

# War and Peace in International Islamic Finance

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*Shawn Wang*

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***Faculty Advisor:***

***Prof. Andrea M. Matwyszyn***

***Associate Professor of Legal Studies and Business Ethics***

***The Wharton School***

*With thanks to:*

*Bethany Schell, Administrative Coordinator, Wharton Research Scholars*

*Prof. Martin A. Asher, Director, Research and Scholars Programs, The Wharton School*

*Vice Dean Georgette C. Phillips, David B. Ford Professor of Real Estate, The Wharton School*

*The Wharton Research Scholars Class of 2009-2010*

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## Abstract

Islamic Finance is more than an asset class – it is a way of life lived by 1.6 billion Muslims around the world. But its reach goes even further – non-Islamic countries, governments, and businesses, have all invested in or issued Islamic securities for one reason or another. With the ongoing push of globalization of trade and finance, Islamic financial flows, long a localized phenomenon, have become international.

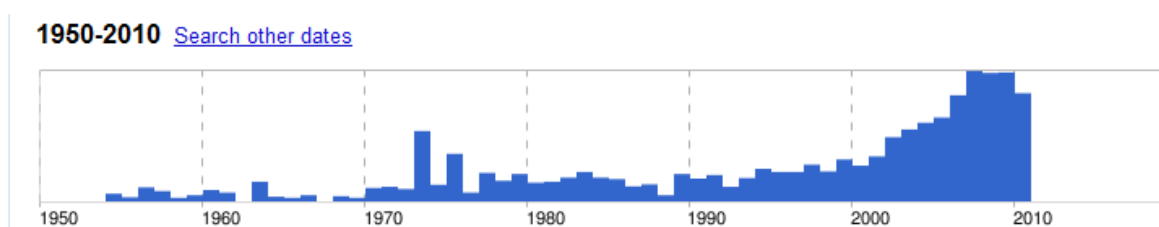
The rise of Islamic Finance transactions between the Islamic and Non-Islamic worlds has led to peace between civilizations and war within civilizations. The Islamic and Non-Islamic world are becoming increasingly interdependent and reliant, while within these worlds intense competition and infighting is ensuing – so-called “internecine fights” – in order to see who can be the friendliest to the alien culture while somewhat staying true to their own.

Islam has never been particularly united, with Islamic jurisdictions disagreeing and sometimes downright contradicting each other interpreting the same verses of the Quran, but the strains are becoming particularly visible as international flows of money get increasingly diverted to Islamic investments and securities. Islamic Finance is unavoidably prone to conflict. In the non-Islamic world, the appearance of such an abundance of foreign wealth seeking a home has led to an intense competition to play host – with countries slashing tax rates and courting investors in a beggar-thy-neighbor race.

This paper examines the rise of International Islamic Finance and discusses how conventional Islamic finance theory is ill-suited to the realities of the global Islamic landscape. Specifically, there is not enough attention paid to the possible areas of conflict that arise in interpretations of Islamic law that pertain to financial transactions. It then looks at examples of how practical issues in Islamic Finance are exposing conflict areas between Islamic and non-Islamic players, but perversely, is building cooperation and understanding between the worlds.

## Introduction

Islamic Finance is a fast-growing sector with increasing importance on the global stage. In 2009, the top 500 Islamic Financial Institutions grew 28.6% in assets to US\$822 billion, while conventional banks only grew by 21.6% (The Banker 2009). Today, major financial institutions, including HSBC, Citibank, Deutsche Bank, UBS, Standard Chartered, and dozens more, have introduced Islamic products and services and see such business lines as key potential engines of growth. Major business publications feature stories on “Islamic finance” with increasing frequency, and financial professionals are coming across the term more often. This chart shows the exponential increase in Google search hits that reference the phrase “Islamic finance” over time:

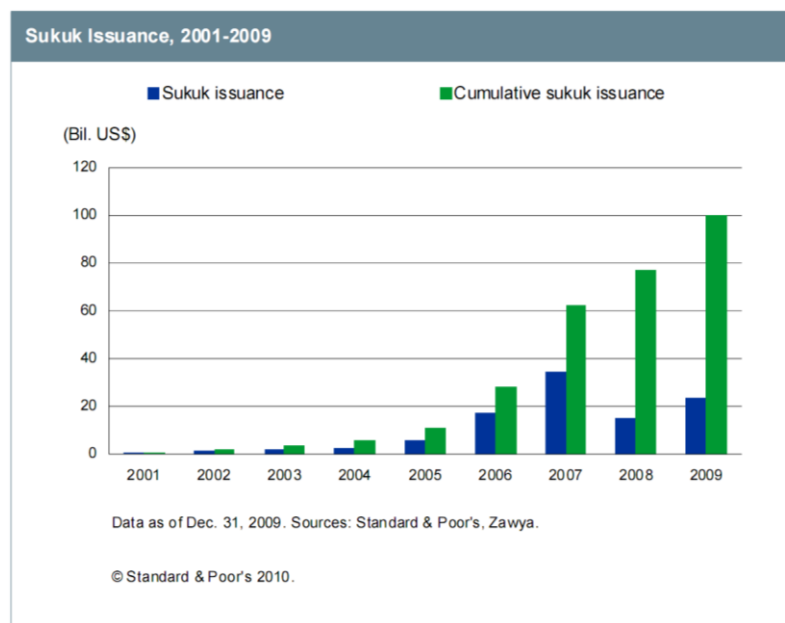


(Image credit: Google Timeline)

In fact, a Harvard Business Review piece on the rise of Islamic finance as a global player was featured in the journal’s “Breakthrough Ideas” issue in 2008 (Harvard Business Review, 2008). The term is quickly becoming a part of the lexicon of global business. By one estimate, there are at least 435 Shariah-compliant institutions and 191 conventional banks with Shariah windows on various parts of the planet (The Banker 2009).

Although Muslims have been conducting business and financial affairs in accordance with the Shariah for over 1400 years, the modern Islamic finance industry is a fairly young sector. Its conceptual roots can be traced back to the 1950s, with modern Islamic financial institutions being established in the 1960s,

1970s, and thereafter. The sector has gained sizable market share, especially in the Gulf region, in the 2000s and is considered to be an integral part of the overall financial system in a number of Muslim countries. In addition, Islamic finance has emerged as a fast-growing niche industry in countries in which there are significant Muslim minority communities, including the United States, the United Kingdom, Germany, Hong Kong, Singapore, and many more. Total issuance of Islamic debt securities, known as *sukuk*, has seen a meteoric rise:



(Image Credit: Standard and Poors)

The main factor fueling the dramatic growth is the spread of the Islamic religion globally – Islam is the fastest growing religion in the world (Zaher and Hassan, 2001). The strategic landscape of the sector is dynamic and rapidly changing, with new entrants appearing in the marketplace, often with substantial capital bases and strong sponsors. As the sector evolves, it faces both promising opportunities and significant challenges.

However, although a number of today's leading Islamic financial institutions are based in the Gulf Cooperation Council, many of the pioneers in the sector were from outside the Gulf region. The earliest ideas, institutions, and initiatives in modern Islamic finance and economics appeared largely in Malaysia, Egypt, and other parts of the Muslim world, for example the "Tabung Haji" in Malaysia in 1962, a savings and investment vehicle for pilgrims performing the Hajj, the once-in-a-lifetime pilgrimage to Mecca, the Faisal Islamic Bank in Sudan in 1977, a commercial bank for Muslims, and the mandatory "Islamization" programs of Iran, Pakistan, and Sudan during the 1980s that made all financial services in those countries comply with the Shariah (Iqbal and Molyneux, 2005).

