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Development of Islamic Finance in Europe and North America: Opportunities and Challenges

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ABSTRACT

The aim of this paper is to shade a light on the development of Islamic finance industry in the west. It is observed that Islamic finance industry in the west traced back to the late 1970s and the main reason behind the interest of western countries in Islamic finance is economical. However, there are regulatory, legal, knowledge and social obstacles facing Islamic finance industry in the west. These matters must be resolved to allow Islamic finance industry to flourish in western countries.

1. Introduction

The origin of Islamic finance dates back to the dawn of Islam 1,400 years ago. Historical books (e.g. Kitab Al-Ṭabaqāt Al-Kubrā written by Ibn Sa'd) written during the early years of Islam indicated that during the 1st century of Islam (AD 600), some forms of banking activities existed that were similar to modern banking transactions. Hence, Ibn Sa'd (Omar ed. 2001, pp.101-102) revealed that Al-Zubair bin Al-Awam (one of the most famous personalities in Islam) was accepting deposits from people as loans and investing that money, and at the time of his death his debt had reached 2,200,000 dinar as counted by his son Abduallah. Also, Ibn Sa'd (Omar ed. 2001, p.102) stated that Al-Zubair bin Al-Awam had several branches in different parts of the Islamic Empire to return deposits to their owners. Some contemporary scholars like Al-Ali call this collection of branches Al-Zubair Bank (Al-Ali cited in Nasser 1996).

In addition, during the rule of Marwan bin Al-Hakam (the fourth Umayyad *caliph*) in the 1st century of Islam (8th century AD) goods *sukuk* were widely used as a method of payment to the state's soldiers and employees (Saraj cited in Nasser 1996, p. 9).Furthermore, the writings of Al-Djahshiyari (1938), Al-Kubaisi (1979), Al-Ali (1953, 1981), Al-Duri (1986, 1995), Fischel (1992), and Al-Hamdani (2000) show that there were bankers called sarraffeen or sayarifah (singular sarraf) or jahabidhah (banks called dawawin aljahabidhah) in the Islamic Empire (Chachi 2005). Also, according to Chachi (2005), during the Abbasid-caliphs period (from the 8th century) the term sarraffeen was used to refer to financial clerks, experts in matters of coins, skilled money examiners, treasury receivers, government cashiers, money changers, or collectors to designate the well known, licensed merchant bankers in those times. Moreover, the first check in history was drawn by a sarraf in Baghdad in the 4th century AH (10th century AD), and it was written by the prince of Aleppo, Saif Al-Dawla Al-Hamadani (the check amount was 1000 dinar;).

The thriving of commercial activities during Abbasid dynasty, ruled from 750 to 1258 AD, led to the establishment of banks. The funding sources of those banks were banks' profits (money exchange, currency evaluation, lending) and deposits made by the public and state. There were two types of banks: state and private banks. The earlier established to advance loans to the government, which secured by the government tax revenues. The first state bank incorporated in 300 AD by the vizier Ali b. Isa during Al-Muqtadir reign. Ali b. Isa requested from two Jewish merchant and bankers, Yusuf b. Pinkhas and Harun b. Imran, to establish a bank to advance loans to the government (150,000 Dirham in the beginning of each month), and they will collect the tax revenues of Ahwaz region in return. This implies that they will get an amount above the principle and this amount is considered an administration fee not interest. It is worth mentioning that the bank operated for 16 years.

Muslims also established banking schools to teach the rules and the regulations of the industry. So, it can be said that there was a will developed financial system in the Islamic empire, Nasser (1996, pp. 15–16) stated that Muslims contributed greatly to the development of banking practices because, during the Islamic empire, there was

1. A legislative system, which included firm rules and regulations to govern all transactions;

2. A strong judicial system, which was capable of enforcing all legitimate contracts;

3. Different kinds of commercial papers and banknotes that were widely accepted, such as promissory notes (reqaah al-sayarifah), bills of exchange (suftaja), and goods sukuk; and

4. Licensed bankers, who had offices or agencies in different parts of the Islamic Empire and accepted deposits, assigned debt (hawalah), exchanged money, issued banknotes, and performed many other services.

Beginning with the decline of the Islamic Empire from about the 12th Century AD, the rule of the sarraffeen began to weaken. Their loss of power within society can be ttributed to several internal and external factors (Chachi 2005).

Islamic civilization began to decline toward the end of the 12th century. There was some respite during the Ottoman Empire (1299–1923), and then the decline resumed and has continued up to the present. This period of decline is known as Usur al-inhitat, or the Age of Decline. This allowed Western influence to increase throughout Islamic countries, especially through colonization.

Under European influence, many Islamic countries began to adopt a Western banking model in the 19th century. This started by opening branches of foreign banks or by establishing banks within countries. For instance, in Egypt, the first conventional bank opened its doors in 1856 under the name Bank of Egypt. This bank was a branch of an English bank but was closed in 1911. The National Bank of Egypt was established in 1898 by Ralph Suarez and Constantine Salvagos (Jewish businessmen) with an English partner; the bank is still in operation today (Nasser 1996; National Bank of Egypt 2009).

This trend continued in all Islamic countries until the middle of the 20th century, when the calls to establish Islamic financial institutions gained momentum with the independence of some colonized Islamic countries. This led to the establishment of the first commercial Islamic bank in the world, Dubai Islamic Bank, in 1975. Since then the number of Islamic banks around the world boomed, and many of the banks established in the early 1970s and 1980s are still in operation today. Moreover, the global market of sharia compliant assets reached $2 trillion in 2014, banks accounts for about 80% of the assets, sukuk 16%, funds 4%, and takaful 1% (UKIF 2014).

2. Trends of Islamic Banking in Europe and North America

The number of Muslims in Europe and North America is estimated to be 47 million in 2010, about 10 percent of the population (Pew Research Center 2011). The center also predicted that Muslims would make 10.2 percent of the population in 2030, 67 million (See Table 1).

In the late 1970s, Islamic finance began to develop in Europe, and many European financial intuitions perceive it as a profitable opportunity to create new business. The first attempt at Islamic banking in the Western world took place in Luxembourg in 1978, when the Islamic Finance House Universal Holding S.A was established[63]. In 1981, Dar Al-Maal Al-Islami Trust, meaning "House of Islamic Funds," was established in the Commonwealth of the Bahamas on July 27, 1981, but its headquarters have been in Switzerland, and the group's chairman is the Saudi prince Mohammad Al-Fisal (Bekkin 2007).

