

2011

## Arab Money: Why Isn't the United States Getting Any

Mushfique Shams Billah

Follow this and additional works at: <http://scholarship.law.upenn.edu/jil>

---

### Recommended Citation

Mushfique Shams Billah, *Arab Money: Why Isn't the United States Getting Any*, 32 J. Int'l L. 1055 (2014).  
Available at: <http://scholarship.law.upenn.edu/jil/vol32/iss4/2>

This Comment is brought to you for free and open access by Penn Law: Legal Scholarship Repository. It has been accepted for inclusion in Journal of International Law by an authorized administrator of Penn Law: Legal Scholarship Repository. For more information, please contact [PennlawIR@law.upenn.edu](mailto:PennlawIR@law.upenn.edu).

**ARAB MONEY:  
WHY ISN'T THE UNITED STATES GETTING ANY?**

MUSHFIQUE SHAMS BILLAH\*

*Bismillahir rahmanir rahim,<sup>1</sup> Alhamdu lillaahir rabiil'alamin,<sup>2</sup> We gettin'  
Arab money, We gettin' Arab money.*

-Busta Rhymes, "Arab Money Remix"

ABSTRACT

Arab money, more formally known as Islamic finance, is starting to play an important role in international finance. The young Islamic finance sector has grown tremendously despite staggering world economic conditions. Because of this unprecedented growth, the international community seeks to harness such profitable returns while simultaneously scrutinizing Islamic financial institutions and charities that may be funding terrorism, a serious worldwide concern. As such, this Comment seeks to show that the best way for nations to standardize, scrutinize, and take advantage of these lucrative and often nebulous investments is to invite, and then regulate Islamic banks. European nations, in particular the United Kingdom, have done just that and have become a hub for Islamic banking outside the Middle East and Southeast Asia. The United States, on the other hand, has not. This Comment argues that the reasons for such disparity lie in the United States' statutory and constitutional framework, both of which present obstacles for Islamic banking. In

---

\* J.D. 2011, University of Pennsylvania Law School; B.A. 2008, The George Washington University. I would like to thank God, my family, and my friends for their support and encouragement, as well as Nabil Issa and Professor David Skeel for offering their time and expertise. I would also like to thank the editors at the University of Pennsylvania Journal of International Law for their keen eyes. All errors are our own.

<sup>1</sup> Translated from Arabic as "In the Name of God, Most Gracious, Most Merciful." THE HOLY QURAN, I:1 (Abdullah Yusuf Ali trans., 3rd ed. 1946).

<sup>2</sup> Translated from Arabic as "Praise be to God, The Cherisher and Sustainer of the Worlds." *Id.* at I:2.

contrast, the United Kingdom has worked around these impediments, and so this Comment studies the British banking model as a means to provide a primarily education-based solution for the United States to invite and then regulate Islamic finance. Such an invitation would allow the United States to take advantage of the growth in the Islamic finance industry and ease some of the nation's financial straits. Among other advantages, it would also allow the United States to reach out to Muslim communities, preventing them from radicalizing like some parts of the Islamic world. For these benefits, the United States should learn from the positives of the British banking system and seek out Arab money.

#### TABLE OF CONTENTS

##### 1. INTRODUCTION

In his controversial 2008 hit rap single, "Arab Money Remix,"<sup>3</sup> Busta Rhymes aptly summed up two world phenomena that appeared unrelated but were slowly converging. First, the world economic situation was failing as banks continued to face credit crises, countries were going bankrupt, and worldwide unemployment rose.<sup>4</sup> Second, despite deteriorating economic conditions, Busta Rhymes ironically praised God<sup>5</sup> because he was getting "Arab money," the functional equivalent of Islamic finance. This was one of the few industries that escaped most of the recent massive economic devastation, growing 28.6 percent in assets from 2008 to 2009.<sup>6</sup> Furthermore, a significant portion of the world

<sup>3</sup> BUSTA RHYMES, *Arab Money Remix* (Universal Motown 2008).

<sup>4</sup> See, e.g., PEW RESEARCH CTR. FOR THE PEOPLE & THE PRESS, *On the Economy, Bad News Better Than No News*, PEW RESEARCH CTR. PUBL'N (Feb. 19, 2009), <http://pewresearch.org/pubs/1127/economic-news-influences-financial-decisions> (stating that approximately sixty percent of Americans felt as though they were hearing "mostly bad [economic] news"). For figures in the United States alone, see WORLD BANK, *WORLD DEVELOPMENT INDICATORS 2009*, at 1 (2009) (stating that unemployment was at a high of 7.2 percent for 2009).

<sup>5</sup> BUSTA RHYMES, *supra* note 3.

<sup>6</sup> See *Islamic Banks Weather Economic Storm: Study*, THE SYDNEY MORNING HERALD, Nov. 6, 2009, <http://news.smh.com.au/breaking-news-business/islamic-banks-weather-the-storm-study-20091106-i0na.html> (noting that the top 500 Islamic banks held assets totaling \$822 billion in 2009, up from \$639 billion in 2008, despite the financial turmoil that devastated mainstream lenders who only experienced 6.8 percent growth).

2011]

ARAB MONEY

1057

population is Muslim.<sup>7</sup> Muslims now make up one out of every four people on the globe, totaling 1.57 billion.<sup>8</sup> In the United States alone, Muslims are growing at a rate of fifteen percent, and are numbered at 7.5 million, or two percent of the domestic population.<sup>9</sup>

As the number of Muslims increase, so will their needs, whether in politics, in economics, with social issues,<sup>10</sup> or in music. For example, Busta Rhymes' original song was an affront to Islamic principles, and so the remix voluntarily catered to Muslim concerns by eliminating some of the offensive materials, such as the juxtaposition of the Quran<sup>11</sup> and music.<sup>12</sup> However, Muslims are not only requesting changes in the music industry, but also in the financial services sector.

In this industry, Muslims are looking for financial instruments that comply with their religious obligations, such as a bank that does not deal with interest.<sup>13</sup> At first glance, these requests seem

---

<sup>7</sup> See THE PEW FORUM ON RELIGION & PUB. LIFE, PEW RESEARCH CTR., MAPPING THE GLOBAL MUSLIM POPULATION 28-33 (2009) (tracking the growth of the international Muslim population, which indicates a potential demand for entertainment or financial instruments that satisfy their religious needs).

<sup>8</sup> *Id.* at 33.

<sup>9</sup> See Scheherazade S. Rehman, *Globalization of Islamic Finance Law*, 25 WIS. INT'L L.J. 625, 644 (2008) ("Although the number of Muslims in the United States is hotly debated, most tend to agree that it is around seven million, or approximately two percent of the US population."). For Muslim populations in other developed nations like France and Germany where Muslims already make up more than five percent of the population, see THE PEW FORUM ON RELIGION & PUB. LIFE, *supra* note 7, at 22.

<sup>10</sup> For a recent heated social issue, see, for example, Kirk Semple, *Opponent Seeks to Block Construction of Downtown Mosque*, N.Y. TIMES, Jan. 11, 2011, <http://www.nytimes.com/2011/01/12/nyregion/12mosque.html> (summarizing the debate over Muslims' rights to build a mosque near the World Trade Center).

<sup>11</sup> The Quran is the holy book for Muslims.

<sup>12</sup> See Busta Rhymes' Controversial "Arab Money" Gets DJ Suspended, ROLLING STONE (Dec. 4, 2008), <http://www.rollingstone.com/music/news/busta-rhymes-controversial-arab-money-gets-dj-suspended-20081204> (stating that in the first version of the song, "the first chapter of the Quran is sung and sampled, which is against strict Arab law dictating that singing a Quran verse in combination with music is prohibited").

<sup>13</sup> See KNUT S. VIKØR, BETWEEN GOD AND THE SULTAN: A HISTORY OF ISLAMIC LAW 326-29 (2005) (explaining how interest is forbidden in the Islamic faith, making this "the most distinctive difference existing between Islamic and Western economic law"); see generally J. Michael Taylor, *Islamic Commercial Banking – Moving into the Mainstream?*, 18 TRANSNAT'L L. 417 (2005) (presenting the alternative system prescribed for Muslims: an interest-free banking system).

1058

U. Pa. J. Int'l L.

[Vol. 32:4]

beneficial only to Muslims, but they satisfy a global need for a new type of bank that can fare better in today's conventional banking system. The United Kingdom has tapped into this global trend to try and become a new hub for Islamic banking whereas the United States has not.<sup>14</sup> What is preventing the United States from following suit and getting some "Arab money"?

In this Comment, I argue that current United States banking statutes and constitutional provisions are limiting the profitable array of Islamic banking models that may help ease the current financial crisis, and that financial regulators in the United States should look to the British banking model to assess ways to capture the Islamic banking market. The main obstacles to Islamic banking in the United States are: (1) statutory, such as built-in double taxation on certain Islamic transactions, and (2) constitutional, such as possible First Amendment restrictions. The British have worked around these concerns, and I advocate analyzing their legal system.

The Comment is divided into several sections to explain why Islamic banking is a pressing issue in today's international arena. Section 2 of this Comment explores banking in the Islamic context and the specific principles that set Islamic banking apart from conventional banking. Section 3 elaborates on why the West—in particular, the United States—should take an interest in the way Islam does banking and finance. Section 4 outlines the current state of Islamic banking in the Western world with a focus on the United Kingdom and the United States. A short history of the Islamic Bank of Britain in the United Kingdom and the University Bank in the United States will be presented because of their pivotal roles in being the first Islamic checking institutions in their respective nations. Section 5 compares the two banking statutory regimes in effect in the United States and the United Kingdom and tries to explain why the British system is more conducive to Islamic banking than the American system. Next, Section 6 analyzes constitutional provisions in the United States that constrict the promotion of a banking system based on Islamic principles, a

---

<sup>14</sup> See, e.g., *IIBI and SII Join Forces to Promote the UK as Islamic Finance Hub*, NEW HORIZON: GLOBAL PERSPECTIVE ON ISLAMIC BANKING & INSURANCE Oct.-Dec. 2009, at 21 (describing how Islamic finance is flourishing in the United Kingdom as the nation prepares to become the next hub for finance in general, and in particular, for Islamic finance); Theodore Karasik et al., *Islamic Finance in a Global Context: Opportunities and Challenges*, 7 CHI. J. INT'L L. 379, 389 (2007) (stating that London is the second largest node of Islamic finance outside of the Middle East).

2011]

ARAB MONEY

1059

limitation that does not exist in the United Kingdom. Then, Section 7 presents a three-tiered solution based on successes in the United Kingdom that could open up the American banking system to Islamic financial products. Finally, concluding remarks will discuss the feasibility of the proposed solution and suggest new areas for economic growth.

## 2. THE FUNDAMENTALS OF ISLAMIC BANKING

### 2.1. *Role of Islam in Muslim Financial Affairs and Economics*

For many Muslims, religious codes derived from the Quran govern all aspects of their lives.<sup>15</sup> One Islamic law scholar, Wael Hallaq, defined Islam and Islamic law as:

[N]ot only the Muslim way of life, but also the entire culture and psyche of Muslims throughout fourteen centuries. Islamic law governed the Muslim's way of life in literally every detail, from political government to the sale of real property, from hunting to the etiquette of dining, from sexual relations to worship and prayer. It determined how Muslims conducted themselves in society and in their families; how they designed and ordered their cities and towns; and, in short, how they viewed themselves and the world around them. If Islamic civilization, culture, or state ever constituted a regime of any kind, it was one of

---

<sup>15</sup> See J. Michael Taylor, *Islamic Banking – The Feasibility of Establishing an Islamic Bank in the United States*, 40 AM. BUS. L.J. 385, 387 (2003) (“As an initial proposition, it should be understood that ‘religious laws in Islam govern all aspects of life.’”); see also NABIL A. SALEH, UNLAWFUL GAIN AND LEGITIMATE PROFIT IN ISLAMIC LAW: RIBA, GHARAR AND ISLAMIC BANKING 13 (Graham & Trotman, 2d ed. 1992) (quoting one author who refused to justify the Quran’s prohibition against *riba* because it was unnecessary “to put forth any intellectual arguments in support of the Quranic injunctions forbidding usury”). As the author explained:

[I]f Quranic theories come into conflict with the modern scientific theories, I find no reason to trouble my conscience. I firmly believe that the sciences of today may become the mythology of tomorrow and what Quran has said, we may not understand it today, but it is likely to become quite clear to us tomorrow.

*Id.*

nomocracy. There has never been a culture in human society so legally oriented as Islam.<sup>16</sup>

As seen above, Islam does not only provide guidelines for dress, diet, or demeanor, but also for economics. For instance, Islam directly forbids Muslims from engaging in activities involving *riba* (interest).<sup>17</sup>

Laws such as the one forbidding *riba* are extracted from Quranic text to form legal rules called *fiqh*.<sup>18</sup> *Fiqh* would be the right word for Islamic law as opposed to the term *shari'a* that has been popularized by politicians and the media. *Fiqh* is distinguished from *shari'a* by the fact that the latter is God's divine revelation and ineffable law, whereas *fiqh* is the human interpretation or extraction of God's divine will as expressed in the Quran and *hadith*,<sup>19</sup> but in the form of everyday manmade law.

Islamic law ties in with broader principles of Islam that require Muslims to live a God-conscious life. In the realm of economics, two Islamic finance scholars described *shari'a*-compliant finance, or more properly, *fiqh*-compliant finance, as "business with ethics."<sup>20</sup> This added dimension of equity makes even the most archetypal Western capitalism principles, such as wealth accumulation, slightly different in the Islamic economic context.<sup>21</sup>

For instance, one definition of Islamic economics is that it is "the methodology of how man uses resources and means of production to satisfy all his worldly needs, according to a

<sup>16</sup> Wael B. Hallaq, "Muslim Rage" and Islamic Law, 54 HASTINGS L.J. 1705, 1707 (2003).

<sup>17</sup> See, e.g., Barbara L. Seniawski, Note, *Riba Today: Social Equity, the Economy, and Doing Business Under Islamic Law*, 39 COLUM. J. TRANSNAT'L L. 701, 702 (2001) ("The concern to avoid *riba* is one of the defining characteristics of the discipline of Islamic economics . . .").