With the growth in Islamic finance activity, the spread of Islam worldwide, and the diverse history of Islamic finance itself, the globalization of activity is giving rise to new conflicts within and without Islam. This is to be expected, but it is interesting to examine the nature of these conflicts, and the parties to them – in particular, we shall see that Islamic finance is promoting interdependence between Islamic and non-Islamic countries, and we shall see that independence within the worlds of Islam and non-Islam is leading to intense, even bitter, competition for a piece of the great Islamic finance boom.

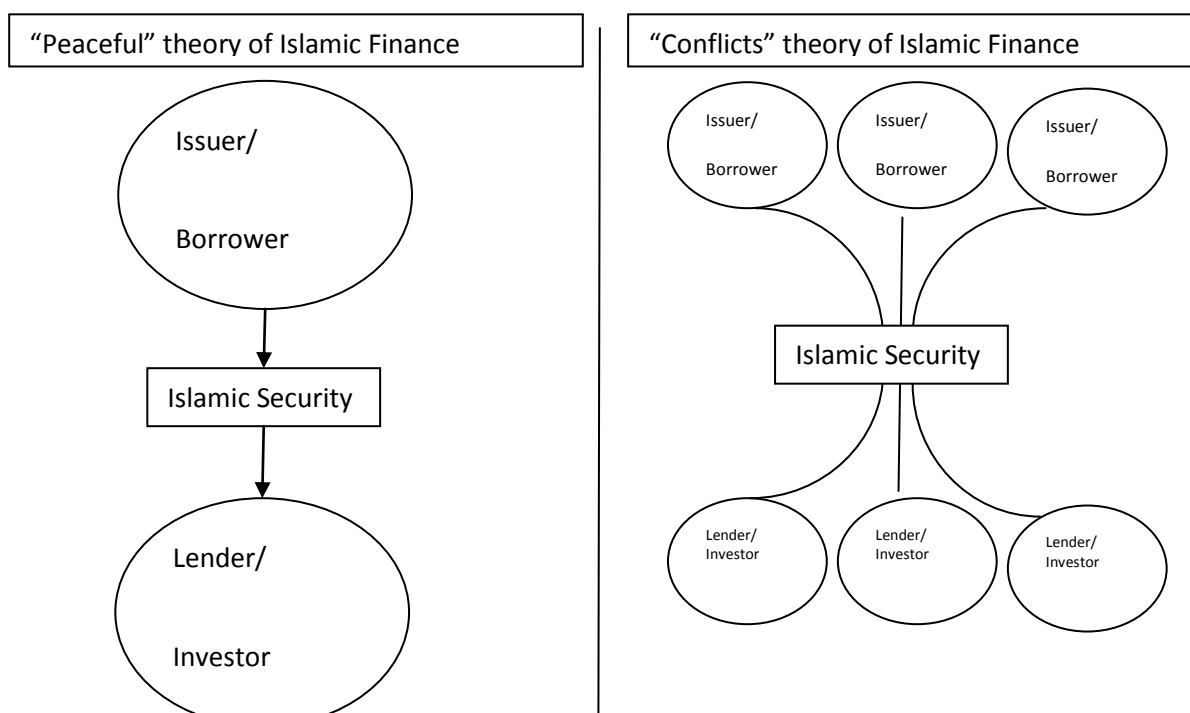
## A note about Terminology

The phrase "Islamic world" is liberally used throughout this paper and indeed in the literature, but a note of caution should be appended to this usage. "Islamic world" simply refers to countries that are majority Muslim, typically in the Middle East (especially the six member countries of the Gulf Cooperation Council – known as the GCC – Saudi Arabia, the UAE, Qatar, Kuwait, Bahrain, and Oman), North Africa, South Asia, and Southeast Asia. By contrast, "non-Islamic world" is the clumsy term of art chosen to encompass all other nations. By no means is the "non-Islamic world" completely devoid of Muslims – and by no means is the "Islamic world" itself fully Muslim, or united in its practices. As

compared to “Islamic” finance, the usual term of reference for non-Islamic finance is to refer to it as “conventional” (i.e. interest bearing, among other things) finance.

## A Conflicts-centric Introduction to Islamic Finance

There are many introductions to the specific structures and features of Islamic securities, but none that highlight the points of contention that may arise – they work in theory, on the assumption of collaboration between the two parties involved, but they start to waver in practice once we figure in the competitive element of who gets to be parties to the deal:



As such, conventional Islamic Finance introductions are inadequate simply because they assume away even the possibility of differences in interpretation, or possible areas of conflict, only filling in the gap on a piecemeal basis after constructing the main body of understanding, as though they were errant “imperfections” imposed by reality on the perfect theory. Perhaps it is the theory itself which needs

adjustment. With this in mind, we can re-interpret the typical introduction to Islamic Finance to understand the basic points of divergence.

## The Islamic Law of Commerce

Islamic law, referred to as the Shariah in Arabic and in other Muslim languages, is a deep and rich intellectual tradition. Like canon law, rabbinical law, and the secular liberal tradition, Islamic law is replete with well-developed schools of thought. The tradition includes scholarly tomes and detailed analysis rooted in principles, texts, and other proofs. The field of Islamic jurisprudence is referred to in Arabic as *fiqh* (from the root word for “understanding”). It signifies the efforts of legal specialists to interpret the Shariah and apply it to particular human circumstances. A trained expert in jurisprudence is referred to as a *faqih* and is often addressed with the honorific title “*shaykh*”.

Importantly, there is a distinction between jurisprudence (*fiqh*), which is expressed in guidelines, and in opinions, referred to as *fatawa’* (the plural form of the word *fatwa*), and legal judgments of the state. A *fatwa* represents the expert opinion of a jurist, but it does not have the status of law and is not backed by the power of the state. Therefore a variety of expert opinions regarding the same matter can be freely circulating in a society. This is especially true in matters that are contemporary in nature (like modern financial services) and are prone to a diversity of opinions. A legal judgment in a court of Islamic law is referred to as *qada’* and is backed by the infrastructure of the state. However, the jurisdiction does not extend beyond that state. Traditional Islamic finance is local and therefore structured under different *fatawa’* and *qada’* – a major bone of contention in international Islamic Finance deals.

Within the field of Islamic jurisprudence, one major category of specialization is the jurisprudence of transactions (*fiqh al-mu’amalat*), an area encompassing business transactions, financial arrangements, and so on. Although many people are exposed only to the aspects of *fiqh al-mu’amalat* that pertain to



Islamic financial services, it should be noted that the field has deep roots in the classical Islamic tradition and refers to more than just finance. For example, the Quran lays out guidelines for paying employees on time and disclosing shortcomings in goods that are being sold are all part of the same body of jurisprudence that governs lending and investments. This should be borne in mind by practitioners and observers of Islamic finance alike, lest the focus be placed solely on the technical aspects of financial structuring, neglecting the broader ethical spirit of the tradition. Again, this is understood by Muslim and non-Muslim participants only to varying degrees, which causes inherent differences in opinion when underlying assumptions do not match up.

## Islamic Finance

It speaks to the relative obscurity of the field when most business school Finance professors, supposedly at the forefront of their fields, do not properly define what Islamic Finance entails. For this reason alone some effort should be expended on a “proper” or faithful description of what the term means to practitioners of the art.