[63] The bank formerly known as the Islamic Banking System International Holding, the name changed due to changes in Luxemburg banking laws in 1985 (Haghtalab 2009).

Table 1: Potential market size in the west for Islamic banks

Country	Estimated Population in 2010	Percent Muslim	Projected Population in 2030	Projected Percent Muslim
Bosnia and Herzegovina	1,564,000	41.6	1,503,000	42.7
France	4,704,000	7.5	6,860,000	10.3
Germany	4,119,000	5.0	5,545,000	7.1
Italy	1,583,000	2.6	3,199,000	5.4
Ireland	43,000	0.9	125,000	2.2
Luxembourg	11,000	2.3	14,000	2.3
Switzerland	433,000	5.7	663,000	8.1
United Kingdom	2,869,000	4.6	5,567,000	8.2
United States of America	2,595,000	0.8	6,216,000	1.7
Canada	940,000	2.8	2,661,000	6.6

Source: Pew Research Center 2011

This trend continued all over Europe, as fully-fledged Islamic banks or branches of established Islamic banks emerged in different countries. Later in the 1908sIslamic finance industry started to develop in North America.

Thus, the theme of this this paper is to look at the development of Islamic finance industry, the reasons behind the growing interest on it and the impediments facing it in the west.

2.1 Bosnia and Herzegovina

The first initiative to establish Islamic bank in in the country was in 1992, at that time the law allowed it, when Vakufska bank d.d. Sarajevo was formed (Ergun and Djedovic 2011). The attempt was unsuccessful; the bank operated on interest principles rather than *Shariah* principles (Ergun and Djedovic 2011). In 1996, Orient bank d.d. Sarajevo established and considered a real attempt to establish a bank on the principle of Islamic finance. The bank provided loans based on *Shariah* principles, but the bank closed for not satisfying the required capital.

The only Islamic bank in the country is Bosna Bank International (BBI), which was established on October 19, 2000. The founders were Islamic Development Bank (with a 45.46% share), Dubai Islamic Bank (with a

27.27% share), and Abu Dhabi Islamic Bank (with a 27.27% share; Bosna Bank International 2009). The bank has a capital of KM 47,5 million and an authorized capital of $300 million (Bosna Bank International 2009). The bank's total assets grown by 24.2 percent yearly from 2007 to 2012 and by 34.4 percent from 2013 to 2014, deposits increased by 24.7 percent and total financing grown by 23 percent (IFN 2015).

The government is reviewing the legal framework to make provisions for Islamic banking. However, the process is still in progress despite the fact that more than 40 percent of the population is Muslims. This because the House of Peoples of Bosnia and Herzegovina[64] is blocking any legislative related to Islamic finance industry. Thus, the development of Islamic finance in the country lies largely on the shoulders of the country's sole Islamic bank (IFN 2015).

To this end, the bank started to increase awareness about Islamic Finance industry in the country. Since 2012 the bank launched two Master's program in collaboration with the School of Economics and Business Sarajevo (SEBS) at the State University of Sarajevo, offered scholarships as well as establishing BBI Academy. In addition, the bank created BBI VIP business club to increase the interaction between businesses and major players in Islamic finance market.

Finally, the growth of Islamic finance industry will remain limited without the support of regulators/government.

2.2. France

France has the highest percentage of Muslims in the West, Table 1. As a result, the French government took positive steps in 2008 to implement Islamic finance in the country, changing its tax laws to ensure that Islamic modes of financing do not attract extra tax penalties ('France and Hong Kong encourage Islamic finance' 2009). Before that in December 2007, EUROPLACE, the organization that promotes Paris role as a financial center, established the Islamic Finance Commission (Rihab and Hassan 2015). Also, at the second French Forum of Islamic Finance held in Paris in November 2008, Minister of Economy Christine Lagarde claimed, "We are determined to make Paris an important site for Islamic finance" ('Islamic finance has setback in UK, shows progress in France' 2009). The French government's stance encouraged some firms to move to France, such as

[64] Its establishment was due to Dayton agreement in 1995 and has 15 members equally distributed among the three ethnic groups. This to insure no law is passed unless all three groups agree on it.

Islamic Finance Advisory and Assurance Services (a UK-based *shariah*-compliance advisory firm), Al-Baraka Islamic Bank from Bahrain, Qatar Islamic Bank (which already has offices in London), and Kuwait Finance House ('France and Hong Kong encourage Islamic finance' 2009; 'Islamic finance has setback in UK, shows progress in France' 2009).

Furthermore, on September 17, 2009, the French parliament passed a law designed to facilitate the issuance of *Sukuk* ('French parliament adopts *Sukuk* law' 2009). This led to issuance of first French *Sukuk* in 2011 with a value of $6 million or Euro 5 million in French fast food sector (Rihab and Hassan 2015).

In June 2011, a conventional bank introduced the first Islamic deposit scheme via its Islamic window. The success of the offer paved the way to launch an Islamic home finance product, a 10-year *Murabahah* contract, which met by strong demand because the product has been a key requirement for French Muslims.

In 2012, Swiss Life launched Europe's first family *Takaful* product in France, followed by Visit Life and FWU's (both parent companies based in Luxembourg). This number of companies is small considering the laws are compatible with the demands of *Takafual* industry.

By 2013, there were six Islamic funds in France with total assets under management of $147.2 million (Caristi et al. 2013).

The only bank offering Islamic financial products is Chaabi Bank, the European subsidiary of the Moroccan bank, as it announced the launch of the first French retail banking products on 25 June 2011. By 2012, the bank was offering Islamic retail products and had established a *Shariah* board (Chaabi Bank 2012). The bank increased its branches until reached 20 in 2015. Also, Al-Baraka bank planned to launch operations in the country by 2012 (Foster 2011), but had not done so as of this writing (December 2015). Meanwhile, the French banks do not offer any Islamic products inside France. For example, BNP Paribas and Societe Generale are major players in the Islamic banking sector, as the former offers wholesale products outside France and the latter has Islamic branches in the Gulf Cooperation Council (GCC) countries.