<sup>18</sup> See generally N. J. COULSON, A HISTORY OF ISLAMIC LAW (1979) (providing a detailed background and history of Islamic law).

<sup>19</sup> *Hadith* are normative statements by Islam's Prophet Muhammad (p.b.u.h.), "p.b.u.h." stands for "peace be upon him," a phrase used by Jews and Muslims to refer to certain deceased people of significant importance, such as prophets.

<sup>20</sup> See generally Yusuf Talal DeLorenzo & Michael McMillen, Joint Address at the National Council on U.S.-Arab Relations Conference: Islamic Finance and the Global Economic Crisis (Feb. 17, 2009) (providing an introductory overview of modern Islamic finance).

<sup>21</sup> See Taylor, *supra* note 15, at 386 (concluding that although they differ, "through innovation and regulatory flexibility, the possibility exists for establishing a *Shari'a*-compliant banking institution in the United States").

predetermined God-given code in order to achieve the greatest equity.”<sup>22</sup> From this definition, Muslims share five unique characteristics for their financial affairs:

1. Man, being an agent and not an original owner, is not a free agent in his exploitation of resources and must use methods and means within a framework given to him in the satisfaction of his economic means.
2. The guiding principle of economic activity is the overall good of society and nature (environmental).
3. Individual man, being part of the overall fabric, must be given consideration for his well being.
4. Equitable reward must be given to man according to his effort (to all according to their efforts, and from all according to their abilities).
5. Certain activities in the exploitation of resources, having over-all [sic] detrimental effects, are proscribed.<sup>23</sup>

From these principles, it is evident that Islam permits wealth accumulation, but through socially conscious means. This view most likely inspired the following restriction on *riba*.<sup>24</sup>

## 2.2. Prohibition of Riba

The Quran expressly prohibits *riba*,<sup>25</sup> which is loosely defined as “increase.”<sup>26</sup> It is difficult to provide a more definitive definition

<sup>22</sup> *Id.* at 387–88 (quoting His Royal Highness Prince Muhammad Al-Faisal Al-Saud, *Islam and the West: Towards a New International Economic Order* at UNESCO (Nov. 14, 1985)).

<sup>23</sup> *Id.* at 388.

<sup>24</sup> Although the prohibition of *riba* has become the centerpiece of Islamic economics, there is so much more to the field that is unfortunately outside the scope of this Comment, such as waste avoidance, consultative governance, and distributive justice. See generally M. A. Muqtedar Khan, *Mythology and Theology in Islamic Economics*, ISLAMIC HORIZONS, Sept./Oct. 2010, at 42–45 (arguing that while *riba* is indeed forbidden, the widespread assumption is that its absence is necessary in an “Islamic” economy, but this is puzzling because there is more to *riba* than interest — *riba* is all kinds of “excesses” or waste).

<sup>25</sup> See THE HOLY QURAN, *supra* note 1, II:274–81.

Those who (in charity) spend of their goods by night and by day, in secret and in public, have their reward with their Lord: on them shall be no fear, nor shall they grieve. Those who devour usury will not stand

of *riba* because the four schools of Islamic thought argue over its precise meaning.<sup>27</sup> Regardless, *riba* has a profoundly deeper meaning than surface translations of usury, interest, or unlawful advantage.<sup>28</sup> There is also a strong ethical foundation that is linked to a major principle in Islamic finance: one cannot get something for nothing.

---

except as stand one whom the Evil One by his touch Hath driven to madness. That is because they say: "Trade is like usury," but God hath permitted trade and forbidden usury. Those who after receiving direction from their Lord, desist, shall be pardoned for the past; their case is for God (to judge); but those who repeat (the offense) are Companions of the Fire: They will Abide therein (for ever). God will deprive usury of all blessing, but will give increase for deeds of charity: For He loveth not creatures ungrateful and wicked. Those who believe, and do deeds of righteousness, and establish regular prayers and regular charity, will have their reward with their Lord: on them shall be no fear, nor shall they grieve. O ye who believe! Fear God, and give up what remains of your demand for usury, if ye are indeed believers. If ye do it not, take notice of war from God and His Apostle: But if ye turn back, ye shall have your capital sums: Deal not unjustly, and ye shall not be dealt with unjustly. If the debtor is in a difficulty, grant him time till it is easy for him to repay. But if ye remit it by way of charity, that is best for you if ye only knew. And fear the Day when ye shall be brought back to God. Then shall every soul be paid what it earned, and none shall be dealt with unjustly.

*Id.*

<sup>26</sup> See Atif Raza Khan, *Training Islamic Bankers: Back To Basics On Islamic Finance For The Uninitiated*, in ISLAMIC RETAIL BANKING AND FINANCE: GLOBAL CHALLENGES AND OPPORTUNITIES 205, 206 (Sohail Jaffer ed., 2005) (stating that in Arabic, *riba* refers to "increase" or "addition"); REINHARD LEOPOLD KLARMANN, ISLAMIC PROJECT FINANCE: A LEGAL STUDY WITH PARTICULAR REFERENCE TO THE LAWS OF SWITZERLAND AND THE UNITED ARAB EMIRATES 38-39 (Schulthess Medias Juridiques 2003) (describing the complexity behind the meaning of *riba*).

<sup>27</sup> See KLARMANN, *supra* note 26 (describing the complexity of the definition of the term). For another definition of *riba*, see SALEH, *supra* note 15, at 16.

[Riba is] an unlawful gain derived from the quantitative inequality of the counter-values in any transaction purporting to effect the exchange of two or more species (*anwa'*, sing. *naw'*), which belong to the same genus (*jins*) and are governed by the same efficient cause (*'illa*, pl. *'ilal*). Deferred completion of the exchange of such species, or even of species which belong to different genera but are governed by the same *'illa*, is also *riba*, whether or not the deferment is accompanied by an increase in any one of the exchanged counter-values.

*Id.*

<sup>28</sup> See SALEH, *supra* note 15, at 12-15 (stating that only by understanding the intricacies of the Arabic language can *riba*'s true definition be understood).

From this basic principle, there are three types of *riba* that are prohibited: (1) *riba jahiliyya* (pre-Islamic usury), (2) *riba tafadul* (usury by excess), and (3) *riba nasi'a* (usury by delay).<sup>29</sup> The first type of *riba* occurred in pre-Islamic Arabia when pagans would exploit the poor and reap excessive gains from interest charged on loans by doubling or multiplying the interest rate when the borrower defaulted.<sup>30</sup> The second type of *riba* is explained in a *hadith* transmitted by Ubada ibn al-Samit who said, "I heard the Messenger of Allah (p.b.u.h.) prohibiting the sale of gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, salt for salt, except through equal measure and immediate exchange. Thus, one who increases or causes to be increased has taken *riba*."<sup>31</sup> This *hadith* is explicit in saying that one cannot receive in excess of what one gives. Thus, according to some scholars, if one loans \$100, one is only entitled to \$100, not \$100 plus some interest, or extra, which is prohibited.<sup>32</sup> The final type of *riba* is explained in a *hadith* narrated by Umar ibn al-Khattab who said, "The Messenger of Allah (p.b.u.h.) said, 'Gold for gold is *riba* except from hand to hand (when exchanged immediately), wheat for wheat is *riba* except from hand to hand, dates for dates is *riba* except from hand to hand, barley for barley is *riba* except from hand to hand.'"<sup>33</sup> This *hadith* expressly states that species that are

<sup>29</sup> See 2 IBN RUSHD, THE DISTINGUISHED JURIST'S PRIMER 158-59 (Imran Ahsan Khan Nyazee trans., 1996) (providing an initial overview of the types of *riba* before going into detail on each type).

<sup>30</sup> See KLARMANN, *supra* note 26, at 42 (detailing that the Quran's prohibition of *riba* applies to transactions with both Muslims and non-Muslims alike). For a further description of *riba jahiliyya*, see FRANK VOGEL & SAMUEL L. HAYES, ISLAMIC LAW AND FINANCE: RELIGION, RISK AND RETURN 72-73 (1998) (describing the *riba al-jahilliyya*, and stating that commentators describe it as a "pre-Islamic practice of extending delay to debtors in return for an increase in the principal").

<sup>31</sup> See RUSHD, *supra* note 29 (noting that only Ibn Abbas narrates a slightly different transmission).

<sup>32</sup> The scholars who believe this state that gold and silver represent the broader species of monetary items, and so paper currency would also fall under this species. *But see* Haider Ala Hamoudi, *Muhammad's Social Justice or Muslim Cant? Langdellism and the Failures of Islamic Finance*, 40 CORNELL INT'L L.J. 89, 110-14 (2007) (arguing that Islamic Langellian modalities or formalism linked to such *hadith* is stifling innovation in Islamic finance, and, therefore, such *hadith* should be abandoned so Islamic commerce can flourish).

<sup>33</sup> See RUSHD, *supra* note 29 (stating that this is the best known transmission of this *hadith*).

not exchanged immediately, but after a delay, will be considered *riba*.

The most prominent reasoning behind these prohibitions is that it (1) ensures fairness in transactions, and (2) prevents extravagant transactions.<sup>34</sup> These two ethical considerations are more a means to regulate transactions, not prohibit them. Thus, the prohibition against *riba*, most prominently understood as money for money, does not mean that money cannot be lent under Islamic law.<sup>35</sup> Instead, it merely means that unearned profit, or profit without expected, normal business risk, is forbidden.<sup>36</sup>

This view stands against the West's primary characteristic of credit, which hinges on the concept of time.<sup>37</sup> Under this model, the lender is taking on risk as a function of time due to products losing demand over time, weather-damaged crops, or money losing value through inflation and so forth.<sup>38</sup> These elements of risk lead the lender to require remuneration or a fixed return for his money.<sup>39</sup> This rent is normally calculated by the debtor according to fluctuations in the supply and demand curve for capital.<sup>40</sup> Muslim jurists consider this fixed remuneration unlawful, and believe it permits the rich to systematically exploit

<sup>34</sup> See RUSHD, *supra* note 29, at 162 (setting forth the Hanafi reasoning); cf. Haider Ali Hamoudi, *Jurisprudential Schizophrenia: On Form and Function in Islamic Finance*, 7 CHI. J. INT'L L. 605, 607 (2007) (arguing instead that only this reasoning is important for the development of Islamic financial laws, not the stringent rules derived from this reasoning, because functionalism should triumph over formalism in Islamic finance).

<sup>35</sup> See Taylor, *supra* note 15, at 391 ("The prohibition of *riba* does not mean that money may not be lent under Islamic law; the prohibition simply forbids unearned profit . . .").

<sup>36</sup> See *id.* (stating that the prohibition, in other words, applies to "profit without expected, normal business risk").

<sup>37</sup> See, e.g., NAYLA COMAIR-OBEID, *THE LAW OF BUSINESS CONTRACTS IN THE ARAB MIDDLE EAST* 54 (1996) (comparing characteristics of Western finance to Islamic finance).

<sup>38</sup> See *id.* ("In Western law, the characteristic element of credit is the time factor, because of which the lender is taking on a risk, due to products once in demand going out of fashion, crops being damaged by bad weather, and money losing value through inflation and so forth.").

<sup>39</sup> See *id.* ("This element of risk therefore leads the lender to require a certain remuneration").

<sup>40</sup> See *id.* (stating that this remuneration, "a rent for his money, is generally strictly calculated by the debtor, sometimes given more generously, all depending on the law of supply and demand").

2011]

ARAB MONEY

1065

the poor and, hence, Muslims are forbidden from charging or receiving interest from anyone, including non-Muslims.<sup>41</sup>

This prohibition against interest is not an alien concept to the West, but a well-rooted principle in Jewish and Christian religious texts. According to the Old Testament, Jews were at least prohibited from charging interest to their co-religionists.<sup>42</sup> In addition, until two hundred years ago, early Christians, like Muslims today, were forbidden from dealing in interest with anyone.<sup>43</sup> These Judeo-Christian principles, along with others, have shaped much of the West and the United States,<sup>44</sup> even though the United States is a secular country. Thus, these similarities should help close the gap. These similarities would also explain the increasing popularity of Islamic finance among non-Muslim consumers. Both sides are working together to search

---

<sup>41</sup> See *id.* (stating that, according to Muslim moralists, this remuneration constitutes "that usury which permits the rich to systematically exploit the poor," and that it is in the name of this morality that Islam forbids any operation of credit relating to speculation); see also SALEH, *supra* note 15, at 39–41 (explaining the views of the different schools of thought on *riba* transactions between Muslims and non-Muslims, and stating that the majority of schools still hold such transactions as unlawful).

<sup>42</sup> See *Deuteronomy* 23:19–20 (King James) ("Thou shalt not lend upon usury to thy brother; usury of money, usury of victuals, usury of anything that is lent upon usury. Unto a stranger thou mayest lend upon usury; but unto thy brother thou shalt not lend upon usury: that the LORD thy God may bless thee in all that thou settest thine hand to in the land whither thou goest to possess it.").

<sup>43</sup> See *Luke* 6:34–35 (King James) ("And if ye lend to them of whom ye hope to receive, what thank have ye? For sinners also lend to sinners, to receive as much again. But love ye your enemies, and do good, and lend, hoping for nothing again; and your reward shall be great, and ye shall be the children of the Highest: for He is kind unto the unthankful and to the evil."). St. Thomas Aquinas firmly held this belief but modern Western Christian majority states still conduct commerce with interest. See KLARMANN, *supra* note 26, at 41 (stating that the justification for the prohibition of interest by the Christians was "founded on Aristotle's theory of the 'barren' nature of money" and was elaborated by schoolmen and St. Thomas Aquinas in particular, but that "in modern-day Western states, interest-taking is a fully accepted, but nevertheless regulated commercial practice").

