UNCONVENTIONAL BANKING IN A CONVENTIONAL ENVIRONMENT: 
ISLAMIC BANKING AND FINANCE IN THE USA

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By

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ABSTRACT

The separation of religion and state is a fundamental principle for the US democratic system and one that is guaranteed by the US Constitution. This division is strictly enforced. The Islamic economic system goes beyond the pure financial and economic matter. Islam emphasizes a religious approach to life. The concept of forbidding transactions involving interest, derivatives or short selling seems like an alien idea to many Western economists. Indeed when one analyzes the foundations of Western economics and compares it to Islamic economics the disparity between the two only becomes more visible. An Islamic economic system holds opposing views from the Western conventional, capitalistic one. Islam is not only a religion, but also sets of norms that influence every aspect of human life including rules for politics, economy, etc.

The main goal set for this work is to investigate and analyze the Islamic financial and banking market in the USA, specifically its development, evolution, and perspectives and to find out whether the USA is an attractive financial market to offer Shariah compliant products and services by examining the demand for Islamic financial services by utilizing a questionnaire that was developed to gauge consumer perceptions and attitudes of Islamic Banking and its products. Although Islamic Banking and Finance has been a part of the American financial environment for quite some time, its
development has been a relatively slow process. However, due to the recent economic shocks in the US, further development of the Islamic Banking industry has a better chance of being more quickly and further integrated as people look for a more ethical and responsible method of banking. The study provides evidence that Islamic Banking fits into the reality of traditional banking within the US but further development of a regulatory structure is needed to make the integration more successful. This paper does not advocate the complete adoption of Islamic financial and banking principles by the US but rather the synthesis of certain aspects that can make US banks and financial institutions more responsible, risk averse, and ethical. Although the data revealed that consumers within the US are willing to do business with nontraditional forms of banking and financial institutions, the general public remains unaware of the alternative that Islamic Banking and Finance provides, as evident by responses to the accessibility and advertisement questions provided in the questionnaire. Although there are numerous Islamic Banking institutions in the US, the number is still too small and more importantly however is the fact that there is no national Islamic Banking institution in existence thereby severely limiting standardization. It is crucial that more Islamic Banks be created throughout the US and that at some point consolidation takes place. Furthermore, the lack of advertisement is also a worrisome aspect that needs to be addressed in order for Islamic Banking and Finance to gain more utility and acceptance. At no other time has there been such a potential opportunity for Islamic Banking and Finance to further establish and strengthen its foundations within the US. The only question now is whether it will take advantage of that opportunity.
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CHAPTER ONE
INTRODUCTION

In 1985 an important conference held in New York City discussed the growth of the Islamic finance movement within the United States and explained the perception of normative concept that could be defined as conduct of banking in consonance with the ethos of the value system of Islam. The most distinctive feature of Islamic banking is of course its total abstinence from interest from observance of Islamic prohibition of all interest-based transactions. However, Islamic banking is much more than just abstinence from interest. To deserve the name, Islamic banking has to make a vital contribution to the achievement of Islamic socio-economic objectives. These objectives briefly are eradication of mass poverty, equitable distribution of wealth and sufficient opportunities for gainful employment.¹

This paper will argue that Islamic banking and finance, while different than conventional and traditional Western economics and banking, notably its features of prohibition of interest and the idea of profit and loss sharing (PLS), permits and encourages development of Islamic banking and finance in the United States. In addition, this thesis examines the evolution and current status of Islamic finance and banking in the US and whether the United States is an attractive market for Islamic finance products.

Islam is not only a religion but an arrangement of general standards of behavior that goes much further than the contents of belief because the Islam proclaims a holistic

approach to life with regards to religion, social aspects, economy, finance and politics. Islamic banks and Islamic financial institutions are part of the Islamic economic system. Islamic economics set up a variety of movements and social projects. The foundations for Islamic economics and finance is the Holy Quran, the local Sunni or Shi’i tradition in practice of Islamic religion and the Shariah, which provides a religious construction as well as social and ethical boundaries for Islamic finance and banking activities. According to the Holy Quran, Islamic finance and bank institutions can’t trade or generate money that uses interest, usury is restrained and interest is not allowed. However, money may be used for creating better value and to improve a country’s economy.

The concept of forbidding any transactions on interest, derivatives or short selling seems like an alien idea to many Western economists. Indeed when one analyzes the foundations of Western economics and compares it to Islamic economics the disparity between the two only increases. Western economists, notably Milton Friedman and Adam Smith argue that the responsibility of the firm is to pursue wealth and not social goals and for a person to maximize utility, which is accomplished by consumption. Banks play a vital role in this process by permitting the conversion of future wealth into present by the idea of interest, which permits artificial demand in the economy and thereby stimulating development. This development however is not always for the greater good of society as money is channeled into projects that maximize profit, regardless if those projects benefit society.
Islamic economics on the other hand does not favor excessive consumption in order to maximize utility, nor does it permit the idea of bringing future wealth into the present. The driving force here is not only profit but also economic justice, i.e. equitable distribution of income.

The United States financial market operates eight types of financial institutions, including commercial banks, credit unions, stock brokerage firms, asset management firms, insurance companies, finance companies, building societies and retailers. Typically, these are the key financial organizations in the United States that control the flow of money in the economy. These various financial institutions operate as the intermediaries between the capital and debt market in the US. The service provided by a financial institution depends on under which type the institution is incorporated and what kind of license it holds. Based on the status of incorporation the financial activities vary and include money deposit, credit, financial commission, money transfer, issuance and administration of electronic money.

The US financial regulators authorized different types of Islamic financial institutions, such as retail banks, mortgage companies, and community based financing organizations, financing investors, mutual funds companies, and investment groups. It is estimated that Islamic finance activities within the US are valued at $150 billion and the profitability of Islamic financial institutions is directly connected to investors/capital value.²

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The funding of Islamic finance and bank institutions in the US is based on the amount of funds available from deposits. The two principal components of capital money are the stable portions of customer deposits and tangential funds. All Islamic financial and banking institutions actively use concentration of capital as a core business method to create attractive additional value. Creating customer value in turn creates institution value. By providing satisfying services based on Shariah principles to their customers Islamic banks bring value to itself by developing its customer market. US Islamic financial institutions work closely together with the client and Shariah scholars to ensure the Shariah compliance of financial products. Islamic financial products must also adhere to the US regulations so that bilateral agreements - between the Shariah and US financial laws - are ensured. Current Islamic financial products provided and offered by the US Islamic financial institutions are merchant banking services as well as capital market instruments and treasury products.

Based on the traditional Islamic contracts the US Islamic financial institutions create modern transactions. Islamic financing techniques are established upon one of two basic principles: A) profit and loss sharing principle; B) mark-up or referred to as the cost-plus financing. Cost of Capital analysis applies to the return on capital ratio as a standard for measuring the performance and financial growth. In the profit-loss-sharing principle the investors are not permitted to escape the consequences of any failed venture.\(^3\)

Islamic financial institutions and banks have to establish a Zakat fund to collect and redistribute donations to charities. The redistribution of Zakat is also a problematic matter for Islamic finance and banks operating in the US. The US Department of Treasury and IRS issues a list of acceptable and tax deductable charities and not for profit organizations operating in the United States, however the list of charities provided by the IRS may differ with what Islamic finance and banks organizations are willing to contribute to. Appendix IV presents a list of the IRS acceptable Islamic charities.

It is interesting that the certification of differential domestic financial products regarding Shariah compliancy is left to the Islamic bank or financial institution discretion of choosing. The reasons for this approach might be lower permanent costs and higher acceptance of the products by the respective client.

1.1 Objective and Organization

This main goal of this paper is to show that Islamic banking and finance, while different than conventional Western economics and banking, notably its features such as the prohibition of interest and the idea of profit and loss sharing (PLS), permits and encourages development of Islamic banking and finance in the United States. This thesis uses Islamic banks and financial institutions in the US as a case study to examine how Islamic financial institutions are developed, how they are performing, and whether they keep true to Islamic ethos. It will examine the legal frameworks and regulations for Islamic finance and banking industry, the financial products, techniques and methods used to create shareholders value and growth, and whether Islamic finance and banking institutions in the USA compete or complement the conventional finance system. It will
evaluate the standards for accounting, reporting and transparency and analyze the demand and perspective for future growth of the US Islamic financial and banking market and services.

The paper is divided into twelve chapters. Chapter Two describes the strategy, study, methodology and limitation of this research. Chapters Three and Four will discuss the theoretical agenda of Islamic finance with its historical and intellectual background as well as the development of Islamic finance and banking industry. Chapter Five examines the structures of the Islamic finance and banking institutions in the U.S. Chapter Six gives critical look and examination of the contracts used for the development of new Islamic financial products in the US financial market and their effect on the performance of Islamic finance and banking institutions. Chapter Seven examines the standards for accounting and reporting and evaluates the transparency of Islamic finance and banking institutions operating in the US. Chapters Eight and Nine will provide management analysis, including liquidity, market and risk management analysis. Additionally, focus is given on evaluating the connection of management techniques with the shareholder value, growth and performance of Islamic banks. Chapter Ten investigates the legal regulations and frameworks that the Islamic finance and banking industry faces in the US. Chapter Eleven presents data obtained from a questionnaire to determine the demand and perspectives for future growth of the US Islamic financial and banking market and its services. Chapter Twelve presents the conclusions and its findings and suggestions regarding Islamic financial institutions.
CHAPTER TWO

STRATEGY AND METHODOLOGY OF RESEARCH

This research uses a qualitative study to investigate the development and growth of the Islamic finance and banks institutions in the USA and to describe and explore the challenges and issues faced by US Islamic finance and banks, the perspective for growth, and to measure the value that they create and have created.

2.1 Research - Approach and Design

The qualitative and descriptive approach will be utilized to conduct the research for this thesis. Books and journal articles are used to provide the foundational framework to establish the concept of Islamic banking and finance. Along with these sources, I also included data and material from the World Bank and International Monetary Fund, with regards to the Islamic banking system and provide useful information in determining the uniformed and harmonized accounting, reporting, and evaluation of performance and policies of Islamic finance and banking institutions.

The descriptive methodology was used to obtain the necessary data and information with regards to the measure of performance and growth of the Islamic finance and banks institutions, which has to incorporate in their operations the Shariah principles and the US regulations and laws.

Table I below deals with the questions and conditions; history; the strategy for the case study; outline for research strategy, archival analysis and the survey used to analyze Islamic institutions and banking in the USA.
Table I
Research Design

<table>
<thead>
<tr>
<th>Research strategy used</th>
<th>Events</th>
<th>Draw attention to questions</th>
</tr>
</thead>
<tbody>
<tr>
<td>History</td>
<td>Past</td>
<td>Who, when, why, how</td>
</tr>
<tr>
<td>Archival Analysis</td>
<td>Past</td>
<td>Who, when, why, how, how much, how many, where</td>
</tr>
<tr>
<td>Case study</td>
<td>Contemporary</td>
<td>Why, what for, how</td>
</tr>
<tr>
<td>Survey</td>
<td>Contemporary</td>
<td>Who, when, why, how, how much, how many, where</td>
</tr>
</tbody>
</table>

Source: Andrzej D. Szczepanowicz

To perform the research this paper has applied the qualitative research approach described by Yin, R.K and used the following design: A) history; B) theory - analysis of archival information; C) survey; D) case study of Islamic finance and banks in the USA.¹

To gain a deeper understanding of the issues in the Islamic finance and banking in the context of the valuation, measuring growth and performance this research is conducted as a qualitative study. This approach provides more affluent and enhanced details for exploring viewpoints.

Provided is a systematic description of the findings and the data is well structured. Attention was paid to validity and reliability in order to reduce the possibility of getting an incorrect answer and conclusion. In order to increase the validity various sources of evidence was used, including available financial data from Islamic banks and institutions, and internet engine research.

2.2 History and Literature

Books and journals articles on the subject were used to describe the substance and background of Islamic banking and finance. In this part of my research strategy I have covered the theory of Islamic banking and finance as is discussed in Chapters Three and Four. In addition this part of research covers the institutional structures of Islamic finance and banks. The accessibility and use of historical information was a simple part as this topic is very well covered.

Writings on Islamic economics theory and practice have flourished around the world in Islamic and non-Islamic countries and were written by Muslims and non-Muslims individuals especially within the last twenty to thirty years. Many factors contributed to such increased interests in writing regarding Islamic economics. The most important factor was the Islamic movement and Islamic renewal way of life, politics, and economics. Other contributing factors are globalization and the money from increased oil prices that came to oil producing Muslim countries.

2.3 Empirical Study

While the initial stage of the research and study dealt with the theory of the Islamic economy and its foundations, financial functions, objectives, as well as Shariah requirements and principles, the second part covers results of the research and investigation on the validity in market creation and growth of Islamic banks and finance in the USA. I paid attention to validity and reliability in order to reduce the possibility of getting an incorrect answer and conclusion. Chapters Five and Six concentrate on the
current events, perspectives and demands for Islamic finance and banking services in the USA.

The target audience for Islamic finance and banking are Muslims immigrants, an American born Muslims and non-Muslim population in the USA and the analysis of the population will be performed in Chapter Eleven. The following questions were asked: Is there a demand for Islamic financial services in the USA? Is the USA an attractive financial market to offer Shariah compliant banking? Will Americans look for different financial products? What are the existing legal and tax frameworks for Islamic finance in the USA? How the development of Islamic finance and banks in the USA is progressing? Is the United States an attractive market for Islamic finance products?

The transparency problem creates the always unknown variable in measuring shareholder value and performance of Islamic banks and finance institutions. Performance evaluation is a method of measuring a company’s accomplishments based on agreed contacts and goals. Part of the Islamic financing and banking industry, such as financing groups, develop their own performance indicators while other institutions such as mutual funds use financial index and valuation methods, which serve the need of various stakeholders for measuring performance and to evaluate shareholders value and growth objective.

The Islamic financial and banking industry operates and uses a cost of capital account. The time value of money is incorporated into contracts, goals, and valuation of shareholders value and the cost of capital is a form of substitution of interests. The cost of
capital or return on capital is the most important factor for performance, goal, shareholders value and growth of Islamic finance and bank institutions in the USA.

2.4 Scope and Limitations

Most of the Islamic banks and finance groups in the USA function more like private equity firms than conventional banking. Islamic finance disclosures are rare and do not provide extensive details about their banks and funds balance sheet or the actual size of its assets.

Because Islamic banks and finance institutions were created using private funds, they are private equity Islamic finance institutions that do not have any obligations to disclose their finance statements and balance sheets to the general public or other groups. To have access to such statements would give me or anyone making similar research the data that would make the task of measuring the real growth and performance of Islamic finance and banks institution against their conventional counterparts in the USA a real possibility. However, without this data it's somewhat impossible to perform any possible analysis. Whether by force or by natural progression, as Islamic Banks and Financial Institutions grow in number and consolidate transparency of their financial data and statements will become more open.

Being restricted to incomplete data with regards to balance sheets limits full and impartial analysis regarding Islamic banking and finance institutions performance, future growth, and value creation. However, future studies can be performed regarding financial performance, as well as Islamic bank employees’ views on whether or not Islamic banks
need to improve or change the methods that are used to create value, as well as the methods used to measure performance.
CHAPTER THREE

HISTORICAL AND INTELLECTUAL BACKGROUND OF ISLAMIC BANKING AND FINANCE

Islamic banks and financial institutions are a part of the Islamic economic system and were established to achieve certain socio-economic objectives in accordance with the concepts of the Shariah laws that are based on the Holy Quran. According to the Holy Quran, Islam is an ideology of social development that requires all individuals and businesses to conduct themselves ethically and in a socially responsible manner. For over a thousand years the Islamic state existed in some shape and or form, independent and powerful, which served as a beacon of inspiration for Muslim identity and fortunes. In under a mere hundred years since the death of Prophet Muhammad in 632 the Islamic state spread through both expansion and conquest into an empire more powerful and advanced than ever seen by humanity. This great civilization developed political, social, and legal institutions and frameworks that allowed it to flourish thousands of miles in either direction from its original source. During the Middle Ages while Christian Europe was experiencing its Dark Ages the new Muslim Empire flourished from Baghdad to Cordoba and served as the world’s center of learning and culture. Even after the Mongol invasion and the fall of Baghdad in 1258 and the subsequent turbulent history afterwards, the Muslim, most notably under the Ottomans Empire was able to take its place allowing Muslims to live in an Islamic state where Shariah remained as the guiding factor for
society that served as the important beacon of identity to all Muslims where it was possible to fulfill their duty to God.¹

The dominant principle of Islamic economics is that of the responsibility for the stewardship of property, derived from the belief in God as creator: The Almighty Allah is the real Owner of everything. Man is no more than His trustee. Man in Islam is Allah Khalifa (vicegerent) and representative on earth. As His trustee, man is obligated to obey the instructions of the One who appointed him in this capacity.²

By the nineteenth century the ability for Muslims to fulfill their duty of serving as God’s representative (khilafah) was severally inhibited by European colonialism. As a result much of the Muslim world was forced upon a path of Westernization and modernization that led to blind adaptation of European modes of operation in areas such as economics, education, and politics. Instead of adapting the factors that would work within an Islamic state and ignoring what would not, Muslims blindly adopted institutions and codes that were the direct products of the West’s historical and cultural experiences that spanned several centuries of development onto a culture with fundamentally different historical traditions, experiences, and values. The end result included migration from villages and rapid urbanization of overcrowded cities that had insufficient social support systems, the breakdown of traditional family, religious, and social values, and the adoption of a western lifestyle that once was a symbol of modernity but became increasingly criticized as the primary source of moral decline and spiritual


malaise. The outright advance of European colonialism into the Muslim world in the beginning of the 19th century brought both Western and Islamic ideals into direct physical contact. Dar al-Harb became no longer a distant mystical domain where the infidel lived and a thought which Muslims could simply choose to ignore, but rather a reality in which a response to the threat was necessary.\(^3\)

Faced with the reality of having the West at its door and the question of how to respond to the confrontation between Islam and the West, two completely different modes of Islamic response were suggested by Muslims that embraced modernity, rejected it, or adapted it to Islam: accommodation or withdrawal. The former group stood for the accommodation of Western ideals into Islam and to learn from the West. Among these group of scholars included are: Sayyid Ahmad Khan, who argued that Islam was compatible with modernity when properly understood and interpreted; Khary al-Din al-Tunisi, who argued that learning from non-Muslims is not only permissible but encouraged; Muhammad Abduh who believed that Islam was compatible with Westernization and made Muslims obligated to use their reasoning powers to adapt the basic principles set out in the Shariah to the changing conditions of life in each generation; and others such as Muhammad Iqbal and Rashid Rida. It was Modernist, secularist, nationalist, and Marxist ideas that garnered the consensus of the majority of Muslims. Although there were alternate antiestablishment ideas presented, most notably that of Jamal al-Din al-Afghani, and armed resistance, such as al-Qadir’s movement against the French in Algeria, the Mahdist movement under Muhammad Abduh in the

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Sudan, or the efforts of the “mad mullah” Muhammad Hasan in Somalia, these ideas and movements, most times associated with the Sufi orders, all ultimately failed due to the technological and military dominance of the West. Finally, any possibility and hope for Pan-Islam and Muslim Unity on a global level was crushed with the elimination of the Ottoman Empire and with it any real countervailing power to that of the West.  

By the middle of the 20th century the dominant theme of Islamic Modernism, which had been in the Muslim history for the past two centuries, and liberal and nationalist modernists were beginning to fail, due to among other factors the near impossibility of justifying Islam to modernity and blatant copying and not adaptation of Western ideals. The defeat by Israel in 1967 signaled the defeat of nationalist/modernist regimes as the political leadership within the Muslim world became seen as a discredited force.

… Israel launched a preemptive strike against Egypt, Syria, and Jordan. In six grueling days, Israel doubled its territory by taking the Gaza Strip and the entire Sinai Peninsula from Egypt. The Israelis then captured the West Bank from Jordan, including Arab East Jerusalem, and in fierce hand-to-hand fighting they seized the strategic Golan Heights from Syria….  

The fabric of society throughout many Muslim countries underwent radical transformation. As the governments were beginning to see their credibility vanish the voices of those Muslims who from the beginning were against accommodation began to gain currency. The groups of Muslims who have been unwilling to accommodate and

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cooperate with the West have been the subject of intense discourse and not surprisingly have been given many names. Due to their argument that to right the present plight of Muslims can be corrected by going back to the golden age when God gave them the comprehensive and unchanging pattern for individual and communal living they have been called scriptural literalists, radicals, fundamentalists, and Islamists. Others have given them the term Muslim normativists: those who persisted in reiterating and perpetuating the heritage with total disregard for, or fervent condemnation of, all foreign ideas as innovation and therefore un-Islamic; and neo-normative: those who have consciously assumed the quest for an Islamic world view that is relevant to the modern world and whose attempt is to revitalize and modernize their societies by insisting that Islam must be the norm by which all aspects of life are to be measured. Furthermore, neo-normative Muslims sidestep past historical, traditional, and linguistic of the Holy Quran and instead choose to use as follows:

...specific verses to address each individual and society in their existential moment. In this context, quotations from the Quran became the validation of and the justification for revolution as authentically Islamic. The mission of Muslims is not to accommodate the guidance of the Quran to prevailing or borrowed social systems; rather, the revelation itself provides a revolutionary ideology that seeks to transform society and liberate people from bondage to human systems....

Whatever name we decide to give them it is important to remember that they promote the return to Islam as an ideology for political action to remedy the problems of Muslims. They are articulating political Islam: an active dynamic force inciting political

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involvement and action by Muslims to bring about the re-Islamization of their societies
and establishment of an Islamic order. They seek to realign politics with Islam in ways
that are anti-Western, anti-secularist, and anti-modernist. Three of the most famous
individuals who argued that Islam is valid everywhere and for all time have been Hasan
al-Banna, Abu Mawdudi, and Sayyid Qutb. Their ideas resonate throughout the current
Muslim fundamentalists and Islamist economics throughout the Muslim world.7

In comparison to contemporary Islamic intellectuals today Sayyid Qutb is as
revolutionary now as he was thirty years ago. His ideology and ideas are radically
different from the more progressive and liberal Islamic thinkers who are attempting to
articulate an Islam for the 21st century. Furthermore, while political party systems,
democratic elections, Islamic economic system and parliamentary forms of government
were adopted throughout the Muslim world, in reality dictatorship and authoritarian rule
was the norm and eventually lead to a government that was unable to deal with the
economic, social, and political needs of their societies. Taken together, these factors
brought disillusionment with the West and lead to many, particularly Islamists who felt
that the secularized societies should be replaced with an Islamic political and social
system, throughout the Muslim world to argue for the abandonment of the Western
secular path of development and returning to the path of Islam. The development of
Islamic economics’ and consequently Islamic finance and banks is a result of Islamic
sociology where Shariah law strictly ruled what a Muslim is allowed or not allowed to
do. Usury which includes interest rate is restrained, Muslims cannot finance or participate

in any forbidden activities and an ethical investing is the only acceptable investing. Islamic economy expresses a variety of movements and social project. However, the modern Islamization starts in 1970 after Libya’s president Muammar Qadhafi gave his famous speech the “Third Way” where he expressed a distinctive, unique, culturally authentic Islamic model - the third way - the Islamic way against the West capitalism and against the communism way. The bank Tabung Haji is one of the oldest Islamic financial institutions in modern times. The bank Tabung Haji based on Shariah principles was founded in 1962 in Malaysia.