Islamic Finance is not the financing of Islamic activities, like financing for mosques or Muslim charities. Islamic Finance is also definitely for-profit – but many people still have the conception that it is a religious benefit performed not-for-profit to address the needs of Muslim investors. It is not necessarily limited to the financial activities of Muslim market participants, and although it certainly easily lends itself to that, we shall see that non-Islamic lenders and borrowers, investors and businessmen, get involved in Islamic Finance. Conversely, Islamic finance does not even encapsulate all the banking and investment activity undertaken by Muslims – the bulk of their activity is in fact undertaken through conventional, and technically speaking “religiously illegal”, means. The Islamic Finance sector therefore makes up only a very small portion of Muslims’ overall financial activities.

Even those with some exposure to Islamic Finance overly focus on the prohibition of interest (one key principle of Islamic finance later to be discussed) and miss the broader ethical and economic frameworks. Furthermore, observers often note the similarities between Islamic offerings and their conventional counterparts and conclude that there is no “real” difference between Islamic finance and conventional banking. Although this is often a fair criticism, it generally overlooks key procedural and structural differences – differences that have an impact on Shariah compliance even if pricing and economic outcomes are identical. Procedure matters. However, again, different practitioners disagree on precisely where the line is drawn between necessary procedural structuring and simple “window-dressing” of non-Islamic securities.

The best way to characterize Islamic Finance is simply that it refers to Shariah-compliant financial services, in the full range of financial services that one typically refers to when one speaks about financial services conglomerates like Citibank and JP Morgan.

Rehman (2010) outlines the four key principles of Islamic Finance:

1. **Morality:** the “no pork, no porn” rule.
2. **Risk-sharing:** the “no interest” rule.
3. **Ownership:** the “no shorting” rule.
4. **Specificity:** the “no general obligation” rule.

### **Morality**

This principle of Islamic Finance can be summed up as the “no pork, no porn” rule, and is simply based on the idea that one’s financial activities must be consistent with her overall ethics and values. This is a concept that is strangely alien to conventional finance, where one’s financial activities flow towards whatever offers the highest return. If an investor believes, for example, that gambling is wrong, it would

be inappropriate for her to profit from gambling by owning a casino. This basic principle generally manifests itself in non-financial interactions – most people would find it difficult to deeply admire someone whose income is derived from selling illegal narcotics, even if he is an exceptionally pleasant and well-mannered person. However, in finance, we have a level of emotional distance that we don't apply in other parts of our lives.

This has led leading asset management institutions, whether they be third-party managers of funds like State Street and Vanguard or principal investors like university endowments and pension funds, to increasingly accommodate investors who seek “socially responsible investments” (SRI), “green” or environmentally friendly funds, and other ethics-based investment criteria. Historically, such constraints have made investment managers uncomfortable – these managers are, after all, trained to optimize returns within a range of possible investment options. It logically follows that the more flexibility they have (all else being equal), the better. In addition, the introduction of ethical screens that rule out certain investments can be complex and time-consuming, not to mention subjective and qualitative and therefore difficult to compare, possibly detracting from the returns and “distracting” investment committees. Nevertheless, there is a gradually increasing interest in socially responsible funds in the conventional sector.

In the case of Islamic investments, the ethical screens are rooted in principles and directives from the Shariah, and the “social responsibility” is religiously motivated. The bulk of the “prohibited” sectors in Islam overlap with the sectors that are customarily screened out of conventional SRI funds, such as (for example) pornography, gambling, and weapons. There are, however, sectors that are unique to Islamic funds because they relate to practices that are prohibited in Islam but not in other ethical traditions:

1. The largest of these sectors is conventional financial services – since Islamic law views interest-based financial services as impermissible, conventional banking and insurance stocks are screened out of Islamic funds.
2. In addition, Islam’s prohibitions on drinking alcohol and consuming pork extend to investing in breweries, bars, and pork-related businesses.
3. The last filter typically applied in Islamic funds is a filter against heavy conventional leverage – the motivation is to screen out companies that benefit from the use of interest, but in this case it also helps screen out very risky companies.
4. In cases where “screening” out this activity is unavoidable or unforeseen, Islamic funds are also generally required to “purify” their returns by removing any portion of the return that is deemed to be from impermissible sources (and, for example, donating that return to charity).

Thus, there is a lot of interpretative leeway: does one categorically not invest in financial services? Or does one cautiously invest in those services, note the contribution to yield of interest-related profits, and then, like a religious tax return, purify those profits?

### **Risk-Sharing**

The most famous injunction of Islamic finance is its prohibition of conventional interest. This prohibition is rooted in the Qur’an, which prohibits a practice that is called *riba* in Arabic and is traditionally interpreted to include modern interest. More precisely, it is understood to include all forms of a guaranteed return on moneylending in excess of the principal amount lent. For example, demanding repayment of \$105 next year for \$100 lent today would be considered an impermissible arrangement. There is also a form of interest related to bartering commodities that is called *riba al-fadl* (prohibiting the uneven exchange of the same commodity), which is generally less relevant to modern, currency-

intermediated financial activity, but may return to relevance due to the unique structures of Islamic Finance.

The central argument for this prohibition is moral. An entrepreneur borrowing money is taking a risk – the business could fail – but the interest-based lender is not, seeking a guaranteed return without undertaking a commensurate risk. Of course, this is not entirely true – the entrepreneur could choose to default, and so we say that the lender is undertaking *credit risk*, but in Islam this conflicts with yet another principle: that agreements should be assessed based on the expectation that they will be fulfilled. Taken together, these ideas lead us to arrive at the conclusion of the immorality of conventional interest. Yet, in 2009 there were two defaults in the sukuk market, from the Saad Group and The Investment Dar Co. K.S.C.C. With no way to hedge credit risk, lenders seem to be unilaterally exposed to this risk – which has led some jurisdictions, like Malaysia, to edge away from the complete risk-sharing concept to some midway point.

Islamic economists also assert that the Shariah also views money as a store of value and a medium of exchange, not as a commodity – thus it should not be exchange at a price (interest) – rather it should be just a means for the exchange of goods and services. Incidentally, the prohibition of interest has an interesting history – interest was long banned by all three Abrahamic faiths (Judaism, Christianity, and Islam) and by other ethical traditions in the world. The Jews were the earliest to relax their prohibition, and Christianity's ban on interest persisted until after the Protestant Reformation, when theologians created a distinction between “usury”, which was deemed to be excessively high compensation for moneylending, and “interest”, which was deemed to be a fair price for extending credit. Islam has had no such distinction.

Although Islamic finance prohibits charging for moneylending and the practice of compounding interest, it is important to note that the Shariah and Islamic economists in general do acknowledge the time value

of money. A merchant can, for example, charge a higher price in the case of a sale with deferred payment (for example, if payment will be made in a year) than she would if the buyer were paying cash today. Similarly, it is acceptable for the price to be lower if a customer pays today for property to be delivered in the future than it would be if the customer paid later on (say, at the time of delivery). There is recognition of the opportunity cost associated with having cash in hand – the merchant could have used these funds for additional trading, and the customer could have invested the money and earned a return elsewhere. Thus, Islamic finance does not neglect the reality of the time value of money.

The key distinction between Islamic finance and conventional lending is that Islamic finance is rooted in trade (the exchange of assets) rather than in moneylending (charging interest on money lent). The Qur'an itself emphasizes this distinction and recognizes its subtleties. Addressing the argument that interest-based lending is simply a form of trade, the Qur'an says, "that is because they say 'indeed, trade is like interest;' whereas God has made trade permissible and has prohibited interest." To comply with this ruling, Islamic finance must be asset-intermediated and involve the exchange of goods rather than charging for the use of money, using the process of goods exchange to address the opportunity cost of capital. However, in practice, many Islamic financial institutions tie their profit rates to conventional world interest rate benchmarks like the LIBOR. This is uncomfortably close to admission that Islamic Finance is simply conventional finance by another name in some circles, but on the other hand, the Islamic financial institutions find it necessary to offer benchmarked profit rates only because of the customer demand for a benchmarked, competitive rate.

