Scope
This chapter examines the experience of Islamic banking in the West, mainly focusing on the developments in the United Kingdom since 1980 and the more recent experience in the United States. The major Islamic finance activities comprise wholesale operations, the provision of retail saving and investment products and home finance. Regulatory and legal issues are discussed, as well as institutional developments and the challenges of serving the British Muslim community of over 1.8 million people and the American Muslim community of over 6 million people.

The operations of exclusively Islamic banks are examined, notably in the case of the United Kingdom, the Al Baraka International Bank during the 1980s and early 1990s and the Islamic Bank of Britain from 2004. The activities of conventional banks offering Islamic facilities in London are also analysed, the focus being on the United Bank of Kuwait and its successor the Al Ahli United Bank, and more recently HSBC through its Amanah Islamic finance subsidiary and Lloyds TSB. In the United States, the institutions surveyed include LARIBA, the American Finance House of California, the Devon Bank of Chicago, the Shape Financial Group and the Guidance Financial Group of Virginia.

Islamic banking in the United Kingdom
Initially the major Islamic finance activity involved wholesale operations, with banks in London providing overnight deposit facilities for the newly established Islamic banks in the Gulf. In other words the business was shari’a-compliant liquidity management. The Islamic banks could not hold liquid assets such as treasury bills, which paid interest, but the joint-venture Arab banks in London, such as Saudi International Bank and the United Bank of Kuwait, accepted deposits on a murabaha mark-up basis, with the associated short-term trading transaction being conducted on the London Metal Exchange (Maroun, 2002).

Although the staff of the joint-venture banks were mainly British and non-Muslims, they became increasingly well informed about shari’a requirements regarding finance, and were able to respond to the demands of their Muslim clients in an imaginative manner. There was considerable interaction between British bankers involved with Gulf clients, shari’a scholars and the British Pakistani community, notably through the Institute of Islamic Banking and Insurance (IIBI) (www.islamic-banking.com), that had been established in 1976 by Muzzam Ali, a former journalist and head of the Press Association of Pakistan. Muzzam Ali worked closely with Prince Mohammed Bin Faisal of Saudi Arabia, a leading advocate of Islamic finance, and became Vice Chairman of Dar Al Maal Al Islami in Geneva, the international Islamic finance organization established by Prince Mohammed in 1982. The IIBI was initially located in the King’s Cross area, near to the City of London where the Arab joint-venture banks operated, and in 1990 moved to more prestigious premises in Grosvenor Crescent in the West End of London.
The Al Baraka International Bank

The next milestone in 1982 was when the Jeddah-based Al Baraka Investment Company bought Hargrave Securities, a licensed deposit taker, and converted it into an Islamic bank. This served the British Muslim community to a limited extent, but its main client base was Arab visitors of high net worth who spent the summer months in London. Its business expanded from 1987 when it opened a branch on the Whitechapel Road in London, followed by a further branch on the Edgware Road in 1989, and a branch in Birmingham in 1991 (Wilson, 1994), as by then the bank had between 11,000 and 12,000 clients (Al-Omar and Haq, 1996, p. 45). It offered current accounts to its customers, the minimum deposit being £150, but a balance of £500 had to be maintained to use cheque facilities, a much higher requirement than that of other United Kingdom banks. These conventional banks usually allow current accounts to be overdrawn, although then clients are liable for interest charges, which Al Baraka, being an Islamic institution, did not levy.

Al Baraka also offered investment deposits on a *mudaraba* profit sharing basis for sums exceeding £5,000, with 75 per cent of the annually declared rate of profit paid to those deposits subject to three months’ notice, and 90 per cent paid for time deposits of over one year. Deposits rose from £23 million in 1983 to £154 million by 1991. Initially much of Al Baraka’s assets consisted of cash and deposits with other banks, which were placed on an Islamic basis, as the institution did not have the staff or resources to monitor client funding adequately. Some funds were used to finance commodity trading through an affiliate company, as Al Baraka was not a specialist in this area.

Al Baraka’s major initiative was in housing finance, as it started to provide long-term Islamic mortgages to its clients from 1988 onwards. Al Baraka and its clients would sign a contract to purchase the house or flat jointly, the ownership share being determined by the financial contribution of each of the parties. Al Baraka would expect a fixed pre-determined profit for the period of the mortgage, the client making either monthly or quarterly repayments over a 10 to 20 year period, which covered the advance plus the profit share. There was some debate about whether the profit share could be calculated in relation to the market rental value of the property, but this was rejected, as frequent revaluation of the property would be expensive and administratively complicated, and, given the fluctuating prices in the London property market, there would be considerable risk for the bank.