The classical Islamic economic theory constitutes a pre-ordained system of God’s commands relating to the duties of each Muslim and four main principles or roots: A) the Holy Quran; B) the early Islamic traditions of the Prophet which are recognized and incorporated into an understanding of the textual interpretations of the Shariah; C) the consensus of religious scholars within historically accepted legal schools of Islamic thought; and D) Shariah new interpretations called fatwa’s.

The accumulated wealth from oil boom brought an escalation to Islamization. From that point, the third way - an Islamic way - gained a considerable appeal, and the idea of Islamic economics was developed and flourished in the Middle East region, Islamic countries in Asia, Africa and Muslim population in Europe, the USA, and Canada. In many Muslim countries in the Gulf region, Asia and Africa Islamic financial

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and banking institutions have taken root since 1970. When the Arab countries started to benefit from the oil wealth in 1973 and 1974, political climate changed and the idea of Islamic economics was supported and banks and Islamic financial institutions were established to achieve certain economic and social objectives in accordance to the Holy Qur’an and with the agreements of law and principles set up by Shariah. A religious supervision is one of the most important features in Islamic finance and bank institutions.10

The Islamic way has gained considerable appeal for Muslims. After a number of decades of conventional banking, people in Muslim majority countries in the Gulf region, Asia and other parts of the world, demand for investment and financing possibilities that comply with their faith increased. This development gave rise to the current dynamic growth of the Islamic financial service industry. The Islamic bank and financial industry grew dynamically after two key institutions were established - the Islamic Development Bank and the Dubai Islamic Bank institutions.11 The Islamic Development Bank is an intergovernmental bank aimed at providing funds for development projects in its fifty-six member countries.12 The Islamic Development Bank gave momentum to the Islamic banking movement followed by private and governmental institutions and has been fostering the development of Shariah compliant financial instrument. The Dubai Islamic

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Bank is the first Islamic bank offering full service and products and is a fully fledged private Islamic bank. Both institutions play a major role in today’s Islamic financial market. During the 1980’s several other Islamic financial institutions as well as the first Islamic mutual funds emerged.
CHAPTER FOUR
THEORETICAL FRAMEWORK

4.1 Literature Framework

Is there a conflict between Islamic theory of doing business and the creation of return on investment or cost of capital which the asset created? There are opposite views regarding Islamic theory of doing business and creation of value in Islamic theory and practice. Some Islamic experts and practitioners admit that conflict exists regarding value creation between Islamic theory and practice. Cultural relativism and geographic mosaic of Muslims in the Middle East, Africa, Asia, Europe and American continent challenge the authenticity of Islamic economics and evaluation of economic programs by the Holy Quran and Shariah law.

Islamic economics has its roots in religion and political advancement and approval, so it’s not very surprising that many economic programs and financial products have various results: some made progress, some are experiencing problems and difficulties and some have failed.

Classical Islamic economic theory is based on four main pillars: A) the Holy Quran; B) the early Islamic traditions of the Prophet which are recognized and incorporated into the textual interpretations; C) the consensus of religious scholars within historically accepted legal schools of Islamic thought; D) Shariah new interpretations
called fatwa’s. Accordingly, religious supervision in Islamic finance and banks is aligned with these standards.¹

In various writings, especially Milestones and In the Shade of the Quran, we can identify some major differences between different theories for Islamic economics’ and finances’ stances represented by likes of Anwar Ibrahim, Abdurrahman Wahid, and Abdolkarim Sorush.

Many extreme Islamist economists base their programs, strategies, and tactics on Qutb’s ideas such as the fusion of religion and politics, jihad, hakimiyya, jahiliyya, and Islamic universalism versus nationalist particularism. Qutb elaborated and popularized an Islamic worldview based on exclusivity and self-sufficiency that is increasingly assertive and combative. Excellent description of his ideas is presented in Voices of the Islamic Revolution.²

One of the most current, up-to-date, and useful books on the overall subject of Islamic Finance and Banking is The International Handbook of Islamic Banking and Finance by Elisabeth Jackson-Moore.³ This book provides an excellent and succinct analysis of the workings of Islamic banking, finance, and explores in detail the various alternative financial instruments and vehicles available to Muslim investors who wish to forgo conventional interest based financing. This book has an excellent section on the entire concept of profit and loss sharing. The two chapters on regulation and governance

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are first rate and will be extremely useful when analyzing the challenges that can arise while seeking funding for development.

Arab Islamic Banking and the Renewal of Islamic Law by Nicholas Ray provides a useful analysis of banking and finance as it relates to Islamic law. Specifically, the section dealing with the modes of Islamic finance and its evolution from medieval to current time will be useful in this research when describing the development of finance and banking within Islam.

Elias Kazarian’s book Islamic versus Traditional Banking analyzes several important factors, including government objectives and policy towards the banking system, the mobilization of savings, the allocation of funds, and financial efficiency. The book mostly focuses on the mobilization of savings, and argues that there are advantages that Islamic banking holds over traditional banking, most notably the Mudaraba contract as an efficient allocator of funds and Islamic ideology as being an incentive mechanism.

Critical Issues on Islamic Banking and Financial Markets: Islamic Economics, Banking and Finance, Investments, Takaful and Financial Planning by Saiful Rosly is valuable as it examines the influence that Islamic banking and finance has had on a developing economy, such as Malaysia. Of the many Islamic countries in the world

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Malaysia has been at the forefront of economic development and its success is largely owned to Islamic financial institutions and instruments. This book has an excellent overview of Islamic banking principles and products, notably bonds and securities utilized by development projects.

Finally, The Islamic Development Bank by S. Meenaiial though somewhat outdated, is still valuable as it gives the historical overview of the development of Islamic banks. The book holds many of the early annual reports that give excellent data on Islamic banking and financial institution’s procedures, operations, and policies.

4.2 The Holy Quran as a Base to Islamic Finance and Banking

The classical Islamic economic theory constitutes a pre-ordained system of God’s commands relating to the duties of each Muslim. The Islamic Alternative therefore must assume leadership of the Muslim community and ensure that God’s laws have sovereignty and all matters are judged in the light of God’s will as evident in his Shariah. The Holy Quran is a vision of society which adheres to God’s will and requires all Muslim believers and businesses to demeanour ethically as well in a socially oriented manner. True Muslims base life on tawhid, the unity of God. Tawhid mandates the unity of church and state because state and religion must be the same in order for men to worship and obey only one power. There cannot be human laws or constitutions, only the Shariah, God’s law.

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The Shariah represents the Islamic principles, rules, and commands previously introduced in the Holy Quran and Sunnah. The Shariah is the Divine Law that lists moral, ethical and legal principles and promotes a certain code of behavior described by the Holy Quran and describes or lists both the unwritten and written code of obligations toward every sphere of human activity. The Shariah includes a set of duties and practices such as prayer, manners, ethics, marriage, conducting business, finance transactions, contracts and other rules of Allah. The Shariah represents the attempt to define the will of God with regard to each and every behavior performed by Muslims in daily life activities as was discussed in Chapter Three. The Shariah is the way of life for a Muslim and regulates the relationship between men and Allah as well as all aspects and relationships of men among believers and infidels. The Shariah offers several ethical and social criteria for exclusion regarding the investment targets and financial products allowed for Muslims.

In addition to the principles set in the Holy Quran, the Shariah also includes the authentic Muslim traditions. It was discussed above that Islam stands for an ideology requiring believers to fully conform to the Shariah, the divine law of Islam. The geographical differences and local Sunni or Shi’i practices with doctrinal differences

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influence how Islamic faith is practiced and how Shariah law is interpreted and implemented.\textsuperscript{11}

Conventional contracts and securities based on interest-financial system issued by conventional banks and insurance companies are not admissible for Muslim investors. The five main Shariah principles that are permanent include the prohibition of riba, application of al-bay’ (trade and commerce), avoidance of gharar (ambiguities) in contractual agreements, the prohibition of maisir (gambling), and prohibition from conducting business involving prohibited commodities such as pork, liquor, illicit sex, and pornography. The forbidden actions are called Haram while the legal, permitted, and admissible actions are referred to as Halal.\textsuperscript{12}

\textbf{4.3 Shariah Supervisory Board Functions and Standards}

The Shariah Supervisory Board acts as a religious supervisory body guaranteeing that the finance practices and transactions are based on Islamic ethics and principles. The Shariah Supervisory Board has a leading and exclusive position in the governance structure of an Islamic finance and banks institutions and its functions can be a constitutive or operative. Figure I below illustrates the importance of the Shariah Supervisory Board and the interaction with banks, regulators, academics and lawyers.


In principle, the role of this board covers five main areas: certifying permissible financial instruments through fatwas (ex-ante Shariah audit); verifying that transactions comply with issued fatwas (ex-post Shariah audit); calculating and paying zakat (a tax on wealth) to charity; disposing of non-Shariah compliant earnings; and advising on the distribution of income or expenses among shareholders and investment account holders. The Shariah Supervisory Board also issues a report to certify that all financial transactions comply with the above mentioned principles.\footnote{Juan Sole, “Islamic Banking Makes Headway,” \textit{IMF}, September 19, 2007, http://www.imf.org/external/pubs/ft/survey/so/2007/RES0919A.htm (accessed November 4, 2010).}

The Shariah Supervisory Board plays an imperative role in advising Islamic financial institutions on their conformity with Shariah principles and rules. The core and basic task of a Shariah Supervisory Board is to certify that the Islamic finance or bank’s products and processes are in compliance with Shariah principles, in order to give
Muslims the confidence that they use financial products and invest or deposit in harmony with Islamic faith.\textsuperscript{14}

Islamic scholars, as experts with authority in Islamic jurisprudence are capable and competent to issue their own interpretation of Shariah law. An opinion issued by a single scholar or a Shariah Supervisory Board is a legal opinion called a fatwa. The fatwa is entirely binding document for the Islamic financial institution in question. However, a fatwa must not be mistaken for mandatory jurisprudence; it is a legal opinion and therefore should be considered as legal doctrine. Therefore it is possible to encounter contradictory fatwa referring to the same issue.\textsuperscript{15} The fatwas issued by the Shariah Supervisory Board members are bidding and will have to be respected by banks and financial institutions.

As the Islamic finance and banking industry further develops and grows, the financial knowledge and expertise of the Shariah Supervisory Board members turn out to be more important. According to the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), every fully-fledged Islamic bank should have a permanent Shariah Supervisory Board. A Shariah Supervisory Board should consist of at least three qualified members that have a comprehensive legal education from the Fiqh Academy. A Shariah Supervisory Board should evaluate Islamic financial products and transactions as well as overall banks compliance with Shariah principles and Islamic


ethos. Additionally, their function is the calculation and distribution of Zakat. According to the AAOIFI it is necessary for the integrity of the Islamic financial institution within the Muslim community that the Shariah Supervisory Board is completely independent to avoid conflict of interest. According to the AAOIFI to avoid conflict of interest the Shariah Supervisory Board members should not have management positions or financial interest as shareholders in a company. If Shariah Supervisory Board members are employed by Islamic financial institutions and they are paid salaries and benefits by management and its board, then the employment status may affect the required impartiality and may affect an unbiased opinion.  

4.4 The Fiqh Academy of the Organization of Islamic States

The Fiqh Academy of the Organization of Islamic States was inaugurated in 1988 in Jeddah under the patronage of the Organization of the Islamic Conference. Since the beginning of the Islamic Fiqh Academy, the Islamic Fiqh Academy has earned the respect of Muslim and non-Muslim scholars around the world. Since the beginning the Fiqh Academy of the Organization of Islamic States has been under continuous pressure from society and public opinions and it is subject to political influences.

The Fiqh Academy of the Organization of Islamic States constitutes the Islamic jurisprudence; fatwas and decrees issued by Islamic Fiqh Academy of the Organization of Islamic States describe how commercial financial transactions and bank institutions are regulated. The Fiqh Academy of the Organization of Islamic States may issue condemnations of business transactions and practices - the ante fatwa. The recent well

known condemnation is a condemnation of artificial murabaha contracts developed by Islamic banks in Pakistan and Malaysia. According to an artificial murabaha a creditor immediately releases the merchandise or commodities to the buyer without really possessing the merchandise or commodities, because sometimes the bank institution lacks the capabilities for storing and warehousing and to fulfill the conditions of the correct murabaha contract. The Fiqh Academy of the Organization of Islamic States has condemned this practice of the artificial murabaha contracts because artificially adhered Islamic contracts and other practices bring hazard and can put the entire Islamic financial system at risk.  

4.5 Foundations for Standardization and Transparency of Islamic Financial and Banking Institutions

The governance of Islamic finance and banking is ruled by the prime commitment to obey Islamic law. This implies that all products and services offered by Islamic finance and banks institutions have to be strictly Shariah compliant. According to Islamic economic theory, Islamic banking main objective is to avoid payment of interest and to conduct banking and financing transactions with the ethos of the value system of Islam and to mobilize funds through a fund management concept. Islamic financial and banking institutions capital structures provide for long term stability and conduct operations using capital in best and efficient way.

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Islamic finance and banking institutions obviously need greater standardization and more forceful regional institutions if they are to implement successfully Islamic financial products and increase their regional and international markets. The allies of Islamic finance movement are the International Monetary Fund’s and World Bank, which support the Islamic financial progress to implement the economic and financing reforms. If Islamic banks and finance will adapt and implement the international regulatory framework it will bring more cooperation and transparency that will contribute to creating additional value.

Islamic religious principles direct and guide business and investment behavior. Religious supervision is one of the most important features in Islamic banking and every business operation conducted by every Islamic financial institution should be in compliance with the strict religious standards. The disclosure and transparency are concepts not commonly practiced in Muslim countries where financial information is available and accessible to the public. Disclosure of relevant business transactions and balances contributes to increased efficiency in running operations and in creation of shareholders value. The lack of disclosure and transparency by Islamic financial institution decreases the efficiency, creation of value and growth. The rapid expansion of the Islamic financial industry that started in the 1970’s was not initially accompanied by the creation of a set of internationally recognized accounting rules. Islamic institutions around the globe, therefore, had to resort to developing their own accounting solutions
for their new products, rendering comparisons across institutions difficult, and sometimes even giving the impression of lack of transparency.\textsuperscript{19}

Unfortunately, Islamic banking and financing is still insufficiently regulated industry. Different Islamic laws and its interpretations exist in different Muslim countries. In order to do more trade and finance on international market a unified regulatory system and procedures are needed for Islamic banks and financial products. The growth of the Islamic banks and finance industry, created an increasingly important issue for the development of uniformed regulations for all Islamic financial and banks institutions. Another important aspect for the regulator is that its rulings and decisions are consistent with those of the Shariah boards of foreign supervisory agencies. An important effort toward achieving international consistency was the creation of two multilateral institutions: the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), which issues internationally, recognized Shariah standards on accounting, auditing, and governance issues; and the Islamic Financial Services Board (IFSB), which issues standards for the effective supervision and regulation of Islamic financial institutions.\textsuperscript{20}

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) was created and established to uniform and harmonize necessary calculations, accounting principles and reporting standards. The attempts by both organizations, the AAOIFI and the IFSB, to uniform and to harmonize the Islamic finance regulations are


\textsuperscript{20} Ibid.
welcome events to the international financial market. The need for a body of accounting standards purposely designed to reflect the specificities of Islamic products became even more pressing as new and more complex instruments were being marketed. To close this widening gap, the AAOIFI was created in 1990. One of the main goals of this organization is to design and disseminate accounting and auditing standards that can be applied internationally by all Islamic institutions.  

Further development of Islamic finance and banking industry creates a growing request for standardization and professionalism across the financial industry. The different standards and practices create a necessity of adopting strong governance systems of internationally accepted standards and to incorporate transparent, uniformed, fair and ethical accounting and reporting conditions.

4.5.1 The Accounting and Auditing Organization for Islamic Financial Institutions

In 1989 large financial institutions from the Middle East - 150 financial institutions such as central banks or monetary agencies as well as regulatory and supervisory authorities, organizations and associations responsible for regulating the accounting and auditing profession from thirty countries and international organizations such the World Bank, and the International Monetary Fund - signed an agreement to create an organization with the objective to standardize the Islamic finance policies and accounting procedures. Based on this agreement the Accounting and Auditing


Organization for Islamic Financial Institutions - the AAOIFI was founded in 1991 in Bahrain as an international Islamic non-profit organization.

To bring standardization and harmonization into Islamic financing and banking practices for accounting, reporting, disclosure, transparency, two central organizations in Islamic finance and banking sector were created: the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB).

The objective of the AAOIFI is to develop, standardize, harmonize and interpret, review and amend standards for accounting and auditing standards for Islamic financial institutions. Since then the AAOIFI has issued many publications with standards in accounting, reporting, auditing, governance, and ethics and Shariah compliance for Islamic financial institutions.

Islamic financial institutions don’t have the responsibility to adapt and implement laws; standards, guidelines and concepts outlined in the “Accounting and Auditing General Standards for Islamic Financial Institutions” issued by the AAOIFI, but increasing number of Islamic financial institutions in many Muslim countries use them as a chosen foundation to conduct business. It is a positive stance that many Islamic financial institutions and banks bring their systems and line up with the standards issued by the AAOIFI. Still the majority reports according to traditional standards for example the International Financial Review Standards (IFRS) instead of the Generally Accepted Accounting Principles (GAAP). Two different accounting and reporting standards and methods practiced by the Islamic finance and banking lead to confusion and problems.
The risks included in active Islamic financing products and techniques, transactions and contracts used create additional issues for accounting and reporting.

4.5.2 The Islamic Financial Services Board - IFSB

The Islamic Financial Services Board (IFSB) was founded in 2002 in Kuala Lumpur. The IFSB is an international organization committed to the development of standardization, uniform coding and criteria for the Islamic financial industry. The existing principles and open standards are being adjusted to accommodate the conventional accounting principles and standards with Shariah law and Islamic financial principles. The IFSB works in close cooperation with international associations of banks and capital groups such as Dar Al Mal Al Islamic, the Al Rajhi Banking and Investment Corporation, the Kuwait Finance House, Bukhari Capital, and the Basel Committee on Banking Supervision, and market supervisors, such as the Islamic Development Bank, the Al Baraka Banking International Monetary Fund, the World Bank, and the Bank for International Settlement.23

The IFSB published the first Guiding Principles on Shariah Governance System in which they discussed and explained what role and function Shariah boards play in the Islamic banking financial services and banking industry. Furthermore it was designed to help Shariah boards to make an effective statement whether Islamic financial institution goals were in compliance with principles of Shariah and discusses standards, guidelines and the technical notes on areas of transparency, market discipline, capital adequacy, risk management and corporate governance of Islamic financial and bank institutions.

The Islamic Financial Service Board published several additional publications - standards, guidelines and technical notes on areas of transparency and market discipline, capital adequacy, risk management, corporate governance, and recognition of ratings. The most interesting and important publications, from a financial standpoint were the Guiding Principles on Conduct of Business. The “Guiding Principles on Conduct of Business” issued by the Islamic Financial Services seek to construct on and harmonize existing international standards and encourage Islamic finance and banks institutions to view conformity as part of a general strengthening of good corporate governance culture. IFSB has also released publications including, The Guiding Principles on Shariah Governance System, Conduct of Business for Institutions offering only Islamic Financial Services (Excluding Islamic Insurance (Takaful), and Shariah Governance System and Governance for Islamic Insurance (Takaful) Operations.²⁴

The new publication of Guiding Principles on Conduct of Business harmonizes existing international standards with traditional Islamic contracts and encourages Islamic finance and banks institutions to view conformity as part of a general strengthening of good corporate governance culture. Principles of good business include the principles of certainty and transparency as a requirement for Islamic financial institutions. Principles of good business are wanted and desirable in provisions of increasing the integrity of the Islamic finance institutions and protecting shareholders interests.

CHAPTER FIVE
STRUCTURE OF ISLAMIC BANKING AND FINANCE IN THE USA

This chapter concentrates on the development of Islamic banks and financial institutions as well as financial products and techniques used for value creation and growth of the Islamic finance and banking services in the USA. Concerns regarding the validity of measuring the performance and growth are very high in Islamic banks and finance. The United States has eight types of financial institutions such as: commercial banks, credit unions, stock brokerage firms, asset management firms, insurance companies, finance companies, building societies and retailers. Typically, these are the key financial organizations in the USA that control the flow of money in the market and economy. These various financial institutions usually operate as the intermediaries between the capital market and the debt market. The service provided by a financial institution depends on under which type the institution is incorporated and what kind of license it holds. The financial activities vary and include money deposit, credit, financial commission, money transfer, issuance and administration of electronic money. The US financial organizations with credit line are fully fledged (retail) financial institutions and need to apply for an unrestricted banking license and have to comply with several equity and liquidity rules; additionally they are also responsible for transferring funds from investors to the companies.¹ Different types of Islamic financial institutions are authorized to operate on the US financial market such as: retail banks, mortgage

companies, community based financing organizations, mutual funds companies, and investment banks or groups. It is estimated that currently the value of the Islamic finance industry in the United States comprises of $150 billion in assets.\textsuperscript{2} The asset of the Islamic financial institutions is directly connected to investors/capital value.

Before a new Islamic bank or any other Islamic financial institution can start operations its Shariah Supervisory Board has to certify the Shariah conformity of all financial products, services and internal processes. The Shariah board prepares a report of a bank’s compliance. The management of Islamic finance institution or bank has to inform the Shariah Supervisory Board regularly on activities and should consult it whenever a new product or process is under the development. For daily business, internal employees with respective knowledge are asked to control the processes and provide their results to the Shariah scholars. In the annual report on the Islamic financial institutions, the report of the Shariah Supervisory Board should be an integral part. Islamic banks and financial groups in the USA must do costly projects appraisal because its profitability is not based only on a bank’s money but also on the profitability of investment. The Islamic bank is responsible for auditing the project or a business venture as a part of profit-loss-sharing (PLS) arrangements which create additional liabilities on a bank’s balance sheet. When employing profit-loss-sharing (PLS) Islamic financial principle, investing requires additional costs not incurred by the conventional banks. Islamic institutions in effort to attract customers are creating Shariah oriented financial products that are attractive to customers. All Islamic financial and banking businesses actively use the concentration on

core business method to create attractive value and growth. Creating attractive customer market and customer value also creates institution value. Islamic financial institutions create value by focusing on new areas of capital investment such as concentrating on specialty services or any transactions which are called content deals that will increase in value overtime. In order to create value the Islamic financial-banking institutions employ efficiency in their operations. By giving good and satisfying services based on Shariah to customers the Islamic banks and financial institutions bring value, develop customer market and create growth. Islamic nations, as services and products are tailored to ensure that religious principles are respected by Shariah compliant banking practices and services. However, by placing the growth of Islamic banking into a global context one can observe that the overall expansion of the industry is not simply limited to these markets, as the demand for Islamic banking is increasing in non-Muslim countries as well. In the non-Middle Eastern markets, the composition of the individual Shariah compliant products looks steadfastly similar to their conventional counterparts. The strategy that banks are using for their initial foray into non-Muslim markets is to construct products in a way that Muslims can compare Islamic banking offerings with their interest bearing conventional counterparts. In many cases, banks in non-Muslim countries face key branding decisions on the use of Arabic terms in describing their products and how they represent profit in ways that are intrinsically familiar to Muslims who are used to living in conventional banking markets. Table II provides data regarding

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Islamic financial institutions operating in the USA, their status and capital funding, offered financial products and services, as well the formation of their financial products.