The government supported initiatives of introducing Islamic finance in its education system, it announced in June 2008 its support to a program titled "Islamic Banking and Finance" offered by National Research Agency (government institute; Belabes and Belouafi 2012). Since then four institutes offered degrees in Islamic finance: French Institute for Islamic Studies and Sciences (25 November 2008); Strasbourg Management School (21 January

2009); University Paris-Dauphine (18 November 2009); Reims (January 2012). The major breakthrough came in on January 8, 2011 when the University Paris 1 Pantheon – Sorbonne and King Abdulaziz University through its Islamic Economics Institute (IEI) affiliate created the Chair for Ethics and Financial Norms.

All of this point out that the Islamic finance has potential to develop further in France.

2.3. Germany

Germany have the largest Muslim population in Western Europe after France. There number estimated to be 4.1 million in 2010, mainly Turks. Thus, it is not strange that Islamic finance in Germany started from within the Turkish community.

In the 1990's several Turkish companies moved into German market and began offering Islamic finance products, they intensively advertised in Mosques. Those companies (eg, Kombassan Holding, Yibitas Holding and Yimpas Holding) through its holdings attracted 200-300 thousand Muslim customers. They were successful in the beginning, but later defaulted and the estimated amount lost due to this fraud ranged between €5 billion to €50 billion (Farhoush and Mahlknecht 2013). The negative experience of so-called "Islamic holding" hampered the development of Islamic finance in Germany. On the other hand, this experience demonstrated the financial power of the Muslim community and that Islamic finance has a potential market in Germany. Furthermore, a recent survey (2010) indicated that 72 percent of Muslims in Germany are interested in Islamic finance products if offered by a German bank (Bälz 2011).

The German Commerzbank, one of the pioneers in the field of Islamic banking, launched in January 2001 Al-Sukoor European equity fund in cooperation with Dallah Al-Barakh Bank targeting investors from Gulf countries and Germany. The fund closed in 2005 as it collected €4 million instead of the envisaged €20 million (Schoenenbach 2013). According to Chahboune and Zaid El-Mogaddedi (2008; cited in Colditz 2009) the reason behind the failure of the fund is the improper marketing in Germany and the events followed September, 2001. The bank later focused its Islamic operations in countries with Muslim majority. In 27 July 2006, Deutsche Bank incorporated Deutsche Noor Islamic Funds Plc (formerly known as DWS Noor Islamic Funds Plc) in Ireland. The company is an open-ended umbrella investment company. It launched five *Shariah* funds in 2006 concentrating on equities as well as precious metals securities (Colditz 2009).

The first quasi-sovereign *sukuk* in Europe was issued in Germany by the German State of Saxony-Anhalt on July 31, 2006, at 100 million euros with a floating return based on a 6-month Euribor rate plus 1% (Wilson 2007). The issued *Sukuk* incorporated in Netherlands to avoid taxes and targeted investors from the Middle East and Europe (Colditz 2009). In 1 December 2009, Meridio (an asset management firm) launched an Islamic fund incorporated in Luxembourg. However, the fund liquidated in 29 May 2012 due to insufficient demand even though it extensively advertised in public media.

The German government does not formally support Islamic banking, perhaps in part because the German government is reluctant to accept Muslims' presence in society and in part because Muslims have not positioned themselves as attractive customers (EL-Mogaddedi 2007). In addition, German banking regulations still do not allow trade based on Islamic transactions and the taxation laws are not favorable to Islamic banking (Schoenenbach 2011).

However, Bundesbank and German Federal Financial Supervisory Authority organized a conference on Islamic finance in October 2009. In October 2012, Kuveyt Turk Participation Bank, which is an Islamic bank in Turkey, applied for a license and after three years in July 20, 2015 opened a branch in Frankfurt.

To sum up, Islamic finance in Germany still in its early stages and has long way to go.

2.4. Italy

The history of Islam in Italy began in 827 AC when Muslims conquered Mazara Del Vallo (city in Sicily), and ended by the distraction of last Islamic settlement of Lucera in Puglia in 1300 AC by European Christians.

In the1970s, the first trickle of Muslim immigrants from Africa began arriving. Nowadays there are approximately one million Muslims in Italy, Table 1.

The first milestone for Islamic finance in Italy took place in January 1994 when a conference on Islamic Banking in Italy held in Roma. The conference sponsored by Banca di Roma and organized by Università di Tor Vergata under the supervision of prof. Francesco Castro, the conference based on previous studies published by the Istituto per l'Oriente (ASSIAF 2015).

This followed by a ground breaking publication by Alberto Brugnoni[65] in 1997. Later in December 2002, asociazione Bancaria Italiana organized a conference about Islamic banks in Rome.

This led to the first Islamic transaction in Italy that constructed and funded by ASSAIF. The transaction, based on *Murabaha* principle, happened in Pavia city in October 2006 with a cost of €290 thousand were a warehouse been acquired by special purpose vehicle (SPV) and then transferred to local Muslim association for its use as a cultural center (Brugnoni 2006). After two months it followed by an *Ijarah wa iqtina* transaction, which required several months of legal and fiscal work, performed by ASSAIF members. The two transaction fully satisfied *Shariaha* requirements and Italian civil code, nonetheless the transactions were pricy due to double stamp issue. While the first Islamic bank in Italy was Mediobanca (investment bank), a conventional bank that offers Islamic financial products (wholesale), bank president was Alberto Brugnoni.

The Italian Banking Association organized two conferences in 2007 and 2008, which resulted in the signing of a Memorandum of Understanding by the Italian Banking Association and the Union of Arab Banks aiming at an enhanced cooperation between Italian and Arabic banks (Colditz 2009). Nevertheless, the Italian regulatory system may hinder the operation of Islamic banks. The Italian banking system guaranteed the repayment of received deposit, (Art.1834 of the Civil Code). Also, regulations restrained banks from engaging in brokerage activities, banks are not allowed to own shares in the financed industrial business (Art 19 of the Consolidation Law). However, the European "mutual recognition of banking licenses" principle will allow Islamic banks in European countries to open branches in Italy and offer Islamic financial products. Moreover, there are no *Shariah* supervisor board to advise the central bank about Islamic finance products and contracts.