Although Al Baraka provided banking services in London, its most profitable area was investment management, and in many respects it functioned more like an investment company than a bank. It lacked the critical mass to achieve a competitive cost base in an industry dominated by large institutions, and the possibility of expanding through organic growth was limited. In these circumstances, when the Bank of England tightened its regulatory requirements after the demise of the Bank of Credit and Commerce International (BCCI), the bank decided that it was not worth continuing to hold its banking licence, as it would have meant a costly restructuring of the ownership and a greater injection of shareholder capital. Consequently, in June 1993, Al Baraka surrendered its banking licence and closed its branches, but continued operating as an investment company from Upper Brook Street in the West End of London. Depositors received a full refund, and many simply transferred their money to the investment company. This offered greater flexibility, as it was no longer regulated under the 1987 Banking Act but under financial services and company legislation.
The United Bank of Kuwait

By the late 1980s, there was an increasing demand from the United Bank of Kuwait’s Gulf clients for Islamic trade-based investment, and the decision was taken in 1991 to open a specialist Islamic Banking Unit within the bank. Employees with considerable experience of Islamic finance were recruited to manage the unit, which enjoyed considerable decision-making autonomy. In addition to being a separate unit, accounts were segregated from the main bank, with Islamic liabilities on the deposit side matched by Islamic assets, mainly trade financing instruments. The unit had its own shari’a advisors, and functioned like an Islamic bank, but was able to draw on the resources and expertise of the United Bank of Kuwait as required. In 1995, the renamed Islamic Investment Banking Unit (IIBU) moved to new premises in Baker Street, and introduced its own logo and brand image to stress its distinct Islamic identity. Its staff of 16 in London included asset and leasing managers and portfolio traders and administrators, and by the late 1990s investment business was generated from throughout the Islamic world, including South East Asia, although the Gulf remained the major focus of interest. Assets under management exceeded $750 million by the late 1990s, just prior to the merger with Al Ahli Bank, which resulted in the bank being renamed the Al Ahli United Bank (www.ubk-plc.com).

After Al Baraka pulled out of the Islamic housing market the United Bank of Kuwait entered the market in 1997, with its Manzil home ownership plan based on a murabaha instalment structure (www.ibu.com). A double stamp duty was incurred on murabaha transactions, firstly when the bank purchased the property on behalf of the client, and secondly when it resold the house to the client at a mark-up. This was felt by many in the Muslim community to be discriminatory and, following effective lobbying by the Muslim Council of Britain, and a report by a committee charged with investigating the issues, the double stamp duty was abolished in the 2003 budget (Paracha, 2004), with the change taking effect from December of that year. The double stamp duty also applied to the ijara mortgages introduced under the Manzil plan in 1999 (Jarvis and Whitfield-Jones, 2003).

The Islamic Bank of Britain

The development that has attracted the greatest interest in recent years has been the establishment of the Islamic Bank of Britain (www.islamic-bank.com). It had long been felt by many in Britain’s Muslim community, especially since the withdrawal of Al Baraka from the retail Islamic banking market, that the United Kingdom should have its own exclusively Islamic bank. A group of Gulf businessmen, with its core investors based in Bahrain but with extensive business interests in the United Kingdom, indicated that they were prepared to subscribe to the initial capital of £50 million. A business plan was formulated in 2002, and a formal application made to the Financial Services Authority (FSA) for the award of a banking licence (Hanlon, 2005).

The FSA was well disposed towards the application; indeed, its staff charged with regulating the London operations of banks from the Muslim world were knowledgable about Islamic banking and believed that, in a multicultural and multi-faith society such as that of Britain in the twenty-first century, Islamic banking was highly desirable – to extend the choice of financial product available to the Muslim community (Fiennes, 2002). There was no objection to the new bank being designated as Islamic, as this was not felt to be a sensitive issue in the UK, unlike the case in some countries where there are large Christian populations, such as Nigeria, where the terms ‘Muslim’ and ‘Islamic’ cannot be used to
designate banks. In Saudi Arabia, a wholly Muslim country, the term ‘Islamic bank’ also cannot be used, as the major commercial banks and many shari’a scholars object to religion being used as a marketing tool.

The major concern of the FSA was that the new Islamic bank should be financially secure by being adequately capitalized, and that the management had the capability to adhere to the same reporting requirements as any other British bank. The emphasis was on robustness of the accounting and financial reporting systems, and on proper auditing procedures being put in place. Systems of corporate governance were also scrutinized, including the responsibilities of the shari’a advisory committee, and their role in relation to the management and the shareholders of the Islamic Bank of Britain. The FSA cannot of course provide assurance of shari’a compliance, as that is deemed to be a matter for the Islamic Bank of Britain and its shari’a committee. However the FSA wishes to satisfy itself that the products offered are clearly explained to the clients, and that full information on their characteristics is provided in the interest of consumer protection.