Table II
Islamic Financial Institutions in the USA

<table>
<thead>
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<th>Financial Institution</th>
<th>Geographic Presence</th>
<th>Company Structure/ Funding Source</th>
<th>Products Offered</th>
<th>Structures Used</th>
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<tr>
<td>University Bank</td>
<td>Headquarters: Canton, Michigan</td>
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<td>Residential real estate financing</td>
<td>Mortgage and loan</td>
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Islamic banks and financial institutions create a competitive, fast paced environment for their employees with a huge opportunity and rewards for success and innovation. One of the customs of Islamic banks and financial institutions is to give high performance at low cost.\(^4\) Islamic finance and banks in the USA have expanded the area of operation and service outside local Islamic communities by participating in long term investing projects such as real estate or constructions.

### 5.1 Islamic Banks in the USA

The US authorized seven standard retail Islamic banks including University Bank, Devon Bank, Lincoln State Bank, Cole Taylor Bank, Broadway Bank of Chicago, RomAsia Bank and Mutual Bank. The Islamic retail banks provide similar services as conventional banks such as bank transfers, automated teller machines (ATMs), and online banking. These banks are structured to serve individual accounts and small businesses clients.

Islamic financial and banking institutions are not only limited to the financial needs of their shareholders, but also they are limited to the ways of doing business and the drivers that are used to measure the growth and create value in order to guarantee that all the activities are within the requirements of Shariah principles. The Shariah precondition and other restrictions under Islamic principles are vital for the provision of Islamic banking services as well as the US laws and bank regulations. The Shariah principles are important and vital for the provision of Islamic banking services such as deposit and credit business can’t be offered by granting interest. Islamic banks are

restricted from charging interest on overdraft, so in order to compensate and balance for any loss banks may impose two different fees such as a “penalty charge” which is a lump sum and second fee which is an overdraft fee.\(^5\)

5.1.1 University Islamic Financial Corporation

The University Bank is a community bank based in Detroit, Michigan and is the first fully fledged Islamic financial institution, state chartered bank and licensed by the FDIC. University Bank has formed the University Islamic Financial Corporation (UIFC) with many branches in Michigan, California, Connecticut, Idaho, Illinois, Maryland, New Jersey, New York, Pennsylvania, Ohio, and New York offering Islamic financial services and financial products.

University Bank mission statement posted on its website states as follows:

...University Islamic Financial Corporation goal is to be the financial institution of choice for the Muslim community in the United States. UIFC provides diverse financial products and services to its customers....UIFC serve the needs of the Muslim community by offering Shariah-compliant deposit accounts through University Bank and Mortgage Alternative (MALT™) products. Through University Bank's subsidiary, University Insurance & Investment Services we (UIFC) also make Shariah-compliant Mutual Funds available to our customers. We are always striving to provide more Shariah-compliant products in order to be your single point of contact for all your financial services needs....\(^6\)

University Bank and its subsidiary currently offers Islamic financial products and services such as deposits products for individual customers as well as merchant businesss.

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banking services, and capital market instruments and treasury products, and mutual funds. The financial products and transactions offered by University Bank are structured and based on Islamic traditional contracts approved by Shariah scholars and Shariah Board. The contracts and products used by University Bank are structured on such Islamic financial products as the murabaha, ijara, and profit sharing and sells shares of mutual funds such as the Amana Mutual Fund, the Iman Mutual Fund, and the Azzad Mutual Fund.

The management of University Bank is sensitive to all dimensions of data quality, and promotes and shares a concern for quality throughout the organization - as the mission statement emphasizes and is held accountable for achieving quality of service and Islamic market creation. Staff training programs emphasize the importance of service quality and give staff an understanding as to how quality and closer relation with customers may be achieved. University Bank as well as the whole University Islamic Financial Corporation provides an infrastructure for quality by recognizing trade-offs economies of scale, and interrelations between data sets.\(^7\)

Islamic financing techniques such as the profit and loss sharing principle, the mark-up or referred to as the cost-plus financing, as well as Economic Valuation Approach (EVA) are tools used to evaluate the creation of shareholders value, institutional growth and to perform an analysis with an objective to determine if a goal was accomplished. If a murabaha contract is employed the mark-up approach is used. The profit margin for the bank is calculated based on: the amount of down payment, the

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purchase price, terms of repayment, and the market rate of return on investment that the investors expect. The evaluation is an important tool in relation to a targeted value, capital deployment, the value creation and growth for Islamic finance institutions as well shareholders. It is important to evaluate transactions and define the most appropriate ways that emphasize different uses of capital and techniques connected to performance. To evaluate growth and created shareholders value by comparing earnings to capital investment is a way of measuring the amount by which the earnings of Islamic finance and banking institutions exceed or fall short of the total amount of capital that was originally invested by its shareholders.

5.1.2 Devon Bank

Devon Bank is an Islamic state chartered bank with headquarters located in Chicago, Illinois. The article posted in USA Today from March, 26, 2008 states:

...Devon Bank, responding to local customers in a neighborhood filled with Pakistani and Middle Eastern immigrants, stumbled onto something big: Islamic finance is booming worldwide, fueled by the windfall from sky-high oil prices and a return to a more strict interpretation of the Holy Quran across the Islamic world. Once Devon Bank introduced Shariah-compliant mortgages and other loans. People started coming out of the woodwork....

Devon Bank has implemented externally recognized processes or activities that focus on Islamic religion and values and quality initiatives publicly available on the organization’s services and products....

Devon Bank offers Islamic financial products for individual customers such as deposit accounts and savings accounts as well as investment accounts in divisions such

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as: residential and commercial real estate financing, real estate construction financing, lines of credit, business and trade financing, investment financing and products. The contract and financial products used by the Devon Bank are based on murabaha, musharakah, and ijara traditional Islamic contracts. Evaluating value creation and growth is tied very closely to evaluating performance by comparing earnings to capital investment. Devon Bank evaluates performance by measuring the amount by which the earnings of a single transaction, project or operation exceed or fall short of the total amount of capital that was originally invested by its owners. Return on Investment (ROI) or mark up to a contract is designed to achieve an optional capital growth. ROI measurements serve as a benchmark for determining the potential value for the Devon Bank transactions and operations. To evaluate creation of value and growth and to judge financial performance is made by comparing earnings to capital investment and by measuring the amount by which the earnings exceed or fall short of the total amount of capital that was originally invested. The Cost of Capital position is a strategy for allocation of resources and assessing of performance. Devon Bank tends to maximize their cash flow while at the same time they invest some capital for future development. Creating interest and profit is forbidden but earnings from mark up cost of capital is permitted and used. The time value of money is incorporated into contracts, goals, and valuation of shareholders value and Islamic financing and baking industry develops their own performance indicators based on the goal accomplished or the Return on Investment or Cost of Capital. Additional evaluation is performed for the Islamic credo and principles. Additionally, Devon Bank sells Islamic mutual funds such as Amanna Fund,
Azzad Fund, Imman Fund and provides services such as cash management, trust and advisory services.

...Devon Bank's Islamic offers finance products that fit within both Islamic law and U.S. law. All contracts and documents were created internally by the Devon staff to meet legal and religious requirements and is in compliance with both: the U.S. and Islamic religion laws and principles. The preconditions of Shariah were resolved and incorporated into the composition of contracts without the uncertainty caused by separate agreements. The details of the Devon contracts with initial murabaha and ijara products were reviewed by the Shariah Supervisory Board of America and a fatwa was issued by the Shariah Board approving Devon financial products....

5.1.3 Cole Taylor Bank

Cole Taylor Bank is a state bank with headquarters in Chicago, Illinois with $4 billion in assets. Cole Taylor Bank offers its Islamic financial products only in the state of Illinois and specializes in Islamic commercial real estate financing and as a base for its contracts uses murabaha and ijara’s contracts.

What is Asset Based Lending (ABL)? It is a loan generally secured by accounts receivable inventory, equipment, and/or real estate. Financing is governed by a borrowing base based on asset values. Lenders are typically focused on liquidity and asset conversion to cash as primary source of repayment. Structures include revolvers supported by working capital assets and term loans supported by fixed assets. Why Use Asset Based Loans? Because they have a limited and more flexible covenants, which are typically based on asset coverage and liquidity. Leverage tolerance for asset-rich borrowers is greater than permitted by "traditional" lending. ABL works well in combination with other junior financing alternatives (second lien, high yield). Efficient borrowing mechanics, which allow for pay down

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and borrowing of funds when needed, thus limiting interest expenses....

5.1.4 Lincoln State Bank

The Lincoln State Bank is a state chartered Islamic bank located in Chicago. Lincoln State Bank specializes in Islamic residential real estate financing and as a base for its contracts uses ijara’s contracts. Lincoln State Bank is a private company categorized under Savings and Loan Associations, Not Federally Chartered and located in Milwaukee, WI and it was established in 1910 and incorporated in Wisconsin. Current estimates show this company has annual revenue of over $1 billion and employs a staff of approximately 250 to 499.

5.1.5 RomAsia Bank

Assets at RomAsia Bank, a subsidiary of Roma Financial Corp., rocketed 52 percent higher over the past year to more than $100 million, bank officials said in a release. RomAsia reported assets of $101.5 million at the end of the first quarter of this year, as opposed to $66.8 million a year earlier.

RomAsia Bank is a state chartered bank located in Monmouth Junction, New Jersey and was opened on June 12, 2010. According to Dominick Mazzagetti, the president and CEO of RomAsia Bank the mission is to attract local deposits while strengthening central New Jersey’s Asian American communities with local loans and

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personalized services in a variety of different languages and from varying cultural perspectives.\textsuperscript{13}

5.2 Islamic Mortgage Companies in the USA

Another category of the Islamic finance institutions operating in the USA are Islamic mortgage companies.

5.2.1 Ijara Realty, LLC

Ijara Realty, LLC is located in Ann Arbor, Michigan. According to their mission statement Ijara Realty, LLC is a company that specializes in marketing Islamic finance alternative whose mission is to provide the best financing alternatives to consumers who abide by religious or ethical prohibitions relating to the payment of interest on loans and to become a resource for Islamic finance alternatives for home acquisition and replacement of existing mortgages, and hope to expand by adding auto financing alternatives. In 1996 the Ijara Home Financing Program called "Lease To Purchase" - Ijara wa Iqtina was created which is free of interest and complies with Islamic Guidelines. The Ijara Home Financing Program has been approved by a Board of Internationally recognized Shariah Scholars. The Ijara Realty financing program and products are in compliance with Islamic Shariah Guidelines and received fatwas.\textsuperscript{14}

Ijara Realty, LLC goals and objectives are adapted to an Islamic credo and principles and all the staff is transformed according to Islamic values and take action

\textsuperscript{13} Ibid.

within the framework of the Islamic principles. The management of Ijara Realty, LLC accept its status as a role model and is attentive in subsequent the standards.

5.2.2 Guidance Residential, LLC

Guidance Residential, LLC is located in Reston, Virginia. Guidance Residential, LLC was funded by foreign investors and by US federal government Freddie Mac and is registered as a financial institution.¹⁵

Their team of financial experts and accomplished professionals are committed to delivering quality products with the highest level of service and strict adherence to the principles of Sharia. Every product they offer is certified by an independent Sharia Supervisory Board to ensure strict standards of Sharia compliance and its own Sharia Board comprises some of the world’s leading experts in the Islamic law of financial transactions. These Sharia scholars are actively engaged in designing its products and in overseeing them. ¹⁶

Figure II present’s confirmation of compliance issued for a financial product by the Shariah Board for the Guidance Residential - Islamic Financial Institution.

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¹⁶ Ibid.
We, the Shari'ah Supervisory Board of Guidance Financial Group, LLC (Guidance) understand that private mortgage insurance is customarily required in the United States for home acquisition contracts in which the Consumer’s Initial Acquisition Payment amounts to less than 20 percent to the value of the property. As an alternative to conventional private mortgage insurance, Guidance has developed a structure to address this issue. The Co-Owner’s ownership stake in the property may subsequently be sold to a third party, with the condition that the third party is eligible to own and sell the property. The third party could then sell this same ownership stake to an ultimate investor along with its guarantee of the Consumer’s performance of his or her obligations under the Contract. It is important to note that the object of these sales must be the full ownership stake as defined and bound by the Co-ownership and related agreements and not constitute the mere assignment of receivables. The Shari’ah Supervisory Board is of the view that this structure and series of transactions is acceptable and conforms to the rules and principles of Shari’ah. Agreed this 21st of October 2002

5.2.3 American Finance House - LARIBA

American Finance House - Lariba was funded by Freddie Mac, Fannie Mea, and Bank of Whittier and offers Islamic products for residential real estate financing, commercial real estate, home constructions, business and trade financing, current accounts and deposit products. The Islamic finance products are offered in all US states and are designed using ijara, musharaka, murabaha Islamic traditional contracts that comply with Shariah laws and are constructed to incorporate the US financial and tax laws. LARIBA provides loans to buy houses, cars, businesses, merchandises and provides money for trades. They never start from an interest rate to calculate your payment. The payment is based on the market rental value of the property someone is seeking to finance. The rental value is determined by mutual agreement between two parties. The financing is based on traditional musharaka contracts and the monthly payments are calculated on the market value of the property with comparison with actual market rental values of comparable houses in the same area. Until the loan is paid off, on the title of financing property are two owners - a leasor and leasee. A leasee has two rights of ownership - first is the ownership of title Milkul Raqabah - the ownership of the neck, and the right is the right to use or rent out the property Haqul Manfa’aa.17

Two different types of Ijarah contracts may be used. Ijara contract is also known as to rent to own debt-financing sale. One is the traditional Ijarah in which the leasee has no option to buy the asset at the end of the lease term and the other is modernized Ijarah called Ijarah wa Iqtina, to be translated as “hire and purchase” where the lease has the

option to buy the asset at the end of the lease term and is lease with transfer of ownership at the end of the lease period or finance lease.\textsuperscript{18}

American Finance House - Lariba purchases a property for a client. A client agrees to purchase the property over time, at pre-arranged and agreed cost. The American Finance House - Lariba purchases a property and places the ownership in his name on the title to the property. On the American Finance House - Lariba accounting books it is an asset position. The unit stays as asset on accounting books over the time and a title to the property is transferred to a client after a client pays the full cost of the property over time. Additional account on the American Finance House - Lariba accounting books affected by the Ijara contract and transaction is the profit from rent. Since a client uses the merchandise or property he also pays rent. This type of transactions creates collusion with the US regulations, accounting and reporting standards under Generally Accepted Accounting Principles (GAAP). According to GAPP the above type of transaction creates double assets such as ownership of the property and receivable on the “loan”, which increases and creates incorrect or double valuation.\textsuperscript{19}

5.2.4 Samad Group

The Samad Group is an Islamic mortgage company that was originally incorporated in Ohio in 1986 with an initial capital of US $7,000. By the end of 1996 it had mushroomed into a group managing of $20 million. The Samad Group offers residential real estate financing. Their Shariah oriented financial products are based on


traditional Islamic ijara contract. SAMAD's Islamic Home Financing Program has been approved by a Board of Internationally recognized Shariah Scholars since 1996.\footnote{Phillip Moore, \textit{Islamic Finance a Partnership for Growth} (London, UK: Euromoney Publications, 1997), 144-145.}

\textbf{5.2.5 Zayan Finance}

Zayan Finance is an Islamic mortgage company located in Chicago, Illinois. The funding to create the Zayan Finance was provided by a foreign capital.\footnote{Shayesteh Abdi, \textit{Islamic Banks in the United States: Breaking Through the Barriers} (London, UK: Institute of Islamic Banking and Publishing, 2009), 5.} Zayan Finance specializes in commercial real estate. For its transactions Zayan Finance uses musharaka’s and ijara’s Islamic traditional contracts and in order to ensure that to deliver the highest quality financial products to the market, their products and services are reviewed and strictly supervised by an independent advisory board of Shariah experts.\footnote{Zayan Finance, “Compliance,” http://www.zayanfinance.com/shariah-compliance.php (accessed: November 23, 2010).} Zayan Finance is a national commercial real estate financier with the capital to help turn your vision for commercial real estate ownership into reality and is the only Shariah-compliant commercial real estate financing provider with a national reach.

Direct Financing and Shariah-compliant launched through strategic relationships with leading international and Wall Street based financial institutions, Zayan Finance directly sources, underwrites and funds Shariah-compliant transactions of $500,000 to $25 million and more for the purchase, refinance or cash out of commercial real estate properties.\footnote{Ibid.}
5.3 Islamic Mutual Funds in the USA

The US financial market offers several Islamic mutual funds for investors with objectives of Shariah complaint observance and Shariah conformity. The first Islamic equity fund was the Amana Income Fund in 1986. The fund was created by the North American Islamic Trust (NAIT). The NAIT is an organization based in Indiana, which manages the funding of mosques in America.\(^{24}\) The Amana Income Fund still exists and has been one of the better performing Islamic funds. The management of the fund is under Saturna Capital Corporation. The Islamic equity fund concept is consistent with the conventional equity fund.

A Shariah Supervisory Board supervises the creation, conformity of the investment decisions and the investment companies operations of Islamic fund. The Islamic equity fund concept is based on the conventional equity fund. Islamic equity funds can be structured in different ways - either as an Islamic equity fund based on Mudaraba partnership, Ijarah funds, commodity funds, or mixed funds. In the US the following Islamic funds were created: the Amana Income Fund: AMANX funded 1986, the Amana Growth Fund: AMAGX funded 1994, the Iman Fund: IMANX, and the Azzad Mutual Fund.\(^{25}\)


5.3.1 Amana Mutual Fund

The Amana Mutual Fund consists of two fully tradable Islamic funds on the US stock exchange - the Amana Income Fund (AMANX)²⁶ and the Amana Growth Fund (AMAGX).²⁷

The Amana Income Fund was established in 1986 by the North American Islamic Trust. The NAIT is an organization based in Indiana which manages the funding of mosques in America. The Amana Fund seeks current income and preservation of capital. The fund invests only in common stocks, including foreign stocks. Investment decisions are made in accordance with Islamic principles. It diversifies its investments across industries and companies, and generally follows a value investment style. The fund purchases only dividend-paying companies, which are expected to have more stable stock prices and tend to be larger companies.²⁸

The management of the fund is under Saturna Capital Corporation which is located in Bellingham, Washington. The Amana Income Fund is a public fund and a fully tradable financial instrument on the US market. Table III shows the assets of the fund is 1.13 billion dollars. The Amana Income Fund is one of the better performing on the stock exchange with impressive income of $38,350,000. The fund Year to Date Return on Assets is 2.95%, which creates income of $38,350,000 from $1.13 billion assets.

Table III
Amana Trust Income Fund

<table>
<thead>
<tr>
<th>Fund Overview</th>
</tr>
</thead>
<tbody>
<tr>
<td>Category:</td>
</tr>
<tr>
<td>Large Value</td>
</tr>
<tr>
<td>Fund Family:</td>
</tr>
<tr>
<td>Amana</td>
</tr>
<tr>
<td>Net Assets:</td>
</tr>
<tr>
<td>1.13B</td>
</tr>
<tr>
<td>Year-to-Date Return:</td>
</tr>
<tr>
<td>2.95%</td>
</tr>
<tr>
<td>Yield:</td>
</tr>
<tr>
<td>1.18%</td>
</tr>
<tr>
<td>Morningstar Rating:</td>
</tr>
<tr>
<td>★★★★★</td>
</tr>
<tr>
<td>Fund Inception Date:</td>
</tr>
<tr>
<td>Jun 23, 1986</td>
</tr>
</tbody>
</table>

Source: http://finance.yahoo.com/q/pr?s=AMANX

The second fund is the Amana Growth Fund. This fund has a very high Return on Assets 6.42%. According to the Ameritrade website posting the fund seeks its income in investment that is long-term capital growth. The fund invests only in common stocks, including foreign stocks. Investment decisions are made in accordance with Islamic principles. It diversifies its investments across industries and companies, and generally follows a value investment style. The fund favors companies expected to grow earnings and stock prices faster than the economy, and tend to be smaller and less seasoned companies.

5.3.2 Iman Mutual Fund

The Iman Mutual Fund is a public fund and fully tradable financial instrument on the US financial market. The management of the fund is under North American Islamic Trust - Allied Assets Advisors Funds. Table V provides information regarding the assets of the Iman Fund. Compared to the conventional funds the Iman fund performs good as
the Year to Date Return on Assets is 3.54%, which creates income of $1,064,973.6 = 30.84 million x 3.54%

Table IV
Iman Fund

<table>
<thead>
<tr>
<th>Fund Overview</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Category:</td>
<td>Large Growth</td>
</tr>
<tr>
<td>Fund Family:</td>
<td>Allied Asset</td>
</tr>
<tr>
<td>Net Assets:</td>
<td>30.84M</td>
</tr>
<tr>
<td>Year-to-Date Return:</td>
<td>3.54%</td>
</tr>
<tr>
<td>Yield:</td>
<td>0.00%</td>
</tr>
<tr>
<td>Morningstar Rating:</td>
<td>★★★</td>
</tr>
<tr>
<td>Fund Inception Date:</td>
<td>Jun 30, 2000</td>
</tr>
</tbody>
</table>

Source: http://finance.yahoo.com/q/pr?s=IMANX+Profile

The Iman Fund (symbol: IMANX) invests in Shariah-compliant companies, in response to the needs of Muslim investors, who not only want to have a financially rewarding investment, but a Shariah-compatible one as well. Since June 2000, IMANX has provided Muslims with an investment option based on Islamic principles.29 The Fund seeks growth of capital while adhering to Islamic principles.

The performance, status and evaluation of the Iman Fund by the Dow Jones Islamic Market US Index, Russell 3000 Growth Index and S&P 500 is presented in Table V.