### Ownership

The restriction against selling something that one does not own lends makes short selling impossible in Islamic finance. This is related to a fundamental view in Islamic finance that investors should have economic incentives that are aligned with the borrowers of capital. When an investor goes long, it is

because he believes that the value of a security will go up, and he wishes to benefit from this rise in value. When an investor goes short, by contrast, she is seeking to benefit from the decline in a security's value. Islamic investors are required to take a more fundamental view of investments than most, buying assets that they believe will appreciate, and simply avoiding those that they believe will decline in value. Short selling and benefiting from the security's decline is simply not an option. This has additional side benefits of the fact that insider trading is limited in its possibility, and that market meltdowns are less likely to happen under Islamic Finance. However it should also be noted that the Ownership requirement strengthens the focus of Islamic Finance on the underlying asset – and thus one cannot simply issue a bond backed by future profits, as those profits have not yet been earned.

### Specificity

The fourth basic principle of Islamic finance is that, in a transaction, one must specify exactly what she is buying and what price is being paid. The underlying concept of relevance is referred to in Arabic as *gharar*, or excessive uncertainty – although this common translation of the term misses the importance of attaching a financial deal to a specific, identifiable, underlying asset. As such, there can be no Islamic securitization deals against general obligations of the borrower (as is typical in “general obligation” municipal bonds in conventional finance) and both parties to the transaction have to be reasonably certain of the value of what is changing hands.

### Islamic financing structures

The most common Islamic financing structures include:

1. Murabaha – markup financing
2. Mudaraba – partnership between capital and management
3. Musharaka – equity partnership
4. Ijara – leasing

#### 5. Other Sukuk structures – “Islamic bonds”

The financing structure called *murabaha* or “markup” financing illustrates the fundamental concept of asset intermediation. The first step in the *murabaha* process – like the first step in a conventional financing process – involves a customer identifying a good that he wishes to purchase (for example, furniture). In a conventional financing, the lender would simply provide the customer with the cash at a particular interest rate. In a *murabaha* structure, however, the financier must itself purchase the furniture, take legal ownership of the furniture, and then sell it to the end customer for profit. Conceptually, the extra step (in which the financier buys the asset) turns the transaction into a trade rather than a moneylending arrangement. In practice, the financier typically appoints the end customer to make the purchase on its behalf (so that the financier technically owns the furniture but does not have to go to the store and collect it). Observers have noted that the *murabaha* structure replicates conventional financing and hardly seems different – in fact, the agency agreement through which the customer buys the asset on behalf of the bank may seem cumbersome. The step by which the financier owns the asset (and thereby takes ownership risk at least temporarily) is nonetheless an important procedural difference, without which the financing arrangement would not be deemed Shariah-compliant. This is largely exploited in Malaysia, however members of the GCC are still not entirely comfortable with this and thus would not invest in it.

The financing structure called *ijara* or “lease” financing is also strictly tied to an asset – typically, real estate, especially of government property which is not significantly leveraged – which is identifiable and therefore especially amenable to Islamic finance securitization. In such a transaction, the financier takes ownership of the asset but leases it back to the end user. The financier thus takes ownership risk on the asset for at least the period of the lease.



## Conclusions

Because of the high likelihood that each lender or investor has different preferences and level of Islamic Finance acceptance, and that each issuer or borrower has different capital needs, it is highly probable that Islamic Finance will continue as a largely OTC market seeing mostly primary activity and little secondary trading, for the foreseeable future. However the location of the market is highly flexible, and since there are plenty of dollars on one side and an insatiable desire for cheap capital on the other, there is much competition just to be a part of the market, much less actually having control of the market. However the concepts surrounding the creation of Islamic securities, because they are being adapted from the playbook of conventional finance, are causing all manner of conflicts and problems for both the Islamic institutional investors and the multireligious issuers they serve. This is because they attempt to arrive at the “best” method of structuring these Islamic Finance deals – without realizing that there really may not be a one-size-fits-all structure that will be palatable in every jurisdiction. The absence of a general, superior solution is taken to indicate the opportunity for creativity and innovation, but this is misguided. Why do we assume that there *is* a general solution? Even if one were found, the root cause of the deficiency of tailor-made solutions has not been addressed – that different participants have different needs and priorities – thus the general solution may not be a solution at all.

## Issues in International Islamic Finance – A Primer

Now that we are sufficiently introduced to the theoretical aspects of conflicts in Islamic Finance, we turn our attention to a brief history of its practical development – focusing again on the conflicts and the two areas of difference that have arisen as a result of the global diversity of opinions surrounding the key theoretical principles, which can be classified as the Authenticity Problem and Regulatory Enablement.

### The Authenticity Problem

In the 1980s, three countries adopted mandatory “Islamization” programs in their banking sectors: Iran, Pakistan, and Sudan. As a matter of policy, these countries felt that their banking sectors must be entirely Islamic, and edicts to this effect were issued. The mandatory and swift nature of such Islamization initiatives led, however, to unintended consequences – one of which was the superficial “conversion” of banks without sufficiently changing their product structures and operations. Often, customers saw no change in their experience except that names and labels were changed (for example, calling something a “profit rate” rather than an “interest rate”), without sufficiently changing the underlying product. Even though forced Islamization has been revoked in Pakistan and conventional banks have long since dropped the Islamic labels, strongly negative impressions of Islamic banking have persisted among customers who witness the “window-dressing” approach. Some assume that all Islamic banks’ claims of Shariah compliance are as weak as those of the banks that adopted window dressing out of regulatory necessity. This assumption continues to act as a barrier to the growth of Islamic finance in certain countries.

Islamic finance is rooted in a set of economic principles, including risk sharing, partnership between capital providers and businesses, limitations on debt, and a focus on productive economic activity. As Islamic finance evolved, adaptive measures were undertaken to enable the sector to conform more closely to the prevailing, conventional financial system. Structuring strategies (referred to as *hiyal* in

Shariah terminology) were devised in order to replicate the outcomes of conventional products through Shariah-compliant means. These strategies were often approved by Shariah scholars as “exceptions,” with a view that the strategies would be used for a temporary period until alternatives that were more consistent with the spirit of Islamic finance could be introduced.

A number of industry observers, especially economists and academics, have commented that the growth of Islamic finance has come with the introduction of structuring strategies that arguably depart from the spirit of the Shariah. The instruments just discussed, among others, have no doubt contributed to the rapid expansion and increased acceptance of Islamic finance. At the same time, concerns about their Shariah authenticity are well founded and must be appreciated. These concerns are fourfold:

1. Customer expectations
1. Regulatory constraints
2. Competitive pressures
3. Staffing and incentives

### Customer expectations

Generally, Islamic financial institutions have found that only a small segment of their potential customer base is willing to pay a significant premium (in terms of higher costs or lower returns) for Islamic financial services compared to conventional ones. To capture a sizable market share, therefore, institutions have needed to offer Islamic products that replicate the features, benefits, and pricing of conventional alternatives. This need to replicate conventional products is *imposed by the customer* and has had real implications for the ability of financial institutions to comply with the spirit of Shariah guidelines. Customers of Islamic Finance may not realize what they are asking for is something they don't actually want.