The Islamic Bank of Britain opened its first branch on the Edgware Road in London in September 2004, less than one month after regulatory approval was given. Its operational headquarters are in Birmingham, where costs are lower, and it has already opened other branches in Birmingham and Leicester. Five further branches opened in late 2005, including Bradford in the north of England and Glasgow. The size of the Muslim population in the immediate locality is one factor determining the choice of branch location, the socioeconomic status of the potential clients being another factor, as middle-class Muslims in professional occupations with regular monthly salaries are obviously more profitable to service than poorer groups. The bank stresses the Islamic values of faith and trust, as these are fundamental, but it also emphasizes value and convenience, the aim being to have standards of service and pricing at least comparable with British conventional banks.

The opening of the first branch attracted much media attention, and therefore free publicity for the bank. The bank has a well designed website to attract business, plans to offer on-line services in the future, and has produced informative and attractive leaflets and other publicity material outlining its services. All the material at present is in English rather than Urdu or Arabic, as the costs of translation and printing have to be seen in the context of promotional benefits. Some staff members are fluent in Urdu and Arabic, but at varying levels of proficiency, and foreign language ability is not a prerequisite for appointing staff, but good English is important. Many staff members have previous banking experience, and most, but not all, are Muslim.

The Islamic Bank of Britain offers current, savings and treasury accounts, all of which are shari’a-compliant. No interest payments or receipts are made with current accounts, but a chequebook and a multifunctional bankcard is provided, these initially being simply cheque guarantee cards. Savings accounts operate on a mudaraba basis with £1 being the minimum balance. Profits on savings accounts are calculated monthly and have been held at 3 per cent since October 2004. No notice is required for withdrawals from basic savings accounts, which in other words can be designated as instant access accounts. Term deposit savings accounts, which are subject to a minimum deposit of £5000, pay higher rates. In March 2005, deposits for one, three or six months earned 3.5 per cent, 3.75 per cent and 4 per cent, respectively. Unique amongst Islamic banks, the Islamic Bank of Britain offers treasury deposits, with a minimum £100 000 for one, three or six months being invested.
These operate on a *murabaha* basis, with funds invested on the London Metal Exchange. This type of account, in other words, replicates for the retail market the type of wholesale or inter-bank deposit facilities first operated on a *shari’a*-compliant basis in London in the early 1980s.

The Islamic Bank of Britain offers personal finance, with amounts ranging from £1000 to £20000 made available for 12 to 36 months. This operates through *tawarruq* with the bank buying *shari’a*-compliant commodities that are sold to clients on a cost plus profit basis. The client’s agent, who is conveniently recommended by the bank, in turn buys the commodities and the proceeds are credited to the client’s account. The client then repays the bank through deferred payments. Islamic mortgages have been offered since late 2005.

*Islamic home finance and current accounts offered by conventional banks*

It is a challenge for a new entrant such as the Islamic Bank of Britain to compete in a mature market for banking services with the major conventional banks offering Islamic products, notably HSBC, through its dedicated Amanah Islamic finance division (Khan, 2005) and Lloyds TSB, which has entered the market through Cheltenham and Gloucester, the former building society that it bought to create a focused mortgage and retail savings subsidiary.

It was the abolition of double stamp duty, as already discussed, that encouraged new entrants into the market for Islamic home finance, notably HSBC Amanah in 2004 and Lloyds TSB from March 2005. At the same time the Al-Ahli United Bank, the successor of the United Bank of Kuwait, reached agreement with the West Bromwich Building Society for the distribution of Islamic mortgages through its extensive branch network. A similar agreement was concluded between the London-based Islamic finance subsidiary of Arab Banking Corporation, Alburaq (Qayyum, 2004), and the Bank of Ireland, for the distribution of Islamic mortgages through its English subsidiary, the Bristol and West Building Society (Smith, 2004, p. 12).