Table V
Imam Fund Performance

Fund Daily Prices as of 11-09-2010

<table>
<thead>
<tr>
<th>Fund / Index Name</th>
<th>Symbol</th>
<th>Price/Value</th>
<th>Change %</th>
<th>Change</th>
<th>YTD %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Iman Fund</td>
<td>IMANX</td>
<td>8.08</td>
<td>-0.74</td>
<td>-0.06</td>
<td>9.93</td>
</tr>
<tr>
<td>Dow Jones Islamic Market US Index</td>
<td>IMUS</td>
<td>2205.89</td>
<td>-0.42</td>
<td>-9.37</td>
<td>7.80</td>
</tr>
<tr>
<td>S&amp;P 500</td>
<td>SPX</td>
<td>1213.40</td>
<td>-0.81</td>
<td>-9.85</td>
<td>8.82</td>
</tr>
</tbody>
</table>

Average Annual Total Returns

<table>
<thead>
<tr>
<th>Fund / Index Name</th>
<th>1-year</th>
<th>3-year</th>
<th>5-year</th>
<th>10-year</th>
<th>Since Inception June 30, 2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Iman Fund</td>
<td>11.58%</td>
<td>-5.42%</td>
<td>1.59%</td>
<td>-1.64%</td>
<td>-2.32%</td>
</tr>
<tr>
<td>Dow Jones Islamic Market USA Index</td>
<td>8.02%</td>
<td>-5.51%</td>
<td>1.59%</td>
<td>-2.33%</td>
<td>-2.78%</td>
</tr>
<tr>
<td>Russell 3000 Growth Index</td>
<td>12.83%</td>
<td>-4.26%</td>
<td>2.12%</td>
<td>-4.27%</td>
<td>-4.69%</td>
</tr>
<tr>
<td>S&amp;P 500 Index</td>
<td>10.16%</td>
<td>-7.13%</td>
<td>0.64%</td>
<td>-0.43%</td>
<td>-0.51%</td>
</tr>
</tbody>
</table>

Source: http://www.investaaa.com

The Iman Fund comprises investments that meet Islamic principles. Under the normal circumstances, the Fund invests its net assets in domestic and foreign securities chosen by its Investment Advisor that meet Islamic principles. Islamic principles generally preclude investments in certain industries and investments in interest bearing debt obligations or businesses that derive a substantial amount of interest income. Any none invested cash will be held in non-interest bearing deposits or invested in manner following Islamic principles.\(^{30}\)

\(^{30}\) Ibid.
5.3.3 Azzad Mutual Fund

The Azzad Mutual Fund is a public fund and has two fully tradable financial instruments on the US stock market, including the Azzad Ethical Mid Cap (ADJEX) and the Azzad Wise Capital (WISEX). The Azzad Mutual Fund is managed by Azzad Asset Management located in Falls Church, Virginia. Table VI provides information regarding the current status of the fund with its assets of 9.62 million dollars.

**Table VI**

**Azzad Ethical Mid Cap Fund**

<table>
<thead>
<tr>
<th>Fund Overview</th>
</tr>
</thead>
<tbody>
<tr>
<td>Category:</td>
</tr>
<tr>
<td>Fund Family:</td>
</tr>
<tr>
<td>Net Assets:</td>
</tr>
<tr>
<td>Year-to-Date Return:</td>
</tr>
<tr>
<td>Yield:</td>
</tr>
<tr>
<td>Morningstar Rating:</td>
</tr>
<tr>
<td>Fund Inception Date:</td>
</tr>
</tbody>
</table>


The Azzad Ethical Mid Cap Fund seeks to provide long-term total returns that, after expenses, match or exceed the annualized performance of the Standard & Poor Midcap 400 index. The fund primarily invests in equity securities of mid-cap companies. Mid cap companies are defined as companies with market capitalizations of $500 million to $10 billion at the time of investment. It avoids companies with significant revenue from tobacco, alcohol, meat products, gambling, pornography, interest,

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insurance, and weapons of mass destruction, also banks or financial services companies. The fund is non-diversified.\textsuperscript{32}

The second fund of Azzad Mutual is the Azzad Wise Capital Fund. Table VII provides information regarding investments. The investment seeks capital preservation and income. The fund invests primarily in certificates entitling the holder to payment of a fixed return on a periodic basis up to and including maturity, at which time the initial investment will be repaid together with a profit amount.

**Table VII**
**Investment of the Azzad Fund**

<table>
<thead>
<tr>
<th>Top 8 Ethical Wrap Portfolios</th>
<th>Full List</th>
</tr>
</thead>
<tbody>
<tr>
<td>Roanoke Small Cap</td>
<td>10.34%</td>
</tr>
<tr>
<td>LCM Mid Cap</td>
<td>8.77%</td>
</tr>
<tr>
<td>REITs</td>
<td>8.64%</td>
</tr>
<tr>
<td>All Cap Value</td>
<td>5.85%</td>
</tr>
<tr>
<td>Azzad Russell Mid Cap Growth</td>
<td>5.77%</td>
</tr>
<tr>
<td>International</td>
<td>5.16%</td>
</tr>
<tr>
<td>Russell Mid Cap Value</td>
<td>4.71%</td>
</tr>
<tr>
<td>Heartland Multi Cap</td>
<td>2.03%</td>
</tr>
</tbody>
</table>

Year to date period Ending September 30, 2010

Source: http://www.azzad.net/new/products_mutual.aspx

Its ethical investment restrictions do not allow investing in certain businesses, including alcohol, gambling, pork, pornography and weapons of mass destruction, as well as the charging or paying of interest from lending, gains from trades that involve

\textsuperscript{32} Ibid.
exchanging the same kind of monetary instruments, gains from trading debt and gains from futures contracts. The fund is non-diversified.  

5.4 Community Islamic Financial Programs and Organizations in the USA

Community based Islamic financial programs and organizations have varied structures, funding and functions. Some of the Islamic community based Islamic financial programs and organizations were created as not for profit organizations, some were government sponsored programs organizations, and some have status of community development corporations. The funding of the Community based Islamic financial programs and organizations have different sources and vary from federal government to private investors.

5.4.1 Government Sponsored Islamic Programs

Government sponsored Islamic programs are numerous throughout the nation. For example, in the City of Minneapolis created the Alternative Financing Program and the State of Minnesota created the Minnesota Finance Agency.  

The Minnesota Finance Agency is a government sponsored and a funded program for low-income Muslim families. The financing instruments are constructed on murabaha contracts and are used in real estate residential financing. The City of Minneapolis - Alternative Financing Program is sponsored by the African Development Center and various financial institutions and community finance providers. The program goal is to help small business

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owners with financing and micro financing of real estate constructions. The financing instruments are constructed based on traditional murabaha contracts.

5.4.2 Nonprofit Community Development Islamic Programs

The nonprofit community development Islamic programs are World Relief, Neighborhood Development Center - Riba Free Program, and the African Development Center. The Neighborhood Development Center - Riba Free Program and African Development Center programs are located in Minneapolis, Minnesota and both organizations provide micro financing for residential real estate. The Islamic financial products used are based on murabaha and musharaka contracts.35

Since April 2007, the city of Minneapolis, in partnership with the African Development Center, has given out 38 loans in a way that is compliant to Islamic law by using a fixed rate in place of a variable interest rate. Through the system, called the Alternative Finance Program, businesses pay a set rate of return, which corresponds with Islamic practices. The program is a slightly altered version of the common two percent loans also offered by the city’s Department of Community Planning and Economic Development.

The World Relief is a nonprofit community development organization located in Nashville, Tennessee. The funding was provided by the Office of Refugee Resettlement in the US Department of Health and Human Services. The World Relief organization

provides micro financing for residential real estate. The Islamic financial products used are based on murabaha contracts. The full list of the Islamic nonprofit community and charitable organization is provided in Appendix IV.

5.5 Islamic Investment Banks in the USA

Stocks or equity shares from the point of view of Shariah Boards are preferred Islamic financial instruments for a few reasons: one, shareholder participates directly in the entrepreneurial success with the capital he provides for productive purpose and two, investments in equity shares are very remarkable for Muslim investor as they don’t have element of riba in it. The investment targets have to be investigated based on two courses, the Shariah industry monitoring is assessed according to the code of ethical investment that distinguishes between Haram and Halal investments. According to Shariah law Muslims are only allowed to invest in shares of Halal businesses. Haram businesses that are excluded for stock investments includes producers of alcohol products, pork-and its products, companies providing conventional financial services such as banking, insurance, hotel industry and providers of entertainment services such as casinos and gambling, cinema, pornography, music. However manufacturers of defense and weapons companies are not on the Shariah list and are not strictly forbidden to invest. The Dow Jones Indexes Industry screen for financial-ratio which composes the following: Debt to Equity, Cash and interest bearing securities, Cash to Accounts

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Receivables Ratio. Additionally the Standard and Poor’s Shariah Indices and the FTSE Global Islamic Index Series

5.5.1 Overland Capital Group

The Overland Capital Group is located in Boston, Massachusetts. The funding was provided by foreign investors and Gulf based financing firms.

Overland Capital, in conjunction with the US-Bahrain Business Council. Overland Asset Management LLC a wholly-owned subsidiary of Overland Capital Group, Inc., is responsible for the oversight and reporting on all assets originated by Overland Capital Group, Inc. and its subsidiaries, including Overland Leasing Group LLC, Overland Development Group LLC and Overland Realty Capital LLC.

Since its formation, Overland Capital has been responsible for the asset management of more than 50 properties across the United States owned by over 30 partnerships, representing more than 11,000 apartment and condominium units, nearly US$300 million in total equity invested and approximately US$1.3 billion in total asset value. Since its formation in 2002, ORC has invested in excess of $300 million of equity capital, representing over $1.3 billion of real estate asset value. ORC has exceeded projected returns on nearly all of its exited transactions, posting a weighted average partnership-level return of more than 20%.  

Figure III presents current investment and business ventures status of Overland Capital Group.

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Figure III Overland Capital Group Investment Projects.

City Heights, San Jose, CA - $12 million participating equity investment in the construction of a 124 unit condominium project.
Clarendon Metro, Arlington, VA (Washington, DC) - $9.5 million participating equity investment in the construction of a 415 unit luxury apartment project (sold to a condominium converter).
Culbreath Key, Tampa, FL - $6.6 million participating equity investment in the condominium conversion of a 254 unit apartment property (100% sold out).
Diamond Ridge, North Richland Hills (Dallas), TX - $3.3 million participating equity investment in the acquisition and renovation of a 256 unit apartment property (sold).
Emerald Dunes, West Palm Beach, FL - $10.2 million participating equity investment in the construction of a 486 unit apartment project (sold).
Four Seasons, Houston, TX - $3.6 million participating equity investment in the condominium conversion of 50 luxury apartment units on the top five floors of a thirty-story hotel (100% sold out).
Ironhorse at Tramonto, Phoenix, AZ - $5 million participating equity investment in the construction of a 324 unit apartment project (sold).
Legato, Fairfax, VA (Washington, DC) - $12 million participating equity investment in the construction of a 594 unit apartment and condominium project (sold).
Manor at Buckhead, Atlanta, GA - $13.5 million participating equity investment in the condominium conversion of a 301 unit apartment property.
Milano, Austin, TX - $10 million participating equity investment in the construction of a 250 unit condominium project (100% sold out).
Rockwood at The Cascades, Sylmar (Los Angeles), CA - $8.3 million participating equity investment in the construction of a 223 unit apartment project.
The Signature, Scottsdale (Phoenix), AZ - $7.6 million participating equity investment in the condominium conversion of a 268 unit apartment property (100% sold out).
Syrah at Natomas, Sacramento, CA - $6.3 million participating equity investment in the construction of a 245 unit condominium project (100% sold out).
The Tides, Richmond (San Francisco), CA - $6.5 million participating equity investment in the construction of a 200 unit apartment project (sold).
Toscano, Miami, FL - $16.5 million participating equity investment in the construction of a 402 unit luxury condominium project.
Villas at Coronado, Houston, TX - $5.1 million participating equity investment in the construction of a 344 unit apartment project (sold).
Source: http://www.overlandcapital.com/index.cfm?fuseaction=section.home&is=12

5.5.2 UIB Capital, Inc.

UIB Capital is located in Chicago, Illinois, offers investing in the real estate and other assets, provides capital market and corporate financing, as well as treasury and merger & acquisitions investments. The main focus of the company is directed and based on private equity. It is a wholly owned subsidiary of the Unicorn Investment Bank in
Bahrain, Malaysia. Founded in 2004 and headquartered in Bahrain, Unicorn Investment Bank (Unicorn) is an Islamic financial service group, with an international presence in the United States, Malaysia, Turkey and Saudi Arabia (through its majority shareholding in Unicorn Capital Saudi Arabia). The Bank is also a major shareholder in Dawood Islamic Bank, Pakistan. Unicorn seeks to deliver exceptional value to clients and shareholders through a focus on innovation, professionalism and integrity – the shared values that drive the Bank’s endeavor to be a leading global provider of Shariah-compliant investment banking products and service. All Unicorn products and transactions are governed by two essential principles: that they fully comply with Shariah principles; and that they are benchmarked against international financial best practices. The Unicorn Shariah Supervisory Board ensures that all investment policies, structures, products and financial services and activities that the Bank is involved in are in conformity with Shariah principles; while the Bank’s stringent corporate governance standards ensure that the Bank, its directors and its employees follow the highest standards of ethical conduct.39

5.5.3 TransOcean Group, Ltd.

TransOcean Group is located in Boston, Massachusetts and is a subsidiary of Kuwait’s Gulf Investment House. The center of investing is on private equity. TransOcean Group is a wholly owned subsidiary of a publicly-traded financial house based in Kuwait, and invests capital exclusively for its parent company. As a result of

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this unique structure, TransOcean Group has no fund-related pressure to sell investments according to a pre-determined investment horizon and seeks to consummate investments with enterprise values between $100 million and $200 million.⁴⁰

5.5.4 Innovest Capital Investment Bank

Innovest Capital Investment Bank is located in Cleveland, Ohio and is a subsidiary of Kuwait’s Gulf Investment House. It is a private company categorized under Real Estate Investment Trusts. Current estimates show this company has annual revenue of $500,000 to $1 million. The center of investing is on real estate. Innovest Capital, Inc. is a wholly owned subsidiary of Gulf Investment House (GIH). GIH is a leading Gulf-based global investment bank offering a wide spectrum of financial services including direct investments, structuring investment funds, private equity, and real estate investments. Innovest Capital is GIH’s U.S. real estate investment platform. Innovest is a fully integrated advisor with production, due diligence and investment asset management functions performed by Innovest professionals. Innovest designs product specific funds and coordinates investment origination for all real estate activities. Innovest targets U.S. real estate investments with capable and well-managed professional sponsor partners. Its process allows real estate companies to expand their resources and grow their businesses. It delivers program oriented solutions to emerging development strategies. Its

commitment to teamwork, discipline and focus serve as the basis of its investment methodology.\textsuperscript{41}

5.5.5 Aracapita Investment Bank

Aracapita Investment Bank is located in Atlanta, Georgia and is a subsidiary of Bahrain’s Aricapita Bank. The main center of attention is on venture capital, private equity and real estate investments.

…At the core of the business is a carefully cultivated corporate culture that encourages teamwork, quality, innovative thinking and integrated decision making. We have steadfastly adhered to a focused strategy, maintaining a solid and conservative capital structure and actively measuring, controlling and mitigating the risk in our business. And we have structured each aspect of the business to ensure that the interests of shareholders, investors and employees are fully aligned. We believe that these factors have been integral to our ability to withstand the sustained pressures of fiscal 2009, and will continue to drive our success in the future. Aracapita will continue to expand its international reach, increase deal volume and underwriting capacity, develop innovative Shariah-compliant products for its investors, and strengthen its business lines and core functions with world-class teams….\textsuperscript{42}

Figure IV provides Aracapita’s comparative financial data from operations.


Figure IV Comparative Financial Data from Arcapitia

5.5.6 Citi Investment Bank

Citibank is the first US conventional financial institution to develop Islamic banking fund and services. The cooperation with Islamic finance dates from 1955 with opening branches in Cairo, Beirut, and Jeddah.

The first independent Islamic unit was set up in 1981 to offer investment services such as short term liquidity management, medium to long term investments, structured transactions, and Islamic products including murabaha contracts, Istina, and Ijara. Citi Islamic Investment Bank E. C. (“CIIB”) was incorporated in July 1996 in Bahrain, as a 100% owned subsidiary of Citicorp Banking Corporation. CIIB operates as the dedicated Islamic Banking vehicle of Citi and is continuing the pioneering and innovative role that Citi has been playing in the industry for almost 25 years, through Islamic Finance windows within.43

Like other Islamic financial institutions in the USA the Citi Islamic Investment Bank offers interest free services and Shariah oriented financial products. Through Citi Islamic Investment Bank (CIIB) it offers specialist services tailored to customers’ Islamic beliefs. The bank’s operations are supervised by a group of Islamic scholars who form its Sharia Board, who make sure CIIB dealings comply with Islamic principles.

The guiding Islamic principles the bank uses derive from the Quran. Islamic banking is founded on asset-based finance free from interest, deception and unfairness. Because charging and earning interest is forbidden in the Quran, the bank avoids this. Islam condemns the renting money as a form of usury. Therefore CIIB follows the

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principle of not selling or trading what one does not have. Money can be exchanged, or invested in a business, but it cannot be rented. Fixed return on an investment is forbidden, because Islamic law requires the investor to share both in the success and in the failure of a project. Thus the bank does not invest in interest-charging companies, such as commercial banks and insurance companies, nor in alcohol, tobacco, gambling, pork or entertainment companies.

Figure V shows Citibank’s financial statement - Balance Sheet with Islamic investment.
Figure V
Citi Islamic Investment Financial Statements

The financial statements were approved by the Board of Directors on 18 August 2010.

CHAPTER SIX
FINANCIAL PRODUCTS AND MANAGERIAL TECHNIQUES USED BY
ISLAMIC FINANCIAL INSTITUTIONS IN THE USA

According to the Holy Quran and Shariah law Islamic finance is based on the concept of partnership and four basic transactions such as: sales (Bay), hire (Ijara), gift (Hiba) and loan (Ariyah). Table VIII below provides information regarding the contracts used by Islamic financial groups and banks in the USA and the roots of the contracts. Additionally, information is provided in what type of transaction the contracts are used.

Table VIII
Islamic Financial Instruments in Creating Value and Growth

<table>
<thead>
<tr>
<th>Name of financial product</th>
<th>Roots of financial product</th>
<th>Transaction Type</th>
</tr>
</thead>
<tbody>
<tr>
<td>Murabaha</td>
<td>Traditional</td>
<td>Equity/Debt Financing</td>
</tr>
<tr>
<td>Mudaraba</td>
<td>Traditional</td>
<td>Equity Financing</td>
</tr>
<tr>
<td>Ijara</td>
<td>Traditional</td>
<td>Equity Financing</td>
</tr>
<tr>
<td>Istitina</td>
<td>Traditional</td>
<td>Equity Financing</td>
</tr>
<tr>
<td>Bay Salam</td>
<td>Traditional</td>
<td>Debt Financing</td>
</tr>
<tr>
<td>Bay al-inah</td>
<td>Traditional</td>
<td>Debt Financing</td>
</tr>
<tr>
<td>Islamic bonds</td>
<td>Contemporary</td>
<td>Debt Financing</td>
</tr>
<tr>
<td>Islamic derivatives</td>
<td>Contemporary</td>
<td>Debt Financing</td>
</tr>
</tbody>
</table>

Source: Designed by AndrzejD. Szczepanowicz

Figure VI provides information on dependency and outcome of the traditional Islamic contracts used in modern transactions performed by US Islamic financial institutions.
Figure VI
Traditional Contracts Used By US Islamic Institutions


Figure VI describes in detail how contracts and transactions are used, and the benefits to the Islamic financial institution when using such contracts. The Islamic contracts describe the transfer of ownership and the transfer of the right to use. The development and growth is interrelated with added value to a contract. Depending on what type of a contract will be used the profit margin will be higher or lower.
6.1 Equity Financing Contracts

In Islamic finance and banking equity-based financing is the ideal form of financing. Equity-based financing techniques are allowing the Islamic finance and bank institutions to participate directly in the business venture and to form together with the entrepreneur a partnership.¹

6.1.1 Murabaha

The most popular and used instrument to create value for Islamic finance and banking is the murabaha contracts. Rather than lending money to purchase with interest, an institution purchases the goods for a customer and sells it to back to a borrower for a fixed price. Islamic finance group or bank funding a murabaha sale must actually first buy the merchandise and then forwards it to a buyer. Such contracts involve the sale of commodity, real estate, at the market price plus an agreed profit margin to the borrower. Usually in commodity transactions the sale involves deferred payments or by immediately selling the assets to a broker or bank. The fixed price will include the price the Islamic finance or bank institution paid for the goods and previously agreed profit margin. To determine the profit many factors are taken under consideration, such as the purchase price, the amount of down payment, the terms of repayment, the market rate of return on particular group transactions that investors expect. Islamic finance institutions create additional values by financing a sale and charging markups to the current price. The murabaha contract is used as equity financial product of wholesale; the murabaha can be used also as debt based financing contracts and debt financing techniques.

Murabaha contracts are used to replicate short-term money market deposits and the financial product.

6.1.2 Mudaraba

The mudaraba contract is a two tiered transaction for the Islamic finance or bank institution. Using mudaraba contracts Islamic finance or bank institution builds its asset by providing money to a borrower - an entrepreneur and finances its project contracts. Islamic finance or bank institutions provide capital and thus possesses all assets because the finance institution is the owner of the enterprise by providing capital and fully funding the project, but does not participate or have any active part in the enterprise, and does not provide management or expertise. At the end of the contract the enterprise is liquidated, and if it generates profit - the profit is distributed on a previously mutually agreed and predetermined basis to the entrepreneur and the finance or bank institution. On the other hand, if the project fails the finance or bank institution takes all loses. Figure VII presents modern transaction and relationship - partnership based on the mudaraba contract.

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6.1.3 Musharaka

The musharaka contracts are equity-based financing products. Musharaka - rent to own - financing may involve sale of the property to a client based on two different types of contracts such as permanent musharaka and diminishing musharaka.³

6.1.3.1 Permanent Musharaka

In permanent musharaka contracts both an entrepreneur and bank, provide capital for enterprise and both parties borrower and financial institution form a joint venture and become partners. Both partners may or may not actively participate in providing expertise and management. Both parties share profits and losses on a previously predetermined

ratio based on the proportion to their respective capital invested or on agreed conditions. However, both partners do not have the same obligation toward a project - the obligations are pre-negotiated and set in the contract. Figure VIII provides relationship between borrower and bank in musharaka contracts.

**Figure VIII**
**Modern Musharaka Contract**

![Diagram of Modern Musharaka Contract]


The length of the contract may or may not be infinite. The contract or the project is liquidated when one party resigns or is liquidated and closed based on pre-negotiated arrangements between parties. Consequently, both parties are co-owners of an enterprise and accordingly share in any financial profit or loss based on percentage of ownership, so both parties have the incentive to invest and to manage wisely the business venture. The permanent musharaka is more complex transaction and has additional costs for Islamic financial institutions when establishing and maintaining the arrangement. However, in
the permanent musharaka the assets stay to the end of a contract on the assets side on the financial books for the accounting and reporting purposes.

6.1.3.2 Diminishing Musharaka

The diminishing musharaka form of financing is designed for a long-term financial investment by the Islamic financial and bank institutions. The diminishing musharaka structure is usually used in real estate financing. In this type of contract the Islamic finance or bank purchases a house of a customer’s choice and a portion of the property ownership is transferred to a client with each payment a client makes. Additionally, a client uses the property that he does not own, so he must also pay rent on the financier’s portion of the property. During the rental period, the payments are predetermined and can be adjusted. The finance or bank institution commits itself to an investment and receives a profit out of the difference between original share value and received price. In the diminishing musharaka the asset is reduced over time on the financial books for accounting purposes and on balance sheet for reporting. To compensate this Islamic banks mark up to a higher price than the original value.⁴

6.2. Debt Financing Contracts

The debt-based financing contracts represent fixed return financing which are based on a mark-up or cost-plus concept.