Regarding education, Italy did not take the plunge to introduce Islamic finance in its education system. The only specific course existing today about Islamic finance is within a Master degree program, Development Economics and International Cooperation, offered by University of Rome Tor (Cattelan 2012).

[65] Alberto Brugnoni, banker and founder and manager director of organization Associazione per lo Sviluppo di Strumenti Alternativi e di Innovazione Finanziaria (ASSAIF) the oldest European consultancy on Islamic finance. In the mid-1980s, he pioneered some of the first Islamic transactions in Europe. He engineered many Islamic financial transactions in Europe and Asia.

Islamic finance industry in Italy will grow if these issues resolved. Alberto Brugnoni (2008) pointed out that the Islamic financial service industry in Italy has considerable growth potential. He listed several reasons for this, including demand from the Italian Muslim community, the growth of the ethical banking market in Europe (especially Italy), Italy's location on the Mediterranean Sea, and the country's proximity to the Arab world, which has resulted in an already existing "multi-billion dollar trade balance with the GCC" (Colditz 2009, p. 85). In 2010, a study by the central bank highlighted that the spread of Islamic financial industry will attract funds from Arabic states and facilities the trade between Italian companies and Islamic countries.

2.5. Ireland

Ireland is planning to become the center of Islamic finance in Europe to benefit from the Islamic funds to revive its economy. The Irish government aims to attract funds from GCC countries, already signed several Double Taxation Agreements with Gulf States. Also, it is targeting ethical investors and Muslims community in Ireland.

Islamic banking introduced in Ireland in the 27th of March 2003 when Oasis Global Management Company (Ireland) Limited received approval for the launch of two open-ended investment companies, Oasis Global Investment Fund (Ireland) plc and Oasis Crescent Global Investment Fund (Ireland) plc in Ireland[66]. In May 2004, Arab Banking Corporation (ABC) signed an agreement with the Bristol & West, one of the leading mortgage providers in the UK and part of the Bank of Ireland Group to launch an Islamic home financing scheme. The year after, the first *Sukuk* was listed on the Irish Stock Exchange. In 2011, the first *Shariah* compliant instruments approved by the Central Bank of Ireland, 35 such instrument approved to date, and by July 2014, 10 *Shariah* compliant funds and a corresponding 31 sub-funds authorized by the Central Bank of Ireland (all funds are UCITS except for one unit trust; Moloney 2015). In 2012, CIMB-Principal Islamic Asset Management Sdn Bhd (CIMB-Principal Islamic; Malaysia) launched an Islamic fund platform in Ireland. In the same year, another Malaysian firm, Amanie Advisors, opened an office in Dublin.

The Irish government amended its Tax laws, section 39 of the finance Act 2010 and section 36 0f the finance Act 2012 made Islamic financial products competitive. In addition, 'Strategy for the IFSC in Ireland 2011-

[66] The two companies comply with the European Communities Undertakings for Collective Investment in Transferable Securities (UCITS) as well as the Irish Financial Services Regulatory Authority.

2016' published by the government in 2010 emphasized on the importance of Islamic finance to Irish economy. In addition, Chartered Institute of Management Accountants (CIMA) has launched a diploma in Islamic Finance in Ireland in 2012.

However, there are no central *Shariah* board in Ireland to ensure that transactions or products are *Shariah* compliant (Moloney 2015).

2.6. Luxembourg

Long before the UK, Luxembourg was the laboratory of Islamic finance in Europe. The first Islamic financial institution on Western soil, Islamic Finance House Universal Holding S.A, was licensed to operate in the country in 1978 (Abdul Rahim 2007). The first *shariah*-compliant insurance company in mainland Europe was established in the country by a Bahraini Solidarity Group in 1983 (Bataineh 2010). In 2002, Luxembourg stock exchange became the first country in Europe to list *sukuk*.

The government and many financial institutions support initiatives to promote Islamic finance. For instance, the Luxembourg Law of 22 March 2004 on securitization revised to allow the issuance of *Sukuk*. In November 23, 2009, the Central Bank of Luxembourg (LCB) became a member in the Islamic Financial Services Board (IFSB) making it the first European central bank to join IFSB. In 2010, Luxembourg Tax Authority clarified the tax treatment, direct and indirect, of some Islamic finance products. In December 2010, Luxembourg became the first European country to adopt the Undertakings for Collective Investment in Transferable Securities Directive (UCITS IV) which allow funds, conventional and Islamic, to move freely based on a single authorization from any member state. In the same year, Luxembourg Central Bank became a founding member of the International Islamic Liquidity Management Corporation. Luxembourg itself issued the first sovereign *sukuk* to be denominated in euro, in 2014.

By 2015, Luxembourg managed more than €5 billion of Islamic assets; 111 Islamic funds are domiciled in Luxembourg and more than 16 *sukuk* listed on the exchange (Ernst & Young 2015).

Regarding education, there are no Islamic finance degrees offered in Luxembourg. However, the Université Catholique de Louvainin in association with ISFIN launched in 2015 the first university diploma in Islamic Finance in the Benelux[67].

[67] Politico-economic union of three neighboring states: Belgium, Netherlands, Luxembourg.

2.7. Switzerland

In October 2006 the Swiss Federal Banking Commission awarded a full banking license to Faisal Private Bank (Fisal Private Bank 2006). This marked the launch of the first Islamic bank to operate in Switzerland. Dar Al-Maal Al-Islami Trust (DMI), which incorporated in Switzerland in 1982, was the major shareholder of Faisal Private Bank. In November 2012, the bank converted its operations in Switzerland to a family office. This because the bank did not met the Swiss government's new regulation on minim capital requirements; additionally the bank's real estate portfolio faced problems when prices fell (Reuters 2012b).

Islamic finance assets in Switzerland is near 7 billion $US which makes 0.40 per cent of the global Islamic finance assets. Regarding education the Geneva business school recently launched a master program specialized in Islamic finance.

