights, labor rights and the fight against corruption. Organizations (companies, associations, local authorities, etc.) that adhere to the Global Compact are committed to making progress on the 10 principles and to report annually on their progress to the United Nations. These 10 principles are based on the Universal Declaration of Human Rights, the Declaration on Fundamental Principles and Rights at Work (International Labor Organization), the Rio Declaration on Environment and Development, the United Nations Convention against corruption. It should be noted that the Global Compact is not binding and is not subject to a review of the signatories' practices.

### iv) Sharing

Being considered a form of SRI, sharing finance involves returning a portion of the profits to NGOs or humanitarian associations. Islamic finance practices its practice in two ways:

- Zakat: one of the five pillars of Islam (alms). It is a compulsory tax which represents one fortieth (2.5%) of the financial resources, and is destined for the most deprived. It serves on the one hand to purify the believer and on the other hand to provide for the needs of society.
- The financing of purification schemes: these relate to financial operations which present a presumption of genesis of interest or an activity deemed inevitable when

it is unlawful.

### v) Islamic Filtering in the Process of Improvement: Strengthening Ethical Requirements

In the construction of financial products, Islamic filtering consists of detecting a financial title in accordance with Islamic law. Once the stock passes this test, it may be included in an investment portfolio. Let us mention an important element in filtering; it is the purification of income.

There are two aspects to the purification of income: on the one hand, purification under zakat, which is one of the five pillars of Islam. Any Muslim holding more than a threshold of 85 grams of gold must pay 2.5% to one of the eight categories of beneficiaries, including the poor. On the other hand, the purification of unclean revenues prevents the accidental circumstances, or not, in which a company owes to pay the sums coming either from one of the sectors prohibited by Islamic law or from the genesis of the interest. This purification is supervised by the Shariah Board. Finally, Islamic filtering can be improved to reinforce ethical and sustainable development requirements.

If information of a quantitative or qualitative nature is needed to establish a selection tinged with ethics, Islamic filtering is also dependent on it. Among the quantitative information, indicators on the consumption of natural resources (water, energy, raw material) will make it possible to refine Islamic filtering. The same is true of the qualitative side. It will be a question of knowing the relations that the society maintains with the associations (for the defense of the environment, for the professional insertion, for the teaching, of defense of the rights of man), with the suppliers and with the population. Then, it would be interesting to know whether the company promotes the rules of the International Labor Organization, good recruitment practices, etc.

### 3) Islamic Finance and Ethical Finance: Compatibility and Complementarity

In general, Islamic finance and ethical finance are not addressed to the same clientele. The management of the two types of funds, launched separately, is located in two different countries (Switzerland for SRI and UK for the Shariah-compliant fund). On the other hand, the two financial approaches do not mobilize the same expertise. They are still compatible but do not converge naturally, perhaps because of the lack of dialogue between the actors of the two finances, but also because the SRI has evolved greatly in relation to these Christian origins and to develop prudence with regard to religious finances. Islamic finance, on the other hand, remains attached to the foundation of Islam. For some actors such as ASRIA (Association for Sustainable & Responsible Investment in Asia), SRI and Islamic finance have in common the fact that they are alternatives to traditional finance, but the issues are analyzed with a different look. In the same vein, two major differences remain:

- In extra-financial matters, SRI goes beyond Islamic finance, looking not only at the sector of activity but also at extra-financial practices. Moreover, sectoral exclusions

are not systematic for SRI.

- The financial architecture of Islamic finance is very different from Western conventional finance, because of the ban on interest and the relationship to risk and uncertainty. As a result, it is not always relevant, if not possible, to associate them with selection criteria applicable to conventional finance.

At the same time, one of the SAM management companies, expert in ESG analysis of sustainable issues and issuer practices, launched a "Shariah-compliant" fund with the British Islamic bank "Gatehouse" focused on water. This project is a combination of an SRI strategy with Islamic finance, other projects are being considered, notably by the British "F & C Investment".

Ethical finance and Islamic finance come together on two fundamental principles:

- The idea that for Islam, man is an intendant who must preserve natural resources is in line with the concept of sustainable development as defined by the Brundtland report.
- The purpose of Islamic finance, which is the improvement of living conditions and social well-being, is quite convergent with themes of sustainability such as the theme of water.

If these "finances" are combined with an overall aim in favor of social well-being and human respect for its environment, Islamic finance is a more standardized system that provides both financial and extra-financial guidance. The latter, when compared to responsible finance, converge rather with ethical finance and sharing, whether in the way of doing or the goal.

Islamic finance, however, remains compatible with other approaches to SRI: although it does not adopt extra-financial selection criteria on corporate practices, it is in line with the principles of the UN Global Compact, which rely on several SRI managers in the context of normative exclusions. Therefore, insofar as the two approaches are not contradictory in their purpose, they could be not only compatible but also complementary, taking account of ESG issues bringing both an ethical and financial added value, in particular a limitation risks. The rise of Islamic finance and ethical finance do not seem to be correlated today, but it is up to local players, financiers, research centers, rating agencies, NGOs or even regulators to promote their rapprochement. This would allow the joint development of these approaches, which aim to encourage more ethical, accountable and transparent practices, and to find new clienteles, particularly for ethical finance in countries where it is currently absent.

## V.CONCLUSION

Throughout this article, we have seen that the Islamic financial system is based on ethical and religious principles that support a certain economic and social prosperity. This so-called halal finance is attracting a spectacular enthusiasm, which is largely explained by a cyclical interest in sustainable development.

From the conceptual point of view, Islamic finance and

ethical finance have been shown to meet the Islamic religious law, which imposes on Believers to inscribe their daily activities, in particular economic, with respect for the environment and the generations to come. Thus, Shariah requires Believers to behave in a "socially responsible" manner. Social responsibility, a major focus of ethical investment, therefore, necessarily has a major role to play in Islamic finance. However, the current financial turbulence, whatever their immediate outcome, is systemic in nature. They are the symptom of the increasing pressure which, year after year, weakens the material, social, intellectual and ethical foundations of the socio-economic system based on political and economic freedom. At the same time, patience, loyalty, duration and trust, the pillars of the relationship, have been weakened, leading to a rise in the mistrust of a likely systemic rupture. This requires a new definition of each party's responsibilities, reaffirmation of the primary role of finance, implementation of appropriate regulatory, moral and ethical instruments that will restore confidence and correct some current system asymmetries. These changes are key factors that will allow finance to move towards more sustainable development, where man's economy and the environment are at the heart of his concerns.

The massive awareness of political decision-makers and civil society must allow the development of ethical finance, which has good prospects for them because they have understood that reconciling financial profitability and economic profitability were not antinomic but decisive in optimizing and perpetuating their activities.

For the past 10 years, the market for SRI and ethical finance has grown steadily. Today, fund managers diversify their management strategies and now offer a range of funds that are particularly geared towards the environment, social and corporate governance. In this environment, Islamic finance will find a prominent place, with a corpus of principles that is a matter of jurisprudence in these periods of questioning the financial system as a whole. The evolution of the demand in terms of social and environmental implication of the actors of the finance, will have to constitute an axis of progress necessary for the developers of Shariah compliant funds.

Finally, it will be necessary for the Islamic financial players (Shariah boards, management companies, organizers, etc.) to think more about harmonizing their corpus of rules with certain SRI criteria (pollution, corporate governance, etc.).

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