6.2.1 Ijara

Ijara is a one out of four basic contracts and is the most popular contract used by Islamic financial institutions. Ijara contracts are very flexible and this flexibility factor of and is used in the construction of various transactions. Ijara contracts can be found in the structures of the most innovative Islamic financial product such as Ijarah sukuk. Usually two different types of Ijarah contracts are used. One is the traditional Ijarah in which the leasee has no option to buy the asset at the end of the lease term. The other Ijarah is modernized called Ijarah wa Iqtina, to be translated as “hire and purchase” in which the leasee has an option to buy the asset at the end of the lease term.\(^5\)

In addition to the pure Ijarah contract, further developments to Ijarah contract are made depending on the need of the Islamic finance institutions. The Ijara contract is also known as to rent to own debt financing sale. Banks purchase a property for a client. A client agrees to purchase the property over time, at pre-arranged and agreed cost. A bank or finance institution purchases a merchandise or property and places an ownership in his name on the title to the property. On the bank accounting books it is an asset as a holding unit. The position stays as asset on bank books over the time and a title to the property is transferred to a client after a client pays the full cost of the property over time. Additional account on bank or finance institution accounting books affected by the Ijara contract and transaction is the profit from rent. Since a client uses the merchandise or property he also pays rent. Based on pre arrangements Ijarah contract may have some additional costs to

establish and to maintain the arrangement. For example an Islamic bank will buy a merchandise, commodity, or real estate from a third party. Based on the Ijarah contract an Islamic bank is selling the right to use the asset for a specific period of time. Assets are leased out to the clients who pay rental fees for the use. The bank as a lesor is responsible for the risk as it is the owner of the assets and is under an obligation for maintenance and Insurance. A bank as an owner of the assets can sell the assets before or after an end of the lease term at bank’s discretion. Both types of Ijara contracts are similar to a conventional leasing system - the conventional operating lease contract or to a financing lease arrangement.\(^6\)

### 6.2.2 Bay Salam

According to the Shariah principles merchandise or goods cannot be sold if they do not exist, and when the contract is closed. The Bay Salam contract creates an exception to these strict Shariah rules and principles. The Bay Salam contracts are mostly used in agricultural framework.

A bank or financial institution purchases the not existing goods such as crops, fruits, or some other goods in advance from a farmer or other merchant and as soon as the contract is closed pays in advance the full purchase price to the farmer or merchant. The quality and quantities of the goods to be sold, the date and the place of delivery, the purchase price and all other aspects of a product or merchandise have to be exactly determined in the contract and before the contract is closed. The Bay Salam contract creates benefits for both parties and both parties have an advantage from such an

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agreement - a farmer or merchant receives capital from a bank immediately and a bank buys the crop or other merchandise at usually a lower price. Most of the banks or some other Islamic financial institutions do not want to be in the physical possession of goods or merchandise or they do not have physical capacity for storage and warehousing and they resell the goods right away with a profit. To do so an additional and parallel new contracts may be created. In present time the Bay Salam contract creates an Islamic alternative to conventional derivatives.\(^7\)

### 6.2.3 Istisna

The Istisna contract is similar to Salam, and just like in the Salam contract the subject of Istisna contract refers to non-existing goods, products or merchandises. The Istisna contracts are designed for a special purpose, such as the financing of manufacturing product or as a contract for a project financing. After all specific issues, requirements, terms of delivery and financial conditions including the profit margin are agreed on, the Istisna contract is closed. Payments to a manufacturer or farmer are made in installments and depend on the progress of production. As a producer, a farmer receives a first installment from a bank from the start of a contract; as the production is in progress further payments are made until the merchandise or a crop is finished or grown. After the product or merchandise is finished it is transferred and handed over to a bank or a financial institution. The title to the good is made in a bank’s or financial institution name. The product creates an asset on a bank’s accounting books and financial

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statements. A bank transfers the product to a customer who pays the purchase price plus a predetermined margin to the bank in regular installments after he has received the merchandise.8

6.3 Capital Market Financial Products - Funding Operations and Accounts

The modern Islamic finance industry is relatively young and the Shariah oriented financial products are limited in comparison to conventional financial instruments. In order to stay competitive the US Islamic financial institutions offer to private and business customers several financial product innovations which are developed on a need basis. The finance products that are offered to customers and shareholders are murabaha, mudaraba, musharaka, istisna, bay Salam, and bay al-inah. The modern implementation of the murabaha contract is fundamentally different from its medieval, theoretical basis. This divergence from the medieval theory is much more basic and crucial in murabaha than the differences obtained between the medieval of two other important contracts (musharaka and mudaraba) and their modern applications. The modern murabaha contract is the result of a process of investigation into possible Islamic alternatives to Western trade financing using letters of credits.9

Islamic banking and financial institutions are obligated to contribute to borrowers’ risks; which means that borrowers’ position is like shareholders, earning a portion of profits. Financing contracts create transactions such as joint purchase and sale

8 Ibid.

9 Nicholas Ray, Arab Islamic Banking and the Renewal of Islamic Law (London, UK: Graham & Trotman, 1995), 12.
agreements, partnerships, lease-to-own arrangements, and layaway plans. The traditional contracts were insufficient to cover complex banking and financing transactions. In order to preserve a unique character the Islamic finance and banking industry develop their own original Islamic financial products and instruments which are Shariah-compliant.\textsuperscript{10}

6.3.1 Current Accounts

Depositors are able to make two types of deposits with Islamic banks – the transaction or investing deposits. The deposit is held in a bank trust as safekeeping without generating any money and depositors are guaranteed their full repayment. These deposits can’t be invested in profit and loss sharing hazard by the bank as this might endanger the customers’ deposits. Customers who make deposits in current accounts are actually making interest free loans to the Islamic bank because it can be used for bank operations which are in conformity with the Shariah principles.\textsuperscript{11}

6.3.2 Savings and Investment Accounts

The second type of account is called Savings and Investment Accounts. In a savings account the bank guarantees the full repayment of deposit plus a small return. In investment accounts at the depositor’s own risk the money is invested and the full repayment of the deposit is not secured; however the return on the investment account if paid can be high. The return can’t be predicted or fixed in advance. The depositor participates in the entrepreneurial risk resulting from the use of his funds in equity participations. The bank acts as an entrepreneur - Mudarib managing the money and the

\textsuperscript{10}Ibid.

depositor takes the role of the capital provider. The return on capital is shared in accordance to a prearranged agreement made in between the bank and the depositor. However in case of a loss, the depositor risks the loss of all of his deposits. Investment accounts are funded on the basis of Mudaraba contracts. By structuring the transactions in a Shariah compliant manner, the lending of money is avoided and no interest is involved.12

6.4 Sukuk - Islamic Bonds

The term Sukuk comes from Arabic word “Sakk” which means a certificate or a bond. According to the Debt Monetary and Financial Statistics Manual (MFSM) securities are instruments - usually tradable in organized and other financial markets - that usually require the issuer unconditionally to pay a fixed or contractually determined variable money amount. The Islamic bonds are new finance products and have diverse compositions and arrangements, which offers multiple variety and preferences for investors. Islamic bonds can be categorized into four general groups: debt-based sukuk, asset-based sukuk, project-based sukuk and asset-backed sukuk. Sukuk is based on Islamic traditional contracts. The most common and most popular forms of Sukuk are equity and debt sukuk’s. Figure IX provides data on the global issuance of sukuk. The first Islamic T-Bills were issued by the Bahrain Monetary Agency in 2000. It was a non tradable sukuk al salam. The T-bills were the precursors of the first tradable Islamic debt securities.13

12 Ibid.

The first tradable Islamic debt security, based on Shariah law - sukuk al ijara, was issued by Malaysia under control of Shariah Advisory Council of Malaysia Securities Commission and consistent with the International Monetary Fund. Table IX provides data regarding issuance of sukuk.
In 2003 the Islamic Development Bank issued tradable bonds. Following years other Muslim banks such as Kuwait, Qatar, and Dubai issued its own bonds. Many Islamic banking and finance institutions issued Islamic bonds, however the insolvency and liquidity of sukuk creates drag in the Islamic finance industry. The first to default on $100 million sukuk was the Kuwaiti investment company - the Investment Dar, in May 2009. The Saad Group came to rescue by investing capital. Another default was by Nakheel fund with $3.52 billion. The bond was rescued by an Abu Dhabi Islamic Group.
The problem in Islamic bonds lies in the lack of universal regulatory junction from Muslim financial industry position, which, if applied, may help to resolve diverse views about issuance, purpose and use. Even though many Islamic banking and finance institutions have issued Islamic bonds, some scholars and Shariah boards suggest that some Sukuk might not be really Shariah-compliant.\textsuperscript{14}

6.4.1 Debt Based Sukuk

The debt based sukuk have different structures based on different type of traditional Islamic contract such as Sukuk al-Ijarah, Sukuk al-Salam, Sukuk al-‘Istisnaa, and Sukuk al-Murabaha. The debt sukuk present a debt to the issuer only, with additional ownership stake in its capital asset or project. The structure of debt based sukuk contains the use of a specified asset or capital and usually the leasor is the original owner of the asset and enters a sale-and-lease back arrangement with a so-called Special Purpose Vehicle (SPV). The leasing project could be a real estate investment, oil project, commodity or any type of market product.\textsuperscript{15}

6.4.2 Equity Based Sukuk

Equity backed Sukuk’s are participation certificates regarded as asset backed securities such as Sukuk al-Mudaraba, Sukuk al-Musharaka, or hybrid Sukuk forms


which incorporates different forms of contract. The US Islamic banks and finance groups to resolve the liquidity problems invest in Islamic bonds - sukuk.  

6.5 Islamic Financial Derivatives

Islamic finance and banks institutions tend to have high exposure to oil development, real estate and construction projects. Currently the global economic takes down-turn, a lot of investors are looking at hedging their risk in investments to oil development, real estate and construction projects in new Islamic financial products such as Islamic derivatives. Islamic finance and banks developed and issued new financial products stipulated on existing Shariah law and traditional contracts such as the bay salam and murabaha contracts. The new Islamic derivatives and hedge market will bring substantial capacity for improving efficiency by reducing the risk coverage of Islamic finance and banking institutions and this risk-sharing requirement of Shariah is within limit of Islam. Additionally, the new Islamic financial instruments will reduce the kind of abuses that led to the subprime mortgage abuse and disorder in the United States. According to the Islamic Financial Services Board the risk mitigation instruments (in particular, derivatives) such as the Islamic profit rate swap, foreign exchange swap, forward (using the Salam principle), forward foreign exchange (using the Wa`d principle), options (using the urbun principle), futures contract and Bay al-Istijrar contracts, only half of the jurisdictions surveyed accepted these contracts as Shariah permissible. The different Shariah interpretations among jurisdictions - and among

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16 Ibid.

Shariah boards of IIFS – have also resulted in non-uniformity in the acceptance and design of Shariah-compliant alternatives.\textsuperscript{18}

Islamic derivatives arise out of the nonconformity with the Shariah principles in various aspects such as the risk reducing financial instruments or deposit insurance; both types are not clear under Shariah principles and are religiously questionable. Some Islamic scholars and Shariah boards consider it un-Islamic to burden a customer with debt or to invest in a company with extreme debt. Hedging that exposure is difficult because hedge funds involve short selling and Shariah boards differ on whether they are permissible under the Shariah law.\textsuperscript{19} Audit and internal risk management can be problematic to Islamic derivatives also, but this approach has inherent problems because Islamic financial transactions must have an underlying asset. Transparency is a concept not very common in Muslim countries where information is not often known to the public. The justification for transparency is important and the need for business entities to disclose relevant information may lead to increased efficiency in running their operations.

\textbf{6.5.1 Hedging}

Hedging is a new Islamic financial product from derivatives group. Islamic finance and banks institutions use hedging to protect themselves against a currency or interest rate risk. Using hedging protects actively against changes in process such as for example in stocks, land, commodities or currencies, with the purpose to make a profit or avoiding a loss. Hedging is allowed for Islamic financial institutions as the derivative


\textsuperscript{19} Nicholas Ray, \textit{Arab Islamic Banking and the Renewal of Islamic Law} (London, UK: Graham & Trotman, 1995), 55.
instruments as long as the hedge structure is in conformity with Shariah requirements. Hedging instrument uses the Islamic traditional debt contract - Bay Salam. In principle the buyer of the commodity in the first place, pays the full purchase price as soon as the contract is closed and the predetermined price is normally lower than the prevailing price.20

6.5.2 Swaps

Swaps involve two transactions, an exchange of currencies on a given date and a reversal transaction on a later date. Swaps transaction at a later date is linked directly to purchasing power of the currency and the real value of money. In swaps transaction money makes money a practice that is forbidden under Shariah principles. According to the Shariah principles and later confirmed by the AAOIFI, exchange of currencies is only allowed on a current need basis in order to avoid riba.21 Consequently only a one-side contract to buy a currency in the future is allowed to hedge currency risk of riba. Swaps are instruments that have been subject of rejection under Islamic law by the Islamic Shariah boards. Swaps are short term loans in conventional financial system.

6.5.3 Insurance - Takaful

Islamic finance institutions located around the world including the United States are in a continuous need of constructing new financial products which can accumulate the assurance of debt instruments issued by finance institutions. To accommodate this demand Muslim economists and Shariah scholars have developed a very controversial

20 Ibid.

financial product which is called Takaful. Several individuals agree to pool resources with the understanding that in case of need, each of them is entitled to draw resources from the pool. Takaful is the Islamic insurance alternative and is based on the concept of mutuality similar to conventional mutual insurance and a contributing contract between the insured parties. Takaful manages these funds and receives payment from the premium payers. The type of takaful transaction depends on the traditional Islamic contracts such mudaraba or musharaka or on the type of insured asset such as property insurance, commodities or life insurance.

CHAPTER SEVEN
ACCOUNTING AND REPORTING ANALYSIS OF US ISLAMIC FINANCE AND BANKING INSTITUTIONS

The analysis of the regulatory framework for accounting, reporting, and tax for the US Islamic finance and banking industry will bring to light and expose the most significant issues and discrepancies that Islamic finance and banking institutions have to deal with when offering Shariah obedient financial products and services in the US. Different accounting and reporting methods, techniques and standards for reporting and calculation of operations have the ability of impacting different accounts, including revenues, cost of assets, expenses, zakat (tax) of Islamic banks and finance institutions and creates discrepancies on accounting books. The impact of the US economic crisis, high rate of unemployment and economic condition based on macro and micro factors creates unfavorable price movements on the economic value of an asset, profitability, creates losses and diverse postings on finance balance sheet.¹

One important area that has divergence is the issue of indexation of debt. In addition to the variety of justifications offered in support of positive time value of money in the context of debt, as was presented in Chapter Six when discussing instruments and methods used in value creation and growth of Islamic financial and bank institutions, one important argument that relates to inflation is the consequent decrease in the value of money. Economists argue that a debt, when repaid at a later date, has a lower purchasing

power due to persistent increases in the general prices of commodities and assets and of course inflation.

To understand better the differences between Islamic finance and conventional finance, Figure X outlines differences between the two types of financial reporting.

**Figure X**

**Balance Sheet Divergence - Islamic vs. Conventional Bank**

<table>
<thead>
<tr>
<th>Islamic bank</th>
<th>Conventional bank</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Asset</strong></td>
<td></td>
</tr>
<tr>
<td>Liquid assets</td>
<td>25</td>
</tr>
<tr>
<td>Receivables (murābahah and others)</td>
<td>35</td>
</tr>
<tr>
<td>Investment, including real estate</td>
<td>24</td>
</tr>
<tr>
<td>Fixed &amp; other assets</td>
<td>16</td>
</tr>
<tr>
<td><strong>Liabilities &amp; equity</strong></td>
<td></td>
</tr>
<tr>
<td>Current &amp; investment accounts</td>
<td>78</td>
</tr>
<tr>
<td>Deposits</td>
<td>14</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>2</td>
</tr>
<tr>
<td>Depositors share of profit</td>
<td>2</td>
</tr>
<tr>
<td><strong>Shareholders’ equity</strong></td>
<td>4</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Islamic bank</th>
<th>Conventional bank</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Asset</strong></td>
<td></td>
</tr>
<tr>
<td>Liquid asset (including treasury note, T-bill)</td>
<td>21</td>
</tr>
<tr>
<td>Investment &amp; deposit</td>
<td>23</td>
</tr>
<tr>
<td>Loans</td>
<td>52</td>
</tr>
<tr>
<td>Fixed &amp; other assets</td>
<td>4</td>
</tr>
<tr>
<td>Liabilities &amp; equity</td>
<td></td>
</tr>
<tr>
<td>Deposits</td>
<td>90</td>
</tr>
<tr>
<td>Borrowing &amp; other liabilities</td>
<td>0.5</td>
</tr>
</tbody>
</table>


As Figure X shows, Islamic financial products are likely to differ in how they are presented in the accounting books and financial reports compared to disclosed conventional accounts. The same account can be presented on the Balance Sheet as an Asset Account in conventional bank statement site and as Liabilities and Equity Account in Islamic bank statement site. Other examples include the treatment of account deposits,
and cost of assets accounts. Islamic financial institutions use different calculations method and different accounts for reporting similar transactions from certain Islamic financing activities and operations. This creates discrepancies in proper calculation of income, performance, tax and reporting of assets and liabilities. For example: the same financial product such as Ijara can affect the balance sheet in completely different ways: as a profit account and asset, or liability account on the balance statement. Accordingly the revenues and income can be lower or higher. On the liabilities side is the bank dependency of Islamic banks financial products to generate revenues.

Additionally, the problem with tax regulations and treatment needs to be addressed. Islamic financial institutions and their financial products need to be in the same bracket as conventional Islamic banks and financial products. Islamic banks and financial institutions replace the interest with additional fees and costs such as Cost of Capital account; however it is not an expense account. How should it be taxed? If classified as expense account it will be a preferential treatment. These problems and other tax defects could be resolved in cooperation with the Treasury Department and other government initiatives.

All the US Islamic finance and banking institutions take actions to create additional value and profit but Islamic banks do not always find sufficient venues to set funds for short and long-term investments with no incurring risks of equity financing. As a result Islamic banks and finance institutions create additional risks comprised of active Islamic financing techniques which create problems for reporting of additional risks. It is important to expose and articulate the higher costs for the development and stipulation of
Islamic financial products which consequently leads to higher costs of a product and increased operational expenses incurred by Islamic finance and bank intuitions. The US Islamic finance and banking institutions have additional duties of disclosure regarding financial products, transactions and reporting on conformity with the Shariah principles to the Shariah Boards as was discussed in Chapter Three and Chapter Six.

Another problem faced by Islamic finance and banking institutions is the problem with calculation and distribution of Zakat. Zakat is a tax on wealth and tariff of non-Shariah complaint earnings. Zakat is calculated and distributed on individual basis by Islamic financial institutions and their shareholders. Islamic financial institutions are missing a uniformed regulation regarding calculation of Zakat and its distribution, which creates additional problem and distortions with respect to US financial law and tax regulations, as well from ownership and control standpoint. Improving such system will be the key to expansion, clarification and improvement of reporting.

With respect to the booming of debt instruments and new Islamic contracts on the financial market, the lack of consensus creates a wide inconsistency between what is considered an adequately Islamic instrument and product across all Islamic financial institutions in the US. Universal Islamic financial products and universal accounting and reporting regulations for all Islamic financial instruments and service are needed for all Islamic financial institutions operating in the US.
CHAPTER EIGHT

PERFORMANCE AND GROWTH ANALYSIS OF ISLAMIC FINANCE AND BANKS IN THE USA

It is important for Islamic finance institution to find the cost of capital, given the role it takes in value creation. The two principal components of core funding are the stable customer’s deposits, investments in fixed assets - loans to customers, and loans on commodities. The development and growth is closely correlated with added value to a contract. Depending on what type of contract will be used the profit margin can be higher or lower. Evaluating value creation and growth is tied very closely to evaluating performance by comparing earnings to capital of investment, by measuring the amount by which the earnings of a single transaction, project, an operation, or if Islamic finance and bank institutions exceed or fall short of the total amount of capital that was originally invested by its owners.

Unfortunately, Islamic finance and banking institutions are missing uniformed index and standards to assess performance and appraisal of growth. To evaluate shareholders value and accomplished growth objectives Islamic finance institutions use various financial indexes, which also serve the need of various stakeholders for measuring performance and to evaluate shareholders value and growth objective. Based on research and investigation of US Islamic financial institutions this chapter divides the valuation approach and methods used in measuring value creation, accomplished goals and growth of Islamic finance and banks institutions in the USA into three categories. Table XI presents the categories used for value creation.
Table XI
Drivers Used for Value Creation

<table>
<thead>
<tr>
<th>Category</th>
<th>Measures Used for Value Creation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Category 1</td>
<td>Return on Investment</td>
</tr>
<tr>
<td>Category 2</td>
<td>Economic Value Advance</td>
</tr>
<tr>
<td>Category 3</td>
<td>Systematic Approach</td>
</tr>
</tbody>
</table>

Source: Designed by Andrzej D Szczepanowicz

Evaluating performance and measuring the achievement of created goals of Islamic financial and banking institutions is important and various methods of measures are empirically used. Performance evaluation is a part of control procedures and as a management tool can help in identifying the deficiencies of its operation throughout the financial year and to create the value to shareholders, institutional growth and to improve its future performance in creating value and growth. Performance evaluation is a method of measuring a company’s accomplishments based on agreed goals. The evaluation of performance in creating shareholders value and growth of Islamic finance and banks institutions is under critical public examination and analysis. Evaluating value creation and growth is tied very closely to evaluating performance by comparing earnings to capital investment, by measuring the amount of earnings from a single transaction, project, an operation, or if Islamic finance and bank institution exceed or fall short of the total amount of capital that was originally invested by its owners or whether the value was or was not created. Measuring value created is a way that contributes to the business improvement of Islamic bank position in industry and if the Islamic finance and banks
institutions perform well the market should have noticed it and this advances the Islamic finance position on US financial market. Another point of view on the benefit to measure value creation is that measuring created value helps and guides management to make right decisions. Based on creation value measurement it can be easy to identify activities that do not create value and these can be easily eliminated or special approach can be applied and management can make decision accordingly. According to another viewpoint measuring created value helps to keep the optimal capital return on investment on the level the shareholders group or management has set. By measuring the created value Islamic finance and banks institutions make sure that they are keeping at that level or not and they will know what to do in the next step and take corrective action.

Islamic finance and banks institutions have to make sure that their activities are in accordance to the Shariah principles. For this purpose the Islamic disclosure index or Shariah compliance indicator is used. Islam disclosure index consists of different components such as Shariah compliance measurements, and Islamic corporate governance component. According to the Holy Quran and the Shariah law, creating interest and profit is forbidden but everyone in the Islamic financial and banking industry operates and uses the terms of the cost of capital or cost of assets. The time value of money is incorporated into contracts, goals, and valuation of shareholders growth and Islamic financing and banking industry. The Islamic finance institutions develop their own performance indicators based on a predetermined goal or Return on Investment or Cost of Capital.
As was described in Table XII the first category in valuation of growth and creation of shareholders value by Islamic financing and banking institutions is the Return on Investment (ROI) method. US Islamic finance institutions using ROI use the capital to achieve an optional growth. In this category there are Islamic mutual funds groups and Islamic investment banks that were introduced and discussed in Chapter Five. The Islamic investment banks institutions tend to maximize their cash flow while at the same time they invest some capital for future development. The ROI is used by the Overland Capital Group UB Capital – Chicago, TransOcean Group, Innovest Capital, Aracapita, City Bank and Islamic Mutual Funds such as Amana Mutual Fund, the Iman Mutual Fund and the Azzad Mutual Fund. Figure XI presents the interaction and interdependency between Cost of Capital, Return on Invested Capital, and growth.