<sup>44</sup> Christianity's influence on U.S. law has many roots. For example, for the United States' long history of prayer and Bible reading in public schools, see *Engel v. Vitale*, 370 U.S. 421 (1962) (ruling that it is unconstitutional for state officials to compose an official school prayer and require its recitation in public schools). For the United States' long-held view that marriage is defined as between a man and woman, effectively banning gay marriage, see *Defense of Marriage Act*, 1 U.S.C. § 7 (2010) (stating that "the word 'marriage' means only a legal union between one man and one woman as husband and wife").

for new ways to conduct commerce. This drive has given birth to the modern Islamic finance sector.<sup>45</sup>

### 2.3. History of the Modern Islamic Finance Movement

Modern Islamic finance is a young, half-century-old phenomenon. It began in 1963 in Egypt under Ahmad El Najjar who set up an Islamic bank under the guise of a savings bank so as not to upset the secular Egyptian government.<sup>46</sup> Out of this secrecy, the Nasir Social Bank emerged in 1971.<sup>47</sup> As British colonialism receded and Muslim countries sought self-identification, the Philippine Amanah Bank was established in 1973, the Dubai Islamic Bank in 1975, the Faisal Islamic Bank of Egypt in 1977, the Faisal Islamic Bank of Sudan in 1977, the Bahrain Islamic Bank in 1979, and the Malaysian Muslim Pilgrims Savings Corporation in 1983.<sup>48</sup> Later, Iran and Pakistan also established Islamic banks.<sup>49</sup>

This global fever soon reached the West when Luxemburg created the Islamic Banking Systems, now called the Islamic Finance House in 1978.<sup>50</sup> The Islamic Bank International (Copenhagen), Islamic Investment Company (Melbourne), and the Citi Islamic Investment Bank (Bahrain) followed suit.<sup>51</sup> This trend has taken much longer to reach the United States, and the reasons

<sup>45</sup> See KLARMANN, *supra* note 26, at 37 ("It is in particular the elements of *riba* and *gharar* which attribute a *raison d'être* to Islamic finance.").

<sup>46</sup> See Rehman, *supra* note 9, at 637 (stating that one "can trace the modern (post-World War II) origins of Islamic banking" to Egypt in 1963).

<sup>47</sup> See *id.* ("Eventually, Islamic banking came out from under the cloak of secrecy in Egypt in the form of the Nasir Social Bank (an interest-free commercial bank) in 1971.").

<sup>48</sup> *Id.* at 638 (explaining that after British colonialism, many Middle Eastern countries chose to link themselves to Islam which, coupled with oil money, inspired Islamic banks).

<sup>49</sup> See *id.* at 639 (stating that "Iran switched to Islamic banking in August 1983" and "Pakistan opted for a gradual 'Islamization' process of its financial system").

<sup>50</sup> See *id.* ("[T]he first attempt at Islamic banking was initiated in Luxembourg with the creation of the Islamic Banking System (renamed Islamic Finance House).").

<sup>51</sup> See *id.* (stating that Islamic banking systems were soon created in other countries "including the Islamic International Bank (Copenhagen), Islamic Investment Company (Melbourne), and more recently, Citi Islamic Investment Bank (Bahrain)").

for this lag will be discussed in Sections 5 and 6, *infra*. Today, there are over three hundred Islamic financial institutions in seventy-five countries, one-fourth of which operate in countries with non-Muslim majority populations.<sup>52</sup>

#### 2.4. Modern Islamic Financial Instruments

Currently, most Islamic financial institutions employ financial instruments serving the same function as Western financial instruments but without interest.<sup>53</sup> Interest-based financing would constitute a grave offense to *shari'a*'s prohibition of *riba*.<sup>54</sup> To ensure compliance with *shari'a*, a bank works alongside a *shari'a* supervisory board ("SSB") of religious scholars to review financial transactions.<sup>55</sup> Often, bankers present questions to the SSB, which then passes a *fatwa* interpreting Islamic law for the bankers.<sup>56</sup> A *fatwa* is a nonbinding legal opinion, the equivalent of a U.S. law professor's legal commentary on an issue.

Through the SSBs and a trial-and-error process, Islamic banks have come to employ several techniques for doing business, the most popular of which are *murabaha*, *ijara*, *musharaka*, and *mudaraba*.<sup>57</sup> Only the first two tools mimic Western forms of financing, but all of them avoid *riba* and reward lenders for risk sharing.<sup>58</sup>

<sup>52</sup> See *id.* at 641 (quantifying the phenomenon of Islamic finance).

<sup>53</sup> See Klarmann, *supra* note 26, at 37 ("The fear of sinning by taking *riba* drives a significant part of the . . . Islamic finance sector . . .").

<sup>54</sup> See *id.* (noting that modern project finance usually involves interest-based forms of financing).

<sup>55</sup> See Taylor, *supra* note 15, at 394 ("[An] important aspect of the Islamic banking movement is the implementation of a system to insure that the actions of Islamic banking institutions comply with *Shari'a*. In practice, the business side of a bank works in tandem with a supervisory board of religious advisors to review proposed financial transactions.").

<sup>56</sup> See *id.* ("[W]hen confronted with a novel question, the banker presents a question to the *Shari'a* Board and a *fatwa*, or statement of guidance interpreting Islamic law, is returned.").

<sup>57</sup> See *id.* at 394–99 (describing the different Islamic business techniques in detail).

<sup>58</sup> See Chian Wu, Note, *Islamic Banking: Signs of Sustainable Growth*, 16 MINN. J. INT'L L. 233, 233–34 (2007) (exploring the feasibility of interest-free Islamic finance in a global market that is dominated by interest-bearing transactions).

#### 2.4.1. *Murabaha* ("Cost-Plus" Basis Financing)

*Murabaha* is a sale contract that is used to finance goods.<sup>59</sup> Here, a customer requests a bank to purchase a good on its behalf.<sup>60</sup> After the bank purchases the good, the bank resells it to the customer for the cost plus a profit, hence "cost-plus basis."<sup>61</sup>

This profit margin is not considered interest because the financial institution actually owns the good before transferring title to the customer.<sup>62</sup> Temporary ownership carries risk because the customer could theoretically refuse to accept the good and the bank would have to find another buyer, and thus justifies a profit.<sup>63</sup> The bank also bears the risks associated with the cost of possible storage, marketing, and overhead.<sup>64</sup> Theoretically, *murabaha* would only be available to trusted customers or those that provide collateral.<sup>65</sup> In practice however, it accounts for nearly ninety percent of most Islamic banks' business because of synthetic *murabaha* transactions and *tawarooq*, both of which offer short-term financing.<sup>66</sup> Short-term financing is critical to the Islamic financial

<sup>59</sup> See Taylor, *supra* note 15, at 395 (explaining that the "*murabaha*, although typically used as a finance method, is 'actually a sale contract'").

<sup>60</sup> See *id.* ("[T]he financial institution acts as a middle-man and purchases a good requested by its customer. . .").

<sup>61</sup> See *id.* (transposing the Arabic term with its functional equivalent in Western finance).

<sup>62</sup> See *id.* ("A key component of *murabaha* financing is the requirement that the financial institution actually own the good before transferring title to its customer.").

<sup>63</sup> See *id.* (explaining that the *murabaha* requirement is necessary "because the financial institution assumes some risk to justify its profit . . . [while] the customer could always refuse to accept the good . . . causing the financial institution to find an alternative buyer").

<sup>64</sup> See *id.* at 395-96 (stating that if the customer rejects the good, the financial institution bears the additional costs of storage, marketing, and overhead).

<sup>65</sup> See *id.* at 396 ("[M]*urabaha* financing is available to trusted customers of a financial institution and to those that provide some form of guarantee or collateral." (footnotes omitted)).

<sup>66</sup> See Wu, *supra* note 58, at 257 (stating that Islamic banks have "a tendency to concentrate on short-term financing with *murabaha* transactions accounting for nearly ninety percent of an Islamic bank's total business"). The reason for the high use of *murabaha* financing is because practitioners in the field have developed an exception to *murabaha* called *tawarooq*, or commodity *murabaha*, that makes a *murabaha* more feasible by providing for more liquidity. Nabil A. Issa & Patrick F. Campos, *Challenges in Structuring Non-Recourse Islamic Financing for Energy Projects in Saudi Arabia*, 2 TEX. J. OIL GAS & ENERGY L. 452, 455 (2007) (explaining the challenges faced by lenders looking to finance energy projects consistent with

2011]

ARAB MONEY

1069

industry because the industry suffers from proportionately higher liquidity risk.

#### 2.4.2. *Ijara* (Lease Financing)

*Ijara* is another common financing tool that is used for leasing.<sup>67</sup> The bank purchases an asset, usually equipment, and leases it to a client.<sup>68</sup> Thus, the bank owns the asset throughout the lease period while the customer pays a fixed rental fee.<sup>69</sup> Like conventional leases, most *ijara* contracts allow the customer to purchase the asset either during or at the end of the lease.<sup>70</sup> Under an ideal *ijara* contract, the customer is not required to purchase the asset, but in practice may be forced to do so due to the bank's pre-stipulated put options.

*Ijara* is fairly similar to conventional leases; there are only three differences.<sup>71</sup> First, an *ijara* commences the day the asset is delivered to the customer, not the day the contract is signed.<sup>72</sup> Second, the lessee is theoretically not liable for the full rent if the asset is destroyed because the bank bears the risk of destruction. In practice, however, the bank takes out insurance on the asset and factors the cost of insurance into the fixed rent.<sup>73</sup> Third, the lessee is technically not required to purchase the asset at the end, but may

---

shari'a law). However, *tawarooq* is often criticized by certain Islamic financial institutions as not *shari'a*-compliant. *Id.* Thus, practitioners have also developed *bai al ajals*, which is a purchase over time using installment payments, as a means to satisfy more stringent Islamic financial institutions. See Nabil A. Issa & Leroy Levy, *Challenges in Structuring Non-Recourse Financing for Energy Projects in Saudi Arabia*, ISLAMIC FINANCE NEWS, 2010, at 46 (stating that there is growing use of *Bai al Ajals*).

<sup>67</sup> See Wu, *supra* note 58, at 239 ("*Ijara wa-iqtina'* is another commonly used financing tool . . ."); Taylor, *supra* note 15, at 397 (describing an *ijara* and comparing it to other leasing arrangements).

<sup>68</sup> See Taylor, *supra* note 15, at 397 (stating that an *ijara* requires a financial institution to purchase an asset and leases it to a client).

<sup>69</sup> See Wu, *supra* note 58, at 239 ("[T]he user of the asset pays a fixed price for the benefit of using the asset.").

<sup>70</sup> See Taylor, *supra* note 15, at 397 (explaining that the customer may purchase the asset either during or at the end of the lease period, but is not required to do so).

<sup>71</sup> See *id.* (listing several differences between Islamic financial instruments and their Western counterparts).

<sup>72</sup> *Id.*

<sup>73</sup> *Id.*

1070

U. Pa. J. Int'l L.

[Vol. 32:4]

be forced to purchase if the bank exercises its put option, which is now a common provision in *ijara* contracts.<sup>74</sup> Because of this provision, an *ijara* is often used to finance homes.

#### 2.4.3. Musharaka (Partnership Arrangement)

A third common investment activity is a *musharaka*, analogous to a typical Western general partnership agreement.<sup>75</sup> Here, the investor and entrepreneur engage in joint profit sharing and decision-making powers.<sup>76</sup> Both parties must provide capital and sweat equity in the form of management efforts and "know-how." Banks can also use a *musharaka* to enter into profit-and-loss-sharing schemes based on a formula agreed upon before the transaction commences.<sup>77</sup> Furthermore, borrowers can buy out lenders using diminishing *musharaka* contracts wherein the lender would gain a greater percentage of ownership over the property, project, or asset, with each payment.<sup>78</sup>

#### 2.4.4. Mudaraba (Venture Capitalism)

Finally, there is *mudaraba*, which is essentially a venture capital transaction.<sup>79</sup> Here, the entrepreneur provides the labor and sweat equity in terms of "know-how," and the bank or investor provides the capital.<sup>80</sup> Unlike *musharaka*, the entrepreneur does not have to provide capital.<sup>81</sup> "The investor shares in the profit earned by the entrepreneur while his losses are limited to his capital investment."<sup>82</sup> *Mudaraba* is accepted because it was a common

---

<sup>74</sup> *Id.*

<sup>75</sup> *See id.* (describing the *musharaka*).

<sup>76</sup> *See id.* ("[T]he financial institution and customer will proportionately share in profits and losses in accordance with a formula agreed upon before the transaction is consummated.").

<sup>77</sup> *Id.*

<sup>78</sup> *See* Issa & Levy, *supra* note 66 (describing how diminishing *musharaka* contracts can be used to buyout lenders).

<sup>79</sup> *See* Wu, *supra* note 58, at 238 ("*Mudaraba* is one form of financing equivalent to venture capitalism.").

<sup>80</sup> *See id.* ("*Mudaraba* allows the entrepreneur who provides the labor, skills, experience and effort to make use of an investor's capital.").

<sup>81</sup> *See id.*

<sup>82</sup> *Id.*

practice that was approved during the Prophet Muhammad's (p.b.u.h.) time.<sup>83</sup>

Like traditional venture capitalism, this is a high-risk mode of financing, and so banks must scrutinize every project, performing credit analyses and risk assessments.<sup>84</sup> Because of the risk aspect of *mudaraba*, and in part due to capital requirements, it only accounts for less than ten percent of worldwide Islamic banking operations.<sup>85</sup>

### 2.5. Three Islamic Banking Models

Islamic jurists have not reached a consensus on the proper form of an Islamic bank.<sup>86</sup> Three models have emerged: (1) the two-tier silent partnership model, (2) the agency-guaranty model, and (3) the mutuality shareholder model.

Unlike conventional commercial banks that envision a lender-borrower relationship between the depositor and a loan-based commercial bank, the first model utilizes a profit-and-loss-sharing mechanism through a two-tier silent partnership (*mudaraba*).<sup>87</sup> The depositors are viewed as principals (silent partners) who extend money to an Islamic bank that is the entrepreneur or investment agent.<sup>88</sup> "The Islamic bank would thus invest the funds on the principals' behalf, in exchange for a share in profits."<sup>89</sup> The bank could then either use that money to invest directly or also act as another principal in a second investment agency contract with a

---

<sup>83</sup> See *id.* (*mudaraba* was the central form of financing trade caravans during the Prophet Muhammad's (p.b.u.h.) era).

