

# QUESTION & ANSWER BUCKET





01

## WHAT ARE SOME OF THE BASIC CHARACTERISTICS OF THE ISLAMIC FINANCIAL SYSTEM?

Ans

**SOME OF THE BASIC CHARACTERISTICS OF THE ISLAMIC FINANCIAL SYSTEM ARE:**

i

### **RISK SHARING AND NOT RISK SHIFTING**

Compared to the conventional finance system, Islamic financing is based on the principle of risk sharing rather than risk shifting.

Risk sharing is when the loss will be borne by both the parties – the investor and the investee.

ii

### **TYPE OF LIMITED LIABILITY PARTNERSHIP**

The risk of loss will be shared by both the partners – the investor (responsibility is limited to the money they contribute) and the investee (responsible for the provision of their expertise, experience, knowledge, and labour).



02

## EXPLAIN THE ROLE OF AN ISLAMIC BANK?

Ans

The idea of Islamic bank is like a joint stock company in which shareholders come together and decide to establish a bank. They agree and decide on the percentages for profit and loss sharing because the depositors are like shareholders – benefit from the profits according to their investments, but also bear the risk of loss with the bank.

Islamic banks raise funds from the little deposits of citizens and customers and pool them together in a single larger amount, and the same with shareholders equity. Using this pool of finances, the Islamic bank finances projects like factories, metros, etc., because individuals on their own cannot finance such projects alone.



## 03

### WHAT WAS THE CAUSE FOR 2008 FINANCIAL CRISIS?

Ans

The demand of loans was very high due to low interest rates. Everyone wanted to borrow so that they could have their own house or their own business. Banks and financial institutions gave out loans with interest on large scales to people without taking care of their credibility or their ability to pay back.

According to the conventional interest-based system, when their borrowers could not pay back the loan installments, they are imposed with fines and an interest premium to be paid along with the installment for late payment. The more one delays in paying back the borrowed sum, the higher the fine and interest they must pay.

Let us assume that a loan of \$1 million is given to a customer for purchasing a house, and after few months he is unable to continue to pay back his installments, due to which he is imposed with a fine and the interest calculation starts until he is able to start paying back his installments.

The important thing to realize is that though the amount that must be paid back to the bank by the borrower keeps increasing (even greater than the amount of the asset purchased, or security kept with the bank – eg: needs to pay back \$10 million for his \$1 million house and \$1 million in security).



But the banks cannot continue with just the calculation of interests with recovering the loaned amount or the installments because the money loaned by the bank belongs to its depositors.

If the borrowers do not pay back their loans, the bank would end up bankrupt because it would not have finances to pay back the depositors when they would want their money.

It was due to such a situation that towards the end of the year 2009, around 8000 financial banks and institutions in United States alone become bankrupt.

The banks tried to liquidate the assets and sell off the houses to recover the loaned amount, but they failed because the supply was more than the demand (assets had to be priced lower than their market value), the amount to be recovered was much higher than the securities and the assets possessed by the banks. To buy off the assets put on sale by the bank, people needed loan, but the banks did not have the finances to give out new loans, and the cycle continues.

This was the cause of the 2008 financial crisis.

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