**Figure XI**
Interdependency of Growth and Shareholders Value

<table>
<thead>
<tr>
<th>Shareholders Value</th>
<th>Cost of Capital</th>
<th>Return on Invested Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Capital Structure</td>
<td>Growth Goal</td>
</tr>
<tr>
<td></td>
<td>Growth</td>
<td></td>
</tr>
</tbody>
</table>

Source: Designed by Andrzej D Szczepanowicz

The Cost of Capital position is a strategy for allocation of resources and assessing performance. Return on capital or return on assets is calculated and indicates value when the return on invested capital exceeds the weighted average of cost of capital. The return
on capital is reinvested and that profitability is directly connected to creation of shareholder value. ROI measurements serve as a benchmark for determining the potential value for some Islamic financing and banking transactions and operations as well as for a whole Islamic financing and banking industry. To evaluate creation of value and growth by comparing earnings to capital investment is a way of judging financial performance by measuring the amount by which the earnings of a project, an operation, a Muslim finance and bank institution exceed or fall short of the total amount of capital that was originally invested by its owners is in line to an Islamic credo and principles.

The second category in valuation of growth and creation shareholders value by the US Islamic financing and banking institutions from Table XII is the Economic Valuation Analysis (EVA) method: \( EVA = \text{Net Operating Profit} - \text{Applicable Taxes} - \text{Cost of Capital} \). EVA is a measure of performance and growth and, it is a powerful way to create and promote shareholder value. This method is adapted by the US Islamic banks and Islamic mortgage companies. Based on different contracts under Shariah law different type of EVA method is employed. If Murabaha contract is employed the EVA = Economic Value Advance - Net Sales approach is used. The profit margin for the bank is calculated based on: the amount of down payment, the purchase price, terms of repayment, and the market rate of return on investment that the investors expect. The EVA valuation is a very important tool in relation to: targeted value, capital deployment, the value creation and growth for Islamic finance institutions and its shareholders in assessing critical tradeoffs and define the most appropriate path for optimizing its transaction strategy. The assessment of growth and created shareholders value is made by
comparing earnings to capital investment, and is a way of measuring the amount by which the earnings of Islamic finance and banking institutions exceed or fall short of the total amount of capital that was originally invested by its shareholders. Islamic financial and banking institutions use EVA as a tool to evaluate shareholder objectives and predetermined goals to find out which business units or transactions best utilize their assets to generate returns and maximize shareholder value, growth and reliability. The same method is used by Islamic finance institutions to assess a company, a business unit, a single plant, office, or even an assembly line. This same technique is equally helpful in evaluating new business opportunities.

Operating returns can be improved as a result of the EVA method in place to drive down expenses and costs used to improve the return on capital. Operating returns can be improved as a result of EVA method used to rationalize and to utilize assets that do not generate sufficient returns and Islamic banks, finance groups and its shareholders receive credit by increasing the value of the company.

The third category in valuation of the Islamic financing and banking industry from Table XII is a Systematic Approach method. This method is adapted by the community based Islamic financial programs and not for profit organizations in the USA such as the Non – Profit Community Development Islamic Programs whose goals and objectives are adapted to the Islamic credo and principles that were discussed in Chapter Five. All the staff of such Islamic finance and bank institutions with this method is reformed according to Islamic values and act within the framework of an Islamic formula. Islamic financial and banking institutions using Systematic Approach method
have a major responsibility to shareholders. Muslim finance organizations and banks institutions with this method of evaluation have a very centralized system. This category is based on valuation of particular project, goal, sector, product line and Islamic religion. The revenues, profits, value creation and capital gains are not important issues; however a greater internal efficiency and lower internal costs improves the creation of shareholders value when a systematic approach is employed to create value.

Management acknowledges its status as a role model and is observant in following the standards. Managers are evaluated on performance of a single project; they have strong incentives to improve operational and capital efficiency. Employees are made aware of the Islamic values, Shariah standards, and ethical practices when they join the organization and employees are divided and adapted to a particular target objective.
CHAPTER NINE
RISK AND LIQUIDITY ANALYSIS OF US ISLAMIC FINANCE AND BANK INSTITUTIONS

As was discussed in the Chapter Eight the variety of methods and Islamic management approaches in running the enterprise and creating shareholder value are different and how they are used fluctuates on individual basis based on shareholders goal, orientation and other factors such as management techniques. During operations there are different value drivers used and the selected driver may be based on management’s choice to achieve the goal set up for the operation. Table XI below shows the drivers used for growth creation in Islamic financial institutions.

Table XI
Drivers Used for Growth Creation

<table>
<thead>
<tr>
<th>Drivers Used For Growth Creation of Islamic Finance Institutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Expansion of Islamic finance institutional structures</td>
</tr>
<tr>
<td>2. Muslim management style</td>
</tr>
<tr>
<td>3. Capital structures</td>
</tr>
<tr>
<td>4. Islamic financial products</td>
</tr>
</tbody>
</table>

Source: Designed by Andrzej D. Szczepanowicz

Islamic financing techniques are established upon one of two basic principles: A) profit and loss sharing principle; and B) mark-up (also referred to as the cost-plus financing). The profit and loss sharing principle in Islamic finance is used for equity-based financing approach as the bank invests directly in business projects and participates in generated profits or losses. The mark-up is applied in debt-financing as the customer
becomes a debtor to the bank, and pays the original purchase price of a commodity plus a predetermined mark-up.

According to Islamic economic theory the profitability and performance of the Islamic finance institution is directly connected to investors and capital values. In practice some Islamic banking and financing groups to measure performance operations use the Cost of Capital analysis. Return on capital or return on assets is calculated and the value created is actually objective of that investment. The Cost of Capital or Return on Assets analysis applies the return on capital ratio as benchmark for measuring the potential shareholders value and financial growth. With this strategy - Cost of Capital - the Islamic financing groups and banks tend to maximize their cash flow while at the same time they invest some capital for future development. Islamic finance and banks as investors are not permitted to escape the consequences of any failed venture - all financing was equity and debt financing contracts. In not letting borrowers bear all the risk and cost of a failure, but including the investor creates an extreme disparity of outcomes between lender and investor as was discussed previously in Chapter Six.

To create value the Islamic financial banking institutions employ efficiency in their operations such as active cost reduction techniques. The most important elements to growth and increase of value are the Islamic management with its flexibility and declaration of integrity. The integrity is connected to the Shariah principles if available financial products on market would be restructured under an Islamic law. To improve the flexibility universal financial products and regulations for all Islamic financial instruments and service are needed. With respect to the booming of debt instruments and
new Islamic contracts on financial market, the lack of uniformed consensus creates a wide inconsistency between what is considered an adequately Islamic instrument and product across Islamic financial institutions in the USA.

Islamic banks bear considerable risks in providing their products, conducting operation and business transactions. Islamic finance and everyone who do business in a Muslim environment is affected by additional values unique to Islamic banks standards and principles that are in compliance with the Shariah. Some of the Islamic contracts are relics. The traditional contracts were not sufficient and adequate in performing modern financial transactions especially with West commercial institutions. New Islamic financial products were needed as it was discussed in Chapter Six. Adjustments to the traditional Islamic contracts are needed on a continuous basis because Islamic financial products are not uniformed. This type of time consuming activities reduces efficiency and increases costs of transactions. Efficiency loss is tied to the certification of Shariah compliance on contracts, because transactions and projects need to be converted to conventional financial contracts and products, which do not have its Islamic alternative, to make them Shariah compliant and to make them compatible with US legal and regulatory system. Additionally, the new Islamic financial products used by the Islamic financial institutions are tied to risk management. The flexibility of new Islamic financial products is connected to Shariah law as a regulation to confirm that Islamic financial available products on the US market are restructured according to the Shariah principles.
Shariah Supervisory Board has to examine all new contracts, audit new contracts, and approve new financial products.¹

Even though the demand for Islamic financial products in the USA is increasing there are no uniformed Islamic financial products and instruments used in the Islamic banking system, so far. This leads to huge difficulties in efficient risk management, value creation and growth of Islamic financial institution. Each time an Islamic finance or bank institution wants to structure a financial transaction in accordance with Islamic law, the firm will consult either an external or internal Islamic Shariah Board. In the first step the management of Islamic finance institution develops a basic draft of the new financial product or internal process. The structured proposal of a contract, transaction, or financial product is then presented to the Shariah Supervisory Board which examines and fundamentally approves the basic structure. The first initial consultation leads to multiple review sessions and follows amendments to the formation of the structure and the documentation of the agreement after each review. Subsequently the final product or process and the outlined transaction description are handed over to the Shariah Supervisory Board that proceeds with the detailed analysis. The Shariah Board examines the structure of a proposed transaction, or financial product. After all the adjustments and provisions are made, the Shariah Board issues a fatwa - which is a final certification stating that the financial product is Shariah compliant. If the Shariah Supervisory Board is not satisfied with the content of management proposals then the proposal process is repeated again, and consequently the development period is of course significantly

longer. To shorten the time for a financial product or transaction development Islamic bank hires a special Shariah consultant who is involved in the process from the beginning and identifies issues before a proposal is outlined or forwarded to the Shariah Board because the inspection and auditing of new products and processes is essential for credibility and marketing of Islamic finance and bank institutions.

The traditional Islamic contracts lack derivate products and the lack of them creates disadvantage for risk management and liquidity management of Islamic banks. Risk management and diversification of risk is of highest importance. Risk Management for Islamic banking is a relatively new concept and financial instruments related to risk management are generally not well understood, and neither are their risks. It was quite problematic to structure derivatives in agreement with Shariah principles, and with old-fashioned Islamic contracts. Consequently new Islamic financial market products were developed, where Islamic finance and bank institutions invested a considerable effort in developing Shariah compliant derivative instruments. Islamic insurance companies were created and new financial products were developed - Takaful. The Islamic financial institutions educate and give detailed information and inclusive advice to their customers.

Profit and loss sharing is a base for Islamic banking. The fact that lenders do not receive any share of net profit from borrowers with successful projects, but can make losses from financing unsuccessful ones, ensures that lenders will be biased against funding risky projects even though they may have higher anticipated returns. In effect, because lenders do not gain gambling successfully, but lose from gambling unsuccessfully, they tend not to gamble at all, even though it may be socially optimal for
them to do so. Hence, banks tend not to finance projects with the highest expected returns, after accounting for risk, but those with the most stable cash-flow. This outcome departs substantially from the first-best allocation.\(^2\)

For an Islamic financial institution the personal risk is especially high due to the Islamic finance structure. In the USA new Islamic business ventures and requests to buy houses and other goods are in demand and create operational risk of direct or indirect assets loss resulting from different factors as well internal and external market factors. The claim for every form of interest paid or interest on money used for overdraft is forbidden and cannot be used to compensate a banks loss in payment. The loss can arise from using Murabaha contracts when the counter party in contract fails to fulfill its debt obligations and a bank as investor takes the losses.

Liquidity assessment of Islamic banks is a problem. According to the Holy Quran and based on Shariah principles, Islamic financial institutions are required to keep a very high amount of capital. Additionally, according US finance and banks regulations a percentage of deposited money needs to be placed in the FDIC deposit account. The liquidity is a two tier problem – one is an excess of money and the other tier is deficit of liquid money. Following the two tiers the liquidity position is strong and the Islamic banks are holding a large amount of liquid assets on their balance sheets. Islamic finance and banks hold a higher level of owners’ equity in relation to debt in comparison to conventional banks that usually operate with higher leverage ratios. The excess of liquidity creates a problem for Islamic banks. The secondary market for investment with

interest free financial instruments and Shariah complaint is not that big for Shariah oriented Islamic financial institutions. The insufficient tools to resolve the liquidity excess creates some risk and lowers the performance and efficiency of Islamic finance and banks. A new tool on the secondary investment market and for Islamic management was developed, a new Islamic financial product - sukuk. As was discussed in Chapter Six sukuk is the most innovative capital market instrument in Islamic finance. Liquidity management of Islamic finance and banks institutions with excess liquidity received convenient and suitable form of investment product - a sukuk.

In order to avoid and limit possible losses Islamic banks favor debt financing contracts such as Murabaha more than an equity contribution contracts like Musharaka. Used by Islamic finance and banking Murabaha contracts hold the market risk on its asset and on specific transaction with additional mark-up risk. The Mudaraba, Musharaka, Bay Salam and Ijarah contracts hold the asset price risk which comes from the factor that an Islamic bank buys an asset on the behalf of its customers and if in case the customer does not fulfill his obligation, a bank may be forced to resell the asset for a lower price and incur a loss. As a result Islamic financial institutions that serve Islamic financial products may be forced to charge higher mark-ups in short-term liquidity transactions compared to conventional financial institutions.

The Fiqh Academy and Shariah laws imposed strict restrictions on the securitization of debt instruments. Islamic banks do not have the means to obtain cash fast at a reasonable cost, which creates funding liquidity risk. The Islamic banks can’t raise funds quickly from the market due to the limitations of justice prudence of Islamic
principles. The liquidity problem creates an uncertain market for Islamic banks and financial institutions as they struggle with the number of Sukuk defaults. Large maturities in Islamic finance and banks indicate a reliance on borrowings and decrease sources of shareholders assets and creation of value by reducing loans and advances to customers. A gap analysis can be performed to measure the liquidity, risk and the point of debt maturity to the total liabilities and asset of Islamic bank or finance institution. The gap analysis is calculated by subtracting an amount of inflows from growing assets less the outflow from maturing obligations and outflow assets. The gap analysis can give an evidence of how well an Islamic bank or finance institution is set to meet its financing obligations.
CHAPTER TEN
REGULATORY ANALYSIS OF ISLAMIC BANKING AND FINANCIAL SERVICES IN THE USA

US financial institutions are heavily regulated by the financial laws of the US federal government and by state authorities. To perform financial services an institution needs to be licensed by the FDIC. The USA has the same rules for all who apply for the license to perform financing services. William L. Rutledge, Executive Vice President of the Federal Reserve Bank of New York (2005) explains below:

Our mindset is to try to accommodate a variety of approaches to finance, focusing to the extent possible on the underlying substance that is, focusing on what the implications for safety and soundness and consumer protection would be of a given product. Consistent with that approach, while we are committed to accommodating Islamic finance within the U.S. structure, we will hold Islamic financial institutions to the same high licensing and supervision standards to which we hold conventional ones. Although we are certainly in no position to take a stance on issues of Shari’a interpretation, it is important that we become more familiar with the principles and practices unique to Islamic finance in order to make our supervisory and regulatory judgments.¹

US federal and states financial regulatory laws are clearly different from Islamic finance laws and economic principles. Financial institutions are described as firms that provide financial services and financial advices to their clients. The US government recognizes eight types of financial institutions such as: commercial banks, credit unions, stock brokerage firms, asset management firms, insurance companies, finance companies,

building societies and retailers. These various financial institutions usually operate as the intermediaries between the capital market and debt market. Federal and state laws and regulations are set for all financial and licensed institutions on the US financial market. The service provided by a financial institution depends on under which type the institution is incorporated and what kind of license it holds and the financial activities vary and depend on the license type.²

All banks in the USA are liquid. Under banking regulations, a licensed FDIC bank who offers money market account must agree to redeem part or all of any such account to the depositor upon demand. The FDIC rules that all consumer deposits less than $100,000 must be insured against capital loss.

Liquidity risks management is posing additional legal exposure for Islamic finance and banks in the USA. Two factors contributing to the risks and which are important to analyze are: A) current financial laws in the USA and B) Islamic principles and Shariah oriented financial products. The uniformed USA finance and banking laws and the Shariah laws are based on different principles. In order to adhere with the US federal and states laws Islamic banks must insure all deposits accounts - a practice condemned by the Shariah. Islamic finance and banking institutions have additional restrictions under Shariah law for the high capital freeze which creates capital constraints and restricts the ability to fund growth. This Shariah requirement has been aggravated by the requirements of the FDIC - financial services authority in the USA. The US legal

requirement to insure money and make deposits to the FDIC on all account deposits might constrain Islamic bank’s efficiency or make certain transactions impossible. In order to minimize the liquidity risks Islamic financial institutions and banks management incorporates and uses financial products that are questionable under Shariah laws, such as sukuk’s, hedges and derivatives. The problem in Islamic bonds lies from the lack of regulatory junction from Muslim financial industry position by the international Shariah Board, which, if applied, may help to resolve diverse views about issuance, purpose, and use.

In the USA an institution cannot work as a bank and cannot accept any deposit until it meets the mandatory and statutory banking and financing requirements of US federal and state laws. The profit-loss-sharing Shariah principle is of course at odds with US federal banking regulations. Insuring investment fund is against Shariah principles, because the losses must be shared by both parties - the depositor and the banker in order to fall in line with Shariah. The profit-loss-sharing Shariah principle creates additional legal problem for Islamic finance and banking institutions operating in the USA. On the liabilities side is the bank’s reliance on the Islamic financial products and market to generate revenues, which has remained uncompetitive compared to the conventional banking sector. In order to improve the Islamic finance and banking transactions and contracts must be standardized, so banks and finance institutions have to invest considerable time and money in the structuring and negotiation of complex transactions as it was indicated and discussed in Chapter Five.
A competitive rate of return if offered by Islamic finance and banking institutions to attract and retain investors as fund providers, can create additional legal risk under US law. Likewise it is a risk under the restrictions of Shariah law, because the Shariah requires that a portion of bank’s own share in profit will be assigned to investment depositors in order to avoid a situation that depositors - if not satisfied - withdraw their funds. Islamic laws are not enforceable in front of the USA courts so the Islamic banks may have problems when suing counterparties who fail to complete their contracts or vice versa.

The calculation, reporting and distribution of Zakat creates additional problem for the Islamic finance and banks. Zakat can affect accounts such as initial capital, revenues and assets. Uniform Zakat regulations are absent, so the calculations of Zakat can lead to the distortion of revenues, income and accounts on balance sheet. Another problem is the distribution of Zakat.

Listed below are the most important laws that affect the banking industry in the United States of America, including the Islamic financial and banking institutions.

Federal Deposit Insurance Act of 1950 (P.L. 81-797, 64 STAT. 873) which has revised and consolidated earlier FDIC legislation into one Act, embodied the basic authority for the financial organizations in the USA that controls the flow of money in the economy. National Bank Act of 1864 (Chapter 106, 13 STAT. 99) was created to establish a national banking system and the chartering of national banks. Federal Reserve Act of 1913 (P.L. 63-43, 38 STAT. 251, 12 USC 221), was created to establish the Federal Reserve System as the central banking system of the U.S. Banking Act of 1935
(P.L. 74-305, 49 STAT. 684) was created to establish the FDIC as a permanent agency of the US government.

Laws for the operations of the FDIC include International Banking Act of 1978 (P.L. 95-369, 92 STAT. 607) was created that brought foreign banks within the federal regulatory framework. This act required deposit insurance from branches of foreign banks engaged in retail deposit taking in the U.S. The Financial Institutions Regulatory and Interest Rate Control Act of 1978 (P.L. 95-630, 92) was created to establish limits and reporting requirements for bank insider transactions. This act created major statutory provisions regarding electronic fund transfers. The Competitive Equality Banking Act of 1987 (P.L. 100-86, 101 STAT. 552) was created to establish new standards for expedited funds availability. This act greatly expanded the authority of federal regulators to combat financial fraud. It prohibited undercapitalized banks from making golden parachute and other indemnification payments to institution-affiliated parties. It also increased penalties and prison time for those convicted of bank crimes, increased the powers and authority of the FDIC to take enforcement actions against institutions operating in an unsafe environment. The Federal Deposit Insurance Corporation Improvement Act (FDICIA) of 1991 (P.L. 102-242, 105 STAT. 2236) greatly increased the powers and authority of the FDIC.\footnote{Federal Deposit Insurance Corporation (FDIC), "Important Banking Legislation," http://www.fdic.gov/regulations/laws (accessed: November 4, 2010).}

Major provisions recapitalized the Bank Insurance Fund and allowed the FDIC to strengthen the fund by borrowing from the Treasury. The act mandated a least-cost
resolution method and prompt resolution approach to problem and failing banks and ordered the creation of a risk-based deposit insurance assessment scheme. Brokered deposits and the solicitation of deposits were restricted, as were the non-bank activities of insured state banks. FDICIA created new supervisory and regulatory examination standards and put forth new capital requirements for banks. It also expanded prohibitions against insider activities and created new Truth in Savings provisions. The Housing and Community Development Act of 1992 (P.L. 102-550, 106 STAT. 3672) was created to combat money laundering, and provided regulatory relief to financial institutions.5

The Riegle Community Development and Regulatory Improvement Act of 1994 (P. L. 103-325, 108 STAT. 2160) was created to establish a Community Development Financial Institutions Fund (CDFI), a wholly owned government corporation that would provide financial and technical assistance to CDFIs

This act contains several provisions aimed at curbing the practice of "reverse redlining" in which non-bank lenders target low and moderate income homeowners, minorities and the elderly for home equity loans on abusive terms. This act relaxes capital requirements and other regulations to encourage the private sector secondary market for small business loans. This act contains more than 50 provisions to reduce bank regulatory burden and paperwork requirements. And this act requires the Treasury Dept. to develop ways to substantially reduce the number of currency transactions filed by financial institutions. Contains provisions aimed at shoring up the National Flood Insurance Program.

5 Ibid.
The International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 (P.L. 107-56) was designed to prevent terrorists and others from using the U.S. financial system anonymously to move funds obtained from or destined for illegal activity. This act authorizes and requires additional record keeping and reporting by financial institutions and greater scrutiny of accounts held by foreign banks and of private banking conducted by foreign persons. This act requires financial institutions to establish anti-money laundering programs and imposes various standards on money-transmitting businesses. It amends criminal anti-money laundering statutes and procedures for forfeitures in money laundering cases and requires further cooperation between financial institutions and government agencies in fighting money laundering.6

Additionally, Islamic finance and banks must adhere to Islamic laws and Shariah principles. It is the requirement under Shariah that Islamic finance and banks industry observes principles of ethical business conduct. HRH Prince Muhammad Al-Faisal Al-Saud and Muazzam Ali stated as follows:

Good banking is not only about good returns, but also about service, corporate ethics, politeness, helpfulness and a friendly image. Ethics demands adequate financing reporting and organizational transparency, while good service demands constant product improvement and cooperation.7

Islamic financial and banking institutions as part of Islamic economics are not only restricted to the financial needs of their shareholders but also are limited to the ways


of doing business and ways used to create value in order to guarantee that all the activities are within the requirements of Shariah principles. Islamic oriented and Shariah compliant banks and financial institutions cannot receive or provide funds for forbidden activities involving alcohol, gambling, etc.

