Islamic Finance: Overview and Policy Concerns

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Summary

Islamic finance is based on principles of *shariah*, or "Islamic law." Major financial principles of *shariah* are a ban on interest, a ban on contractual uncertainty, adherence to risk-sharing and profit-sharing, promotion of ethical investments that enhance society, and asset-backing.

While the Islamic finance industry represents a fraction of the global finance market, it has grown at double-digit rates in recent years. By some estimates, total assets held globally under Islamic finance reached $1 trillion in 2010. Islamic banks have appeared to be more resilient than conventional banks to the immediate effects of the international financial crisis and global economic downturn. Some analysts have attributed this to Islamic banks' avoidance of speculative activities. However, the Islamic finance industry has not been completely immune to the general decline in demand and investor uncertainty. Global issuance of Islamic capital market securities (*sukuk*), a fast-growing segment of the Islamic finance industry, peaked in 2007 at $35 billion, declined to $15 billion in 2008 and then rose to $20 billion in 2009.

Islamic finance historically has been concentrated in Muslim-majority countries of the Middle East and Asia, but has expanded globally to countries with smaller Muslim populations. A number of European and other countries are working to reform their tax, legal, and regulatory frameworks to attract Islamic investments. There is a small but growing market for Islamic finance in the United States.

Through international and domestic regulatory bodies, there have been efforts to standardize regulations in Islamic finance across different countries and financial institutions, although challenges remain. Critics of Islamic finance express concerns about possible ties between Islamic finance and political agendas or terrorist financing and the use of Islamic finance to circumvent U.S. economic sanctions. Supporters argue that Islamic finance presents significant new business opportunities and provides alternate methods for capital formation and economic development.

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Background

Islamic finance is based on *shariah*, an Arabic term that often is translated to "Islamic law." *Shariah* provides guidelines for aspects of Muslim life, including religion, politics, economics, banking, business, and law.[1] *Shariah*-compliant financing (SCF) constitutes financial practices that conform to Islamic law. SCF institutions are similar to conventional financial intermediaries in that they are profit-maximizing institutions and offer traditional banking services, but differ in some of the principles under which they operate.[2] Research from the International Monetary Fund (IMF) indicates that Islamic banking appears to be a complement to conventional banks, rather than a substitute.[3] Major principles of *shariah* that are applicable to finance and that differ from conventional finance are:

- **Ban on interest (*riba*):** In conventional forms of finance, a distinction is made between acceptable interest and usurious interest (i.e., excessive rates of interest). In contrast, under Islamic law, interest is considered to be usurious and is prohibited. Some question how lenders profit from financial transactions under Islamic law. For instance, in a real estate setting, SCF takes the form of leasing, as opposed to loans. Instead of loaning money to a prospective purchaser, the bank obtains the property and leases it to the *shariah*-compliant investor, who pays rent instead of interest.
- **Ban on uncertainty:** Uncertainty in contractual terms and conditions is prohibited, unless all of the terms and conditions of the risk are clearly understood by all parties to a financial transaction.
- **Risk-sharing and profit-sharing:** Parties involved in a financial transaction must share both the associated risks and profits. Earnings of profits or returns from assets are permitted so long as the business risks are shared by the lender and borrower.[4]
- **Ethical investments that enhance society:** Investment in industries that are prohibited by the *Qur'an*, such as alcohol, pornography, gambling, and pork-based products, is discouraged.
- **Asset-backing:** Each financial transaction must be tied to a "tangible, identifiable underlying asset," such as real estate or commodities. Under *shariah*, money is not considered an asset class because it is not tangible and thus, may not earn a return.[5]

[1] Michael Silva, " Islamic Banking Remarks," *Law and Business Review of the Americas*, Spring 2006, Volume 12, Issue 2.

[2] Patrick Imam and Kangni Kpodar, *Islamic Banking: How Has it Diffused?*, International Monetary Fund (IMF), WP/10/195, August 2010, p. 3.

[3] Ibid., p. 20.

[4] Andreas Jobst, "The Economics of Islamic Finance and Securitization," IMF Working Paper WP/07/117, August 2007.

[5] The National Bureau of Asian Research, "Islamic Finance: Global Trends and Challenges," Volume 18, Number 4, March 2008. Standard & Poor's, "Islamic Finance Outlook 2008."