2.8. United Kingdom

Although the first Islamic bank in the West was established in Luxembourg, the UK has been the gateway for Islamic finance to enter Europe. The majority of Islamic banks that operate in Europe are located in the UK because the UK has encouraged Islamic banking activities for years. The existence of the Islamic finance transaction in London dates back to the 1980s, when Islamic banks based in the GCC countries used commodity *murabaha* transactions through London Metal Exchange as a tool for liquidity management (Wilson 2007). Also, DMI opened an office in London in 1982 to provide funds for Luxembourg Investment Company and Luxembourg *Takaful* Company, and one year later DMI established *Takaful* UK Limited to cater for the need of British Muslims (Belouafi and Chachi 2014). In 1983, Al-Baraka Bank obtained a license to operate in UK. The bank did launch its business until it opened three branches, two in London in 1988 and 1989 and a branch in Birmingham in 1991 (Belouafi and Chachi 2014). However, due to regulatory issues the bank closed as bank in June 1993, but continued to operate as an investment company (Housby 2013 cited in Belouafi and Chachi 2014). The first Islamic fund launched by British investment bank Kleinwort Benson[68] in 1986 aiming to draw funds from Gulf State countries.

[68] In 2009 acquired by RHJ International

In another development of Islamic banking in the UK, the United Bank of Kuwait[69], which was established in London in 1966 to serve Kuwaiti overseas financial and commercial interests, established an Islamic division in 1991 under the name Islamic Investment Banking Unit. The bank offered house purchasing product which given the name *Manzil*. The scheme was based on *Murabaha* principle but in 1999 it introduced *Ijarah* mortgage version which proved to be more popular (Housby 2013 cited in Belouafi and Chachi 2014).

Since the early 2000s, the British government has introduced several changes to its taxation and legislative system to remove obstacles from the development of Islamic finance in the country. The Finance Act of 2003 exempted Islamic banks from being taxed twice on the purchase and sale of property, which marked the first significant change in favor of Islamic banking (Ainley et al. 2007). In July the same year 2003, HSBC[70] introduced an Islamic current account and Islamic home purchase finance in the United Kingdom under the name *Amanah* that means trust (Belouafi and Chachi 2014).

Moreover, the Finance Acts of 2005 and 2006 made Islamic financial products equal to conventional products, and the Finance Act of 2007 clarified the tax framework for *Sukuk* (Ainley et al. 2007). The policy stance of the Financial Service Authority (the regulating body of the banking industry in the country) toward Islamic banking is "no obstacles, no special favors" (Ainley et al. 2007). In addition, the deposits division of the Financial Service Authority employs specialists in Islamic Banking to supervise Islamic financial institutions. In 2009, UK relieved tax on capital gains to facilitate the issuance of *Sukuk* and in January 2010, the government gave more strength to this provision. And in 2014 the government sold £200 million of *Sukuk*, maturing 2019, for investors based in UK and in major hubs in Islamic finance industry around the globe making it the first EU country to issue sovereign *Sukuk* (UKIFS 2014).

By 2008, the UK had six full-fledged Islamic banks: Al Rayan Bank (formerly known as Islamic Bank of Britain ; 2004), European Islamic Investment Bank (2005) , Bank of London and the Middle East (2007), Gatehouse Bank (2008), European Finance House (2008), and Abu Dhabi Islamic Bank (2013). The total assets of these banks $3.6 billion by the end of

[69] In August 2000, the United Bank of Kuwait merged with Al-Ahli Bank and formed Al-Ahli United Bank.

[70] One of the largest banking and financial services organizations in the world.

2014 (UKIFS 2014). Also, some conventional banks in the country offer Islamic financial products, 16 banks. In addition, the Bank of England has joined the IFSB in December 9, 2015.

These developments accompanied by offering postgraduate programs in Islamic banking and finance at UK universities. The first educational institute to introduce teaching of Islamic economic and finance in academia was the University of Loughborough in October 1995, part of one of its MSc modules, and later in 1996 offered full MSc course as well as PhD program (the first of their kind in the Western world; Rahman 2004 cited in Hassan 2012). The number of universities offering programs in Islamic finance in UK increased responding to the increase in demand. By the end of 2013, there are 49 universities and colleges offering Islamic finance programs in UK (Global Islamic Finance Education Special Report 2013).

2.9. United States of America

The number of Muslims in the United States is somewhere between 2 and 7 million. The CIA World Fact Book, July 2015, estimated the number to be 1.9 million representing 0.6 percent of the entire population. Pew Research Center's 2015 The Future of Global Muslim Population study found that Muslims represent 0.8 percent of the U.S population, Table 1. This variation related to the fact that U.S. Census Bureau is not permitted to include a question about a respondent's religion unlike Canada. Regardless of which numbers are used Muslims population will not exceed 2 percent. And they mainly concentrated in Boston, New York City, Washington, DC, Atlanta, Chicago, Detroit, Minneapolis-St. Paul, Houston, Dallas, Los Angeles and San Francisco. This demographical concentration allowed Islamic financial institutions to develop on those areas (Goud 2009). The US government also has shown interest in Islamic finance; in April 2002, for instance, a seminar was held in the US Department of the Treasury under the name Islamic Finance 101[71]. The second Islamic Finance 101 seminar took place in November 6, 2008. The aim of these seminars was to inform the policy community about Islamic financial services.

The history of Islamic finance in the United States began in the mid of 1980's after twelve years of its existence in other parts of the world. The story of retail Islamic finance in the United State began in 1984 when Yaqub Mirza

[71] The seminar held after the meeting, in Bahrain, between AAOIFI officials and then-Secretary of the Treasury Paul O'Neill in 2002 who requested his deputy secretary for international affairs John B. Taylor to reach out to the Islamic financial industry in the US. (Goud 2009). The event organized by the Treasury Department and Harvard University in Washington, DC.

and Bassam Osman[72], two members of the North American Islamic Trust[73], introduced the concept of Amana Funds and mutual funds to the market for the first time in Indianapolis, IN. They sought assistance from Nicholas Kaiser, who was then portfolio manager and partner at Unified Management Corporation, based in Indianapolis, IN. Later in June 1986, Amana Income Fund began operations. This led to incorporation of Saturna Capital[74] in Bellingham, Washington in July 1989, which managed the fund. Amana Income Fund assets in 1987 were \$3.2 million and grew to exceed \$10 million in 1994 (Goud 2009). The second fund (Amana Growth) launched in February 3, 1994.The inception of the third fund which called "Amana Developing World Fund" happened after fifteen years, September 28, 2009. In 28 September 2015, the fourth fund launched under the name "Amana Participation Fund". As of September 30, 2015 the four fund family has a net assets of more than \$US3.3billion (Saturna Capital 2015).The same as Amana Funds, American Finance House-LARIBA its capital came from a group of dedicated Muslims how invested \$10,000 each to raise a capital of \$200,000 to start the company (Abdurrahman 2010). In 1998 LARIBA acquired the Bank of Whittier; later in 2001 it received approval for financing from the Federal Home Loan Mortgage Corporation (Freddie Mac) which considered a landmark in the industry according to Goud (2009).