There are a number of different structures for Islamic home finance in the United Kingdom, the original Al Baraka and the United Bank of Kuwait Manzil scheme being *murabaha*-based with fixed monthly repayments to cover the cost of the house purchase that the bank undertook, plus the mark-up profit margin. In 1999, a second Manzil scheme was introduced based on *ijara*, with the United Bank of Kuwait, and its successor the Al Ahli United Bank, purchasing the property, but with the client paying a monthly rent, as well as a monthly repayment. The rent varied, but, rather than being calculated on the rental value of the property, which would have implied frequent expensive revaluations, the rent was simply benchmarked to LIBOR, the London Inter-Bank Offer Rate. As this was an interest-based rate, this was potentially controversial from an Islamic perspective, but the Bank’s *shari’a* board approved its use as a benchmark, as LIBOR is often used in Islamic finance calculations because of its widespread acceptance in the banking community. The HSBC Amanah monthly home finance payments are also calculated in this way, as are those of the ABC Alburaq home financing facility marketed through the Bristol and West, although the latter is designated as a diminishing *musharaka* scheme as, over the life of the mortgage, the client’s ownership share increases as repayments are made, and the share of the bank in the equity of the house correspondingly reduces.
One factor that appears to be limiting the uptake of Islamic home finance is that the cost is higher than for conventional mortgages. For Islamic financing worth £135,000 from Lloyds TSB over a period of 25 years, the monthly repayments were £883 plus £21 a month for buildings insurance in March 2005. This comprised a rental payment of £693 plus a capital repayment of £190. The total monthly payment was over £100 per month more than the cost of a Lloyds TSB conventional mortgage (Cumbo, 2005, p. 26). With HSBC Amanah for the same loan of £135,000 over 25 years the monthly repayments were £857, only £7 per month more than the bank’s conventional mortgage, but the buildings insurance of £34 per month was obligatory with the Islamic financing as the property itself is owned by the bank, unlike the case of a conventional mortgage, where the bank simply has a charge on the property so that it can be repossessed in the case of payments default.

A survey of 503 Muslims in ten cities throughout England undertaken by Dr Humayon Dar of Loughborough University showed that many respondents had little knowledge of shari’a-compliant finance, but those who had enquired about Islamic home finance were deterred from proceeding by the higher costs. These, however, partly reflect the limited scale of the market, and hence the higher costs per mortgage approved, as well as the costs involved in shari’a compliance, not least paying the fees and expenses of members of the shari’a committee. Of course the cost of a mortgage is not the only factor determining the level of business, as those Muslims who have signed contracts for Islamic finance have been prepared to pay a premium for shari’a compliance. Rather the issue seems to be the size of the premium, which greater competition in the market should reduce.

A further factor inhibiting the uptake of Islamic home finance is that a significant proportion of the Muslim population in the UK is in a low socioeconomic position and cannot afford to buy property. This applied in areas such as East London where many of those in the Bangladeshi community are quite poor, but property prices are relatively high. One solution might be co-ownership through Islamic housing associations, with the tenant, association and bank all owning a share in the property, but at present these do not exist in the UK.

Both HSBC Amanah and Lloyds TSB offer Islamic current accounts, these being linked to the Islamic home finance being offered, as clients make their repayments through these accounts. Neither HSBC Amanah nor Lloyds TSB pay or charge interest on these accounts, but the accounts offer normal transactions facilities such as cheque books, standing orders and direct debit facilities, monthly statements and multifunctional cards that serve as cheque guarantee and debit cards. With HSBC Amanah a minimum balance of £1000 is required to maintain the account, but with Lloyds TSB there is no minimum. At present savings and investment accounts based on mudaraba are not offered by either bank in the UK, as the liabilities to match the Islamic mortgage assets are generated elsewhere, notably in the case of HSBC Amanah through shari’a-compliant deposits in the Gulf.

**Future outlook for Islamic finance in the United Kingdom**

Although the UK has the most active and developed Islamic banking sector in the European Union, most activity until recently has been related to the role of the City of London as an international financial centre, rather than serving the retail banking needs of British Muslims. However, this is likely to change in the years ahead, especially if other major UK-based mortgage banks, notably Halifax Bank of Scotland (HBOS) and Royal
Bank of Scotland (RBS, which owns NatWest) enter the market for Islamic mortgages. United National Bank (UNB) launched an Islamic mortgage product in 2004, aimed at the Scottish market, with the international law firm, Norton Rose, providing advice on shari’a issues, and the mortgages being based on the diminishing musharaka principle.\(^8\) HBOS and RBS have already sent representatives to several Islamic finance conferences in London, and it seems likely that the UNB Islamic mortgage aimed at the Scottish market, even though UNB is a minor player, may encourage the larger Edinburgh-based institutions such as Standard Life to bring forward their launch plans for Islamic financial products.

HSBC Amanah launched an Islamic pension fund in May 2004, where the assets held in the fund are screened for shari’a compliance, shares of companies involved in alcohol production and distribution, pork products and conventional banking being excluded, including ironically HSBC shares (Wilson, 2004). The pension fund is marketed to individuals and small Muslim family businesses. This may be a more promising way forward in the UK market than Islamic mutual funds, where there has been a history of failure, from the Kleinwort Benson Islamic unit trust of the 1980s to Flemings Oasis Fund and the Halal Mutual Fund of the 1990s, all of which failed to attract sufficient investors to ensure sustainability (Wilson, 2000).

