

Islamic Banking and Finance on the European Market

Islamic Finance, developed during the 70's in the Muslim countries, is experiencing an increasing popularity far outside the Muslim World's frontiers. In a world where the dominance of the capitalist economy is obvious, the development of a system where the main principle is the exclusion the interest rate comes close to being an exploit.



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At first, Islamic finance has been implemented in the Western World mainly to benefit from the advantages offered by European financial centres such as the Luxembourg and Switzerland. From this first tendency, only the corporate and private banking clients have taken advantage of. It is only recently that retail services started to be offered on the Western territory, conscious of the increasing economic power of the different European Muslim communities.

Characteristics of the Muslim communities in the Western World

The Muslim communities settled in Europe have different origins and migration stories. They have however the common ground of being newly installed in their host country, claiming at most fifty years of presence. They are mainly characterised by a religious revival and a desire, pronounced even deeper for the new generations, to live in compliance with their faith. This search of a particular identity has resulted in the emergence of a niche market with an exceptional potential: the ethnic market and more specifically in a Muslim context, the "halal" market, the word "halal" meaning

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"compliant to the Islamic law". In a context where Islam is a minority religion, Muslim immigrant populations tried to adapt their environment to their religious values. The first market influenced by Islamic rules is the food sector, especially the meat industry. Over the last few years, the consumption of halal food has increased tremendously. Although there are no official figures, it is estimated that 10% of the food in France is halal, while the Europe-wide business is valued at around €5 billion.

This growing market illustrates two important facts: the first is that the Muslim population is increasingly considered as an important potential market with specific

needs. The second is that the building of a European identity of the Muslim community is reconciling capitalist consumption norms and Islamic values.

Initially limited to the food industry, the halal market is in fact much bigger: alternative sodas, clothes, music... and finance. In the field of finance, this objective of conformity implies the impossibility for Muslims to use the majority of financing and investment products available on the market, as most of them are based on the paying or receiving of an interest fee.

The Islamic Finance system in a few words

As basic fundament of its functioning, Islamic finance rejects any source of unjustified wealth creation: one of these sources considered as unjustified is the payment and reception of an interest rate fee, as Islamic recognises only two roles to money: exchange middle and a unit of value and does not legitimate the role of money as a "value reserve". Therefore, it cannot accept the traditional financing system based on a predefined remuneration, the interest fee as price of the capital.

The first Islamic economists defined and built a parallel financial system based on a participative finance, where the money will become working capital only when it is linked with the evolution of an economic activity or with the value of goods/services. Its yield will depend on the principle of profit and loss sharing, principle that links the profit of a transaction to the achievement of an economic activity.

This principle modifies the way a bank is organised: being a financial intermediary between its investing and financing clients, the relationship between these two parties

becomes an investor-entrepreneur relation based on the profit and loss sharing instead of a predefined interest margin.

In this framework, the Islamic bank will deploy new techniques based on initially commercial contracts that were adapted in order to meet investment and financing needs of their clients.

The banking system itself is based on the Mudhabara contract: in this contract, two or more participants will be associated into an economic project, one bringing the financial part (Rabb al Mal), the other one taking care of the project management (Mudharib). Both will share the potential profit of the developed activity, according to a predefined ratio. On the liabilities side, the bank will play the role of a Mudharib and will receive the funds from its clients. On the asset side, the bank will play the role of a Rabb al Mal and will invest in the projects of its clients.

A second instrument that is often used is the Musharaka contract: it is relative similar to the Mudharaba contract with the difference that both parties bring money and management to the common project.

These two first contracts are the basic of participative financial practices in the Islamic Finance and are generally applied to long term corporate project financing. Given the risk implied in such investment contracts, it cannot be easily applied to SME or retail clients with short term financing needs. Therefore, other techniques have been developed, based also on commercial contracts that have been adapted: among these contracts, the Murabaha and Ijara contracts are the most popular.

The Murabaha contract is initially a simple sale contract where the sales price and the profit margin are negotiated between the buyer and the seller. This commercial practice has been adapted in order to apply as financing instrument: in this case, the bank which will finance the client's project will become an intermediary owner between the seller and the buyer and will let a credit to its clients, allowing him to reimburse its debt in an agreed duration.

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The Ijara contract is similar to the leasing contract with a sale option at the end of the lease period: the bank will buy the good and rent it to its client. At the term of the contract, it will transfer the ownership of the contract to its client, in exchange of an agreed residual amount of money.

Islamic Finance in Europe – the Offer analysis

UK is from far the first European Financial place for Islamic finance development. Being implemented since the 80's for Corporate and Private banking clients, the recent development of retail Islamic services by a.o. the implementation of the Islamic Bank of Britain has marked a turning point in its integration into the UK financial sector.