<sup>84</sup> Taylor, *supra* note 15, at 398 ("[A]s with traditional venture capitalism . . . a financial institution must use 'extraordinary efforts to carefully scrutinize [the] feasibility and projections' provided by the customer . . .").

<sup>85</sup> *Id.*

<sup>86</sup> See MAHMOUD A. EL-GAMAL, *ISLAMIC FINANCE: LAW, ECONOMICS, AND PRACTICE* 139, 143, 160 (Cambridge University Press 2006) (explaining that Islamic jurists at Al-Azhar in Egypt, judges in Pakistan, and other institutions issue conflicting *fatwas* on the proper form of an Islamic bank).

<sup>87</sup> See *id.* at 138 ("At its inception, Islamic banking was theoretically conceived based on the principle of profit and loss sharing through two-tier silent partnership (*mudaraba*) . . .").

<sup>88</sup> See *id.* (stating that those who provide funds are viewed as principals or silent partners who extend their funds to an Islamic bank, the entrepreneur or investment agent).

<sup>89</sup> *Id.*

customer who is looking for a loan.<sup>90</sup> Because two levels of partnership exist here, this is called the two-tier silent partnership. This model most closely resembles a mutual fund.<sup>91</sup>

The second model envisions the depositor not as a principal, but as an investor who seeks to finance the various activities of bank customers.<sup>92</sup> In this model, the bank acts as an intermediary agent (*wakala*) and guarantor (*kafala*) of the parties.<sup>93</sup> Because the bank now serves only an agent function for both parties, it can provide third-party guaranty for the debtor-customers' liabilities. Therefore, some Muslim jurists consider predetermined profits permissible under this model.<sup>94</sup> However, most jurists reject this form of banking.<sup>95</sup>

The final alternative model is the mutuality shareholder model. Here, depositors are viewed as equal shareholders of the Islamic bank.<sup>96</sup> This sets up a mutual bank wherein managers have an incentive to hold less risky investment portfolios and provide low-risk, low-return investments for their customers who are the shareholders.<sup>97</sup> This model is analogous to mutual savings banks in the United States, which are often associated with nonprofit organizations that seek to avoid usury, like churches.<sup>98</sup> Although

---

<sup>90</sup> See *id.* (explaining the ways Islamic banks can use funds).

<sup>91</sup> See *id.* at 178 (stating that, in "the early days of Islamic economics . . . an Islamic bank was envisioned as a mutual-fund-like two-tier *mudaraba*").

<sup>92</sup> See *id.* at 156-57 ("Consider the depositors themselves as investors who finance the various activities of the bank customers and the bank itself acting merely as an intermediary agent and guarantor of the financed parties.").

<sup>93</sup> See *id.* at 160 (explaining that *wakala* and *kafala* play two distinctive roles in Islamic financial transactions).

<sup>94</sup> See *id.* (stating that it is important to "ensure that the guarantor may not collect fees for offering guaranty, although it is allowed to collect enough fees to cover clerical costs associated with it . . . the collection of agency fees, however, is accepted unequivocally").

<sup>95</sup> See *id.* (describing that contemporary jurists who are active in Islamic finance do not approve of this banking model, namely, the combination of agency and guaranty).

<sup>96</sup> See *id.* (stating that in the agency model of mutuality, the depositors are, in fact, shareholders of the Islamic bank).

<sup>97</sup> See *id.* at 173 (that research confirms the low-risk nature of mutuality as well as an operational efficiency rating equal to their stockholder-owned counterparts).

<sup>98</sup> See *id.* (discussing the important features of mutual banks and stating that there is no secular reason to question the economic merits of mutualization of

2011]

ARAB MONEY

1073

this Islamic banking model is not as prevalent, it has the greatest potential to gain footing in the United States.<sup>99</sup> In conclusion, Islamic banks use the above techniques to provide financial services for their clients.

### 3. WHY SHOULD THE UNITED STATES BE INTERESTED IN ISLAMIC BANKING?

There are five reasons why the United States should be interested in expanding domestic Islamic banking operations. First, the sector is growing at an unprecedented rate and should be regulated. Second, attracting foreign capital would be beneficial for a national economy recently dislocated by a global credit crisis. Third, banking unbanked religious citizens in the United States would add further capital reserves into the banking system. Fourth, providing choices and alternatives for consumers has a beneficial effect on the U.S. economy. Finally, there are potential foreign policy benefits for openly welcoming and recognizing a new form of finance that originated from the Muslim world.

#### 3.1. *Growth in the Islamic Finance Sector*

Islamic finance and banking is a growth industry with an annual projected growth rate exceeding fifteen percent.<sup>100</sup> In 2009 alone, the assets of the world's top 500 Islamic banks rose 28.6 percent to more than \$822 billion,<sup>101</sup> compared to world GDP

---

Islamic banks, and that mutual banking institutions have played an important role in the development of the U.S. financial system).

<sup>99</sup> See Taylor, *supra* note 15, at 413 (describes how this model of Islamic banking would be successful in the United States because it already fits into existing U.S. banking forms, such as a commercial bank, savings association or credit union).

<sup>100</sup> See Rehman, *supra* note 9, at 640 (discussing the rapid growth of Islamic banking while cautioning that Islamic banking represents only a small fraction of the global financial market).

<sup>101</sup> See Soren Billing, *Double Digit Growth for Islamic Banking Assets in 2009*, ARABIANBUSINESS.COM, Nov. 5, 2009, <http://www.arabianbusiness.com/572616-double-digit-growth-for-islamic-banking-assets-in-2009> (comparing the 28.6 percent growth of Islamic banks to the meager 6.8 percent annual asset growth of the world's conventional banks).

growth of nearly zero percent.<sup>102</sup> By the end of 2010, the industry potentially crossed the \$1 trillion mark and continues to grow.<sup>103</sup>

While the above figures may appear impressive, the Islamic finance industry lacks depth compared to the finance industry as a whole. Relative to just one large private bank, UBS, whose total assets in 2008 were worth \$1.9 trillion,<sup>104</sup> the entire global asset pool of Islamic banks is only half that figure. Although the Islamic banking market is relatively small, there is tremendous growth potential in the coming years, which should appeal to the United States. Thus, the United States may want to consider incentivizing and regulating the industry.

### 3.2. Attract Foreign Capital

Second, from a macroeconomic viewpoint, the United States will likely be interested in attracting Gulf-based capital that has built up since 2004 due to bullish oil markets.<sup>105</sup> Such capital would provide further liquidity to U.S. markets, which have faced a credit crisis since 2007.<sup>106</sup> One way to create capital inflows from this sector post 9/11 is to be more accommodating to Islamic finance. Currently, the United Kingdom has captured some of this liquidity by supplying Middle Eastern investors with *shari'a*-compliant financial assets that pique their investment appetite.<sup>107</sup>

<sup>102</sup> See World Bank, 2009 WORLD DEVELOPMENT INDICATORS, THE WORLD BANK, at 1 ("Most forecasts show world GDP growth slowing to near zero or negative values, after a 3.4 percent increase in 2008.").

<sup>103</sup> See AGENCE FRANCE PRESSE, *Islamic Finance Assets May Top One Trillion Dollars*, DAILY NEWS & ECON. REV., June 14, 2010, <http://www.hurriyetdailynews.com/n.php?n=islamic-finance-assets-may-top-one-trillion-dollars-2010-06-14> ("Islamic finance will likely outpace mainstream banks and top \$1 trillion in total assets this year . . .").

<sup>104</sup> UNITED BANK OF SWITZERLAND, QUARTERLY REPORT (FORM 6-K) 16 (Nov. 3, 2009).

<sup>105</sup> See Abdi Shayesteh, *Islamic Banks in the United States: Breaking Through the Barriers*, 171 New Horizon 1, 1 (2009), available at <http://www.kslaw.com/people/pdffbio?id=330374> ("[T]he United States, like other western countries, has every interest in attracting Gulf-based capital that has built up over the last five years due to the bullish oil market.").

<sup>106</sup> See, e.g., Sean T. Seelinger, *Auction-Rate Securities: A Fast & Furious Fall*, 13 N.C. BANKING INST. 287, 295 (2009) (providing a history of the recent financial crisis and how it led to the disastrous Auction Rate Securities failure in February 2008).

<sup>107</sup> See MICHAEL AINLEY ET AL., ISLAMIC FINANCE IN THE UK: REGULATION AND CHALLENGES, FINANCIAL SERVICES AUTHORITY 7-8 (2007) (explaining that excess

2011]

ARAB MONEY

1075

For instance, recently, two Kuwaiti financial institutions acquired Aston Martin, a British luxury sports car manufacturer, through *shari'a*-compliant financing.<sup>108</sup> Only one company in the United States has significantly tapped into this liquidity – General Electric, and they did it through Malaysian markets.<sup>109</sup>

### 3.3. *Start Banking the Unbanked*

Third, from a microeconomic perspective, U.S. regulators and policy leaders should be interested in Islamic banking because it could serve as a means to provide banking services to unbanked populations.<sup>110</sup> For instance, many Muslims in the United States do not bank at a conventional bank because they believe doing so violates their religious values.<sup>111</sup> For adherents, this mindset arises from the belief that Islam is a way of life that touches all aspects of an individual's life. Thus, it is important for many Muslims to ensure that their finances align with their religious values.

Like their counterparts in the United Kingdom, there is likely an equally high percentage of the Muslim population that puts a premium on *shari'a* compliance, causing them to refuse to participate in conventional banking systems, or demand new banking options. As explained in Section 4, *infra*, although there are some options available in the United States, not all Muslim

---

liquidity in the Middle East has resulted in a surge in demand for Islamic assets in the countries of the Gulf region, and that this demand was “quickly identified by Islamic and conventional institutions that now provide a channel through which assets within other markets are sold . . . by way of Sharia-compliant transactions”).

<sup>108</sup> See *id.* at 8 (“A recent example is the acquisition of Aston Martin by two Kuwaiti financial institutions, using Sharia-compliant financing.”).

<sup>109</sup> See Joanna Slater & Kate Haywood, *GE Enters Market for Islamic Bonds*, WALL ST. J., Nov. 20, 2009, at C4 (noting that in November 2009, GE Capital became the first major U.S. company to sell *sukuk* – which are fractional undivided interests in an asset that some equate to as Islamic bond). GE Capital sold a five-year, \$500 million *sukuk*, exemplifying the continuing strength of the Islamic finance sector despite worldwide economic stagnation.

<sup>110</sup> See Shayesteh, *supra* note 105, at 1 (explaining that U.S. regulatory involvement with Islamic banks or banks that offer Islamic products or services would be viewed as a method of enhancing community development activities in unbanked markets).

<sup>111</sup> *Id.* (explaining why Muslims in the U.S. remain an untapped market for banks).

Americans have access to these options because of Islamic Banks geographic limitations.

In addition, although the size of the unbanked Muslim population is unknown, its monetary contributions may be significant because Muslim Americans, even as a small minority group, earn a disproportionately high income as professionals compared to the national average.<sup>112</sup> Thus, capturing this population could be beneficial from a financial standpoint, and as a means for the government to provide services that could enhance community development outreach activities with Muslim Americans who are becoming marginalized due to increasing adversarial politics.<sup>113</sup>

#### 3.4. Benefits of Choice

Fourth, Islamic finance could provide an alternative financial product for all consumers in the United States. It might be popular, because as it stands, half the customer base of some Islamic banks is already non-Muslim.<sup>114</sup> Interest-free Islamic banks may even be appealing for American citizens who no longer trust conventional financial institutions. In addition, interest-free banking may appeal to Jews and Christians in the United States who strictly follow their religious scriptures.

<sup>112</sup> See *Muslims American Demographic Facts*, ALLIED MEDIA CORP. (2009), <http://www.allied-media.com/AM/> (explaining that the U.S. average income in 2000 was \$42,158 per year, whereas 66% of American Muslim households earned over \$50,000 a year and 26% of American Muslim's earned over \$100,000 a year).

<sup>113</sup> See generally Shayesteh, *supra* note 105 (postulating that community development and outreach are key interests of the United States). Compare William Dalrymple, Op-Ed., *The Muslims in the Middle*, N.Y. TIMES, Aug. 17, 2010, at A27 (citing efforts by groups to connect Americans and the Muslim community), with N.R. Kleinfield, *Rider Asks if Cabdriver Is Muslim, Then Stabs Him*, N.Y. TIMES, Aug. 26, 2010, at A19 (describing a young man driven by fear-mongering politics to stab an innocent Muslim taxi driver and thus creating further division between the two communities).

<sup>114</sup> See Assif Shameen, *Islamic Banks: A Novelty No Longer*, BUSINESS WEEK, Aug. 8, 2005, [http://www.businessweek.com/magazine/content/05\\_32/b3946141\\_mz035.htm](http://www.businessweek.com/magazine/content/05_32/b3946141_mz035.htm) (noting the surprise at how over half of HSBC Amanah's clients were non-Muslim); see also *Islamic Banking Attracts Rising Number of Non-Muslims*, MENAFN-KHALEEJ TIMES, Apr. 21, 2009, [http://www.menafn.com/qn\\_news\\_story\\_s.asp?StoryId=1093244840](http://www.menafn.com/qn_news_story_s.asp?StoryId=1093244840) (describing the growing non-Muslim customer base of Islamic banks in predominantly non-Muslim countries such as Japan, Canada, Mauritius, Singapore, and South Korea).

2011]

ARAB MONEY

1077

Regardless of the customer base for Islamic banks, the very existence of an alternative financial product benefits the economy because choices often breed efficiency.<sup>115</sup> Under economic theory, with more choices, there is often more informed and efficient decision making.<sup>116</sup> For this very reason, accommodating Islamic banks may be of interest to U.S. banking regulators. The United States is already accustomed to being an innovator in the financial world, through their stock exchanges, commodities markets, derivatives markets, and other unique financial exchanges, and breaking down barriers to Islamic finance and banking would continue this trend.