The UK government is determined to create a level playing field for shari’a-compliant products. In the 2005 budget statement the same treatment was extended for ijara leasing mortgages and diminishing musharaka co-ownership mortgages as had already been applied to murabaha mortgages in the 2003 budget, with only a single stamp duty levy applying. The Chancellor of the Exchequer, Gordon Brown, announced at the Muslim News Awards for Excellence in March 2005 that a consultation paper would be issued concerning equal treatment for Muslim council tenants under the ‘right to buy scheme’, that at present is restricted to interest-based mortgages.\(^9\) All this bodes well for the future, as a non-discriminatory system of taxation and regulation will encourage more competition in the market for Islamic financial services, reduce prices and margins, and make Islamic products more affordable. There is much that other European Union member states can learn from the quarter of a century of experience in the UK and, even if some of the lessons are cautionary, many in the Muslim community now believe that British Islamic finance is really taking off.

**Islamic finance in the United States**

Despite the American Muslim community being the largest in the West, Islamic banking remains in its infancy, with a few small and geographically dispersed institutions providing home and vehicle finance and small business funding. Unlike London, New York has not played a significant role as an international centre for Islamic finance, partly reflecting its geographical isolation from the Muslim world, which makes it more convenient for American institutions such as Citibank to locate their Islamic finance operations elsewhere, in the case of Citi Islamic Bank in Bahrain.

Insofar as the American population are aware of the existence of Islamic banking and finance, the events of 11 September 2001 were unhelpful to the industry. Some Americans, encouraged by often anti-Muslim media biases, have tended mistakenly to equate Islamic finance with terrorist funding (Pfeiffer, 2005). There is little appreciation or understanding of Muslim beliefs, and a lack of understanding of the meaning of shari’a law.
Fortunately, however, international relations issues have not had an impact on Islamic financial institutions at a local level, and home-grown banks and financial service providers run by American Muslims are much less likely to encounter hostility than institutions based in the Middle East.

As California has the largest Muslim population in the United States, estimated at more than 700,000 (Abdul-Rahman, 2005), it is perhaps appropriate to examine Islamic activity there first, focusing on LARIBA, the American Finance House, based in Pasadena. In Illinois, where an estimated 3.6 per cent of the population are Muslim, the Devon Bank serves as a community-based savings and financing institution. In addition the Shape Financial Group also provides mortgage products in the Mid-West through the University Bank of Ann Arbor, Michigan. The Guidance Financial Group based in Virginia also provides some Islamic home purchase financing, as does the United States operation of HSBC Amanah, which is potentially the largest player in the market.

**LARIBA, the American Finance House**

The oldest Islamic financial institution in the United States is LARIBA, the American Finance House, which designates itself as offering *halal* banking. LARIBA is the acronym for the Los Angeles Reliable Investment Bankers Association (www.lariba.com/company/index.htm). It was founded by a group of American Muslims in 1987 in Pasadena, a small community 18 miles north of Los Angeles. Although initially it was only licensed to operate in California, by 2005 it was registered to conduct business in every state of the union, excluding New York. LARIBA has an agreement with the Bank of Whittier, a self-designated ‘Socially Responsible Bank’, to distribute its products in all states of the union, including New York. The Bank of Whittier is based in the California town of the same name, where it has operated since 1982 (www.bankofwhittier.com/about.htm). It is a community institution that provides personal finance and home loans as well as small business finance, including leasing.

The major activity of LARIBA is home finance, both directly and through the Bank of Whittier. The financing is based on a lease-to-purchase model which it equates with *ijara wa iqtina* and diminishing *musharaka*, although it has only one structure rather than two contrasting between these potentially different types of Islamic financing, as *musharaka* involves a partnership, whereas pure *ijara* is an operational lease, the *iqtina* being the instalment purchase element. Under the LARIBA scheme the property is purchased jointly with the client, with the latter repurchasing the share of LARIBA over a predetermined period of up to 30 years. The client’s initial share of the purchase can be as little as 5 per cent, although many opt for a larger share of 10 to 20 per cent of the purchase price.

The financing by LARIBA is based on the fair market value of the property, defined as the lease value if it was rented in the open market (www.lariba.com/home-financing.htm). The client is expected to obtain independent valuations from at least three estate agents, and LARIBA will also have the property valued separately. The client and LARIBA then negotiate over the mutually acceptable fair value, with the initial shares in this apportioned according to the amounts that each of the parties has contributed to the purchase. The lease value determines the monthly payment by the client to LARIBA and, as repayments of the amounts financed are also made to LARIBA monthly, the rental element in each monthly payment diminishes over time. The rental element is referred to as the return
on capital (RonC), and the ownership instalments the repayment of capital (RofC). It should be noted that the structure of repayments can be flexible, with smaller repayments made initially when the client is perhaps financially constrained by the need to furnish his or her home at a time when perhaps they are starting a family on a limited income, with higher repayments made in later years when the client will, it is hoped, earn a higher salary.