Presently the interpretation of Islamic law is still not homogeneous and standardized. The Islamic financial product constructed by any Islamic financial institution or bank can be withdrawn from the market and contradicted by Shariah Board because the terms agreed in the contract do not effectively comply with Islamic jurisprudence and thus are not valid under Islamic law.\(^8\) In effect the Islamic bank can lose its reputation within the Muslim community. For example the Forex swaps in Islamic finance uses a synthetic Murabaha contract. The practice is not allowed under Shariah law and was condemned by some Islamic scholars. Accordingly, constant monitoring of a Shariah Supervisory Board or Shariah is required.

Based on this analysis the most moral and ethical hazard for Islamic banks and financial institutions is the use of religion in financial transactions to avoid censure, condemnation, disapproval and scrutiny from religious leaders, orthodox believers, and Islamist nationalists.

CHAPTER ELEVEN
DEMAND ANALYSIS FOR ISLAMIC BANKING AND FINANCIAL SERVICES IN THE USA

Using a questionnaire consisting of twenty-three questions, this chapter examines and identifies the attitudes and behaviors that current and potential US customers (both Muslim and non-Muslim) have towards Islamic banking, as well as the particularities in consumer behavior of Muslims living in the US. The investigation of Muslim population is without special regard of which particular Islamic financial group or bank institution and services are used.

11.1 Methodology - Participants and Materials

A stratified random sampling method was used in this study to collect the data from the respondents. This sampling approach was chosen following Sekaran’s suggestion that this sampling method is the most efficient when differentiated information is needed regarding various strata within the population.\(^1\) Data were collected from respondents in the Northern Virginia area USA. The survey was handed out to Islamic bank customers as well as customers frequenting conventional banks. Twenty-five Muslims were approached that were frequenting the Islamic banks located in the Northern Virginia. Another twenty-five non-Muslim respondents were approached who were frequenting randomly selected conventional banks in the Northern Virginia. Participants were approached and were asked if they wanted to fill out a questionnaire on

the spot, upon consent participants were provided with the questionnaire that was attached to a clipboard and a pencil.

A sample size of 50 participants was found to be adequate for this study. Although the sample size is small in comparison to the actual population, the sample size is adequate for the study. As Roscoe indicated a rule of thumb for determining sample size is that if the sample is larger than 30 and less than 500 it is therefore appropriate for most research.\(^2\)

A structured questionnaire was constructed to collect the necessary data to answer the research hypothesis questions. The survey questionnaire consists of two parts. The first part of the questionnaire focuses on the demographic information of the respondents which includes gender, income, religion, age, and occupation. The second part of the questionnaire deal with respondents’ beliefs and attitudes toward the Islamic banking. Respondents had to rate on a Likert scale questions such as: How often do you see advertisements or commercials on Islamic banking a) very often (5 times a day), b) often (5 times a week), c) sometimes (once a week), d) Rarely (once a month), and e) never (zero).

11.2 Results and Discussion

This study used SPSS 17 to analyze the findings. Descriptive analysis was conducted to create and represent participants’ demographic profiles. Frequency analysis was conducted to measure US Muslim and non-Muslim attitudinal differences in their perceptions about the Islamic Banking services in the US. The demographic profile of the

respondents of this current study comprised of middle aged predominately male adults with a mean income of fifty to sixty thousand dollars (see Table XII). According to the selected sample 60 percent of respondents were male and 40 percent respondents were female. From the descriptive result, demographic profile shows that 62 percent of the respondents were between 40 to 49 years of age, 12 percent of respondents were between 20 to 29 years of age, and 8 percent of respondents were 60 years of age and up. The descriptive analysis revealed that customers that frequent Islamic banks are Muslims, those that were sampled at conventional banks 12 were Christian, 4 were Jewish, and 8 indicated other. With regard to occupation, highest number (80 percent) of the respondents indicated that they were private sector employees, 10 percent respondents indicated that they were retired, 8 percent indicated that they were self-employed and 2 percent of sampled respondents indicated that they were government sector employees.

<table>
<thead>
<tr>
<th>Table XII Respondents Demographic Profile</th>
</tr>
</thead>
<tbody>
<tr>
<td>Description</td>
</tr>
<tr>
<td>--------------------------------</td>
</tr>
<tr>
<td>Gender: Male</td>
</tr>
<tr>
<td>Female</td>
</tr>
<tr>
<td>Income: $20,000-29,000</td>
</tr>
<tr>
<td>$30,000-39,000</td>
</tr>
<tr>
<td>$40,000-49,000</td>
</tr>
<tr>
<td>$50,000-59,000</td>
</tr>
<tr>
<td>$60,000-100,000</td>
</tr>
<tr>
<td>$100,000-up</td>
</tr>
<tr>
<td>Religion: Muslim</td>
</tr>
<tr>
<td>Christian</td>
</tr>
<tr>
<td>Jewish</td>
</tr>
<tr>
<td>other</td>
</tr>
<tr>
<td>Age: 20-29</td>
</tr>
<tr>
<td>30-39</td>
</tr>
<tr>
<td>40-49</td>
</tr>
<tr>
<td>50-59</td>
</tr>
</tbody>
</table>
Frequency and percentage analysis revealed that 90 percent of customers would want to do business with an Islamic bank (see Table XIII). Even though customers indicated that they would want to do business with Islamic banks, it is unfortunate that about 98 percent of customers indicated that they have not seen any commercials and advertisements that promotes doing business with Islamic banks. With that in mind, the question should not be if US customers would want to invest in Islamic banking but rather are Islamic banks promoting their existence as well as their investment products, clearly the answer is no. Islamic banks need to invest in advertising so that US customers consider their products from among the many possible investment opportunities that are available on the US financial market.

Table XIII
Frequency & Percentile of Customers Attitudes and Behaviors Towards Islamic Banking

<table>
<thead>
<tr>
<th>Descriptions</th>
<th>Frequency</th>
<th>Percentile</th>
<th>Cumulative (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Would you bank with an Islamic Institution:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly agree</td>
<td>45</td>
<td>90</td>
<td>90</td>
</tr>
<tr>
<td>Somewhat agree</td>
<td>4</td>
<td>8</td>
<td>98</td>
</tr>
<tr>
<td>Neutral/no opinion</td>
<td>1</td>
<td>2</td>
<td>100</td>
</tr>
<tr>
<td>Do you feel there is enough advertising of Islamic</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>services and products:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>49</td>
<td>98</td>
<td>100</td>
</tr>
<tr>
<td>Somewhat disagree</td>
<td>1</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>How accessible do you find Islamic banking to be:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Very little accessibility</td>
<td>Little accessibility</td>
<td>Accessibility</td>
</tr>
<tr>
<td>-----------------------------------------------------------------</td>
<td>---------------------------</td>
<td>----------------------</td>
<td>---------------</td>
</tr>
<tr>
<td>How much do you know about Islamic banking:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Know a lot about what Islamic banking is</td>
<td>30</td>
<td>60</td>
<td>60</td>
</tr>
<tr>
<td>Know somewhat what Islamic banking is</td>
<td>17</td>
<td>34</td>
<td>94</td>
</tr>
<tr>
<td>Never heard of Islamic banking</td>
<td>3</td>
<td>6</td>
<td>100</td>
</tr>
<tr>
<td>Do you think Islamic banking offers the kind of products that you would want to invest in:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly agree</td>
<td>8</td>
<td>16</td>
<td>94</td>
</tr>
<tr>
<td>Somewhat agree</td>
<td>3</td>
<td>6</td>
<td>100</td>
</tr>
<tr>
<td>Neutral/no opinion</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Do you think that participation in Islamic banking is more beneficial than participation in conventional Western banking:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly agree</td>
<td>9</td>
<td>18</td>
<td>100</td>
</tr>
<tr>
<td>Somewhat agree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Neutral/no opinion</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>How important is it for you to invest in Islamic banking:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Very important</td>
<td>13</td>
<td>26</td>
<td>26</td>
</tr>
<tr>
<td>Somewhat important</td>
<td>31</td>
<td>62</td>
<td>88</td>
</tr>
<tr>
<td>Neutral/no opinion</td>
<td>1</td>
<td>2</td>
<td>90</td>
</tr>
<tr>
<td>Somewhat unimportant</td>
<td>2</td>
<td>4</td>
<td>94</td>
</tr>
<tr>
<td>Very unimportant</td>
<td>3</td>
<td>6</td>
<td>100</td>
</tr>
<tr>
<td>How certain are you that Islamic banking will be beneficial:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Very certain</td>
<td>29</td>
<td>58</td>
<td>58</td>
</tr>
<tr>
<td>Somewhat certain</td>
<td>17</td>
<td>34</td>
<td>92</td>
</tr>
<tr>
<td>Neutral/no opinion</td>
<td>4</td>
<td>8</td>
<td>100</td>
</tr>
<tr>
<td>How well do you think an Islamic bank can manage your funds:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Very well</td>
<td>27</td>
<td>54</td>
<td>54</td>
</tr>
<tr>
<td>Well</td>
<td>19</td>
<td>38</td>
<td>92</td>
</tr>
<tr>
<td>Neutral/no opinion</td>
<td>4</td>
<td>8</td>
<td>100</td>
</tr>
<tr>
<td>If you had a choice between Islamic banking and conventional banking, you would choose to invest in Islamic banking:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly agree</td>
<td>38</td>
<td>76</td>
<td>76</td>
</tr>
<tr>
<td>Somewhat agree</td>
<td>8</td>
<td>16</td>
<td>92</td>
</tr>
<tr>
<td>Somewhat agree</td>
<td>Neutral/no opinion</td>
<td></td>
<td></td>
</tr>
<tr>
<td>----------------</td>
<td>--------------------</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>4</td>
<td>8</td>
<td>100</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>How often do you see advertisements or commercials on Islamic banking:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rarely (once a month)</td>
</tr>
<tr>
<td>Never (zero)</td>
</tr>
<tr>
<td>14</td>
</tr>
<tr>
<td>36</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Do you feel religious obligation to invested in Islamic banking:</th>
</tr>
</thead>
<tbody>
<tr>
<td>very strong obligation</td>
</tr>
<tr>
<td>somewhat strong obligation</td>
</tr>
<tr>
<td>somewhat little obligation</td>
</tr>
<tr>
<td>no obligation</td>
</tr>
<tr>
<td>5</td>
</tr>
<tr>
<td>31</td>
</tr>
<tr>
<td>8</td>
</tr>
<tr>
<td>6</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>My main purpose of depositing my money into a checking account is to use the account on daily basis for daily purposes:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly agree</td>
</tr>
<tr>
<td>Somewhat agree</td>
</tr>
<tr>
<td>Somewhat disagree</td>
</tr>
<tr>
<td>Strongly disagree</td>
</tr>
<tr>
<td>26</td>
</tr>
<tr>
<td>22</td>
</tr>
<tr>
<td>2</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>My main purpose for depositing my money into a savings account is because of the interest rate that I receive:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly agree</td>
</tr>
<tr>
<td>Somewhat agree</td>
</tr>
<tr>
<td>Somewhat disagree</td>
</tr>
<tr>
<td>Strongly disagree</td>
</tr>
<tr>
<td>5</td>
</tr>
<tr>
<td>1</td>
</tr>
<tr>
<td>1</td>
</tr>
<tr>
<td>43</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>I would consider Islamic banking for my financial purposes:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly agree</td>
</tr>
<tr>
<td>Somewhat agree</td>
</tr>
<tr>
<td>49</td>
</tr>
<tr>
<td>1</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Have you ever considered doing business with an Islamic bank:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Never</td>
</tr>
<tr>
<td>Sometimes</td>
</tr>
<tr>
<td>Often</td>
</tr>
<tr>
<td>Always</td>
</tr>
<tr>
<td>3</td>
</tr>
<tr>
<td>2</td>
</tr>
<tr>
<td>16</td>
</tr>
<tr>
<td>29</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Islamic banking is a good alternative to conventional banking:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly agree</td>
</tr>
<tr>
<td>Somewhat agree</td>
</tr>
<tr>
<td>Neutral/no opinion</td>
</tr>
<tr>
<td>42</td>
</tr>
<tr>
<td>5</td>
</tr>
<tr>
<td>3</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Islamic banking is not realistic because the rest of</th>
</tr>
</thead>
</table>
If Islamic banks future goal is to compete with conventional banks then their second priority after advertisements is to build many branches throughout each state so that customers will have easy access to go to if they are considering investing in Islamic financial products. However, at this point the analysis revealed that 86 percent of respondents indicated that Islamic banking is not accessible to US customers (see Table XIII). Of those respondents (14 percent) who have indicated that there is very little
accessibility, these respondents must be living in the area where there are Islamic banks already available. Whether or not US customers will want to invest in Islamic financial products and do business with Islamic banks depends on whether or not US customers know what Islamic banking is. Majority of the respondents (60 percent) have indicated that they know what Islamic banking is. Those participants that have indicated that they know what Islamic banking is have indicated that they are Muslims. Responders who have indicated that they are non-Muslim, majority of those responders have indicated that they do not know what Islamic banking is. This is not surprising as the non-Muslim population does not know and have never heard of Islamic banking, and how can they if Islamic banks have not invested their money into advertisements to promote their Islamic products to the US public.

For the statement “Do you think Islamic banking offers the kind of products that you would want to invest in” 78 percent of respondents agreed that Islamic banks offer the kind of financial products that they would be interested in investing in. When asked “Do you think that participation in Islamic banking is more beneficial than participation in conventional Western banking” 78 percent of respondents indicated that they thought that investment in Islamic products is more beneficial.

Whether or not respondents will indicate if Islamic banking is important to them or not will depend on whether they are Muslim or not, indeed 62 percent of the respondents indicated that it is important for them to invest in Islamic banking (see Table XIII). For the statement “How certain are you that Islamic banking will be beneficial” 58 percent of the respondents indicated that they were very certain that Islamic banking will
be beneficial. This is to be expected as majority of the respondents understood what Islamic banking is and have had experience with Islamic banking in the past. The statement “How well do you think an Islamic bank can manage your funds” is closely tied to the previous question, indeed 54 percent of the respondents indicated that an Islamic bank will manage their funds very well, 38 percent indicated well. This is to be expected, as with experience and understanding of what Islamic banking is consumers are able to answer with certainty whether or not Islamic bank is able to manage their funds or not.

The frequency analysis also revealed that for statement “If you had a choice between Islamic banking and traditional banking, you would choose to invest in Islamic banking” 76 percent of respondents indicated that they would choose to invest in Islamic banking. When consumers’ understand what Islamic banking is and have had experience with Islamic banking they are more willing to say that they would invest in Islamic banking (see Table XIII). For the question “How often do you see advertisements or commercials on Islamic banking (on television, newspapers, magazines, etc.)?” 72 percent of respondents have indicated that they never see advertisements and commercials about Islamic banking. Respondents who have seen advertisements on Islamic banking were those who have previously conducted business with an Islamic bank, and have therefore seen brochures on Islamic banking. However, majority of respondents do not see advertisements and commercials on Islamic banking on daily basis.
For the statement “Do you feel religious obligation to invest in Islamic banking” 62 percent of the respondents indicated that they feel somewhat strong obligation to invest in Islamic banking, 10 percent indicated that they feel very strong obligation, 16 percent indicated that they feel very little obligation and 12 percent indicated no obligation (see Table XIII). For the statement “My main purpose of depositing my money into a checking account is to use the account on daily basis for daily purposes” 52 percent of respondents indicated that they strongly agree, and 44 percent indicated that they somewhat agree. For the statement “My main purpose for depositing my money into a savings account is because of the interest rate that I receive” 86 percent of the respondents indicated that they strongly disagree, 2 percent indicated that they somewhat disagree, 2 indicated that they somewhat agree, and 10 percent indicated that they strongly agree. It is not surprising that they majority of the respondents indicated that their main purpose in depositing their money into a savings account is not because of interest rate that they receive as half of the respondents are Muslim, rest of the respondents may have different reasons for depositing their money into a savings account.

For the statement “I would consider Islamic banking for my financial purposes” 98 percent of the respondents agreed that they would consider Islamic banking for their financial purposes (see Table III). The statement “Have you ever considered doing business with an Islamic bank” is a good precursor to the previous statement. 58 percent of the respondents indicated that they have always considered doing business with an Islamic bank. That is to be expected as half of the respondents surveyed in the study are
Muslim. For the statement “Islamic banking is a good alternative to conventional banking” 84 percent of participants agreed with the statement. This percentage is not surprising as majority of the participants have indicated that they know what Islamic banking is and as such are able to make an accurate opinion on whether or not Islamic banking is a good alternative to conventional banking. When asked “Islamic banking is not realistic because the rest of the world’s financial system is based on interest” of 90 percent of the respondents disagreed with the statement. Since half of the respondents are Muslim, and majority of the participants know and understand what Islamic banking is, it is not surprising that respondents disagreed with the statement.

When asked “Islamic banks provide a better chance at receiving a loan than conventional banking” 74 percent of the respondents somewhat agreed with the statement (see Table XIII). This is to be expected as of those respondents who have indicated that they understand and have had experience with Islamic banking, their knowledge and experience would tell them that Islamic banks provide a better chance at receiving a loan than receiving a loan from a conventional bank. Although this perspective may not be true for respondents located in different parts of the country that have done business with Islamic banks. For the statement “I frequent Islamic banks because they are Shariah obedient” 64 percent of respondents indicated that they agreed with the statement, 24 percent indicated that they somewhat agreed and 12 percent indicated that they strongly disagreed. This is to be expected as half of the respondents are Muslim, and as such they would want to look for investment opportunities by following the religious doctrine. Of those that indicated that they somewhat agree, respondents may have had a reason for
investing in a Shariah obedient financial product other than religious obligation, such as thinking that if a product following religious teachings, it is more ethical than conventional investment products. Of those participants that indicated that they strongly disagreed, these participants also indicated that they do not understand what Islamic banking is so naturally they would not invest in a financial product because it is Shariah obedient.

For statement “Islamic banks have very few branches to choose from” 98 percent of respondents agreed with the statement (see Table XIII). Whether respondents are Muslim or non-Muslim, all agree that there are very few branches that customers can go to if they wish to conduct business with an Islamic institution. For the statement “Islamic banking provides wide range of investment” 88 percent of respondents agreed with the statement. Since majority of the respondents know what Islamic banking is, it is assumed that they also understand that just like conventional banking, Islamic banking provides diverse investment and financial opportunities. For the statement “Islamic investment opportunities are as diverse as traditional investment opportunities” 86 percent of respondents agreed with the statement. Again just like with the above statement, respondents who know what Islamic banking is and have had experience with Islamic banking, are able to answer whether Islamic banking opportunities are as diverse as conventional banks.

Analysis of Variance (ANOVA) is performed when there are more than two levels of the independent variable. When there are more than two groups, and we would like to compare their performance across a dependent variable ANOVA is used. Using a
One Way ANOVA we determine whether there are significant differences in means across a dependent variable, which in this case, are the statements that asked respondents about their attitudes and beliefs about Islamic banking. The independent variable is religion, which in this case are Muslims, Christian, Jewish, and other. The alpha level was set at .05. In the one-way ANOVA if the p value associated with the F ratio is less than or equal to the $\alpha$ level then the null hypothesis can be rejected that all the means are equal. If the F ratio is greater than the $\alpha$ level we fail to reject the null hypothesis that there is no statistically significant difference between the means.

The ANOVA results in this study indicate that for all but three statements the responders were in agreement (see Table XIV). When looking at each presented statement the results show that for the statement “Would you bank with an Islamic Institution” the p value equals .181, which is greater than $\alpha$ level (.05), so the null hypothesis is not rejected which indicates that there are no mean differences between the four religious groups, instead all responders from the four religious groups agree that they would bank with an Islamic bank. For statement “Do you feel there is enough advertising of Islamic services and products” the result was not significant (p=.811). All responders regardless of what religion they claimed believed that Islamic banking is not adequately advertised. When asked “How accessible do you find Islamic banking to be” the results indicated that there were no statistically significant differences between the means among the four religious groups (p = .201). Each group has indicated that if they wanted to conduct business with an Islamic bank, they would be unable to because there are very few branches where from which customers could choose from.
For statement “How much do you know about Islamic banking” the results show that there were no statistically significant differences between the means, the p value equals .201, which is greater than the alpha level (see Table XIV). Majority of the respondents indicated that they either know a lot or somewhat about what Islamic banking is. This result is not surprising as customers who frequent Islamic banks are Muslim, and as such have had enough time to familiarize themselves with what Islamic bank do and what possible products they provide. For the statement “Do you think Islamic banking offers the kind of products that you would want to invest in” there were no significant differences between the means, the p value equals .454, which is greater than the alpha level .05. The respondents from the four religious groups agreed that Islamic banks offer the kind of products that they would want to invest in. However, again even though customers may be willing to invest in Islamic products, they may be unable to do so as there is limited accessibility and limited number of Islamic bank branches from which customers can choose from.

For the statement “Do you think that participation in Islamic banking is more beneficial than participation in conventional Western banking” there was no significant mean difference (p = .854) between the groups, majority of the four religious groups respondents agreed that Islamic banking is more beneficial than participation in conventional Western banking (see Table XIV). Since majority of customers who frequent Islamic banks have had experience with Islamic banks respondents can legitimately answer whether Islamic banking is more beneficial as compared to conventional banking. For statement “How important is it for you to invest in Islamic
banking” there was no significant mean difference between the groups (p = .070). With limited accessibility and no advertisement about Islamic banking, customers that frequent Islamic banks are Muslim, so they all naturally would answer that it is important for them to invest in Islamic banking because their religion requires that investments need to be Shariah compliant.

For the statement “How certain are you that Islamic banking will be beneficial” there were no significant mean differences between the respondents (p = .221) (see Table XIV). Since majority of respondents that have done business with an Islamic bank in the past are Muslims, they were able to answer with certainty that Islamic banking will be beneficial. For the statement “How well do you think an Islamic bank can manage your funds” there was no significant difference between the means (p = .357), majority of the respondents agreed that Islamic banks will manage their funds very well or well. When asked “If you had a choice between Islamic banking and conventional banking, you would choose to invest in Islamic banking” there was no significant difference between the means (p = .057). Although this statement was close to significance, this is more likely due to non-Muslim respondents no having had experience with Islamic banking, which would influence their decision of whether or not to do business with an Islamic bank. When on Muslim respondents gain the necessary experience with Islamic banking and are exposed to Islamic banking through advertisements and commercials, non-Muslim consumers will be more certain whether or not they would choose to Invest in Islamic banking. Still Muslim respondents were certain that they would invest in an Islamic bank.
Financial consumers will be more willing and open to investing in Islamic products when they are conditioned and exposed to the idea of Islamic banking. However, it is unfortunate that at this time all four religious groups respondents agreed that they rarely or never see advertisements and commercials on Islamic banking (p = .080) (see Table XIV). If Islamic banks invest money in advertisements it is highly possible that with exposure US customers will be willing to do business with Islamic banks and to invest in Islamic products. For the statement “My main purpose of depositing my money into a checking account is to use the account on daily basis for daily purposes” there was no statistical significant difference between the means (p = .129). All four religious groups agreed that their main purpose in investing their money into a checking account is to use the account on daily basis for daily purposes. For the statement “I would consider Islamic banking for my financial purposes” there was no significant mean difference between the groups (p = .209), all four religious groups agreed that they would consider Islamic banking for their financial purposes. The statement “Have you ever considered doing business with an Islamic bank” follows the previous question, and just like the previous questions there was no significant mean difference between the groups (p = .152). All four religious groups have considered doing business with an Islamic bank.