### 3.5. Foreign Policy Benefits

Finally, connected to the benefits from attracting foreign capital, there is the added benefit of salvaging some of the trust lost in parts of the Muslim world that were aggravated by the actions of the Bush administration. One way the Obama administration could repair such relationships is through accommodating Islamic banks and businesses in the United States. Doing this and then touting it could have positive foreign policy benefits because it shows initiative by the United States to cooperate. Cooperation through business was one way France and Germany were able to overcome their differences after two world wars when they decided to create the European Union.<sup>117</sup> Using similar methods, the United States can buttress its foreign relations positions.<sup>118</sup>

---

<sup>115</sup> Cf. Merton Miller & Franco Modigliani, *Dividend Policy, Growth and the Valuation of Shares*, 34 J. BUS. 411, 433 (1961) (citing other economists that believe that corporations that offer choices to customers, such as stock investments or bonds, receive increased value due to efficiency and catering to more subtle needs); see also MELVIN A. EISENBERG, *CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS: CASES AND MATERIALS* 1227-29 (9th ed. 2005) (explaining that the real world has several dividend payout policies because different investors desire different payout schemes, suggesting that market forces prefer more choices).

<sup>116</sup> *Id.*

<sup>117</sup> See generally BEN ROSAMOND, *THEORIES OF EUROPEAN INTEGRATION* 59-113 (Neil Nugent et al. eds., 2000) (describing how the spillover effect of mutual business transactions under the European Coal and Steel Community later helped assuage differences between France and Germany and provided for collaboration and integration under the European Union).

<sup>118</sup> See, e.g., Barack Obama, President of the United States, Remarks at Cairo University: A New Beginning (June 4, 2009) (transcript available at

#### 4. CURRENT STATE OF ISLAMIC BANKING IN THE UNITED KINGDOM VERSUS THE UNITED STATES

For the above reasons, Europe<sup>119</sup> has recognized the long-term benefits of Islamic finance.<sup>120</sup> Consequently, European nations have been competing to become the new hub for Islamic finance,<sup>121</sup> but the United Kingdom has succeeded in making London that hub.<sup>122</sup> Comparatively, the United States is a weak contender.<sup>123</sup> Thus, the following section will explore the history of Islamic finance in the United Kingdom versus the United States to assess the legal reasons and other explanations for this disparity.

---

<http://www.whitehouse.gov/the-press-office/remarks-president-cairo-university-6-04-09>) (marking a new change in foreign policy towards the Muslim world).

<sup>119</sup> Includes France, Germany, Luxemburg, and the United Kingdom.

<sup>120</sup> See Mushtak Parker, *UK Aims to Make London Center for Islamic Finance*, ARAB NEWS, July 6, 2009, <http://www.arabnews.com/?page=6&section=0&article=124320&d=6&m=7&y=2009> (quoting Sarah McCarthy-Fry, exchequer secretary to the UK Treasury, announcing at the inaugural session of the 2009 London *Sukuk* Summit that "[t]he Islamic finance market presents huge long-term opportunities for London and for the UK."). McCarthy-Fry continued, "Islamic finance is an opportunity that we want to see realized for the benefit of Britain as a whole — strengthening London's position — not just as one of the world's leading financial centers — but as the world center."

<sup>121</sup> Compare James Joyner, *Islamic Banks Surge, Thanks to Financial Crisis*, ATLANTIC COUNCIL, Dec. 24, 2009, [http://www.acus.org/new\\_atlanticist/islamic-banks-surge-thanks-financial-crisis](http://www.acus.org/new_atlanticist/islamic-banks-surge-thanks-financial-crisis) (expounding on France's late entry into the competition to invite Islamic finance) and Talal al-Kandari, *France Seeks Islamic Financial System*, SABA, Jan. 16, 2010, <http://www.sabanews.net/en/news203317.htm> (describing France's lagging efforts after much deliberation about how to encourage Islamic finance in France where current Islamic financial investments are estimated at only \$120 million), with Christoph Pauly, *Sharia Banking Comes to Germany*, BLOOMBERG BUSINESS WEEK, Oct. 26, 2009, [http://bx.businessweek.com/islamic-banking-and-finance/view?url=http%3A%2F%2Fwww.businessweek.com%2Fglobalbiz%2Fcontent%2Foct2009%2Fgb20091026\\_154613.htm](http://bx.businessweek.com/islamic-banking-and-finance/view?url=http%3A%2F%2Fwww.businessweek.com%2Fglobalbiz%2Fcontent%2Foct2009%2Fgb20091026_154613.htm) (describing Germany's more successful path to inviting Islamic finance as evidenced by their 2010 opening of the first German Islamic bank, Kuveyt Türk Beteiligungsbank, a subsidiary of a Turkish-Kuwaiti bank).

<sup>122</sup> Parker, *supra* note 120 (stating that the London Stock Exchange, now lists nineteen *sukuks* "with an estimated total value of around \$11 billion, a figure exceeded only by the *sukuk* listings on the NASDAQ in Dubai").

<sup>123</sup> Shayesteh, *supra* note 105, at 1 (explaining that there are only nineteen total providers of Islamic banking products, not even one of which issues *sukuk* products). For a general landscape of Islamic banks in the United States and the United Kingdom, see Rodney Wilson, *Islamic Banking in the West*, in HANDBOOK OF ISLAMIC BANKING 419 (M. Kabir Hassan & Mervyn K. Lewis eds., 2007).

#### 4.1. *Islamic Finance in the United Kingdom and the Islamic Bank of Britain*

Although most of the retail growth of Islamic finance in the United Kingdom started in 2002, Islamic finance has been present in London since the 1980's with commodity *murabaha*-type transactions.<sup>124</sup> The reasons for the success of Islamic banking in the United Kingdom include: (1) the sophisticated market and skill base in London in terms of legal, accounting, and financial expertise; (2) a preference for Anglo-Saxon common law in Islamic financial transactions;<sup>125</sup> (3) public policy and taxation changes; and (4) the United Kingdom's switch to a single financial regulator, the Financial Services Authority ("FSA").<sup>126</sup> In comparison, the United States has all the above advantages except for the single financial regulator. Thus, given some changes, the United States could theoretically also be able to attract Islamic finance investors.

However, if the United States does not act quickly, then it will fully cede the first mover advantage to the United Kingdom, similar to how states within the United States can no longer successfully compete with Delaware to attract corporations.<sup>127</sup> Like Delaware, which won the charter competition, the United Kingdom is winning the Islamic finance hub competition. Britain's advantageous legal and regulatory environment has attracted several powerhouse Islamic financial institutions and mainstream Islamic windows, including, but not limited to, HSBC Amanah, Lloyds TSB, the United Bank of Kuwait, the Islamic Bank of Britain, Gatehouse Bank, Investment Dar, Barclays, Citibank, Kuwait Finance House, Samba Financial Group, and European Islamic Investment Bank.

The most remarkable story out of these, warranting further analysis, is the founding of the Islamic Bank of Britain ("IBB"). IBB

---

<sup>124</sup> See AINLEY ET AL., *supra* note 107, at 6 (discussing the long history of Islamic finance in London).

<sup>125</sup> See, e.g., *Shamil Bank of Bahrain EC v. Beximco Pharmaceuticals Ltd*, [2004] EWCA (Civ) 19 (presenting an Islamic finance contract that cited both the *shari'a* and English law in its choice of law clause).

<sup>126</sup> See AINLEY ET AL., *supra* note 107, at 7-8 (proposing that the creation of the FSA is one of six main reasons for the growth of Islamic banking in the UK).

<sup>127</sup> See EISENBERG, *supra* note 115, at 482-514 (describing Delaware's superior judiciary and bar and other aspects of Delaware that prevent other states from competing in the charter incorporation race).

1080

U. Pa. J. Int'l L.

[Vol. 32:4]

is the first wholly Islamic retail bank in the Western world.<sup>128</sup> The FSA authorized its charter in August 2004 after working nearly two years with its founders.<sup>129</sup> The FSA's only requirements were that the bank be well-funded and well-managed, two requirements to which all British banks are held.<sup>130</sup>

The funding requirement was met by investors from the Middle East and British Muslims who provided fourteen million sterling pounds of start-up capital.<sup>131</sup> Then, during its initial public offering, it raised an additional forty to fifty million sterling pounds.<sup>132</sup>

As for management, IBB's chairman was the former chairman of the Abu Dhabi Islamic Bank and IBB's managing director was a regional director of retail banking for Barclays.<sup>133</sup> Together, they provided sound expertise on Islamic financial dealings and Western commercial banking regulations.<sup>134</sup>

As the first stand alone Islamic bank in the British regulatory system, IBB focuses on providing current and savings accounts and a mortgage facility for its customers through the use of techniques such as *musharaka* and *murabaha*.<sup>135</sup> First, IBB pools its deposits to invest in permitted projects, such as enterprises not associated with "tobacco, alcohol, gambling, weapons, or pornography."<sup>136</sup> The money from these funds is then returned in the form of dividends

---

<sup>128</sup> AINLEY ET AL., *supra* note 107, at 14 (noting that the process of approving the bank took 18 months to complete, but provided the FSA with a framework it could use in later applications).

<sup>129</sup> *Id.*

<sup>130</sup> Taylor, *supra* note 13, at 422 (pointing out that "no formal applications for the establishment of Shari'a-compliant banking institutions had yet been received by the FSA" when IBB requested approval).

<sup>131</sup> *Id.* at 423.

<sup>132</sup> *Id.*

<sup>133</sup> *Id.*

<sup>134</sup> *Id.* (suggesting that IBB's success was due in part to its selection of personnel and its ability to combine expertise in Islamic financial dealings with Western commercial regulations).

<sup>135</sup> See *id.* at 424 (describing *musharaka* and *murabaha* transactions as complying with Muslim beliefs where "an Islamic Bank will negotiate so-called purchase agreements that allow it to buy properties on behalf of homebuyers" (quoting Gavin Serkin, *Bank Seeks to Lure Muslims in Britain*, INTL HERALD TRIB. Aug., 12 2004, <http://www.iht.com/articles/533595/html>)).

<sup>136</sup> *Id.* at 424 (listing various industries that are impermissible to invest in according to Islamic law).

2011]

ARAB MONEY

1081

to equity owners. Already, the bank has eight branches, 50,000 accounts, 42,000 customers, and is continuing to expand.<sup>137</sup>

Although some of its expansion is linked to the 1.65 million Muslims in the United Kingdom,<sup>138</sup> the bank's customers are predominantly non-Muslim. IBB appeals to them by promoting ethically-based investment practices, unique product offerings, and a highly professional bank staff that is thirty percent non-Muslim.<sup>139</sup> Soon, IBB seeks to expand to other European nations.<sup>140</sup> Studying such a successful international banking model is important for bankers and regulators in the United States.

#### 4.2. *Islamic Finance in the United States and the University Bank*

Unlike the British who have adopted the "no obstacles but no favors" approach to Islamic finance, spurring its growth in London,<sup>141</sup> the United States has only stated this position without implementing it. The First Vice President of the Federal Reserve Bank of New York proclaimed, "Islamic bankers have been quite ingenious in developing financial transactions that suit their needs: we bank supervisors, too, can be ingenious and will want to work with any of you should you decide that you want to engage in Islamic banking in the United States."<sup>142</sup> While this proclamation is

---

<sup>137</sup> See AINLEY ET AL., *supra* note 107, at 15 (noting that "the eight branches [are] in cities with large Muslim populations" so as to ensure a solid customer base before expanding further).

<sup>138</sup> THE PEW FORUM ON RELIGION AND PUB. LIFE, *supra* note 7, at 22.

<sup>139</sup> See Taylor, *supra* note 13, 425–26 (describing the bank's intention and plan for attracting non-Muslim customers).

<sup>140</sup> See *id.* at 426 ("[T]he Bank has the potential (by itself) to spread Islamic commercial banking practices to different countries within Europe.").

<sup>141</sup> See AINLEY ET AL., *supra* note 107, at 11 (quoting Sir Howard Davies, Chairman, Financial Services Authority, Conference on Islamic Banking and Finance in Bahrain (Mar. 2, 2003), <http://www.fsa.gov.uk/Pages/Library/Communication/Speeches/2003/SP118.shtml>).

<sup>142</sup> Ernest T. Patrikis, First Vice President Fed. Reserve Bank of N.Y., *Islamic Finance in the United States – The Regulatory Framework*, Remarks before the Islamic Finance and Investment Conference (May 23, 1996) (transcript available at [http://www.ny.frb.org/newsevents/speeches\\_archive/1996/ep960523.html](http://www.ny.frb.org/newsevents/speeches_archive/1996/ep960523.html)). More recently, in May 2004, the Under Secretary of the U.S. Treasury focused on regulating domestic Islamic banks in a public address, "[W]e need to deepen our understanding and awareness of Islamic finance, to protect its unique role, to honor its tradition, and to ensure sound regulatory frameworks and suitable jurisprudence that allow for efficient financial intermediation." John B. Taylor, Under Sec'y of The Treasury Understanding and Supporting Islamic Finance:

promising, the United States government has done little in the past decade in removing the main regulatory obstacles that are preventing this international form of banking from prospering in the United States. That is why there are as few as only nineteen providers of Islamic financial products in the United States, none of which is a full-fledged Islamic commercial bank like the IBB.<sup>143</sup>

Out of all the small Islamic financial institutions in the United States, the most prominent one is the University Islamic Financial Corporation ("UIFC"), a wholly owned subsidiary of University Bank, headquartered and chartered in Michigan.<sup>144</sup> Compared with superstar IBB, UFC only provides limited services<sup>145</sup> to customers in a select number of states.<sup>146</sup> However, it is important to note that UFC is the only Islamic financial institution in the United States that provides some deposit and checking services.