Regulation of Islamic Finance

Financial institutions seeking to offer *shariah*-compliant products typically have a *shariah* supervisory board (or at a minimum, a *shariah* counselor). The *shariah* board is to review and approve financial practices and activities for compliance with Islamic principles. Such expertise raises the attractiveness of *shariah*-compliant financial intermediaries to investors considering Islamic banking.[6]

International institutions have been established to promote international consistency in Islamic finance. The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), founded in 1991 and located in Bahrain, issues international standards on accounting, auditing, and corporate governance. It has 200 members from 45 countries; its membership includes central banks, Islamic financial institutions, and other bodies in the Islamic banking and finance industry.[7] Another regulatory body is the Islamic Financial Services Boards (IFSB), which began operations in 2003 and is based in Malaysia. IFSB puts forth standards for supervision and regulation.[8] Many leading Islamic financial centers around the world have adopted international SCF regulation standards.[9]

U.S. federal banking regulators have provided some formal guidance about Islamic products. The Office of the Comptroller of the Currency (OCC) issued two directives concerning *shariah*-compliant mortgage products. In 1997, the OCC issued guidance about *ijara* ("lease"), a financial structure in which the financial intermediary purchases and subsequently leases an asset to a consumer for a fee. In 1999, the OCC recognized *murabaha* ("cost-plus"), under which the financial intermediary buys an asset for a customer with the understanding that the customer will buy the asset back for a higher fee.

Standardization of Islamic finance regulations has been of increasing interest in the industry. *Shariah* is open to interpretation and Islamic scholars are not in complete agreement regarding what constitutes SCF. Islamic finance laws and regulatory practices vary across countries. The lack of concurrent viewpoints makes it difficult to standardize Islamic financing.[10] Standardization also may be challenging because the maturity of Islamic finance markets varies from country to country, with some markets well-established and others that are more nascent.[11]

Without standardization, some industry officials express concern that *shariah*-compliance risk may grow. The lack of standardization across Islamic finance markets raises legal uncertainty that a contract will not be recognized as valid under Islamic law by all Islamic scholars. This uncertainty has been highlighted by a recent dispute between Lebanon's Blom Bank and Kuwait's Islamic firm Investment Dar over whether or not a contract between the two entities was

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[6] Juan Solé, "Introducing Islamic Banks into Conventional Banking Systems," IMF Working Paper WP/07/175, July 2007.

[7] AAOIFI standards and membership body information are available at http://www.aaoifi.com/.

[8] IFSB standards and membership body information are available at http://ifsb.org.

[9] "Watchdog is Developing Governance Standards," *Misr Information Services and Trading News*, July 28, 2008.

[10] "Islamic Banks: A Novelty No Longer," *BusinessWeek*, August 8, 2005.

[11] Liau Y-Sing and Frederik Richter, "Islamic Finance Seems Overwhelmed by Scholar Reforms," *Reuters*, September 28, 2010.

compliant with Islamic principles and if payment should be made.[12] Many observers view standardization of SCF regulations as important in increasing the marketability and acceptance of Islamic products.

Over the years, there have been numerous initiatives to improve regulatory practices. For example, in 2009, the IFSB published guiding principals on issues such as governance and capital adequacy requirements for various financial products. The AAOIFI is in the process of developing new standards in risk management and corporate governance.

Islamic Finance Trends

Estimates vary of the size and growth rates of assets held internationally under Islamic finance, but suggest that Islamic finance is a rapidly growing industry. While it represents a small proportion of the global finance market (estimated at 1%-5% of global share), the Islamic finance industry has experienced double-digit rates of growth annually in recent years (estimated at 10%-20% annual growth).[13] Industry experts estimate that assets held under Islamic finance management doubled between 2007 and 2010 to reach around $1 trillion.[14]

A survey of the top 500 Islamic financial institutions shows that *shariah*-compliant assets in these institutions rose from $822 billion in 2009 to $895 billion in 2010. In 2010, 18 new banks offering SCF entered the market and six conventional banks started providing SCF via “Islamic finance windows.”[15]

Global Financial Crisis

Internationally, Islamic banks appear to have been more resilient to the primary effects of the global economic turndown and international financial crisis than conventional banks. They tend to avoid the speculative investments, such as derivatives, that many analysts believe led to the financial crisis affecting conventional banks. For some observers, Islamic finance serves as a vehicle for recovering from the international financial crisis. The Islamic banking industry may be able to strengthen its position in the international market as investors and companies seek alternate sources of financing.[16]

However, as Islamic banks operate within a global financial system, they have not been completely insulated from the recent economic and financial shocks. For instance, on the one hand, the Islamic financial industry is considered by many to be less risky because financial transactions are backed by physical assets. On the other hand, Islamic banks may be more vulnerable to fluctuations in the mortgage market, given their high activity in the real estate sector

[12] Liau Y-Sing, "Default Woes May Spell Islamic Finance Turning Point," *Reuters*, August 5, 2010.