Under the laws of California and most American states the transaction is simplified if the client takes immediate title to the property upon the initial purchase. As the client gives LARIBA an undertaking that he or she will repurchase the property, LARIBA authorizes the registration of title with the client. As in the United Kingdom, where Islamic housing financial transactions have to comply with English or Scottish law, in the United States the documentation has to comply with the laws of the state in which the home is purchased, otherwise the ownership of the title cannot be registered. Compliance with shari‘a law has of course to be approved by the scholars comprising the shari‘a committee, but the laws of California, and indeed of England or Scotland, do not recognize shari‘a law in general; however, they can be, and have been, used in the resolution of disputes arising in contracts drawn up in compliance with shari‘a law, provided the parties to the contract agree to shari‘a provisions, as specified in the contracts, being used as the basis for settlements.

LARIBA also provides vehicle finance, using structures similar to that used for home finance, but over a much shorter period, typically three to five years (www.lariba.com/auto-financing.htm). The car finance is through a lease-to-purchase scheme, with the monthly rental payments determined through a survey of the rates offered by car rental companies and car dealers. This varies according to location, rather than being nationally determined, as is the case with interest. This process of determining the rental value is referred to as marking the item to the market, the crucial factor being the price of the car as a tangible asset, not the price of money or interest as with a conventional loan. LARIBA purchases the car jointly with the client, and the client then buys LARIBA’s share at cost over time. The client has the title to the car from the start, but LARIBA holds a first-position lien, or in other words a legal claim, on the car. It should be noted that the financing involves two agreements, a loan agreement in which the original capital is returned without interest, and a lease agreement, which is the source of LARIBA’s profit. Based on these agreements a promissory note is drawn up, in which the client guarantees payment. Under US law the monthly payments stream has to be calculated on a traditional amortization basis, so that clients can compare the percentage rate with those offered in conventional forms of financing. Such full and complete disclosure is in the interest of consumer protection. Similar provisions apply in the United Kingdom.

The Devon Bank
This old established community bank has been operating in the north side of Chicago since 9 June 1945 (www.devonbank.com/aboutus.html). Gradually over time the community it serves has changed, as northern Chicago has become one of the most multicultural and multiethnic populations in the United States, with a substantial Muslim community, mainly of South Asian or Arab origin. Many of the bank employees are Muslim and, as a self-designated caring community bank, there was a desire to provide financing in a shari‘a-compliant manner. This was not for philanthropic reasons, although the bank has
a good record of community endowment in this respect, but it made sound business sense given the demand by local Muslims for riba-free finance.

The Devon Bank does not have its own shari’a committee, but the Shari’ a Supervisory Board of America has vetted all of its shari’a-compliant products, with respect both to the documentation and to the way the products are actually used. The guidance of other shari’a scholars is also sought on an ad hoc basis when necessary. All shari’a-compliant products of course have to conform to United States federal law and the laws of Illinois and the other 18 states where it is allowed to offer its services, and it is attempting to secure approval in a further 15 states (www.devonbank.com/availability.html). The Devon Bank stresses that it aims to make its Islamic products competitively priced, but adds ‘where possible’ in recognition that there are often higher costs in providing shari’a-compliant products that have to be passed on to the client.

As with LARIBA, residential finance is the major Islamic funding activity of the Devon Bank, as most American Muslims would like to own a home if they have sufficient income. The Devon Bank offers both murabaha and ijara home financing, the former being the cheaper and more popular facility. The murabaha home financing scheme works in the standard shari’a-compliant manner by making the home purchase a trading transaction, with the bank purchasing the property and reselling it to the client at a mark-up. The client makes an initial deposit payment, and then pays monthly instalments over a period of 15 to 30 years. With the ijara plan the client makes monthly repayments plus a rental payment, the latter determining the Devon Bank’s profit. The rent can be varied over time with preset limits, set for the rental adjustment. The rent calculation is made in relation to an objectively measurable index, such as the rise in residential property values.

The Devon Bank also provides business financing using both murabaha and ijara structures. Terms for the murabaha finance run for up to seven years, with the client making an initial payment to the bank, followed by a series of monthly or quarterly payments, the total amount paid including the mark-up, the latter representing the Devon Bank’s profit. The murabaha may be only valid for a single transaction, as is the case traditionally, but the Devon Bank has also developed a murabaha guidance line, that can be used repeatedly for equipment or traded goods purchases. In this case the murabaha resembles a revolving line of credit. The Devon Bank also provides shari’a-compliant letters of credit, in the form either of a standby facility, where a supplier of goods only seeks assurance that the bank’s client is creditworthy, and will be able to make payments settlements, or of a documentary letter of credit, where the credit will actually be drawn upon to make the payment once the conditions of the bank’s client regarding the goods being financed as specified in the documentation are met (www.devonbank.com/Islamic/BusFin.html). One of the advantages of murabaha is that, since the bank rather than the client is paying the supplier directly, letters of credit may not be required, as the bank is less likely to default on its obligations than a small or medium-sized business.