Other American Islamic financial institutions are also limited in scope. For example, Broadway Bank of Chicago, Lincoln State Bank, Mutual Bank, and Cole Taylor Bank only serve Illinois residents.<sup>147</sup> Zayan Finance, Guidance Residential, Lariba, and Samad Group mainly do residential mortgages.<sup>148</sup> Saturna Capital, Azzad Asset Management, and North American Islamic Trust are only involved in mutual funds.<sup>149</sup> As is evident, the American Islamic finance sector is developing but is fragmented. This stunted development, I argue in the next section, is attributed

---

Product Differentiation and International Standards, Keynote Address at the Forum on Islamic Finance, Harvard University (May 8, 2004) (transcript available at <http://www.treasury.gov/press-center/press-releases/Pages/js1543.aspx>). Finally, in 2008, U.S. Treasury Department Deputy Secretary Robert Kimmit made a trip to the Middle East where he "publicly expressed the U.S.'s positive and accommodating attitude towards the development and growth of the industry in the country." Shayesteh, *supra* note 105, at 2.

<sup>143</sup> Shayesteh, *supra* note 105, at 1.

<sup>144</sup> See *id.* at 3–4 (providing a chart of financial institutions' banking information).

<sup>145</sup> See *id.* at 3 (including these services: deposits, money market accounts, mutual funds, and residential mortgages).

<sup>146</sup> See *id.* (listing the states where the UFC provides services: California, Connecticut, Idaho, Illinois, Maryland, Michigan, New Jersey, New York, Ohio, Pennsylvania, and Virginia).

<sup>147</sup> *Id.*

<sup>148</sup> See *id.* (noting that this group of financial institutions also provides, to a limited degree, certain commercial and business loans).

<sup>149</sup> *Id.* at 4.

2011]

ARAB MONEY

1083

primarily to statutory and constitutional reasons. However, I will also account for alternative financial explanations.

## 5. BANKING REGULATIONS IN THE UNITED STATES AND IN THE UNITED KINGDOM

The regulatory banking scheme in the United States is unnecessarily complicated, while the scheme in the United Kingdom is simpler. The United States is fraught with multiple regulators at both the federal and state level, whereas the United Kingdom has consolidated its regulators into one agency, the FSA.

### 5.1. REGULATORY HURDLES IN THE UNITED STATES

#### 5.1.1. Statutory Elements

Understanding why Islamic banks are not flourishing in the United States requires an overview of the regulatory banking framework in the United States, starting with the statutory definition of what a bank is within this framework. Under the Bank Holding Company Act ("BHCA"), given certain exceptions,<sup>150</sup> a bank is defined either as an institution whose deposits are insured by the Federal Deposit Insurance Corporation ("FDIC"),<sup>151</sup> or:

An institution organized under the laws of the United States, any State of the United States, the District of Columbia, any territory of the United States, Puerto Rico, Guam, American Samoa, or the Virgin Islands which both—

(i) accepts demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties or others; and

(ii) is engaged in the business of making commercial loans.<sup>152</sup>

<sup>150</sup> See Bank Holding Company Act 12 U.S.C. § 1841(c)(2) (2006) (listing certain exceptions, such as foreign banks and insured bonds).

<sup>151</sup> See *id.* (referencing the Federal Deposit Insurance Act under 12 U.S.C. § 1813(h) for further definitions of a bank, all of which rely on deposits).

<sup>152</sup> *Id.* § 1841(c)(1)(B) (2006).

As can be seen from the above definition, the term “bank” does not apply to a bank organized outside the United States. In such foreign contexts, as often is the case with Islamic banks, the International Banking Act (“IBA”)<sup>153</sup> applies.

Whether under the BHCA or the IBA, the definition of a bank hinges on the word “deposit.” Like other countries, the United States does not permit the initial deposit to be at risk, and thus the FDIC insures it up to a specified limit.<sup>154</sup> However, in the Islamic banking model, a deposit account is based on a profit-loss sharing scheme, an arrangement that puts the initial deposit at risk.<sup>155</sup> Thus, the U.S. statutory definition of deposit poses a potential obstacle to Islamic banking.

Another statutory obstruction to Islamic banking is the National Bank Act of 1864,<sup>156</sup> which prohibits commercial banks from the purchase, holding of legal title, or possession of real estate to secure any debts to it for a period exceeding five years. This ban would effectively restrict Islamic home finance products, like the availability of *murabaha* (cost-plus financing).<sup>157</sup> However, in two interpretive letters, 806 and 867, the Office of the Comptroller of the Currency (“OCC”) concluded that particular versions of *murabaha* and *ijara* transactions would be considered exceptions to the National Bank Act rule if they meet the standards for functional equivalence to conventional asset financing.<sup>158</sup> As such,

<sup>153</sup> See Banks and Banking, 12 U.S.C. §§ 3101–07 (2006) (“For the purposes of this chapter the term ‘foreign bank’ includes, without limitation, foreign commercial banks, foreign merchant banks and other foreign institutions that engage in banking activities usual in connection with the business of banking in the countries where such foreign institutions are organized or operating.”).

<sup>154</sup> See 12 U.S.C. § 1813(l) (2006) (stating the definition of “deposit” under the BHCA). For the FDIC temporary increase in standard maximum deposit insurance coverage from \$100,000 to \$250,000, see Helping Families Save Their Homes Act of 2009, H.R. 1106, 111th Cong. (1st Sess. 2009).

<sup>155</sup> See Isam Salah, *Legal Issues Arising in Islamic Finance Transactions in the United States*, in ISLAMIC FINANCE IN NORTH AMERICA 61 (2009) (describing the obstacle to Islamic retail investment products in the United States).

<sup>156</sup> 12 U.S.C. §§ 21–216d (2006). See also Shirley Chiu et al., *Islamic Finance in the United States: A Small but Growing Industry*, 214 CHICAGO FED LETTER (2005) (describing challenges Islamic finance will face in the United States).

<sup>157</sup> See Chiu et al., *supra* note 156, at 3 (noting that *Murabaha* financing involves financing for “purchasing homes, cars, and small businesses”).

<sup>158</sup> See *id.*

1) the underwriting standard used in these models must incur the same risks as that of a conventional loan; 2) the risk incurred by the bank if a

2011]

ARAB MONEY

1085

although regulatory hurdles exist, bankers and U.S. government regulators are gradually working around them.

### 5.1.2. Structural Elements

Putting the threshold definitional problems aside, there are also chartering issues. Once an institution meets the above statutory elements, the institution must be chartered, either at the national or state level, by complying with requisite laws. Weaving through the entire maze of the United States' dual banking scheme is beyond the scope of this Comment, but a cursory look at the landscape will expose impediments to Islamic banks and foreign capital infusion.

First, if an Islamic bank wants to be nationally chartered, whether it is a foreign bank or a domestic bank, it will primarily be regulated by the OCC.<sup>159</sup> Second, national banks face more regulations from the Board of Governors of the Federal Reserve System and are automatically a member of the FDIC.<sup>160</sup> Thus, there are multiple regulators that Islamic banking investors would have to deal with at the national level.<sup>161</sup> National chartering is particularly difficult and may explain the lack of a nationally chartered Islamic bank in the United States compared with the United Kingdom.

---

customer defaults on payments must be the same as that of a conventional loan; and 3) the risk from the bank's holding of legal title to the property must be the same as that of a bank providing a conventional loan.

*Id.*

<sup>159</sup> See 12 U.S.C. § 1813(q)(1) (2006) (stating that "the term 'appropriate Federal banking agency' means the Comptroller of the Currency, in the case of any national banking association or any Federal branch or agency of a foreign bank").

<sup>160</sup> See 12 U.S.C. § 1813(q)(2)–(3) (2008) (stating when the board of Governors of the Federal Reserve System and the Federal Deposit Insurance corporation is the appropriate Federal Banking Agency). In addition, recently, the Fed has gained increased banking powers through the Dodd-Frank Act. See also Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 165, 312 (2010) [hereinafter Dodd-Frank Act] (describing new powers of Board of Governors).

<sup>161</sup> The Dodd-Frank Act added several new regulators as well, such as the Bureau of Consumer Financial Protection Bureau housed within the Fed and the Financial Stability Oversight Council. Dodd-Frank Act, *supra* note 160, §§ 111, 1011.

In contrast, state-chartered banks are primarily regulated by the state's Banking Commissioner, but also by the FDIC because state banks are typically federally insured.<sup>162</sup> In addition, if a state bank applied for membership in the Federal Reserve System, then the Federal Reserve has jurisdiction.<sup>163</sup> The handful of U.S. Islamic banks are all state chartered, most likely because state banking commissioners are likely more flexible than the OCC.

A final layer to this mess is that banks are also regulated differently based on their operations. There are different regulators for commercial banks, savings and loan associations ("S&Ls"), and credit unions. If the banking institution is a S&L, its principal regulator was the Director of the Office of Thrift Supervision ("DOTS"), but the Dodd-Frank Act recently transferred these duties to the OCC.<sup>164</sup> If the institution is a credit union, then supervisory regulation is shared with the National Credit Union Administration ("NCUA").<sup>165</sup>

The above regulatory scheme is extremely confusing for conventional bankers, let alone Muslim bankers looking to start an Islamic bank in the United States. Not only would they be dealing with the above regulatory agencies, but they would also have to communicate with the Internal Revenue Service ("IRS") and the Securities and Exchange Commission ("SEC"), among others, during their bank chartering process. These excessive layers of bureaucracy often lead to frustration, confusion, and are a waste of time and resources for potential investors. Moreover, they may be misleading to some who think that the United States is opposed to Islamic banking, and merely wishes to throw unnecessary regulatory hurdles into the process.<sup>166</sup>

The above regulatory hurdles also spill over into timing problems for foreign investors. Chartering an Islamic bank in

---

<sup>162</sup> See 12 U.S.C. § 1813(r) (2008) (explaining the possible levels of State bank supervisors).

<sup>163</sup> See *id.* § 1813(q)(2) (defining the jurisdiction of the Federal Reserve).

<sup>164</sup> See generally Dodd-Frank Act, *supra* note 160 (providing statutory language regarding the federal government's recent gain in banking powers through the Dodd-Frank Act).

<sup>165</sup> See 12 U.S.C. § 1813(r) (2008) (discussing the powers of the State bank supervisor); see also Taylor, *supra* note 15, at 406 (discussing shared regulation between the NCUA and credit unions).

<sup>166</sup> See Shayesteh, *supra* note 105, at 2 (describing the misplaced fears of Middle Eastern investors).

other countries often takes six months to two years.<sup>167</sup> As noted earlier, the Islamic Bank of Britain was chartered in under eighteen months.<sup>168</sup> However, in the United States, the chartering process for an Islamic bank, with all these regulatory hoops, would likely take over two years.<sup>169</sup> As such, this lengthy process, imbued with high transaction costs, further discourages Muslim and Middle Eastern bankers from investing in the United States.<sup>170</sup>

However frustrating this may be, the current downturn in the economy is the best time for foreign investors and American regulators to work together and take advantage of the low prices of banking assets. This is an ideal climate to start building the necessary infrastructure and relationships required to start a full-fledged *shari'a*-compliant bank in the United States.<sup>171</sup> These lower prices would offset some of the financial challenges facing future Islamic banks in the United States.

### 5.1.3. Tax Obstacles

There may be several tax obstacles to Islamic banking, but the most apparent one is in home financing. Many states in the United States have property transfer taxes that impose an additional tax burden on Islamic mortgages because such mortgages involve two transfers. Muslims often finance their homes with a *murabaha* transaction, which is when the bank buys the home and sells it to the customer at a markup. Even though this is essentially one transaction, the transfer tax is levied twice, once on the bank when the bank buys it and again on the homeowner when he buys the house from the bank. States have failed to address this double

---

<sup>167</sup> See *id.* (describing how Middle Eastern investors typically misunderstand and are discouraged by the typical time frame of over two years for launching a *shari'a*-compliant bank in the United States).

<sup>168</sup> See AINLEY ET AL., *supra* note 107, at 14 (discussing the establishment of the Islamic Bank of Britain).

<sup>169</sup> See Shayesteh, *supra* note 105, at 2 ("Launching a bank that has *Sharia'ah* components may take up to two years or more depending on the types of products and services the institution plans to offer.").

<sup>170</sup> See *id.* (noting that investors are "often discouraged when they learn about the potential lengthy timeframes").

<sup>171</sup> See *id.* (stating that the economic downturn presents an ideal time "to build the appropriate infrastructure," and engage in the time consuming process of attaining regulatory approvals).

taxation on a broad statutory level,<sup>172</sup> but the OCC has provided a temporary solution at the national level.<sup>173</sup>

#### 5.1.4. Ownership Schemes

The above *murabaha* transaction also presents several legal ownership problems for banks in the United States. In the United States, with certain exceptions, banks are not allowed to own real estate because of the OREO ("other real estate owned") rule. Thus, if an Islamic financial institution purchases real property on behalf of a customer in a *murabaha* transaction, the institution becomes part of the "chain of title" of the property even if it only owns it for a moment. This exposes the financial institution to liability because United States laws impose various responsibilities on current and prior owners of real property, such as the legal obligation of current and prior owners to pay the cost of any required environmental clean-ups.<sup>174</sup> In addition, Islamic banks, through the ownership of property, also carry the risk of liability for injuries occurring on the property.<sup>175</sup>

Normally, conventional banks are not subject to these risks because of safe harbor provisions, but these provisions may not cover Islamic banks.<sup>176</sup> The only safe harbors in place for Islamic banks were provided by the OCC letters mentioned above. These letters mitigate some of the risk in the case of *murabaha* transactions because the bank is not considered a title owner in that case. Regardless, Islamic banks and U.S. banking regulators need to continue to work together to mitigate all these onerous risks while still maintaining *shari'a*-compliance.

<sup>172</sup> See Salah, *supra* note 155, at 58 (explaining that New York tax authorities have recognized the tax inequity, and have only chosen to redress the double taxation on a case-by-case basis, not at a broad statutory level).

<sup>173</sup> See Office of the Comptroller of the Currency, Interpretive Letter #867 (Nov. 1999) (citing National Bank Act, 12 U.S.C. §§ 24(7), 29 (2010)) (noting that *murabaha* transactions should be considered loans for tax and accounting purposes).

<sup>174</sup> See 42 U.S.C. § 9607(a)(4)(B) (2006) (stating that current and past property owners are strictly liable for the costs of environmental clean-ups).

<sup>175</sup> See Salah, *supra* note 155, at 60 (focusing on the new ownership risks that Islamic finance practitioners must be aware of in the United States).