The story of the implementation of Islamic Finance in UK is quite interesting and generally serves as model for the other countries as it succeeded in overcoming the main obstacles linked with such an implementation. This success is closely due to the direct and voluntary implication of the UK financial regulators, the FSA and the Bank of England who defined a "level playing field" between the Islamic and conventional products: for instance, applied to the Mortgage financing, the stamp duty linked with the double ownership transfer implied by the Murabaha contract has been removed for the Islamic mortgage financing contract in

order to make it equal to the conventional mortgage contract.

Since then, the British authorities have multiplied calls for the development of Islamic finance on the UK territory, as illustrated by the desire of FSA president in 2006 to develop a "reasonable and fair regulatory framework" for Islamic finance.

Paradoxically, the Continental Europe has not yet followed this trend, despite the presence of important Muslim communities in countries such as Germany or France. Recently, the French government has marked its will to foster Islamic finance and various debates, discussions and even law modifications have been implemented, without however, leading to the development of a concrete offer for the French Muslim community. In Belgium, despite some local efforts and declaration of the Finance Minister to welcome Islamic Finance on the Belgian territory, no offer of sharia-compliant products has been developed yet.

Such an absence on a growing sector can be explained by several factors, such as simply the absence of a demand and/or the presence of important legal obstacles.

Implementation of Islamic Finance in Europe – Myths and Realities

The sole analysis of the Muslim presence in Europe can help contradict the premise that there is no demand for Islamic Finance in Europe. According to demographic projections of the US-based Pew Research Center, the Muslim population in Europe is expected to rise by a third by 2030. Moreover, the Pew report joins the conclusion of the figure presented hereabove by estimating that France and Belgium will join in 2030 the eight other countries where the Muslim population will make up more than 10 percent of the total population¹.

In Belgium, while representing 6% of the population at national level, in Brussels, the

1 « The Future of the Global Muslim Population » - PewResearchCenter Publication – January 2011

Muslim population covers more than 20% of the population of Brussels². Moreover, a survey performed in 2004 by the CEREL demonstrates that only 30% of the Muslim population is owner of a real estate, which is quite low compared to the 80% of real estate ownership at the national level. The main reason mentioned for this gap is the absence of a sharia compliant mortgage contract.

Therefore, despite a clear demand for such products, one can ask why the Islamic finance market has not yet known the popularity experienced in other Western countries. An in-depth analysis of the situation in the Belgian context has been performed by the Belgian Association of Muslim Professionals (ABPM³) allowing

2 « In Belgique wonen 628 751 moslims », Jan Vertogen, Indymedia, September 12, 2008
3 www.abpm.be

to clarifying the main obstacles to such development.

The analysis focussed on the implementation of Islamic Mortgages, as it is, without surprise, the most demanded product by the local population. The main conclusion is that the application of a product such as the Murabaha, implying a double ownership transfer, would result in the payment of a double stamp duty, first on the purchase price between the seller and the bank, the second on the sale price between the bank and its client. This double taxation will directly be impacted on the client rate, which will result in a too expensive financing contract, contract that would certainly be prohibited by consumer protection services.

A second difficulty is the scope of application of existing Mortgage law for these

products: will the Murabaha fall within this law? At a first glance, no, as it is not an interest based contract as foreseen by the law. Another question concerns the deductibility of interest and capital payments for the Islamic mortgages contractors: would they also benefit from such a system, while they are not paying interests to the bank but profit on the sale of the real estate?

All these points deserve to be discussed with the competent authorities, in order to challenge the flexibility and adaptability of the Belgian legal and tax framework on new issues. Moreover, on a social point of view, this necessary discussion will allow a significant part of the Belgian population to access, as their fellows, to the universal banking services and therefore solve what we can consider as a new “banking” exclusion. ●

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In a few months, IsFin has managed to pull as members some of the strongest law firms in the world. Evidence of the interest for a global approach to Islamic Finance law. “We are filling a gap in the market” says IsFin’s Board Member Josep Marsal (Partner Banking & Finance, Cuatrecasas, Spain). “Private, public and corporate Islamic investors are looking at stable investments and seek to invest in Western countries and emerging countries like China, Brazil, India,... On the

other side, Western companies are willing to invest in the Arab world where macro-economic and political changes occur.”

“We are seeking and cherry-picking the best Islamic Finance legal teams in the market” says IsFin’s CEO, Prof. Laurent Marlière. “We receive a tremendous wave of enthusiasm from both the investors’ market and the legal practitioners. The economic context is really boosting our project. The high energy prices and the fact that Islamic banks have been protected from the credit crunch, due to their ethical approach, has provided Islamic investors with huge liquidities (ca. 900 billion dollars). This capital now needs to be invested.”

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Florence Stainier.

Read also in this issue the article ‘Islamic Banking and Finance on the European Market’ by Karich Imane.



Laurent Marlière

Private, corporate and public Islamic Finance investors are seeking a truly global solution

