Islamic banking grows more popular

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LONDON — Imagine a world of interest-free mortgages, car loans and overdrafts. It's not imaginary, and it may soon be coming to a bank near you.

Islamic banking — which follows rules that bar the paying or taking of interest — is booming, with banks racing to attract Muslims and non-Muslims alike with products conforming to Islamic laws.

"We have plans to make our products widely available in cities throughout the United States," said Amjid Ali, head of HSBC's Islamic banking unit HSBC Amanah, which launched operations in New York in 2002.

Banks such as HSBC have hailed Islamic banking as finally coming into the mainstream as they prepare to target not only the estimated 6 million Muslims in America — with a wealthy middle class that's growing in size — but members of other faiths as well.

Already, Islamic banking operations have been established in more than 100 countries, with an estimated $300 billion in assets that are surging by 15 percent a year, according to the Asian Banker, a financial services consultancy.

Islamic banking bans interest because the Koran prohibits investors from making a guaranteed profit on capital. The rules also prohibit investments in pork, alcohol, gambling or areas subject to speculation.

Traditionally, Islamic banking has been trade-based. It's a system through

which profit and loss are typically shared. Customers — or shareholders — receive dividends when banks turn a profit, and suffer losses when their banks do.

Muslims have long been divided though over how far the ban on interest should go. For example, some believe stocks and bonds should be allowed, while others don't.

When it comes to mortgages or car loans, typically the bank buys the home or car for the customer, who in turn leases the items back from the bank.

"We buy property on behalf of the customer and they pay us back in monthly installments over a maximum of 25 years," said Emile Abu-Shakra, a spokesman for Lloyds TSB in London. "The bank and buyer enjoy a kind of partnership."

He said that the bank contributes up to 90 percent of the purchase price of a home.

While big investment banks such as Citibank and UBS Warburg have long been building up Islamic banking branches in the Middle East, home to about 92 percent of Islamic banking assets, interest in the idea is also rising in the United States.

Financial institutions such as University Bank in Ann Arbor, Mich., are aiming to attract large local Muslim populations that in the past have been forced to either use conventional banking accounts or opt out of traditional services altogether.

There is a Dow Jones Islamic Fund that avoids so-called "sin stocks" and invests only in companies that comply with the Shariah, the system of law and jurisprudence based on Islamic religious principles.

And Freddie Mac has offered home-financing schemes in accordance with Muslim beliefs since 2001 through American Finance House in southern California. These contracts utilize a lease-to-own mortgage model that allows buyers to build up equity through monthly payments that combine principal with rent.

"Like all things in the United States, Islamic finance is growing from a very local community level — which, in a way, is how it should develop," said Emmanuel Daniel, managing director of the Asian Banker. "We came across one bank, Whittier Bank in California, which started from the home of its founder and caters to Muslims in his neighborhood."

In Britain, the West's first totally Islamic bank — the Islamic Bank of Britain — launched in London last year with a variety of accounts and an ambitious branch-opening scheme aimed at the country's 1.8 million Muslims.

At the same time, HSBC and Lloyds TSB, both among Britain's main conventional banks, began offering Shariah-compliant products earlier this year.

HSBC's unit, for example, offers Islamic mortgages and current accounts as well as a pension fund, which tracks an index including the top 100 companies involved in permitted activities.

"We're also looking at a product similar to homeowners insurance as well as the development of a Shariah-compliant child trust fund," Ali said.

The Lloyds account forbids both the paying and receiving of interest. It has no credit interest and no overdraft facility, but does provide a debit card. Unlike some other compliant accounts, it does not charge a fee or require a minimum balance.

"There is a huge Muslim population here in the U.K. and it's a fast-growing population," said Abu-Shakra of Lloyds. "Surveys say that about three-quarters of Muslims here are interested in Islamic banking."

The Asian Banker's Daniel says there's no reason why Islamic banking shouldn't attract non-Muslims as well as Muslims.

"The principle of shared risk in Islamic finance is fundamentally different from the practice of charging interest," he said. "This creates an especially interesting situation where, for a small business loan, the bank is not just the financier but a co-owner of the business and has an interest in its success as if they have equity.

"Certainly there are many non-Muslims who believe in the kinds of principles that are behind this system of banking," he said.

Alun Williams, marketing director of the Islamic Bank of Britain, told the Guardian newspaper that his bank should have no problem appealing to Muslims and non-Muslims alike, especially those so-called "ethical" investors.

"Non-Muslims are fascinated by us, the more so because we intend offering better service, and an ethical dimension," he said. "Our biggest appeal outside the Muslim community will be to those who feel disenfranchised by, and bitter about, mainstream banks."

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Still, roadblocks to worldwide proliferation remain. For example, an absence of standardization can make interpreting the Koran's guidelines on how to manage money more of an art than a science.

There is a Shariah board at every Islamic bank, and one board's interpretation of compliance with the Koran is not necessarily the same as another's.

"Further growth in Islamic banking cannot proceed without regulatory changes, especially in terms of standardization as well as in terms of risk management tools such as capital adequacy requirements," said Bala Shanmugam, director of the banking and finance unit at Monash University Malaysia.

He said that regulation is largely dictated by supply and demand, and so amendments to current regulations are inevitable if current growth continues.

Shanmugam sees that growth mostly confined to Islamic regions in the coming years.

"I'm not convinced that the critical mass in the U.S. and U.K. will allow Islamic banking to be a major driving force," he said. "Islamic banking will continue to grow more so in Islamic nations."

Islamic banking first surged in the mid-1970s when the oil-producing Persian Gulf began reaping billions of dollars from the boost in world oil prices.

In more recent years, it has been riding the wave as Islam has become the world's fastest-growing religion.

That interest has spurred an increased demand among Muslims in Europe and the United States for financial services that reflect their religious faith.

Demand has become so keen even in the United States that in May 2004 the Treasury Department appointed Mahmoud el-Gamal, a professor of Islamic economics at Rice University in Houston, as its first Islamic scholar-in-residence to advise the department on Islamic finance as it struggles to better grasp the market.

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