### Regulatory constraints

A second major challenge to greater Shariah authenticity is the regulatory framework governing banks. Islamic financial institutions have found it imperative to incorporate as licensed banks so as to be authorized to collect customer deposits and provide retail financing. Banking laws, however, place constraints on the investment risk that banks can take using customer deposits. Thus, the principles of Shariah might encourage lenders to be genuine partners with homeowners and actively take equity risk as well as market risk. Regulators, however, would view such arrangements as investment activity rather than financing activity. To be a bank, an institution can place only a limited amount of its customer deposits into investments – placing more would make it an investment company. Islamic Financial Institutions may not be able to make everyone happy – to satisfy conventional regulators, and at the same time satisfy its Islamic clients.

### Competitive pressures

A third challenge is the competitive pressure within the Islamic finance sector. When one institution introduces a product or service, it becomes difficult for competitors to refuse to match it – even if the second institution's Shariah preference would be to not introduce the product. Surveys find that customers generally take comfort in the fact that Islamic banks profess to be Shariah-compliant overall and therefore do not need to assess the Shariah authenticity of each product or service. Therefore, if one Islamic bank has launched a product, then customers expect their own institution to be able to launch a similar one; if it does not, the customer may switch banks. Product offerings are highly competitive between Islamic Financial Institutions.

### Staffing incentives

As the sector has grown, Islamic finance has needed to staff an increasing number of fast-growing institutions. The most readily available talent pool for staffing Islamic financial institutions has been the

conventional banking labor market, from which professionals are able to bring skill sets and experience bases that are highly relevant for Islamic financial services. Often, senior executives in Islamic banks come directly from conventional banking and take on roles equivalent to those that they have previously held. As a result, executives in Islamic financial institutions may often feel inclined to replicate the products, services, and systems with which they are familiar. Not only is this easier and in some ways safer, but also the banks' incentive systems may contribute to the pressures to replicate. Key personnel will be fought over between Islamic Financial Institutions.

### **The Tradeoff**

One can argue that with the four pressures on the Shariah-compliance of Islamic financial institutions, the evolution of Islamic finance to date suggests that the market share gains have come at a price of introducing less authentic structures. Thus, prolonged growth in the industry would imply eroding adherence to the Islamic principles that are supposed to guide its activity. As the sector evolves and competition intensifies, a key area to watch will be whether customers will differentiate among Islamic financial institutions based on Shariah authenticity. There are signs that this is already happening. Large pockets of Muslim customers, particularly outside the Gulf, often criticize Islamic finance for not being "different enough" from conventional banking and therefore not being worth patronizing.

### **Regulatory Enablement**

If Islamic finance is to thrive, an environment of regulatory enablement is generally crucial. Banking laws worldwide, including those in Muslim countries, have been created with the conventional banking system in mind. These laws can often put Islamic finance at a disadvantage, producing a negative impact on the sector's ability to gain market share and flourish.

There are three main legal limitations imposed by conventional banking laws. First, prudential limitations on banks' ability to share risks with their customers lead to structuring strategies that

arguably reduce Shariah authenticity. Islamic finance calls for genuine risk sharing between financiers and borrowers; conforming to banking laws requires structuring strategies that reduce risk sharing. This inherent conflict can be resolved by reform accommodating investment-like financing modes intended in Islamic finance while still enabling the institution to take retail deposits. Tax laws can pose another obstacle – tax codes customarily treat interest as tax-deductible, whereas Islamic finance charges often are non tax-deductible, creating an incentive for customers to choose conventional finance, or at least increasing costs for the Islamic financial institution, making it less competitive. To level the playing field, it is important that regulators treat Islamic finance charges as also tax-deductible and thereby not disadvantage Islamic lenders. A third example relates to stamp duties and transaction charges – regimes that charge duties on the transfer of property need to waive potential double taxation in the context of Islamic financing arrangements that involve multiple transfers. The appropriate reform would thus be to combine Islamic finance transactions as a single transfer or waiving the second stamp duty/transaction charge.

There are three types of regulatory reform approaches to resolve this issue.

The most common approach adopted in the majority of Muslim countries is simply to do nothing – they apply the same set of laws to all financial institutions – conventional and Islamic – without provisions that specifically enable Islamic finance or put it on a level playing field. While such an approach has the benefit of standardization, it has the major drawback of often putting Islamic institutions at a disadvantage as a result of the abovementioned constraints .

The second approach is to keep a single regime, but to create exemptions within the framework that accommodate Islamic finance. Without creating a separate regulatory category for Islamic institutions, this approach seeks to remove the barriers that hinder Islamic financial institutions. The United Kingdom provides a prime example of such a regime – its Financial Services Authority (FSA) does not treat Islamic

banks separately from conventional ones, but taxation and stamp duty laws accommodate Islamic transactions by eliminating the hurdles discussed earlier. Importantly, the UK laws make no reference to “Shariah” or to “Islamic finance” – they merely describe the types of structures for which the exemptions from relevant laws exist. This way, there is no favoritism for Islamic finance or limitation of the exemption for a single religious group; the regulator remains religiously neutral.

The third approach is most supportive of Islamic finance. It can be characterized as a dual regime – Malaysia and Bahrain, for example, have adopted a separate set of laws for financial institutions that are licensed as Islamic. These laws recognize the distinctive attributes of Islamic finance and apply regulations that are sensitive to these attributes. At the same time, conventional banks are governed by laws that suit the needs and practices of conventional finance.

## Interdependence between Islamic and non-Islamic World

From the standpoint of Islamic Finance, the relationship between the Islamic and non-Islamic world is increasingly characterized by increasing interdependence over time. The Islamic world is interested in investing in foreign assets to diversify risk and boost yield, while the non-Islamic world is interested in lowering cost of capital and managing the depreciationary pressure of their currencies. There is a natural confluence of interests, which lead to a lot of potential areas for deal making to happen, but it must be understood that as more deals happen, more financial relationships are being created that may or may not be a desirable side-effect of the deals themselves.

To put it bluntly, there is no systemic risk regulator for either the Islamic or the non-Islamic world to monitor the counterparty risk of dealing across religious boundaries.

A hypothetical scenario will drive the point home. What if, because of some unrelated political mishap, a jihad was decreed barring all Muslims from buying from or selling to the British? This jihad is actually implementable in real-economy terms (basically, this would constitute a religious embargo on goods and services with Britain), but what about the needs of Muslim investors investing in British assets? In this scenario, a potential economic jihad against Britain would actually *hurt* the Muslim investors as they would not be allowed to accept their profit-sharing payments or even the return of their principal as these are also transacted by underlying transfers in ownership of goods and/or real estate. This may cause the Muslim investors, who are likely to also wield power and influence, to protest the issuance of the jihad in the first place because of their vested interest in Britain as a nonpolitical entity, but as a trading partner. The mere existence of the transaction cannot but make Islamic investors *more*, not less, dependent on the situation of the non-Islamic world.



Conversely, British borrowers will also have to take into account their Islamic investors. To say that because they are borrowers, they are therefore dependent on the Islamic investors is true, but trite – it is also not unique to *Islamic* finance. What non-Islamic issuers fail to understand prior to getting into the financing deal is that there is more than a financing deal involved – often there is a real change of ownership of the underlying asset, one that can therefore be subject to all sorts of unexpected events. Since the Islamic investor in an *ijarah* structure technically owns the building in which the borrower operates, a transaction that has not been well drafted from the perspective of the borrower may result in the borrower getting kicked out of the building and having his operations shut down for potentially any reason – and with no liquidated damages to boot since these clauses are not generally deemed *halal*.