<sup>176</sup> See 42 U.S.C. § 9601(20)(E)(2006) (discussing the exclusion provision for non-managing conventional lenders). However, in Islamic banking, there is no lender relationship because the financial institution partakes in a profit-loss sharing scheme with the buyer.

### 5.1.5. Financial Challenges

Although financial challenges may be a bit outside the scope of this Comment, it is important to address alternative explanations to the legal obstacles preventing Islamic finance from burgeoning in the United States. First, Islamic financial institutions face the challenge of developing products that have little precedence in the United States.<sup>177</sup> It would be expensive for such firms to develop, design, and produce such innovative financial instruments, then consult religious and regulatory experts, and most importantly, train staff in different Islamic products and home purchase procedures.<sup>178</sup> Although some of these costs are passed onto the consumer, U.S. Islamic financial institutions may have to absorb these costs to maintain competitive pricing.<sup>179</sup> Islamic financial products tend to generate less profit on a per transaction basis than conventional products.<sup>180</sup>

A second financial burden is linked to skepticism in the secondary market for Islamic financial products.<sup>181</sup> Although Islamic mortgage companies have securitized and sold their specialized “mortgages” to Freddie Mac and Fannie Mae, other opportunities for selling assets on the secondary market may be limited.<sup>182</sup> Securitization is important for the growth of the Islamic banking industry and so U.S. bankers, analysts, and regulators

---

<sup>177</sup> See Chiu et al., *supra* note 156, at 3 (discussing two principal challenges to providers of Islamic finance in the United States, namely, (1) to offer products that conform to Islamic religious doctrine as well as to state and federal regulations, and (2) to incur the costs associated with developing and providing innovative methods of financing compliant with Islamic religious doctrine).

<sup>178</sup> See *id.* (“The . . . challenge for financial institutions involves the cost of offering new products that have little precedent in the United States.”); see also Bjorn Sorenson, Note, *Ethical Money: Financial Growth in the Muslim World*, 23 AM. U. INT’L L. REV. 647, 652–56 (2008) (discussing the high expenses of getting approval from an independent *Shari’a* supervisory board and of complying with the Sarbanes-Oxley regulations).

<sup>179</sup> See Chiu et al., *supra* note 156, at 3 (noting that although some of the costs can be passed on to consumers to alleviate the second challenge to Islamic finance in the United States, some of these costs are absorbed by the financial institution).

<sup>180</sup> See *id.* (explaining that although these products generate less profit per transaction, the volume of sales has compensated for the increased costs for most providers).

<sup>181</sup> See *id.* (noting that the costs and investors’ lack of familiarity with Islamic financial products inhibit sales in secondary markets).

<sup>182</sup> See *id.* (providing an example of a U.S. Islamic financial institutions that has sold bundled mortgages on the secondary market).

need to be educated further because they are unfamiliar with the underlying structure and risks associated with these Islamic finance transactions.<sup>183</sup>

One final financial hurdle is consumer marketing,<sup>184</sup> a problem that exists in the developing world. In the United States, however, Islamic financial institutions report relatively low marketing and advertising costs because of grapevine communication by mosque congregants and real estate brokers.<sup>185</sup> In addition, with the advent of the Internet and related technology, communication problems and information asymmetry are mitigated. Regardless, the United States faces a number of financial challenges, along with the statutory and regulatory obstacles discussed above, that may foreclose the entry of Islamic financial institutions and products.

## 5.2. LACK OF REGULATORY HURDLES IN THE UNITED KINGDOM

Compared to the layers upon layers of financial regulatory agencies in the United States, the United Kingdom recently consolidated all their financial regulators into one entity: the Financial Services Authority ("FSA"). The FSA was originally established in 1997 by combining eleven different regulators<sup>186</sup> into a single body under a single piece of legislation, the Financial Services and Markets Act of 2000 ("FSMA").<sup>187</sup> Unlike the previously fragmented system where regulatory functions were divided as they are in the United States, the current British framework has resolved several complications. In particular, the FSA now provides a comprehensive platform to look across the

<sup>183</sup> See *id.* at 3–4 (mentioning a threshold matter for this secondary market issue, which is whether such sales in the secondary market are even permissible in Islam because some Muslim jurists are in disagreement).

<sup>184</sup> See Sorenson, *supra* note 178, at 655–57 (discussing the challenges of reaching out to Islamic finance consumers).

<sup>185</sup> See Chiu et al., *supra* note 156, at 4 (discussing "low marketing and advertising costs due to the heavy reliance on word-of-mouth communication by mosque attendees and real estate agents").

<sup>186</sup> Some of these previous regulators include the Bank of England that oversaw banks under the Banking Act of 1987, the Securities and Investment Board in charge of investment regulation under the 1986 Financial Services Act, and other self-regulatory organizations. See AINLEY ET AL., *supra* note 107, at 11 (discussing predecessor regulators prior to the founding of the FSA).

<sup>187</sup> See *id.* at 10–11 (discussing the creation of the FSA).

2011]

ARAB MONEY

1091

financial system as a whole to assess and integrate Islamic financial institutions and products.<sup>188</sup> This new agency enabled foreign investors to deal with a one-stop shop for regulations. The FSA deals with banks, insurance companies, securities dealers, partnerships, and all financial institutions and regulated activities.<sup>189</sup> Such a streamlined system enabled the IBB to establish itself within less than two years.<sup>190</sup>

Part of the FSA's success is linked to its observance of the "FSMA's six Principles of Good Regulation, in particular, facilitating innovation and avoiding unnecessary barriers to entry or expansion within the financial markets."<sup>191</sup> Adhering to these principles enables British policymakers to regulate new financial products with flexibility. One example involves a holdup over the definition of a deposit, which the United Kingdom defines as a "sum of money paid on terms under which it will be repaid either on demand or in circumstances agreed by parties."<sup>192</sup> Thus, in the United Kingdom, like in the United States, a "customer is assured full repayment [of his deposit] as long as the bank remains solvent."<sup>193</sup> However, a deposit for an Islamic bank is based on a profit-and-loss sharing account, or *mudaraba*, where the customer would have to accept the risk of loss of original capital. This Islamic definition of deposit ran counter to the FSA's requirement of capital certainty.<sup>194</sup>

Unlike in the United States, the FSA had the flexibility to contract around this. The FSA and IBB agreed that legally, depositors were "entitled to full repayment, thus ensuring compliance with FSA requirements."<sup>195</sup> However, at the same time, customers had "the right to turn down deposit protection on religious grounds."<sup>196</sup> Instead, they could choose to be repaid

---

<sup>188</sup> *Id.* at 11 ("There is, therefore, a 'level playing field' in dealing with applications from conventional and Islamic firms.").

<sup>189</sup> See Shayesteh, *supra* note 105, at 2 (discussing the FSA's regulatory role).

<sup>190</sup> See *id.* (discussing the potential amount of time needed to launch a "shari'ah compliant financial institution").

<sup>191</sup> AINLEY ET AL., *supra* note 107, at 11.

<sup>192</sup> *Id.* at 14 (internal citations omitted).

<sup>193</sup> *Id.*

<sup>194</sup> See *id.* (noting that the concept of profit-and-loss sharing is contrary to the loss prevention guarantee provided by banks so long as they are solvent).

<sup>195</sup> *Id.*

<sup>196</sup> *Id.*

under the *shari'a*-compliant risk sharing and loss bearing formula. Because the FSA can conclusively analyze each case for its merits, it provides needed comfort for investors that are setting up Islamic banks. It is uncertain whether the United States can offer such maneuverability within its multilayered regulatory scheme.

Another example of the effectiveness of the new British framework is the ease with which it identified tax barriers to Islamic banking. For instance, when a home is sold in England, it is subject to a stamp duty similar to the United States' property transfer tax.<sup>197</sup> For British Muslims who financed their homes with a *murabaha* transaction, which is when the bank buys the home and sells it to the customer at a markup, "the stamp duty was imposed twice on essentially the same purchase."<sup>198</sup> To redress the unnecessary double taxation, the FSA investigated the matter and abolished the double stamp duty in 2003.<sup>199</sup> The United States could learn from such swift action in the realm of rewriting and removing statutory and regulatory obstacles to Islamic banking instead of just issuing temporary interpretive letters.

## 6. CONSTITUTIONAL LIMITS

The next barrier to Islamic finance in the United States is constitutional. The U.S. Constitution exerts opposing forces on Islamic finance. On the one hand, the Free Exercise Clause<sup>200</sup> of the First Amendment places a duty on American policymakers to accommodate religious requirements, even as it relates to banking practices.<sup>201</sup> On the other hand, the Establishment Clause<sup>202</sup> of the

<sup>197</sup> Kyle Gaffaney, Comment, *Buying A Home Can Be Difficult For Muslims in the United States*, 21 LOY. CONSUMER L. REV. 557, 567-68 (2009) (explaining Britain's stamp duty that is triggered when a home is sold in England).

<sup>198</sup> *Id.*

<sup>199</sup> *Id.* at 568 (stating that a working group abolished the tax in 2003).

<sup>200</sup> See U.S. CONST. amend. I ("Congress shall make no law . . . prohibiting the free exercise [of religion] . . .").

<sup>201</sup> See Shayesteh, *supra* note 105, at 1 ("From a constitutional perspective, US regulators are (and will continue to be) involved, in part, because it is their duty as public servants under the U.S. Constitution to make sure they accommodate the free exercise of religion, even as it relates to banking practices."); see also *Church of the Lukumi Babalu, Inc. Aye v. City of Hialeah*, 508 U.S. 520 (1993) (Scalia, J., concurring) (finding that even a statute's incidental burdens on the Free Exercise Clause can be invalidated as unconstitutional).

<sup>202</sup> U.S. CONST. amend. I ("Congress shall make no law respecting an establishment of religion . . .").

2011]

ARAB MONEY

1093

First Amendment prohibits the promotion of one religion over another by public officials or agencies.<sup>203</sup> The latter limit may explain why United States public officials do not “cheerlead” the coming of Islamic finance as much as their counterparts in the United Kingdom.<sup>204</sup>

Regardless, United States regulators may have a duty to issue banking regulations that accommodate different religions because government programs and regulations, according to case law, must be “neutral with respect to religion.”<sup>205</sup> Banking regulations, along with other public benefits, must apply to all citizens regardless of religion and must present no obvious impediment to the free exercise of any religion, including Islam.<sup>206</sup> When a regulation is not neutral, such as when a commercial banking regulation would prevent Islamic banks from owning real estate, then only a narrowly tailored sufficient state interest could override such a religious requirement.<sup>207</sup> For Islamic finance so far, there have been no major conflicts between banking regulations and Islam.

Instead, the Establishment Clause may present setbacks. The Establishment Clause forces American regulators to walk a thin line so as not to give the appearance of promoting Islam above other religions. This is especially difficult in a post-9/11 world where the American population is skeptical of anything Islamic.<sup>208</sup> For instance, United States regulators and investigative authorities

---

<sup>203</sup> Shayesteh, *supra* note 105, at 1.

<sup>204</sup> *Id.*

<sup>205</sup> See *Zelman v. Simmons-Harris*, 536 U.S. 639, 652 (2002) (explaining that general government programs must be neutral with respect to religion versus non-religion, and sect to sect) (citations omitted).

<sup>206</sup> Islam, in early American history, was called Mohammedanism based on Islam’s Prophet Muhammad (p.b.u.h.). Under this label, courts expressly protected Islam and insured that government regulations did not impede on Islamic beliefs. See *Everson v. Bd. of Educ.*, 330 U.S. 1, 16 (1947) (stating that federal and state laws “cannot exclude individual Catholics, Lutherans, Mohammedans, Baptists, Jews, Methodists, Non-believers, Presbyterians, or the members of any other faith, *because of their faith, or lack of it*, from receiving the benefits of public welfare legislation”) (emphasis in original).

<sup>207</sup> This is basically the strict scrutiny test. Cf. *Wisconsin v. Yoder*, 406 U.S. 205, 214–15 (1972) (finding that state interest in compulsory education did not override the legitimate religious beliefs of the Amish to educate their children outside the state school system after eighth grade).

<sup>208</sup> See *Semple*, *supra* note 10 (reporting that even the building of a Muslim house of worship or community center was scrutinized and blocked).

1094

U. Pa. J. Int'l L.

[Vol. 32:4]

are increasingly scrutinizing Islamic charities and financial institutions.<sup>209</sup> Furthermore, if Americans are afraid of prayers in schools and are willing to litigate,<sup>210</sup> then Islamic financial institutions may face (and have faced)<sup>211</sup> similar litigation. In comparison, in the United Kingdom, where there is no strict separation of church and state,<sup>212</sup> there is often less negative media attention directed towards politicians and regulators publicly encouraging the ethical ideals of Islamic finance.<sup>213</sup> It will thus be interesting to note whether the Free Exercise or Establishment Clause right triumphs in the Islamic finance context.<sup>214</sup> Lawmakers can facilitate the process if they framed legislation in neutral terms,

---

<sup>209</sup> See Glenn R. Simpson, *Islamic Charities Draw More Scrutiny*, WALL ST. J., Feb. 24, 2008, at A4 (describing the skepticism felt by government officials towards Islamic charities).

<sup>210</sup> See Jeff Branscome, *ACLU Advises Stafford School Board on Prayer*, FREDERICKSBURG.COM (Jan. 15, 2010 12:31 PM) [http://connections.fredericksburg.com/blogs/view?blogger\\_id=54&p=1263576679](http://connections.fredericksburg.com/blogs/view?blogger_id=54&p=1263576679) (quoting a letter by the American Civil Liberties Union of Virginia to stop a public school in Virginia from opening school board meetings with a prayer); see also *Sch. Dist. v. Schempp*, 374 U.S. 203 (1963) (holding that Pennsylvania's requirement that ten Bible verses be read during school every day was a violation of the Establishment Clause); *Engel v. Vitale*, 370 U.S. 421 (1963) (holding that New York public schools could not require that short prayers be read before class).