The first milestone for Islamic finance in the United States took place in the late 1990s, when the New York branch of United Bank of Kuwait obtained two interpretive letters issued by the Office of the Comptroller of the Currency to offer Islamic retail banking services in the country (Jammeh 2010; Zyp 2009). The first approval letter was issued in 1997, which involved a residential net lease-to-own home-finance product through an *ijarah wa iqtina* contract (product developed by Samad Group/CIHF Partners based in Ypsilanti, Michigan). Under this scheme, the Office of the Comptroller of the Currency determined that United Bank of Kuwait would act as "riskless principal" because the bank would not buy real estate until the lessee requested

[72] Yaqub Mirza, Ph.D, member of the Islamic Society of North America (INSA), and President and CEO of Sterling Management Group, Inc. (founded 1998). Also, Bassam Osman is a member of INSA and managed its investments since 1976. Later in May 2001, he established Iman fund.

[73] A financial subsidiary of the Islamic Society of North America (ISNA; based in Plainfield, Indiana), founded in 1973 in Indiana by members of the Muslim Students Association of the U.S. & Canada. It is nonprofit organization and it owns Islamic properties and promotes *waqf* in North America.

[74] Nicholas Kaiser sold his shares in Unified Management Corporation to establish Saturna Capital.

it and then rent it to the lessee (Zyp 2009). The bank would hold the legal title of the property until the payment of the final lease installment, at which point the lessee would take the title of the property. The second letter was issued in 1999 in response to the bank's proposal to offer certain *murabaha*-based financing products. Similar to the previous scheme, the Office of the Comptroller of the Currency viewed the bank as acting as "riskless principal" in such transactions and therefore permitted the activity. The bank ceased its operations in the United States in 2000 after its merger with the Al-Ahli Commercial Bank of Bahrain. The Bank bought and leased back 60 homes for American Muslims before closing (Sachs 2001) and its main markets were California and Connecticut.

In another development of Islamic finance industry in the United State, Failaka Advisors launched in 1996 in Chicago, Illinois. The company provided gauging for the performance of Islamic mutual funds. However, there still a gab in the market which filled by the launch of Dow Jones Islamic Market Indexes (DJIM; initial consists of eight indices) on the NYSE in February 1999. The index became the industry benchmark for equity screening. The number of indices increased to over 70 as at July 2009 (Goud 2009). The index adopted by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)-Standard 21on financial papers. The arrival of DJIM other indices launched such as FTSE and Morgan Stanley Capital International (MSCI), and other closed.

Also in 1999, the mortgage company HSBC[75] was authorized by the New York State Banking Department to offer a *murabaha* product for real estate financing .However, HSBC's New York City office had limited success, wrote about $50 million in Islamic mortgages since 2001 and stopped offering them in December 2006 (Pincus 2007).

In 2002, Guidance Residential (formally called Guidance Financial), subsidiary of Guidance Financial Group[76], incorporated to provide retail home financing to its customers using *diminishing Musharakah* transactions. The company initial target markets were Washington DC, Maryland and Virginia suburbs. It began following an agreement with Freddie Mac to finance $200 million in home finance purchases (Goud 2009), which eventually rose to more than $3.5 billion by the end of 2015 and have presence in 32 states (Guidance Residential 2015). The bank operations is covering 32 states. After

[75] HSBC Mortgage Corporation, formerly known as Marine Midland Mortgage Corporation, founded in 1988.

[76] Founded by Dr. Mohamad Hammour.

one year from the inception of Guidance Residential, Chicago-based Devon Bank (Member FDIC) which owned by a Jewish family launched its Islamic division. The bank in 10 January, 2005 started selling its Islamic home financing products to Freddie Mac. In the same year in December University Islamic Financial Corporation (UIFC)[77], subsidiary of University Bank[78] (located in Ann Arbor-Michigan; Member FDIC), was established. Stephen Lange Ranzini and Joseph Ranzini acquire the majority of University Bank shares in 1988. In 1996, Stephen Ranzini replaced the bank original management and in late 1997 became involved in the bank's day-to-day management. He played a role in launching UIFC. In addition to home finance product, the bank also offers deposit products developed by SHAPE Financial[79]. The deposit product has attracted $20 million in deposits and the returns based on the return on the company's home finance products (Goud 2009).

In the past 15 years, small Islamic financial institution have entered the market like African Development Center which started by Hussain Samatar, former banker, in 2003 in Minneapolis-St. Paul, Minnesota. The center provided business and entrepreneurial training and *Shariah* compliant financing to American Muslim immigrants especially Somalis (Goud 2009). The center in 2011 opened a new office in Rochester, MN. In addition, conventional institutes started to offer Islamic products including Broadway Bank, Lincoln State Bank, Mutual Bank, Cole Taylor and RomAsia Bank.

There are some challenges for Islamic financing in the US. These challenges are Bank ownership of real estate, Bank Secrecy Act (BSA, taxation, profit–loss sharing deposits, and deposit insurance.

The National Bank Act of 1864 prohibits state-owned banks from holding legal titles to real-estate property. This restricts Islamic financial institutions from offering some financial products such as *murabaha* and *ijarah*, which require the Islamic financial institution to hold a legal title to property to comply with *shariah* law. However, the same act allows banks to possess real-estate property for up to 5 years for business transactions and for

[79] The bank capital came from virtue investors, LLC, group of local grand rapids investors (Goud 2009)

[78] University bank was offering Islamic products since 2003 (Goud 2009).