[13] David Oakley, Shannon Bond, Cynthia O’Murchu, and Celve Jones, “Islamic Finance Explained,” *Financial Times*, May 30, 2008. Jennifer Jacobs, "Special Focus: Islamic Finance Gains Ground," *The Edge Malaysia*, October 25, 2010.

[14] Reuters, "Islamic Finance Set to Cross $1 Trillion: Moody's," *The Economic Times*, October 21, 2010.

[15] Jospeh DiVanna and Brian Caplen, "Top 500 Islamic Financial Institutions," *The Banker*, November 2, 2010.

[16] Stephen Timewell, “A Template for Averting Disaster? - Roundtable,” *The Banker*, January 1, 2009, Academic OneFile, Gale, Library of Congress, accessed February 6, 2009.

compared to conventional banks. The recent slowdown in real estate activity in the Gulf economies raises concerns about some Islamic banks' financial positions.

Geographical Expansion of Islamic Finance

Modern Islamic finance has existed since the 1970s. Traditionally concentrated in Muslim-majority countries in the Middle East and Asia, in recent years, Islamic finance has expanded to other countries with smaller Muslim populations.

The geographical expansion of Islamic finance can be attributed to a number of factors. Muslims represent about a quarter of the world's population, and there is greater awareness of and demand for Islamic-based financial products by Muslim consumers. Among non-Muslim businesses and investors, there also is growing interest in Islamic finance. Some consider the principles of Islamic finance to be prudent and risk-mitigating, while others are looking to diversify their portfolios or to raise new sources of capital.[17] In the traditional centers of Islamic finance in the Middle East and Asia, Islamic finance activities may be accelerating due to growing oil liquidity and the need for investment in development projects. Countries without large Muslim populations also may be interested in Islamic finance in order to attract new sources of capital or to facilitate trade and investment with Muslim-majority countries.[18]

The Middle East continues to be the primary geographic center for *shariah*-compliant financing. By some estimates, Iran accounts for about 40% of total global assets in Islamic finance. However, according to some analysts, the reach of Iran's Islamic finance market may be limited because of international sanctions.[19] Elsewhere in the Middle East, major Islamic finance markets are Bahrain, Kuwait, Qatar, Saudi Arabia, and the United Arab Emirates (UAE). More recently, Asia has emerged as the second-largest hub for Islamic finance. Malaysia, a regional leader in Islamic finance, boasts more than half of the global share of Islamic capital market securities. [20]

In recent years, Islamic finance has become an increasingly visible form of banking in other parts of the world. Outside of the Middle East and Asia, the United Kingdom, which has a sizeable Muslim population, often is viewed as the largest Islamic financial center. In August 2004, the United Kingdom's Financial Services Authority (FSA) approved a banking license for the Islamic Bank of Britain (IBB), the country's first Islamic bank to serve the consumer market with *shariah*-compliant products.[21] In March 2006, the FSA licensed the European Islamic Investment Bank as the United Kingdom's first independent bank for *shariah*-compliant investments. Other countries that have made inroads into Islamic finance in recent years include sub-Saharan African countries, Indonesia, and Thailand.

A number of countries are revising their tax, legal, and regulatory frameworks to attract Islamic finance. For example, several countries that want to foster an Islamic financial market are working to address issues in the taxation of Islamic products. The goal is "to create a level

[17] "Islamic Banking: An Asset of Promise?," *OECD Observer*, No. 275, November 2009. Emmanuelle Smith, "Islamic Finance: Investment Strategy About More Than Faith," *Financial Times*, June 21, 2010.

[18] Anita Hawser, "Market Forces: Islamic Finance in Asia," *Global Finance*, June 2010, p. 76.

[19] "Faith-based finance," *Economist*, Volume 388, Issue 8596, September 6, 2008, p. 82. Patrick Imam and Kangni Kpodar, *Islamic Banking: How Has it Diffused?*, IMF, WP/10/195, August 2010.