For the statement “Islamic banking is a good alternative to conventional banking” there was no significant mean difference between the groups (p = .065) (see Table XIV). All four religious groups agreed that Islamic banking is a good alternative to conventional banking. When asked “Islamic banking is not realistic because the rest of
the world’s financial system is based on interest” there was no significant mean difference between the groups (p = .393). All four religious groups disagreed with the statement, majority of the respondents indicated that Islamic banking is realistic. Since majority of the respondents know what Islamic banking is and more than half of the respondents have had deal with Islamic banking, it is understandable and expectable that respondents would disagree with the statement. For statement “I frequent Islamic banks because they are Shariah obedient” there was no significant mean difference between the groups (p = .154). Majority of the respondents are Muslim and non-Muslim respondents who have indicated that they know what Islamic banking is understand that the investment that they are making is ethical, something that conventional banks cannot guarantee of their investment products.

Whether or not Islamic banking will succeed in the future will depend on whether or not Islamic banks invest their money in expending the number of branches compared to the number that is currently available. When asked respondents the statement “Islamic banks have very few branches to choose from” there was no significant mean difference between the religious groups (p = .209). All four religious group respondents agreed with the statement that “Islamic banks have very few branches to choose from” (see Table XIV). For the statement “Islamic banking provide wide range of investment opportunities” there was no significant mean difference between the groups, majority of the respondents agreed with the statement that Islamic banks provide a wide range of investment opportunities (p = .187). The last statement “Islamic investment opportunities are as diverse as conventional investment opportunities” there again was no significant
mean difference between the groups (p = .296). Majority of the respondents indicated that they though the Islamic banking provides diverse investment opportunities just like conventional banks.

Table XIV
ANOVA

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<td>50</td>
<td>4.4000</td>
<td>.60609</td>
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<tr>
<td>Islamic banks provide a better chance at receiving a loan</td>
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<td></td>
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<tr>
<td>Muslim</td>
<td>25</td>
<td>1.8000</td>
<td>.40825</td>
<td>3.325</td>
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<tr>
<td>Christian</td>
<td>12</td>
<td>2.1667</td>
<td>3.325</td>
<td>.028</td>
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</tbody>
</table>
There were three statements in which statistical mean difference between the religious groups was observed (see Table XIV). For statement “Do you feel religious obligation to invest in Islamic banking”, there was a significant mean difference between the religious groups (p = .018), which is understandable, as responders claiming to be Muslim would indicate that they feel religious obligation to invest in Islamic banking that

<table>
<thead>
<tr>
<th></th>
<th>Jewish</th>
<th>2.5000</th>
<th>.38925</th>
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<tbody>
<tr>
<td></td>
<td>other</td>
<td>2.0000</td>
<td>.57735</td>
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<td></td>
<td>Total</td>
<td>1.9800</td>
<td>.70711</td>
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<td>.51468</td>
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<tr>
<td>Frequently Islamic banks</td>
<td>Muslim</td>
<td>1.4400</td>
<td>.50662</td>
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<tr>
<td>because they are Shariah</td>
<td>Christian</td>
<td>1.7500</td>
<td>.54479</td>
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<tr>
<td>obedient</td>
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<td>3.0000</td>
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<tr>
<td></td>
<td>other</td>
<td>1.8889</td>
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<td>1.7200</td>
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<td>Islamic banks have very few</td>
<td>Muslim</td>
<td>1.0000</td>
<td>.00000</td>
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<tr>
<td>branches to choose from</td>
<td>Christian</td>
<td>1.0000</td>
<td>.00000</td>
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<tr>
<td></td>
<td>Jewish</td>
<td>1.2222</td>
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<tr>
<td></td>
<td>other</td>
<td>1.0400</td>
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<tr>
<td></td>
<td>Total</td>
<td>1.0400</td>
<td>.28284</td>
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<tr>
<td>Islamic banking provide wide</td>
<td>Muslim</td>
<td>1.0400</td>
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<tr>
<td>range of investment opportunities</td>
<td>Christian</td>
<td>1.2500</td>
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<td></td>
<td>Jewish</td>
<td>1.5000</td>
<td>1.0000</td>
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<tr>
<td></td>
<td>other</td>
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<td>Islamic investment opportunities are as diverse as conventional investment opportunities</td>
<td>Muslim</td>
<td>1.0800</td>
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<td>Christian</td>
<td>1.2500</td>
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<td></td>
<td>Jewish</td>
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<tr>
<td></td>
<td>other</td>
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<tr>
<td></td>
<td></td>
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<td>.58169</td>
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</tbody>
</table>

Source: Designed by Andrzej D. Szczepanowicz

There were three statements in which statistical mean difference between the religious groups was observed (see Table XIV). For statement “Do you feel religious obligation to invest in Islamic banking”, there was a significant mean difference between the religious groups (p = .018), which is understandable, as responders claiming to be Muslim would indicate that they feel religious obligation to invest in Islamic banking that
is not based on interest and is Shariah obedient. Likewise a statistical significance was
observed for the statement my “main purpose for depositing my money into a savings
account is because of the interest rate that I receive” (p = .036). The difference between
the means is expected as only responders who do not claim to be Muslim would indicate
that their reason for depositing their money into a savings account was because of the
interest that they will receive. It is highly likely that responders claiming to be Muslims
would not agree with that statement. A third statistical significance between the religious
groups was observed for the statement “Islamic banks provide a better chance at
receiving a loan than conventional banking” (p = .028). This is to be expected, as
depending on whether a responder has had experience with an Islamic bank would a
responder be able to answer whether a client has a better chance at receiving a loan from
an Islamic bank than from a conventional bank.

This study suggests that US customers are willing to do business with Islamic
banks. When Islamic banks invest their money into advertisements and promote Islamic
banking to US customers, US customers will be motivated to invest in Islamic banks.
Islamic banks need to promote Islamic banking to US customers by publishing brochures
and through mass media. They need to teach potential customers what possible Islamic
products are available, and how potential customers will be able to benefit from them if
they choose to invest in them. When Islamic banks invest in promoting their products, by
circulating brochures and through mass media, their goal at competing and surpassing
conventional bank will be realized. In addition, not only Islamic banks and institutions
need to invest in promoting their products, they also need to invest in building large
number of branches where customers can go to and conduct business. Today there are not enough Islamic banking branches for customers to choose from, and since the branches are scarce, US customers have no choice but to turn to conventional banking to conduct their financial business.

This study has limitations. First, the relatively small size of the sample (50) limits generalization of the research outcomes. Nevertheless, since this research is exploratory, this limitation creates an opportunity for future research. By escalating the sample size and testing customers in more than one geographical region (more than one state or numerous states at the same time) in the US, future research would be more generalizable.

11.3 Estimates of Muslim Population Within the US

Based on Islamic values and with reference to Islamic faith, Islamic banks and finance groups have gained recognition and confidence among the Muslim communities in the US which gives support to creating new approaches in establishing a domestic Islamic banking market. Table XII below shows estimates of the number of Muslims within the US.

Table XV
Estimates of Muslim Population Within the US

<table>
<thead>
<tr>
<th>Muslim population estimates</th>
<th>Million (Year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>American Religious Identification Survey</td>
<td>1.3 (2008)</td>
</tr>
<tr>
<td>Pew Research Center</td>
<td>2.3 (2009)</td>
</tr>
<tr>
<td>Encyclopedia Britannica</td>
<td>4.7 (2004)</td>
</tr>
<tr>
<td>Council on American-Islamic Relations (CAIR)</td>
<td>7 (2010)</td>
</tr>
</tbody>
</table>

Source: [http://www.islam101.com/history/population2_usa.html](http://www.islam101.com/history/population2_usa.html)
The US Census Bureau does not collect data on religious declaration or identification. To find out how many Muslims reside in the USA numerous surveys were performed by various institutions and organizations that have given widely varying estimates and results. Different organizations come up with different estimates and the numbers of Muslims living in the USA are controversial, especially with the numbers that have led to result in higher estimates. For now there is no accurate number measuring the size of the Muslim population in the USA.

Major differences exist, especially regarding to the various generations and countries of origin of Muslim immigrants living in the USA. For the sake of argument and analysis the current and prospective customers of Islamic financial institutions in USA are divided as follows: A) newly arrived – first generation Muslim population; B) US born next generation Muslims; C) non Muslim population.
CHAPTER TWELVE
CONCLUSION AND REFLECTIONS

Currently Islamic banks and financial institutions in the USA are a compliment to the
conventional finance system rather than competitive. The success of Islamic finance
and banks in the USA in previous years showed that the demand for Shariah financial
products in the US financial market and the demand for Shariah financial products
continue to rise and will likely continue to do so. However, much more effective and
consolidated Islamic financial institutions are needed in order to expand Islamic financial
markets throughout the US. It could be a long term and an attractive goal for Islamic
finance, but the supporting core systems and regulations for Islamic finance in the USA
will remain a gap for the next few years.

As the number of immigrants will likely increase in the near future demand for
Islamic products and services will continue to be strong. Based on the results from the
survey it can be forecasted that Islamic finance has a significant financial market
potential for Shariah compliant products in the USA. US Islamic banking and financial
institutions have a potential for future growth and increased demand for their services and
Shariah oriented financial products. However it is imperative that US Islamic banks and
financial institutions lay a sound course for that future growth and demand. To enhance
Islamic financial services in the US, Islamic banks and financial institutions need to raise
the market awareness for Shariah compliant financial products and services that they
offer in the US. Presently, Shariah oriented financial products and Islamic financial
services have not yet been adequately advertised in the USA.
In order for Islamic banks and finance institutions to operate in the US they need to incorporate three sets of laws: USA finance and banking laws, states laws, and Shariah laws. Implementation of Shariah standards strictly when dealing with US financial regulations is not realistic. However, the newly published Islamic Guiding Principles are innovative and open a new field for Islamic finance in which an idea of globalization may take part. The Guiding Principles show clearly how closely interrelated the Shariah doctrines are with the basic West principles of business control while at the same time showing how the principles are fundamentally different than the US financial regulations. In order to stay competitive on the US market the US Islamic financial institutions need to make adjustments to cover the discrepancies in regulations of financial reporting, accounting and distribution of Islamic products. Limited regulations for example in distribution of Zakat may distress the relationship between banks and depositors; as well as the US regulatory and controlling division of the US government.

Of course the Islamic faith is not the only thing ruling and directing the US Islamic financial market and behavior of their shareholders. Another result obtained in this study and analysis was that Islamic finance institutions do not promise a fixed rate of return on capital investment account but the owners expect an attractive return on their investment. The US Islamic banks and finance institutions are obligated to fulfill such expectations otherwise without such pledge the creation of value and growth will decline because of unfulfilled expectations.

Fundamentally the structures of Islamic banks and finance are at disparity with the US banking and financing regulations in that: A) banks are not allowed to trade on
their own account, and they cannot be a buyer and seller at the same time to avoid manipulations; B) to own and sell real estate; C) treatment of variances in the reporting of assets, liabilities, revenues; expenses, and insurance of money; D) calculation and distribution of Zakat. The results obtained in the study suggest that perhaps the US Islamic banks may have a more serious interest in structural adjustment because some of the modern contracts used are based on traditional musharaka and mudaraba contracts, and operations based on them involve greater risks than conventional lending. The major portion of outstanding real estate credit extended by Islamic banks takes the form of murabaha but the proportion of it is artificial. However, any systematic attack on the artifice structures of Islamic financial products could place the entire US Islamic financial establishment in jeopardy.

It was found that certainly the heavy transaction costs of constructing and adapting Islamic financial products and innovations creates obstacles to institutional growth of US Islamic financial institutions and that they need to resolve the technical problems of constructing and adapting new financial products and innovation. Creating new Islamic financial products requires an expertise degree of coordination of financial and religious position when developing new financial products. The result leads to a significant increase in administration and operational costs.

As the study shows the Holy Quran and the Shariah principles encourages tolerance, abolishes late payments and fines, loan forgiveness to a delinquent borrowers and acceptance of losses on bad loans. The present economic situation in the USA can contribute to a rise in non-performing personal loans and mortgages for Islamic finance
and banking institutions, and consequently contributes to lower creation of value and slower growth. Consumers within the US are issuing demands for the conventional financial market and institutions for ethical behavior. In the past two years it has become evident that the USA public lost trust and confidence in the investment practices, disclosures, transparent and sustainable investments and the compliance with ethical values of conventional banks and financial institutions. Islamic financing and banking principles promoting strict investment criteria and offering advance programs to achieve credibility could be an alternative for these lost values. Islamic financial institutions with their values and principles have established a different brand of financing that can deliver ethical and ecological banking products.

By utilizing a questionnaire this paper has shown that a demand for Islamic Banking and Financial Services and Products exists within the US. This should not come as a surprise for a number of reasons. With the recent global economic recession that was facilitated to some degree by conventional banking institutions, the public’s trust and attitude has been severely shaken. As a result new ideas and alternatives that only a few years earlier would have been brushed aside have been given a more credible force. US Islamic Banking and Financial Institutions must take advantage of this shift or else the opportunity for it to further strengthen its foundations will be wasted. As the data revealed consumers within the US are willing to do business with alternative forms of banking institutions. However, the general public in large remains unaware of the alternative that Islamic Banking and Finance provides, as evident by responses to the accessibility and advertisement questions. Although there are numerous Islamic Banking
institutions in the US, the number is still too small. More importantly however is the fact that there is no national Islamic Banking institution in existence. It is crucial that more Islamic Banks be created throughout the US and that at some point consolidation takes place. Furthermore, the lack of advertisement is also a worrisome aspect that needs to be addressed in order for Islamic Banking and Finance to gain more utility and acceptance.

History records past events and gives us many practical lessons. History teaches us that in times of conflict, establishing the harmony of common financial values is the greatest approach to building healthy relationships, mutual respect and trust between opponents and most importantly to avoid a clash of ideas and interventions.
APPENDIX I

Questionnaire:

I. Demographic Questions

1. Gender
   0 male
   0 female

2. What is your income level
   0 20,000-29,000
   0 30,000-39,000
   0 40,000-49,000
   0 50,000-59,000
   0 60,000-100,000
   0 100,000 – up

3. What religion are you
   1 = Muslim
   2 = Christian
   4 = Jewish
   6 = other

4. How old are you
   0 20-29
   0 30-39
   0 40-49
   0 50-59
   0 60 – up

5. Occupation
   0 self-employed
   0 private sector employee
   0 government sector employee
   0 retired

II. Attitudes and potential behaviors towards Islamic banking in the US

1. Would you bank with an Islamic Institution
   0 strongly agree
   0 somewhat agree
   0 neutral/no opinion
   0 somewhat disagree
   0 strongly disagree
2). Do you feel there is enough advertising of Islamic services and products
0 strongly agree
0 somewhat agree
0 neutral/no opinion
0 somewhat disagree
0 strongly disagree

3). How accessible do you find Islamic banking to be
0 not accessible
0 Very little accessibility
0 no opinion
0 Somewhat accessible.
0 Very accessible

4). How much do you know about Islamic banking
0 know a lot about what Islamic banking is
0 know somewhat what Islamic banking is
0 heard very little of Islamic banking but understand little of what it is
0 heard very little of Islamic banking but do not understand what it is
0 never heard of Islamic banking

5). Do you think Islamic banking offers the kind of products that you would want to invest in
0 strongly agree
0 somewhat agree
0 neutral/no opinion
0 somewhat disagree
0 strongly disagree

6). Do you think that participation in Islamic banking is more beneficial than participation in traditional Western banking
0 strongly agree
0 somewhat agree
0 neutral/no opinion
0 somewhat disagree
0 strongly disagree

7). How important is it for you to invest in Islamic banking
0 very important
0 somewhat important
0 neutral/no opinion
0 somewhat unimportant
0 very unimportant
8). How certain are you that Islamic banking will be beneficial
0 very certain
0 somewhat certain
0 neutral/no opinion
0 somewhat uncertain
0 very uncertain

9). How well do you think an Islamic bank can manage your funds
0 very well
0 well
0 neutral/no opinion
0 somewhat well
0 not well

10). If you had a choice between Islamic banking and traditional banking, you would choose to invest in Islamic banking
0 strongly agree
0 somewhat agree
0 neutral/no opinion
0 somewhat disagree
0 strongly disagree

11). How often do you see advertisements or commercials on Islamic banking
0 very often (5 times a day)
0 often (5 times a week)
0 sometimes (once a week)
0 rarely (once a month)
0 never (zero)

12). Do you feel religious obligation to invest in Islamic banking
0 very strong obligation
0 somewhat strong obligation
0 somewhat little obligation
0 very little obligation
0 no obligation

13). My main purpose of depositing my money into a checking account is to use the account on daily basis for daily purposes
0 strongly agree
0 somewhat agree
0 neutral/no opinion
0 somewhat disagree
0 strongly disagree
14). My main purpose for depositing my money into a savings account is because of the interest rate that I receive?
0 strongly agree
0 somewhat agree
0 neutral/no opinion
0 somewhat disagree
0 strongly disagree

15). I would consider Islamic banking for my financial purposes
0 strongly agree
0 somewhat agree
0 neutral/no opinion
0 somewhat disagree
0 strongly disagree

16). Have you ever considered doing business with an Islamic bank
0 Never
0 Rarely
0 Sometimes
0 Often
0 Always

17). Islamic banking is a good alternative to traditional banking
0 strongly agree
0 somewhat agree
0 neutral/no opinion
0 somewhat disagree
0 strongly disagree

18). Islamic banking is not realistic because the rest of the world’s financial system is based on interest
0 strongly agree
0 somewhat agree
0 neutral/no opinion
0 somewhat disagree
0 strongly disagree

19). Islamic banks provide a better chance at receiving a loan than conventional banking
0 strongly agree
0 somewhat agree
0 neutral/no opinion
0 somewhat disagree
0 strongly disagree
20). I frequent Islamic banks because they are Shariah obedient
0  strongly agree
0  somewhat agree
0  neutral/no opinion
0  somewhat disagree
0  strongly disagree

21). Islamic banks have very few branches to choose from
0  strongly agree
0  somewhat agree
0  neutral/no opinion
0  somewhat disagree
0  strongly disagree

22). Islamic banking provides wide range of investment opportunities
0  strongly agree
0  somewhat agree
0  neutral/no opinion
0  somewhat disagree
0  strongly disagree

23). Does Islamic banking provide similar investment opportunities as compared to conventional banking
0  strongly agree
0  somewhat agree
0  neutral/no opinion
0  somewhat disagree
0  strongly disagree
APPENDIX II

List of Tax Deductable US Islamic Charities

<table>
<thead>
<tr>
<th>Name</th>
<th>City</th>
<th>State</th>
<th>Country</th>
<th>Code</th>
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<tr>
<td>A 6 Islamic Organization Inc.</td>
<td>Liburn</td>
<td>MN</td>
<td>USA</td>
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<tr>
<td>Abu-Hurairah Islamic Center</td>
<td>Minneapolis</td>
<td>MN</td>
<td>USA</td>
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<tr>
<td>Al-Imam A-S-Sadiq Islamic Center</td>
<td>Memphis</td>
<td>TN</td>
<td>USA</td>
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<tr>
<td>Al-Shahada Islamic Center</td>
<td>Louisville</td>
<td>KY</td>
<td>USA</td>
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<td>Al-Shahada Islamic Center</td>
<td>Columbus</td>
<td>OH</td>
<td>USA</td>
<td></td>
</tr>
<tr>
<td>Academy for Learning Islamic Faith Inc.</td>
<td>Plano</td>
<td>TX</td>
<td>USA</td>
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<td>Adhaman Islamic Center</td>
<td>Yonkers</td>
<td>CA</td>
<td>USA</td>
<td></td>
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<tr>
<td>Afghan Islamic Society</td>
<td>San Jose</td>
<td>CA</td>
<td>USA</td>
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<tr>
<td>Afghan Refugee Islamic Community of the DFW Area</td>
<td>Dallas</td>
<td>TX</td>
<td>USA</td>
<td></td>
</tr>
<tr>
<td>Afghan Community Islamic Center Inc.</td>
<td>San Diego</td>
<td>CA</td>
<td>USA</td>
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<td>Afghan Immigrant Islamic Center</td>
<td>flushing</td>
<td>NY</td>
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<td>Afghan Islamic Center</td>
<td>Tracy</td>
<td>CA</td>
<td>USA</td>
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<tr>
<td>Afghan Islamic Center for the New York Capital District</td>
<td>Schenectady</td>
<td>NY</td>
<td>USA</td>
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<tr>
<td>African Islamic Society of Boston Inc.</td>
<td>Dorchester</td>
<td>MA</td>
<td>USA</td>
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<tr>
<td>American Islamic Center (Philadelphia)</td>
<td>Philadelphia</td>
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<td>USA</td>
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<tr>
<td>Ahed Murti Islamic Mission</td>
<td>Romeoville</td>
<td>IL</td>
<td>USA</td>
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<tr>
<td>Ahlul Bayt Digital Islamic Library Project</td>
<td>Spring Lake Park</td>
<td>MN</td>
<td>USA</td>
<td></td>
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<tr>
<td>Al-Huda Islamic Center</td>
<td>Houston</td>
<td>TX</td>
<td>USA</td>
<td></td>
</tr>
<tr>
<td>Alikah Islamic Community Inc.</td>
<td>San Francisco</td>
<td>CA</td>
<td>USA</td>
<td></td>
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<tr>
<td>All-Ihsan Islamic Charitable Foundation</td>
<td>Mifflin</td>
<td>PA</td>
<td>USA</td>
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<td>Al-Madinah Islamic Center Inc.</td>
<td>Hamilton</td>
<td>MI</td>
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<td>Al-Kalam Bn Islamic Community</td>
<td>Chattanooga</td>
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<td>USA</td>
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<td>Al-Madany Islamic Center of Norwalk Inc.</td>
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<td>Al-Noor Islamic Center Inc.</td>
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<td>CT</td>
<td>USA</td>
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<td>Seattle</td>
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<td>USA</td>
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<td>Al-Amir Islamic Association Inc.</td>
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<td>NJ</td>
<td>USA</td>
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<td>Al-Quran Islamic School</td>
<td>Sacramento</td>
<td>CA</td>
<td>USA</td>
<td></td>
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<tr>
<td>Al-Huda Islamic Center</td>
<td>Pensacola</td>
<td>FL</td>
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<td>USA</td>
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<td>Al-Huda Islamic Center</td>
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<td>UT</td>
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<td>Al-Huda Islamic Center of Finger Lakes Charitable Trust</td>
<td>Sandusky</td>
<td>OH</td>
<td>USA</td>
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<td>Al-Azhar Islamic Center Inc.</td>
<td>St. Paul</td>
<td>MN</td>
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<td>Al-Huda Islamic Center</td>
<td>St. Louis</td>
<td>MO</td>
<td>USA</td>
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Source: http://www.irs.gov/app/pub78


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