<sup>211</sup> See, e.g., *Murray v. Geithner*, 2011 U.S. Dist. LEXIS 3788 (E.D. Mich. Jan. 14, 2011) (granting defendant's motion for summary judgment dismissing plaintiff's claim that the government's investment in AIG violates the Establishment Clause because AIG provides *shari'a*-compliant insurance products, i.e. *takaful*).

<sup>212</sup> See, e.g., Melissa Kite, *Labour MPs Back Separation of State and Church of England*, TELEGRAPH (London), Dec. 20, 2008, <http://www.telegraph.co.uk/news/newstopics/religion/3868700/Labour-MPs-back-separation-of-state-and-Church-of-England.html> (discussing the Labour party's stealth pushes for separation of church and state despite history of a "centuries-old link between church and state").

<sup>213</sup> See Shayesteh, *supra* note 105, at 1 (mentioning recent "cheerleading" type speeches given by Gordon Brown, the former British Prime Minister, and Kitty Ussher, former Treasury minister and Under Secretary at the Department of Work and Pensions, expressing interest in Islamic financing).

<sup>214</sup> Sometimes neither right triumphs when "there is room for play in the joints." *Locke v. Davey*, 540 U.S. 712, 718 (2004) (citation omitted). The Supreme Court explained that the Establishment and the Free Exercise Clause are frequently in tension, but sometimes, there are some state actions that are permitted by the Establishment Clause but not required by the Free Exercise Clause, such as not giving state money to college students majoring in devotional theology. *Id.* at 719 (citations omitted).

2011]

ARAB MONEY

1095

but whether there is the political will to do so is another issue, as noted *infra* Section 7 and 8.

## 7. SOLUTION

I propose a simple three-tiered solution to overcome the impasse that is preventing Islamic banking from flourishing in the United States. Tier one involves expanding educational initiatives in the United States and abroad. If there are still barriers after implementing tier one, then I would recommend that U.S. legislators follow the United Kingdom and consolidate their financial regulatory agencies. Finally, as a last resort, U.S. policymakers may want to create a statute that authorizes the creation of Islamic banks in the United States.

### 7.1. Educational Initiative

The education initiative needs to occur in three spheres of influence, with: (1) U.S. regulators, (2) foreign investors, and (3) domestic consumers. First, United States regulators need to learn what Islamic finance is. The United States Treasury Department has already embarked on this educational journey by hosting the first “Islamic Finance 101” seminar for banking regulatory agencies, Congress and parts of the executive branch in 2008.<sup>215</sup> Furthermore, state regulatory agencies have stated their intention to hold regional discussions with financial institutions aimed at developing regulatory standards that account for the institutional and systemic risks of Islamic financial products.<sup>216</sup> Such educational efforts by the government need to continue in order to

---

<sup>215</sup> See Chelsea Schilling, *U.S. Treasury Teaches ‘Islamic Finance 101’*, WORLDNETDAILY (Nov. 5, 2008, 10:45 PM) <http://www.wnd.com/index.php?fa=PAGE.view&pageId=80003> (discussing the Treasury Department’s collaboration with Harvard University’s Islamic Finance Project to educate 100 policy makers about Islamic finance); see also Mahmoud Amin El-Gamal, *Overview of Islamic Finance: Occasional Paper No. 4*, DEP’T OF TREASURY (Dept. Treasury Office Int’l Affairs, Washington D.C.), August 2006, at 1, 11 (providing a grim assessment on the growth of Islamic finance if Muslim consumers continue to witness its convergence with conventional finance).

<sup>216</sup> See Chiu et al., *supra* note 156, at 4 (noting that given the potential demand for Islamic financial services in the United States, federal and state regulators intend to consult with regional financial institutions to develop regulatory standards “that take into account the institutional and systemic risks of Islamic financial products”).

remove misguided views about Islamic finance that link it to terrorism.<sup>217</sup> In addition, such efforts would aid regulators in developing new ways to eliminate regulatory barriers to Islamic banking and in doing so, would properly prepare the nation's banking system for the future international growth of Islamic finance.

The second educational project needs to focus on teaching foreign investors, such as those in the Middle East and Southeast Asia about the banking regulatory regime in the United States. For example, it would be prudent to teach these investors about the American dual banking system, the role of each agency, and how agencies are divided not to frustrate investors, but to undertake specific tasks. This second set of educational programs, either undertaken by the government or private firms, would help increase foreign direct investment ("FDI") by attracting petrodollars, thereby potentially bolstering the United States' economic situation. Although the United Kingdom is geographically closer to the Middle East and is in a strategically better time zone, the United States should try to actively compete with the United Kingdom to become a new hub for Islamic finance.<sup>218</sup>

Finally, Islamic financial institutions should continue marketing and educating Muslim and non-Muslim consumers in the United States about the advent of interest-free Islamic financial products. Otherwise, some Muslims and others will continue being unbanked, thinking there are no legitimate alternatives for their money. In conclusion, these simple educational efforts are the easiest way to facilitate the growth of Islamic banking in the United States.

---

<sup>217</sup> See Schilling, *supra* note 215 (describing some individual fears that the onslaught of Islamic finance in the United States is a façade for funding Islamic extremism).

<sup>218</sup> In addition, if the United States does not compete with the United Kingdom to become the next global hub for Islamic finance, then the United States may also lose to Toronto, Canada, which has been slated to become the next hub for Islamic finance in North America. See Isam Salah et al., *A Brief History of Islamic Finance in North America*, in ISLAMIC FINANCE IN NORTH AMERICA 12, 14-16 (2009) (presenting demographic reasons why Toronto may be better suited to be the center for Islamic finance in North America).

2011]

ARAB MONEY

1097

### 7.2. *Simplify the Regulatory Regime*

If education efforts are not enough, as a supplement, the United States government can adopt some of the British financial reforms, in particular, the consolidation of financial regulatory agencies. The current Obama presidential administration proposed such a scheme in June 2009<sup>219</sup> after senators such as Charles Schumer (D-NY) proposed mimicking the British banking system back in March 2008.<sup>220</sup> Although the Treasury Department proposed to consolidate and create a new National Bank Supervisor to supervise all federally chartered banks,<sup>221</sup> the proposal did not make it into the final Dodd-Frank Act.<sup>222</sup> This is likely a consequence of bureaucrats and government agencies fighting against a reduction in the size and number of agencies because of entrenchment. As such, agency consolidation is a tough prospect, given the gravity of the politics behind such a proposition.

### 7.3. *New Statutes*

The final tier of my three-tiered solution is to propose a statute that provides for an alternative mode of banking, one that does not fit the conventional commercial bank, S&L, or credit union model. Such a bank, while complying with capital adequacy,

<sup>219</sup> See U.S. DEP'T OF TREASURY, FINANCIAL REGULATORY REFORM: A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION (June 17, 2009), available at <http://online.wsj.com/public/resources/documents/finregfinal06172009.pdf> (outlaying the Treasury Department's proposals to consolidate financial regulatory agencies) [hereinafter TREASURY DEP'T]; see also Damian Paletta, *Single-Regulator Plan for Banks Now Close*, WALL ST J., May 28, 2009, at A2 (explaining that the Obama administration was close to recommending the creation of a single regulator to oversee the entire banking sector but that there were still suggestions that administration officials might pursue a more streamlined approach to supervision as opposed to creating a new, single regulator).

<sup>220</sup> See *Sen. Schumer Urges New Financial Regulation: Report*, REUTERS (Mar. 28, 2008, 3:52 AM) <http://www.reuters.com/article/2008/03/28/businesspro-financials-schumer-dc-idUSN2833735020080328> (noting that U.S. Senator Schumer (D-NY) suggested that financial institutions have become linked in their fate due to the rapid development of new financial instruments and that a single regulator focused on results rather than rules would be better able to manage systemic risk).

<sup>221</sup> See DEP'T TREASURY, *supra* note 219, at 3 (proposing that "[a] new National Bank Supervisor to supervise all federally chartered banks").

<sup>222</sup> See Dodd-Frank Act, *supra* note 160 (codifying reforms to the bank regulatory system, which did not include the full adoption of a single regulator).

management, and consumer protection concerns would essentially provide interest-free banking for religiously conscious Muslims, Jews, Christians, and others. The statute must be secular, pursuant to *Zelman v. Simmons-Harris*, 536 U.S. 639 (2002). *Zelman* held that a statute may indirectly help one religion, but if it does, it must be facially neutral. Hopefully, this final drastic step would not need to be taken, and instead, bankers and U.S. regulators could work within the bounds of the current framework to offer unique financial products such as *shari'a*-compliant banking products.

Whether that becomes the case or not, the Islamic finance sector is growing and as it grows, U.S. legislators should start regulating the industry to guide its growth. While there are concerns such as possible ties between Islamic finance and political agendas, terrorist funding, and U.S. economic sanction circumvention, these concerns are the very reason U.S. legislators should start regulating the industry.<sup>223</sup> Regulating the industry would allow the nation to reap the benefits of Islamic finance, such as capital formulation and economic development, while fostering transparency and preventing illicit use of funds through disclosure requirements. Furthermore, it would allow the United States to shape, comment, and weigh in on standards for the industry through discussions with international standard-setting organizations, such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB).<sup>224</sup>

## 8. CONCLUSION

In sum, the United States has a lot to gain from reshaping and lifting the regulatory, constitutional, and financial barriers to Islamic finance and banking. By emulating the British banking scheme, which has undergone educational initiatives, regulatory consolidation, and statutory reconstruction, the United States

<sup>223</sup> See SHAYERAH ILIAS, CONG. RESEARCH SERV., RS 22931, ISLAMIC FINANCE: OVERVIEW AND POLICY CONCERNS 6 (2009) (recognizing a potential need for congressional oversight over the industry to accommodate its growth and debunking that it would be inordinately susceptible to "money launderers or terrorist financiers").

<sup>224</sup> See SCOTT SCHMITH, INT'L TRADE ADMIN., DEP'T OF COMMERCE, TRENDS IN ISLAMIC-FINANCE REGULATION 7 (2006) ("To remain competitive [in the Islamic finance industry], U.S. banks must adapt their products and strategies to accompany important regulatory and market trends.").

2011]

ARAB MONEY

1099

could tap into some of the billions of petrodollars, also known as “Arab Money,” from the Middle East.

The easiest way to start the process is with tier one of my three-tiered solution: an educational drive. The other two tiers, (1) consolidating the entire financial regulatory sector or (2) ratifying a bill that would usher in an unprecedented banking model, would face tremendous political opposition in Congress, especially given the current climate with the World Trade Center mosque controversy, as well as the failed Times Square and Christmas bombers.<sup>225</sup> Such events have sparked proposed anti-*shari'a* statutes in Oklahoma and other states.<sup>226</sup> However, at the same time, Americans are desperately seeking a change in financial regulations given the ineffective response of the current regulatory scheme in dealing with bank failures, the subprime mortgage crisis, and the credit crunch.<sup>227</sup> Thus, there is potentially a broad base of support from voting constituents for the advent of a single financial regulator that would be more effective in preventing financial crises and in attracting foreign investments.

If Islamic banking is successful in the United States, there will then be room for further financial innovation that could spur the growth of future financial markets. For instance, there is *takaful* (Islamic insurance),<sup>228</sup> *shari'a*-compliant pension schemes, *shari'a*-compliant open and closed end funds, ethically based Islamic

---

<sup>225</sup> See, e.g., Adam Nossiter, *Lonely Trek to Radicalism for Nigerian Terror Suspect*, N.Y. TIMES, Jan. 17, 2010, at 1 (stating that the father of Umar Farouk Abdulmutallab, the alleged Islamic extremist and “Christmas underwear bomber” was a secular Nigerian banker).

<sup>226</sup> For a federal version of these failed anti-*shari'a* statutes, see Jihad Prevention Act, H.R. 6975, 110th Cong. §§ 2–4 (2008) (proposing to require aliens to attest that they will not advocate installing a *shari'a* law system in the United States as a condition for admission).

<sup>227</sup> Around the world, people are looking to Islamic finance for solutions. For instance, in March 2009, the Vatican’s official newspaper “L’Osservatore Romano” argued that banks should consider looking to the rules of Islamic finance to restore confidence amongst their clients at a time of global economic crisis. See Lorenzo Totaro, *Vatican Says Islamic Finance May Help Western Banks in Crisis*, BLOOMBERG, (Mar. 4, 2009, 3:33 AM), <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aOsOLE8uiNOg>.

<sup>228</sup> For background on *takaful* and Islamic insurance products, see Hania Masud, Comment, *Takaful: An Innovative Approach to Insurance and Islamic Finance*, 32 U. PA. J. INT’L L. 1133.

1100

U. Pa. J. Int'l L.

[Vol. 32:4]

private equity<sup>229</sup> and real estate investment trusts ("REITS"), and even the potential for Islamic hedge funds. Thus, although the demand for Islamic financial products is unknown, the growth potential is both large and worthwhile. Such opportunities abound for the United States to get some of that "Arab Money."

---

<sup>229</sup> For examples of the United States being a beneficiary of Islamic private equity money, see Craig M. Douglas, *At Private Equity Firm, Culture Clash Yields Legal Spat*, BOS. BUS. J., (May 9, 2005, 12:00 AM) (last modified July 8, 2005, 12:53 PM) <http://www.bizjournals.com/boston/stories/2005/05/09/story3.html> (describing Transocean Capital's investments out of Boston as a subsidiary of Gulf Investment House in Kuwait); Joe Rauch, *Arcapita Nets \$362M Profit, To Invest \$1B*, ATLANTA BUS. CHRON., (July 29, 2008, 12:00 AM), <http://www.bizjournals.com/atlanta/stories/2008/07/28/story2.html> (describing Arcapita Inc.'s investments in Atlanta as a subsidiary of Arcapita Bank in Bahrain); *Unicorn Announces Successful Exits from its Two Earliest Investments*, AMEINFO.COM, (Mar. 26, 2007, 2:49 PM) <http://www.ameinfo.com/114808.html> (describing a Saudi Arabian private equity firm's successful investment in the Gardens, an assisted living project in southern California). For information on Islamic private equity in general, see SHAHZAD SIDDIQUI, *SHARI'A-COMPLIANT PRIVATE EQUITY: A PRIMER FOR THE EXECUTIVE* (2010).