The Shape Financial Corporation
The employees of Shape are financial services and real estate professionals who design specialized products that represent shari’a-compliant alternatives to conventional financial products. Shape is the rebranded and refocused successor to SAMAD, which provided limited Islamic financial services until 2004 for American Muslims. Shape is not a bank and does not deal with the public directly; rather its clients are banks, credit unions
and mortgage providers who wish to develop products to suit the needs of their Muslim clients, but who lack the in-house expertise and, most crucially, the shari’a assurance that Shape can provide by issuing its own fatwa or Islamic guidance.

The strength of Shape is in the expertise of its own people, notably Abdulkader Thomas, an American Muslim graduate of the Fletcher School of Law and Diplomacy who has extensive experience of Islamic banking in the Gulf, London and New York, where he developed the Islamic mortgage products offered by the United Bank of Kuwait in the late 1990s (www.shapefinancial.com/team/abdulkader.asp). Shape’s ethical advisory board includes the American Shari’a scholar, Sheikh Yusuf Talal DeLorenzo, a Cornell University graduate who also serves on the Shari’a advisory board of HSBC Amanah and the Dow Jones Islamic Indices, and Sheikh Nizam Yaquby, a graduate of McGill in Montreal, and a leading international Shari’a scholar. It is the credibility of these advisors that is crucial for Shape’s reputation, together with the professionalism of Abdulkader Thomas, who can act as a bridge between the American Muslim community and mainstream bankers and real estate professionals.

The University Bank of Ann Arbor in Michigan (www.university-bank.com), with Midwest Loan Services providing back office processing and administration (www.midwestloanservices.com), offers Shape Islamic mortgage products. Shape is not licensed to offer deposit facilities, but the shari’a-compliant profit sharing account that it designed is offered by the University Bank of Ann Arbor through its Mid Western branches. The deposits in the profit sharing account are invested in the Islamic home finance offered by the University Bank of Ann Arbor to residents of south eastern Michigan. The profit shares are derived from the rental income paid by those obtaining home finance, rather than coming from the income on interest-based loans and mortgages. The deposits are structured on a mudaraba basis, with the proportionate share of the profit paid out to the depositor depending on the period of notice required to withdraw funds. The rents on which the profit shares are based are very stable over time, providing an assured, but not a guaranteed, income, as that obviously depends on the performance of the overall home financing portfolio. Further products are currently being developed to complement the mudaraba deposits and the redeemable leases used for Islamic home finance.

Guidance Financial Group
The Guidance Financial Group is based in Virginia, and started operations in 2002. As with LARIBA and the Devon Bank, its major service is the provision of Islamic home finance, in the case of Guidance through a declining balance co-ownership financing structure. It can provide both new Islamic mortgage finance and the conversion of existing mortgages to Islamic products. It is not dependent on local deposits as the source of its Islamic mortgage finance, as it has extensive overseas connections, including a connection with the Abu Dhabi Investment Authority, on whose behalf it invests funds in a shari’a-compliant manner (Abdul-Rahman, 2005).

Under the declining balance co-ownership programme the client must put up at least 5 per cent of the value of the property as a deposit, with Guidance providing the remainder over a 15, 20 or 30-year period. Guidance does not charge any interest on its funding, and the amount of the total repayments does not exceed the financing made available. However the client pays a rent to Guidance for the use of the property, which represents the profit share. This is identical to the LARIBA home financing structure, which seems
to be increasingly accepted by American Muslims, as well as the regulatory authorities at state and federal level.

Guidance has a *shari'a* supervisory board whose members represent much of the Islamic World, with Justice Taqi Usmani of Pakistan acting as Chairman (www.guideancefinancialgroup.com/sharia/shariabios.asp). Other members come from Syria, Bahrain and Malaysia, along with Sheikh Yusuf Talal DeLorenzo of New York, who, as already mentioned, also serves as an ethical advisor to Shape. The Malaysian connection is important, as Hasnita Hashim, who is well known as one of the leading women in Islamic financial circles, serves on the senior management (www.guideancefinancialgroup.com/company/management.asp). Dr Mohamad Daud Bakar, the internationally known Malaysian *shari'a* scholar, serves on the Guidance Supervisory Board.