We have observed, hypothetically, the increase in interdependence between borrower and lender in the context of interfaith Islamic Finance. A more extreme formulation of this interdependency statement would be to say that it makes both worlds internalize the effects of actually doing harm to the other. However it is worthwhile to look at real-world examples of this happening, and observe the interdependence effect at play.

### **Islamic funds invested in Non-Islamic assets**

The most famous private institutional investor from the Middle Eastern region is arguably Prince Alwaleed Bin Talal Alsaud, the part-owner of Citicorp. Clearly, as Citicorp earns its money from various conventional world financial transactions involving the use of interest and risky derivatives, Prince Alwaleed has less religious qualms than the average Islamic Finance investor when it comes to wealth management (perhaps this is a necessity due to his enormous wealth). However, his holding company, Kingdom Holding Company of Saudi Arabia, was established in 1980, has an Islamic portfolio vetted by the Zawya information service, and it includes major non-Islamic world holdings like a 45% stake in the Four Seasons Hotels and Resorts, a 1% stake in Pepsi, P&G, Time Warner, Disney, and other institutions

deeply ingrained in the non-Islamic culture. His fortunes certainly rise and fall with those of the companies he invests in. For their part, companies in trouble regularly call on deep pocketed investor like Prince Alwaleed for a no-questions-asked bailout, something which, if they get, they can actually depend on *before* getting help from their own government (Zawya 2009).

One feature to contrast the world of Islamic finance is the fact that Asia, more specifically, Malaysia, dominates the Islamic Finance league tables in terms of sukuk issuance. In fact, during 2009 63.9% of global issuance occurred in Asian countries, with Malaysia taking 54.1% of that pie (Damak 2010). However, non-Islamic issuers are overwhelmingly interested in Gulf wealth. Why is this? Malaysia issues largely for a local market, and in some respects can be considered to have the most highly developed (but lenient) Islamic financial sector domestically. However, almost all the international flows of money come from the Gulf.

### **Non-Islamic issuers funded by Islamic funds**

The non-Islamic world is also gradually waking up to the opportunities offered in securing financing from Islamic Finance. This is happening at all levels of market participation: in national government, local government, and corporate issuers of all shapes and sizes. Comparatively speaking, corporate issuers likely have the easiest time borrowing money from Islamic financial markets. Having less stakeholders who are religiously motivated, companies can simply speak to the low interest rates available in these markets and point out their profit-maximization fiduciary duty. Major non-Islamic issuers of Islamic securities include General Electric, Shell, and Tesco of the UK. The most recent transaction, General Electric's \$500 million Islamic bond sold at just 155bp over US Treasuries, illustrates the interdependent relationship that this financing deal supported: "[General Electric has] a huge commercial interest in the Middle East and this deal is a reflection of our strengthening business ties in the region while providing a platform to diversify our funding." (Euroweek 2009) Although in this particular case the Islamic financial

transaction did not create an interdependent relationship by itself, it deepened the existing commercial relationship General Electric had with customers in the region (it had in July already signed an \$8 billion commercial finance joint venture with Mubadala, a state-owned investment company based in Abu Dhabi) and worked triply as a show of good faith, a way to tap cheap financing, and to illustrate General Electric's willingness to be culturally sensitive and innovative at the same time. The deal was remarkable not only because General Electric claimed the title of being the first US corporate issuer of Islamic bonds, but also by blazing the trail of broadening the list of securitizable assets. The General Electric deal was the first *Ijarah*-structured Islamic bond that was not based on real estate, but instead based on operating lease receivables of General Electric's aviation leasing business. As further deals build momentum in the future, it is likely that the Islamic world will look to the non-Islamic world for higher-yielding assets, but also for creativity and innovation in structuring Islamic deals.

Local government of non-Islamic states have also gotten in on the action. In February 2005, the State of Sachsen-Anhalt in Germany successfully issued an €100 million sukuk. An *Ijarah*-structured Islamic bond, the security was based on the transfer of ownership of several buildings of the state's Ministry of Finance for a 100 year term (Todd 2007). The deal not only created extremely long term dependencies between the German state and its Middle Eastern investors, but it also created interdependencies in Netherlands (where the Special Purpose Vehicle related to the transaction was incorporated) and Luxembourg (where the Sukuk is listed), bringing yet more countries in the non-Islamic world into the fold and increasing the probability that more interdependent deals will be done in the future.

Last but not least, national governments have also gotten in on the act, generally issuing in hard currencies instead of their own fiat currencies because of the abundance of Middle-Eastern wealth. The UK has also initiated a sovereign Islamic bond issuance program, as has Singapore (Mufti Hassan Kaleem 2008).

## Competition in the Islamic world

Within the Islamic world, Islamic finance is bringing to bear the ugliest unresolved conflicts in the religion. This is because Islam is run strictly on the interpretation of Quranic verses, which does not have precisely defined language that applies directly to the modern era. Thus there are wide differences in approaches based on interpretations adhering with varying strength to the letter and spirit of Shariah law. At the regional level, there is a competition to determine who emerges as the global Islamic authority. The Islamic Financial Services Board represents a broad number of non-GCC Islamic financial regulators, including representatives from Korea, Singapore, and Hong Kong, while the Organization for the Islamic Conference is the GCC-dominated equivalent group. Both are standards-setting bodies that are actively trying to outdo each other in creating internationally acceptable forms of securitization. Beyond the government involvement, however, the competition is more brutal within the private sector.

## Institutional landscape

Within the landscape of institutions offering Islamic financial services, there are four main categories of business models as well as an emerging fifth model. Each category of institution has played an important role in the development of the sector and is likely to continue to do so as Islamic finance evolves:

1. Local Banks
2. Regional Banks
3. Multinational windows
4. Specialist Firms
5. Highly Capitalized new Entrants

## Local banks

The single largest category of institutions offering Islamic financial services is *local banks* – deposit-taking financial institutions that serve a single country or market. As Islamic finance took root in the 1970s and beyond, it became customary for Islamic banks to be created in each country to serve the local market. Dozens of local Islamic banks remain to this day, such as Bahrain Islamic Bank, Bank Islam Malaysia, and Qatar Islamic Bank.

Local banks have played a pivotal role in mobilizing deposits in their home markets, especially from Shariah-inclined customers who were underserved by conventional financial institutions. Local Islamic banks tend to have deep insights into and expertise in their home markets, and they often were the sole providers of Islamic banking services in their respective countries for some time. Being “first movers” allowed them to build solid (and often very loyal) customer bases, and these banks flourished – especially since local competition was historically fairly limited. While their geographic focus has enabled local banks to connect with customers and build successful businesses, they often struggle to achieve adequate scale and procure world-class global systems. Like other small banks around the world, local Islamic banks often find it challenging to build efficient operating models or to undertake investments in the latest systems and platforms. The size of their customer bases relative to the fixed costs associated with operating a bank may make such efficiency impossible.

As the Islamic finance sector evolves, local banks are attractive acquisition targets for larger institutions that are seeking to expand their businesses or for financial investors who are looking for a strong return. Bank Islam Malaysia, for example, is now 40% owned by Dubai Islamic Investment Group, a part of the broader Dubai Group of institutions (Bank Islam Malaysia, 2009). Within the Gulf, local Islamic banks are prime acquisition targets, pending ongoing deregulation and openness to such acquisitions.

Consolidation of smaller-scale banks seems like a natural step in the evolution of the Islamic financial sector, and it is likely to take place if and when regulators allow such consolidation to occur.