[79] Shape financial corp. established in 2002, experienced in financial consulting. The company founder is Abdulkader Thomas. He "gained experience working with United Bank of Kuwait and was involved in requesting and receiving the interpretive letters from the Office of the Comptroller of the Currency regarding banks offering *Ijarah* and *Murabaha* which have enabled significant growth in the US Islamic financial industry" (Goud 2009).

debt settlements. Also, US banking law restricts non-real-estate investments to ensure that banks do not take unnecessary risks, consequently, investments are limited to fixed-income, interest-bearing securities, and these types of investments are prohibited under Islamic law (Rutledge 2005). The OCC letters of 1997 and 1999 addressed these issues as explained above. Furthermore, Islamic financial institutions must meet some disclosure policies, such as the Consumer Credit protection Act, also known as the Truth in Lending Act. The Truth in Lending Act of 1968 was designed to protect consumers in credit transactions by requiring clear disclosure of key terms of the lending arrangement and all charges from the lender. The law also requires Islamic lenders to base their profit on a benchmark such as the London Interbank Offering Rate, and this does not fit with Islamic finance principles. The real estate transfer tax is another hindrance for Islamic financial institutions in the United States. The state property transfer taxes in case of Islamic home financing structures, *Murabaha* or *Ijarah* will be doubled. This problem addressed by some states, New York in 2008, by removing the tax incurred at the end of the contract when the deed transferred from the bank to the customer.

On top of these issues, Islamic banks in the US face difficulties regarding profit–loss sharing deposits because US banking policy favors certainty of deposits, as specified in the Bank Holding Company Act and the International Banking Act. SHAPE financial corporation developed a deposit product scheme for University Bank were the customer shares the profit not the losses. However, this product is not compliance with Islamic principles. In addition, Islamic financial institutions that finance the purchase of homes or other commodities in the US lack a secondary market to provide liquidity. Secondary-market purchasers require that the mortgagor hold property insurance and private mortgage insurance, but Islamic customers are unable to buy insurance because doing so violates the *shariah* principle of not engaging in a profit and risk-sharing transaction. Also, there is the issue of double transaction costs, which may be associated with offering *murabaha* mortgages as it is been viewed as two transactions.

Another problem for Islamic finance in the country became clear prior to the launch of University Bank (owned by Roman Catholic family), the first banking institution in the United States to be run completely on *shariah* principles (University Bank 2006). Because not all of the firms engaged in the Islamic finance business are 100% lawful, US scholars in some communities have spoken out against Islamic banking in general. In addition, some Islamic products start out as lawful products but become unlawful at the closing date;

this problem can be solved by designing high-quality products that will be sold and serviced in a professional manner (Ranzini 2007).

According to Stephen Lange Ranzini, President and Chairman of Ann Arbor's University Bank, which owns University Islamic Financial Corporation (UIFC), stated that "UIFC's products have received favorable legal rulings (*fatawa*) from some of the leading Islamic legal scholars in the US and the world" (University Bank 2006). However, research by Dr. Al-Qudah (2005) indicates that LARIBA's financing contracts do not adhere to *shariah* principles. Moreover, the Assembly of Muslim Jurists of America (AMJA) *Fiqh* committee in its meeting in December 2014 conformed Dr. Al-Qudah opinion. The committee, the same meeting, also ruled that the contracts of University Islamic Financial Corporation, Guidance Residential, Devon Bank and Ammen Housing has some violations but there are "no harm in dealing with this [contract of this] company when one is in a state of dire need"[80] (AMJA 2014).

Coming to Islamic insurance (*Takafual*) industry, the first company to offer *Takafual* products was First Takafual USA which established in 1996 (the company is no longer in operation; Goud 2009). In December 1, 2008 Risk Specialists Companies, Inc. (RSC), a subsidiary of AIG Commercial Insurance, announced it will provide *Takafual* service. The announcement came after the September 2008 bailout of AIG by the US government, which owned 80 percent of the company. However, Kevin J. Murray[81] in 15 December 2008, represented by Thomas More Law Center[82], filed a federal lawsuit against U.S. Treasury Secretary Henry M. Paulson and the Federal Reserve Board to stop the bailout of AIG. The plaintiff claimed that the promotion of *Shariah* insurance products by AIG violates the First Amendment of the constitution[83] (Establishment Clause[84]). The government asked the court in 2008 to dismiss the lawsuit, but on May 26, 2009, the government's motion to dismiss the lawsuit denied by the District judge hearing the case. This ruling based on the notion that the government did not restrict the flow of bailout funds, the launch of *Shariah* complaint product

[80] Fatwa released in October 2014.

[81] Former Marine.

[82] Christian nonprofit law firm based in Ann Arbor, Michigan, that promotes conservative Christian values.

[83] "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof …"

[84] Emergency Economic Stabilization Act of 2008 enacted as a results of the supreme mortgagee crisis to bailout the financial system.

occurred after the influx of government cash and after the treasury department co-sponsored a forum titled Islamic Finance 101, second seminar. The court decision overturned on January 14, 2011, claiming that there was no evidence presented of religious indoctrination and the amount of taxpayers money directed to support the subsidiary is trivial, which is $153 million from the $47.5 billion used to bailout AIG (Thomas More Law Center 2015). The second *Takafual* company in the US is Zayan Takafual Company, incorporated in 15 January 2009. Even though, the court ruling found out that the AIG bailout did not violate the First Amendment the lawsuit may discourage businesses to enter the US *Takaful* market. In addition, the regulation of the industry is not clear.

Regarding education of Islamic banking and finance in the US is still lagging and research programs dominate the landscape in the country.

Islamic finance seems to have a great future in the United States and will likely be driven by the growing number of Muslims in the country. The US State Department has noted that Islam is one of the fastest growing religions in the country. According to *shaykh* Yusuf DeLorenzo, "Islamic finance has really grown here over the past few years, and this growth is nowhere near its peak" (Asokan 2009). From the regulatory side, U.S. regulators have an open mind about Islamic finance, and this should drive the Islamic financial market to grow in the country. In his speech before the Arab Bankers Association of North America, William Rutledge, executive vice president of the Federal Reserve Bank of New York, explains that US regulators are making more concerted efforts to learn about the risks associated with Islamic banking by participating in Islamic finance conferences and learning from other regulators who have experience in this area (Pasha 2006).

