

How the West Came To Run Islamic Banks

Giants like Citigroup dominate the sector, through Islamic subsidiaries and hired Sharia scholars.

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Oct. 31, 2005 issue - You're a pious Muslim with a few million in oil dollars to invest. So would the perfect Islamic bank for you be Citigroup, perhaps? HSBC?

Actually, yes. Giant Western banks—or, rather, their Islamic subsidiaries—are leading the market for financing that complies with Qur'anic laws forbidding lending money for profit, or sponsoring un-Islamic activities such as gambling or smoking. Citigroup's Bahrain-based Citi Islamic subsidiary was first into the market in 1996, and now leads the pack with deposits of more than \$6 billion. Citi and at least 10 other Western majors dwarf the biggest locally owned rival, Al Baraka of Bahrain, worth a little more than half a billion.

Westerners are drawn in by oil money. The Middle East is enjoying its fastest growth in a generation. According to Islamic Banking and Finance magazine, there are \$265 billion in deposits that comply with Sharia, the law that governs the behavior of Muslims, finances included. That's up 17 percent in the past year, and by almost 10 times in the past decade, according to the U.A.E.'s Sharjah Islamic Bank. Since 1996 Dow Jones has offered indexes of stocks vetted by Sharia scholars. Now there are more than 40 Islamic indexes, and last year Islamic stocks on average outperformed the market by 5 percent.

How did Western banks come to dominate a market predicated on Islamic purity? A generation ago, an Islamic bank was just a simple investment house that, instead of paying interest on deposits, created dividends by buying and renting out property. "Islam forbids making money on money," says Alun Williams, marketing director of the new Islamic Bank of Britain. "But it does allow you to rent, and to trade." Now Western banks are using that template to pioneer Islamic credit cards, Islamic mortgages and Islamic bonds (known as *sukuks*) that

during the past year have financed everything from a \$1 billion upgrade of Dubai airport to Pakistani government debt. As growth picks up in the Middle East, more and more Muslim-run corporations find they need sophisticated services, from bond issues to derivatives, that so far only Western banks provide.

[The Western banks gain Islamic credibility by hiring top-drawer Sharia scholars to sit on their boards.](#) "The caliber of your scholars is the basis on which these [financial products] are marketed," says Majid Dawood, a London-based consultant on Sharia compliance. Because there are just a handful of financially literate Islamic scholars in the market, most sit on the boards of many institutions and can, says Dawood, command salaries of as much as \$88,500 per year per bank. Sheik Mohammed Taqi Usmani, a former Sharia judge on the Supreme Court of Pakistan, sits on the board of Citi Islamic, HSBC, Al Baraka and eight others, and is chairman of the Dow Jones Islamic indexes' Sharia panel.

But the trend toward investing in Islamic funds really took off after 9/11, when many Muslims began bringing their money home from America. Since then, international banks like Societe Generale, BNP Paribas, Deutsche Bank and Standard Chartered have all entered the Islamic banking business. Accounting and consulting firms like Ernst Young are now offering Islamic financial services. The recently opened Islamic Bank of Britain, owned by leading Islamic banks and other institutions from the Middle East, plans to create a retail-banking chain for "average income" Muslim Britons, says Williams.

Customers in Muslim nations are driven to Western banks in part by distrust of their own banks. Prominent failures, such as the 2001 collapse of Turkey's Ilhas Finance dented depositors' faith. In Turkey, the Islamic world's largest economy, the fledgling Islamic-banking sector is lobbying the state to guarantee deposits of up to \$36,000, which could in time make Turkey a major player. In Malaysia, where more than 11 percent of deposits are now Sharia-compliant, local houses like Bank Muamalat are working to gain on the multinationals. "Local Islamic banks lack sophistication," says Humayun Dar, an Islamic economist. "Customers are still more comfortable with an international name." Even if the rules are strictly local.