### Regional Banking Conglomerates

A second category is regional banking conglomerates – financial institutions with a presence in more than one country. Much of the dynamism in the sector in recent years has been driven by this category, as banks have expanded from their home countries into new markets and thereby become regional players rather than local ones.

Multimarket banking conglomerates have existed in Islamic finance for decades. Two major Gulf-based conglomerates, the Dar Al-Maal Al-Islami (DMI) Trust and the Al Baraka Banking Group, trace their roots back to the 1970s and have established substantial presences in a wide range of markets. Al Baraka's subsidiaries and affiliates are in no fewer than 12 countries, spanning five geographical areas. More recently, a number of Gulf-based Islamic banks that are leaders in their home markets have begun expanding abroad. Al Rajhi Bank of Saudi Arabia, the Kingdom's dominant Islamic bank, has expanded into Malaysia. Kuwait Finance House (also the dominant Islamic bank in its home market of Kuwait) has similarly expanded strongly into Malaysia. Dubai Islamic Bank has established a presence in Pakistan, tapping into the employment and trade flows between the UAE and Pakistan.

As multimarket conglomerates expand, they are likely to drive change in the sector through acquisitions, partnerships, and pan-regional strategies. They also have the potential to achieve the scale required to enable efficiency and profitability levels that are less attainable by small players. To thrive, however, these institutions will need to overcome the legacy issues associated with being originally established as local banks. For example, as Kuwait Finance House grows in Malaysia and potentially beyond, one key challenge will be to position KFH as being more than a "Kuwaiti bank" and ensure that it is seen as being committed to the local markets that it serves. Beyond the issues of perception, it is critical that

management, operating models, systems, and governance structures all evolve appropriately as multimarket conglomerates expand. As these institutions outgrow their home markets, their entire enterprises need to adapt in order to capitalize on their multimarket presence. If they fail to do so, their ability to win regional market share will be limited.

### Windows of Global Institutions

Since the 1990s, leading global banks have entered the Islamic finance market with teams dedicated to Shariah-compliant products and services. Citi Islamic Investment Bank was established by Citigroup in the 1990s as a dedicated business unit, and HSBC Amanah was founded by the HSBC Group in 1998. The entry of Citigroup and HSBC into the Islamic finance field marked a major milestone in the sector's evolution, and it was seen as an important endorsement by the world's financial services establishment. Whereas doubts as to the long-term viability of Islamic finance had abounded prior to this development, the commitment of major banks (such as HSBC, Citigroup, Standard Chartered, Deutsche Bank, UBS, and many more) has affirmed to many the ongoing importance of Islamic finance.

Conventional banks customarily serve Islamic clients through *Islamic windows* – Shariah-compliant, but not self-contained, business units within the overall bank. Under the window model, the Islamic business unit is not a separate legal entity and does not have a separate balance sheet. This has several business advantages, such as allowing the Islamic business to build off the strength of the conventional business, reducing the costs and complexity associated with entering the Islamic business, facilitating the sharing of resources across Islamic and conventional operations, and so on. It does, however, also have the disadvantage of being perceived as less authentic by some customers and by Shariah scholars, who prefer distinct Islamic entities when possible. Many customers are skeptical of an institution's Shariah compliance if they know that their Islamic deposits will be placed in a general treasury that may

be used for conventional loans, or that their Islamic loan may be funded through conventional deposits on which the bank is paying fixed interest.

That said, windows of global banks are likely to continue to play a key role in the advancement of the Islamic finance sector in the years ahead. Their access to talent and to their institutions' overall expertise allow for product innovation and operational excellence at levels that often exceed those of the other categories of institutions. For example, HSBC Amanah's introduction of the international sukuk ("Islamic bond") was a major innovation that has since been adopted by both conventional and fully Islamic institutions worldwide. Leading global institutions often have access to the most sophisticated institutional and retail clients in a market, as a result of their international reach and their well-established reputations. They can, therefore, introduce Islamic products and services to segments of the market that are less accessible to fully Islamic banks. As sophisticated clients increasingly see Islamic finance as a viable alternative, windows of global financial institutions stand to gain considerably.

### Specialist entities

The fourth category in our landscape is that of specialist entities – the investment firms, advisory firms, and other institutions that focus on specific areas within financial services. Bahrain-based Arcapita, which is registered as an investment bank and focuses on principal investments, is an example of this category, as is the Kuwaiti firm Gulf Investment House and Bahrain-based Unicorn Investment Bank. Specialist institutions and fund managers are growing rapidly in number as demand for Islamic products and services grows in the Gulf and beyond.

Specialist entities often bring deep expertise in their areas of focus and are pioneers in product development. The US-based and London-listed firm Shariah Capital, for example, has positioned itself as a leader in introducing Shariah-compliant alternatives to conventional hedge funds. Since specialist entities are not deposit-taking banks and therefore cannot offer end-to-end propositions to their clients,



they often partner with full-service banks to distribute products or provide related services. Specialist institutions' business models allow for significant profit margins and efficient operations, but they can also be constrained in terms of absolute size and scalability.

As the sector evolves, specialist entities can continue to be critical to the ongoing development of Islamic finance. One can expect this category to be a source of innovative ideas, sophisticated product development, and new concepts for the industry. Products initiated by specialist bodies may find their way to the broader marketplace through banks and other large institutions, multiplying the impact of these innovators many times over. Specialized talent is likely to continue to migrate to focused entities that provide an organizational culture in which innovation and creativity thrive.

### New Entrants

In addition to the four categories of institutions featured in our landscape, the newest type of institution can be loosely termed *highly capitalized new entrants*. This category, which is a form of the local bank category, has unique attributes related to having a strong capital base and the potential for significant investment. Highly capitalized new entrants have the potential to shape the industry landscape through investments and acquisitions. For example, the Alinma Bank was established in 2006 in Saudi Arabia with paid in capital of \$2.8 billion, and the Noor Islamic Bank was established in 2007 in Dubai with \$1.09 billion in capital. These new entrants have a number of key advantages – they enjoy the support of government-linked bodies or rulers as founding sponsors and stakeholders, reflecting an increased emphasis on Islamic finance by the leaders of their respective countries. They also can actively seek growth through heavy investment in their businesses. One form of investment will be investment in organic growth through initiatives like new branches, expansion into new product lines, and targeting new customers. Inorganic growth should also not be ruled out, including domestic and international acquisitions that will consolidate a fragmented Islamic finance landscape.

## Competition in the Non-Islamic world

Several countries have actively pursued regulatory and trade strategies to attract GCC capital to their shores. Regulators in the United Kingdom have recognized the need for the tax treatment and stamp duty reforms and have made changes to enable Islamic finance to better compete with its conventional counterparts. In quick succession, regulators in Singapore and France followed suit. Recognizing that Gulf investors have choices, these countries have worked to position themselves as particularly accommodating of Gulf capital and its needs.

## Diplomacy

One mechanism for doing so is through events like state visits and trade delegations – even without introducing formal regulation, such measures convey enthusiasm and acceptance of investment flows and trade ties. In recent years, for example, there have been multiple delegations sent between China and GCC countries. In early 2009, Chinese president Hu Jintao traveled to the Gulf and met with senior leaders, including the king of Saudi Arabia. In the meetings with King Abdullah, Hu reportedly “proposed that the two countries maintain high-level visits, establish a high-level consultation mechanism, take advantage of their own resources and markets, promote an all-around energy partnership, and expand two-way investment.” (Xinhua Net, 2009) This multifaceted agenda indicates to both GCC and Chinese institutions that the two countries view their economic interests as aligned and that they see value in collaboration. The spirit of balanced engagement is also reflected in trade figures – in 2007, trade volume from the GCC to China was \$30 billion, and the flow from China to the GCC was \$28 billion. Hence it should not be surprising that Gulf investors have played central roles in a number of Chinese IPOs and investment opportunities. China’s interest in “two-way investment” is also a key signal of partnership – not only does China want to tap into the Gulf’s surpluses, but it also wants to invest in the

region and benefit from its ongoing growth. Such reciprocation is a message that is well received by Gulf decision markets.