**Prospects for Islamic banking in the West**

Although Islamic banking is still in its infancy in both the United Kingdom and the United States, it is evident that it can be self-sustaining in a non-Muslim financial environment where *riba*-based banks are dominant. In both countries the key driver for financial product development is client demand, and Islamic banks will emerge to provide for the needs of the Muslim population if this is perceived to be profitable. This also applies to conventional banks offering Islamic products, as there is no inherent objection or bias against such products if the selling potential is favourable.

The problem to date, however, is that most of the initiatives have been supply rather than demand driven, with the initiative usually coming from the Muslim world rather than from Muslims in the West. Al Baraka was largely funded from Saudi Arabia, and even the Islamic Bank of Britain had most of its capital raised in Bahrain and the other Gulf states, although it does plan to secure a listing on AIM, the Alternative Investment Market. Guidance and Shape financial services also have external backing from the Arab Gulf states and Malaysia, and only the Devon Bank’s Islamic products and LARIBA, the American Finance House, can be regarded as home-grown. In the case of HSBC Amanah, which offers home finance in both the United States and the United Kingdom, the source of the *shari'a* funding is the Muslim world, the bank’s role being to recycle money into *shari'a*-compliant residential property financing. Only Lloyds TSB amongst the major banks needs to attract *shari'a*-compliant deposits to fund its Islamic mortgages, as it enjoys only limited access to Arab capital.

Although most Muslims in the West are aware of the Islamic prohibition of *riba*, they are not necessarily willing to investigate Islamic savings and financing possibilities, especially if the services seem expensive compared to the conventional equivalents. The United Kingdom possibly offers the greatest potential in the medium term, with two of the ‘big four’ banks offering Islamic products, and the likelihood that Barclays and Royal Bank of Scotland, which owns NatWest, will follow. In the United States, where the retail banking system is much more fragmented, national initiatives are virtually impossible; hence the enclaves in southern California and the Mid-West, where much of the Islamic banking activity is focused on the Pakistani and Bangladeshi communities, and to a lesser extent Arab Americans.

The Federal Reserve has been less proactive than the Bank of England and the United Kingdom’s Financial Services Authority in their support for Islamic finance, but the US Treasury has been helpful and well disposed towards the industry, and the negative effects
of 11 September 2001 can be exaggerated. Less helpful have been continental European regulators, but this has been more because of a lack of awareness or knowledge of the issues rather than because of any inherent hostility. Banks in France and Germany have been uninterested in Islamic product development for their local Muslim communities, largely because of their lower socioeconomic position in relation to British Muslims, with many of the Arabs in France and Turks in Germany unemployed, or in casual and sometimes illegal jobs, paying low wages. This is correctly, although unfortunately, not perceived to be a profitable customer base for the banks.

Furthermore, alternative banking models, notably ethical or socially responsible banking, are more developed and accepted in the United States and the United Kingdom than in continental Europe. The Devon Bank was a self-designated socially responsible bank long before it provided Islamic banking, and the development of these services was seen as a natural development of its community involvement. In the United Kingdom the Co-operative Bank, one of the top ten banks, is a self-designated ethical bank, and although it does not at present provide Islamic finance, it would certainly be well placed to enter the market. In contrast, in continental Europe, the Triodos Bank, the Dutch based ethical bank, is a very small and marginal institution with branches in Spain and Belgium, but an insignificant presence in any market. It does not offer Islamic finance, and has no plans for such an initiative.

The only substantial Islamic financial institution in continental Europe is Dar Al Maal Al Islami, the Geneva-based bank that was founded by a group of Saudi Arabian and Gulf investors headed by Prince Mohammed Bin Faisal in 1981. Dar Al Maal Al Islami caters largely for Arab clients based in the Middle East, and some wealthy Arab temporary residents of Geneva, but not for the needs of Switzerland’s small Muslim community, the majority of whom are of Turkish or North African origin, and have rather menial jobs.

Despite the limited extent of Islamic banking in the West, its development is already having a major impact on the Islamic finance industry worldwide. The climate for innovation is more favourable in the West than in much of the Islamic world, not least because of the better protection of intellectual property rights. The Shape Financial Corporation has registered trademarks for its Islamic financial products which limits their being replicated in the United States without permission. The Islamic Bank of Britain, although in its infancy, was the first Islamic bank anywhere to offer murabaha treasury deposit accounts. Similarly the emergence of Islamic home finance in the West has resulted in several different shari’a-compliant structures emerging, and much vigorous debate about the merits and drawback of each product, both from a shari’a and a financing perspective. This has undoubtedly contributed to further product development. Dynamic economies usually have innovative financial sectors, and in this respect Islamic finance in the West stands an excellent chance of leading the way.

Notes
References