2.10. Canada

In Canada, Islamic finance is growing but at a relatively modest rate, but this may change in the coming years as Canada has a large, growing, and demographically young Muslim population. The Canada's 2011 National Household Survey, showed that Muslims are making about 3.2% of the population (1.1 million) making them the second largest religion after Christianity. Consequently, this is expected to increase the demand for Islamic financial services in Canada. According to Cardozo and Pendakur (2008), the number of Muslim Canadians is projected to be near 1.8 million by 2017, and the majority will be young. Similar to American Muslims, Canadian Muslims tend to be better educated than the average citizen (Cardozo & Pendakur 2008).

Although there are some Islamic financial products available in Canada, the Islamic financial-services sector is still peripheral and limited, as there are no major financial institutions offering *shariah*-compliant products. The first Islamic financial institute in Canada the Islamic Co-operative Housing Corporation Ltd. (the "Co-operative") established in Toronto in 1979. In 1990, three Islamic financial institutions founded in Quebec, Qurtuba Housing Co-op, Al-Ittihad investments (investment company) and Al-Yusr (RRSP investment). After 12 years An-Nur Cooperative Corporation established in Ontario, specialized in real estate investment services. The first Canadian Financial institute to offer Islamic mortgagees was Assiniboine Credit Union[85] in 2010. It is worth noting that a proposed merger between Assiniboine Credit Union and Access Credit Union was declined by the later members on the base of religious believes.

In November 2006, frontierAlt Oasis Funds Management Inc.[86] launched the first Islamic mutual fund under the name frontierAlt Oasis Canada Fund. The fund gone out of business in June 30, 2010 due to low number of unitholders and the costs associated with maintaining a small fund. In March 10, 2009, Global Prosperata Funds Inc. launched Global Iman Fund, Canada's only *Shariah* compliant fund. In the same year, Anwar Global Properties Inc. issued CAD$498.1 million *Ijarah sukuk* (KFHR 2010) targeting Middle Eastern investors.

Islamic finance industry in Canada took a blow in October 2011 when UM Financial declared bankruptcy[87]. UM Financial in Ontario, founded 2004, is one of the primary Islamic financial providers in the country. UM Financial specializes in Islamic mortgages using *musharakah* contracts in a partnership with the Central Credit Union of Canada. In an 18-month span from 2006 to 2007, UM Financial provided USD 86.1 million in home financings (Ranzini 2007). The collapse of the company event though it hurt Islamic finance industry reputation it will not affect the future of the industry in Canada. This shown by the study titled "The Canada Islamic Finance

[85] Formed in 1943 in Manitoba, Canada. As of 2014 the company has $3.9 billion in assets under management (Assiniboine Credit Union 2015).

[86] Whole owned subsidiary of frontierAlt Capital Corporation, its head office in Toronto, Ontario.

[87] Omar Farooq kalair (CEO of UM) and Yusuf Panchbhaya (UM *shariah* advisor) charged with multiple offences under the bankruptcy and insolvency Act (BIA) and the criminal Code (CC).

Outlook 2016" which prepared by Thomson Reuters and the Toronto Financial Services Alliance and presented in the 22nd Annual World Islamic Banking Conference (WIBC) held in Bahrain in December 2015. The report revealed that Canada in position to become a hub for Islamic finance. Also, Islamic finance country index 2015 ranked Canada number 24 which is improvement from the last year ranking, ranked last.

Meanwhile, there are obstacles that need to resolve to achieve this goal. One of the hurdles is the lack of awareness of Islamic finance, according to Hejazi[88] "We need to have people across the country that understand Islamic finance, which we don't have" (Posadzki 2015). The only Islamic banking and finance program in Canada is offered by Rotman School of Management, MBA course in Islamic finance which launched in 2012, University of Toronto. The second barrier is regulation; according to Edward (2011), who examined the prospect of Islamic banking in Canada using DEPEST and SWOT analysis, Islamic finance has potential to grow in Canada if regulatory framework amended. Another stumbling block is Canadian anti-Muslim sentiment; the merger between Assiniboine Credit Union[89] , the first Canadian Financial institute to offer Islamic mortgagees was in 2010, and Access Credit Union in 2015 was declined by the later members on the base of religious believes.

Conclusion and Results

There are several reasons for the growing interest in Islamic banking in the west. First, the number of Muslims in western countries is estimated to be 47 million in 2010 (Pew Research Center 2011). This number continues to grow and is already large enough to attract financial-service providers. Second, demand is growing for ethical products and socially responsible services. Islamic finance fits conveniently into this, as Islamic principles prohibit trade in debt and ensure that all financial activities are related to the real sector of the economy. Another reason is that some countries wish to attract investors from Islamic nations. Yet another reason is diversification: many investors are looking for new instruments, products, and asset classes that are unrelated to existing products and services to diversify their portfolios. Islamic finance provides this for those investors.

However, some obstacles need to be resolved to allow Islamic financial industry to grow in the west (Table 2 shows that the share of Islamic finance

[88] Associate Professor of International Business at Rotman School of Management.

[89] Formed in 1943 in Manitoba, Canada. As of 2014 the company has $3.9 billion in assets under management (company annual report).

in the global market is still small). Firs, regulatory bodies must tailor specific laws for Islamic finance industry. Second, Islamic finance industry must address the issues of islamophobia, lack of political support and diversity of opinion (*fatwa*) as to whether some particular practices or products are *Shariah* compliant. Third, the industry must resolve the legitimacy of Islamic contracts issue (i.e., Validity of Islamic contracts can be challenged in bases that one or more of the parties lack the capacity to enter the transaction[90]; Moloney 2015). Finally, the educational system in the west and Islamic finance industry needs to spread consciousness about Islamic finance industry (e.g., offering postgraduate degrees, seminars, establishing academic institutions).

Table 2: Breakdown of Islamic Finance Segments by Region (USD billion, 2014 YTD*)

Region	Banking Assets	*Sukūk* Outstanding	Islamic Fund Assets	*Takāful* Contributions
Asia	203.8	1476.2	23.2	3.9
GCC	564.2	95.5	33.5	9.0
MENA (exc. GCC)	633.7	0.1	0.3	7.7
Sub-Saharan Africa	20.1	1.3	1.8	0.6
Others	54.4	9.4	17.0	0.3
Total	1476.2	294.7	75.8	21.4

Source: Islamic financial services industry stability report 2015

*Data for banking and Takāful as of 1H2014, while for Sukūk and funds as of 3Q2014.

[90] Investment Dar Company KSCC v Blom Developments Bank Sal.

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