Other countries have also been sending high level delegates to events such as the Islamic Financial Services Board summit, which in 2009 saw attendants like the Governor of the Financial Supervisory Service of Korea, Kim Jong-Chang, as well as Edmund Lau, the executive director of the Hong Kong Monetary Authority (Asia: 2009). This indicates a rising level of interest among East Asian industry players, which could pave the way for Islamic finance to take on an expanded role within the region. These countries are signaling that Islamic finance is not only welcomed, but actively courted by the local authorities.

The battle between non-Islamic countries for the Islamic dollar is heated. On May 7, 2009 the Monetary Authority of Singapore unveiled new measures that would equalize tax, regulations and liquidity treatment of Singapore's dollar Islamic bonds with those of the city state's government bonds, and eased rules to facilitate tax-equivalent treatment of Islamic financing. Its rival as a regional financial center, Hong Kong immediately outlined in a report the steps it had taken to develop the necessary regulatory framework to allow more Islamic financial institutions on board and the coexistence of sukuk alongside conventional debt instruments, despite having almost no Muslims as compared to Singapore. South Korea is also rumored to be considering issuing its first Islamic bond. (Asia: 2009)

## Regulatory competition

Another way in which governments signal their interest is by accommodating Islamic finance. Regimes that accommodate Shariah-compliant financial structures and investment can hope to tap into growing pools of Islamic capital based mainly in the GCC region. The United Kingdom has been particularly active in promoting its ambition to act as a global hub for Islamic finance. Initiatives by the Ministry for Trade

and Investment, the Financial Services Authority, and other bodies have conveyed a consistent message of seeking to accommodate Islamic finance. In 2007, the chairman of the FSA articulated the United Kingdom's stance, saying, "It is important that we showed we were able to accommodate Islamic banking practices alongside traditional non-Islamic banking, for reasons of both principle and practical importance." (UK Trade 2007) The UK authorities have removed double-taxation provisions and double stamp-duty provisions in order to ensure that Islamic finance operates on a level playing field. UK regulators have even permitted the establishment of fully Islamic banks, including the Islamic Bank of Britain, signaling their commitment to Islamic financial services, and have established advisory bodies that are consulted by the government on matters of Islamic finance.

As indicated in the FSA chairman's statement, the UK's promotion of Islamic finance is for both principled and practical reasons. Since it has a substantial and growing Muslim population, it is important that the United Kingdom ensure that the financial system is equally accessible to all. Aspirations for being a global hub, however, indicate the United Kingdom's keen interest in remaining a leading destination for Islamic capital from the Gulf and the broader Muslim world. Having long been a leading destination for Gulf investors (who frequent London for both business and recreation), the United Kingdom does not want to miss out on outward GCC investments. The enthusiasm for Islamic banking shown by Malaysia, Singapore, and even France is often motivated (at least in part) by a drive to attract Gulf investors. French Finance Minister Christine Lagarde has promised to make adjustments to the regulatory and legal arsenal to enable Paris to become a major marketplace in Islamic finance (Vandore 2009).

## Issuance

Non-Islamic participants are also benefiting from the rise of International Islamic Financial flows because of the relatively cheap rates at which Islamic investors will accept simply because of their desire to diversify their holdings and the lack of alternatives for their investment. This is good news for borrowers.

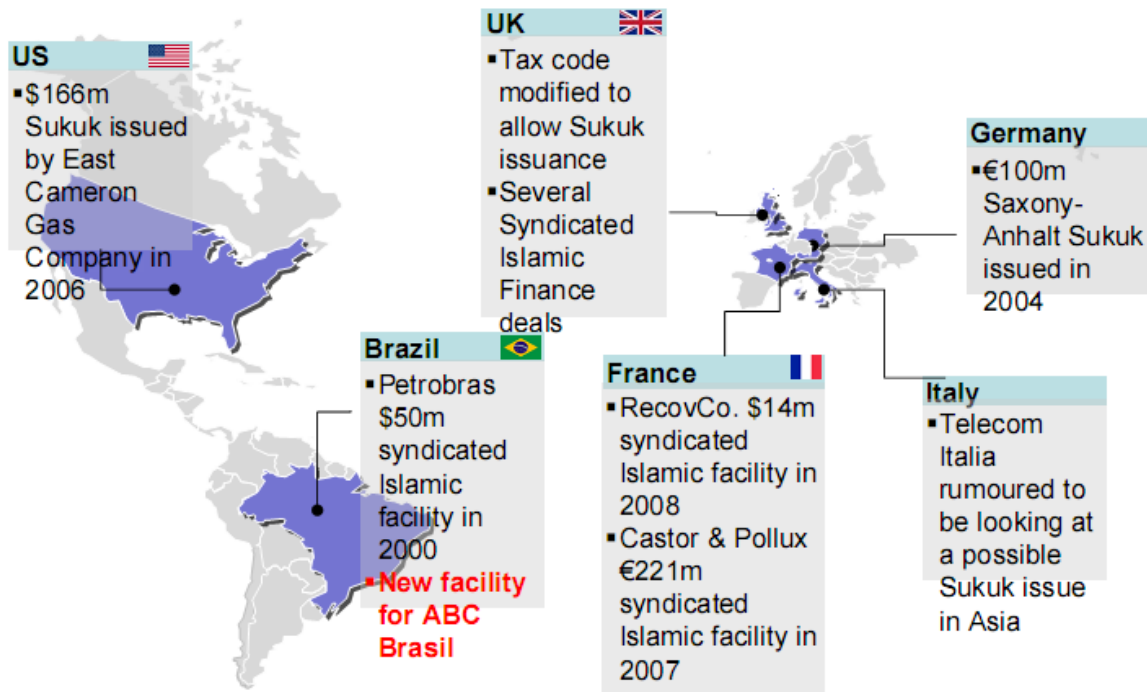


Image credit: Gatehouse Bank plc. presentation

This chart shows a selection of international, non-Islamic issuers, both government and corporate, who are tapping into the cheap liquidity of International Islamic Funds. As the volume of transactions increase, these issuers will start to compete with each other for an exhaustible supply of funds, leading to an eventual rise in profit rates.

## A Conclusion

Tolstoy's supernoel, *War and Peace*, describes the contentment of humanity in the knowledge that "Everything [is] just as it [is] everywhere else." We take comfort in agreeing with the masses, but in this global age, we have to come to grips with the fact that there are many masses – each having self-interested goals. Islamic Finance is riven with divides – with gently "warring" factions of Islamic legal thought and levels of adherence to Islam, and openly "warring" non-Islamic nations desperate for a piece of the Islamic Finance pie. In the face of multiple standards in Islamic Finance, the conventional approach has been to encourage "standardization" of these standards – as though the matter were some negotiable issue of international law. But people cannot negotiate and accept something that they do not agree with as a matter of religious belief. Perhaps it is better to make peace with the fact of continuous war in Islamic Finance, and remark on the incredible "peace"-making interdependency that is slowly but surely bridging the cultural divide between the non-Islamic and the Islamic worlds, brought on by a shared interest in economic prosperity on both sides.

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