[20] Anita Hawser, "Market Forces: Islamic Finance in Asia," *Global Finance*, January 2010, p. 75.

[21] Standard & Poor's, "Islamic Finance Outlook 2008."

playing field with the tax treatment of equivalent conventional products." European countries working to amend their laws to allow or attract Islamic finance include France and Ireland. Countries in Asia that are doing so include Japan, South Korea, Hong Kong, Singapore, and Thailand. Australia also is engaged in such efforts.[22]

From a few Islamic financial institutions and banks in the mid-1970s, there are now hundreds operating in over 40 countries around the world.[23] In some countries, such as Iran and Pakistan, Islamic banks are the only mainstream financial institutions. In others, SCF exists alongside conventional banking.[24] Several international banks that offer conventional financial products, such as HSBC, Deutsche Bank, JPMorgan, and Standard Chartered Bank, have opened "Islamic windows" through which they offer *shariah*-compliant financial products as well.[25]

Development of Islamic Financial Products

Islamic finance instruments can be used to manage a range of financial activities, such as credit, savings, investment, and trade. While Islamic banking has gained the most traction in real estate, leasing, and commodities, it has expanded into other areas as well.

In the industry's early stages, a limited number of financial products were compliant with Islamic principles. Common Islamic finance instruments tend to be sales contracts, leasing, and asset-pooling partnership agreements.[26] However, the past couple of decades have witnessed innovations in Islamic financial products. In 1999, the Dow Jones presented its first Islamic market index, which follows *shariah*-compliant stocks internationally. The Dow Jones maintains more than 100 indices in its Islamic series and is advised by an independent *shariah* supervisory board, which consists of five Islamic scholars from Bahrain, Malaysia, Saudi Arabia, Syria, and the United States.[27] Islamic capital market securities, now a fast-growing segment of the Islamic finance industry, were first introduced in 2001 (discussed in the next section).

Some practitioners have encouraged the Islamic finance industry to continue to innovate, especially in the area of risk management. For example, some say that the use of securitization and derivatives, if implemented with care, may help to reduce risk exposures of Islamic finance institutions and improve their credit ratings. However, the application of derivatives in Islamic finance is controversial because of speculation and uncertainty. In recent years, there have been consultations between scholars and industry professionals that have produced derivatives considered to be *shariah*-compliant.[28]

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[22] Gerry Thornton, "Ireland Attracts Shari'a Finance," *International Tax Review*, July/August 2010. "The Road Ahead - Writing New Rules for Islamic Finance," *The Gulf*, October 1, 2010.

[23] Omar Hasan, "Growing Islamic Finance Should Diversify, Regulate: Analysts," *Agence France Press*, September 4, 2010.

[24] Shirley Chiu, Robin Newberger, and Anna Paulson, "Islamic Finance in the United States," *Society*, September/October 2005.

[25] Emmanuelle Smith, "Islamic Finance: Investment Strategy About More Than Faith," *Financial Times*, June 21, 2010.

[26] International Trade Centre, *Islamic Banking: A Guide for Small and Medium-Sized Enterprises*, Geneva, 2009.

[27] Dow Jones Indexes, "Dow Jones Islamic Market Indexes Index Review Results: 4th Quarter 2009," press release, December 10, 2009, http://press.djindexes.com/index.php/dow-jones-islamic-market-indexes-index-review-results-4th-quarter-2009/. For details on Dow Jones' *shariah* supervisory board, see [http://www.djindexes.com/islamicmarket/?go=supervisory-board].

[28] Moody's Investor Services, "Moody's: Islamic Industry Faces Need for Innovation, Including Its Own Derivative (continued...)

The growth in Islamic finance has fueled the need for professionals who are conversant with Islamic principles and financial products. According to some observers, there is a shortage of trained professionals who understand both Islamic and conventional finance.[29] Some experts believe that this lack of professional expertise may curtail Islamic finance's growth.[30] New courses, degree programs, and educational institutions that specialize in Islamic finance are being launched in the Middle East, Europe, and Asia to meet this demand.[31]

Trends in *Sukuk*

A key segment of the Islamic finance market is Islamic capital market securities or bonds, commonly referred to as *sukuk*.[32] The global market for Islamic bonds is estimated to be upwards of $110 billion.[33] In 2009, corporate issuances represented 64% of total new Islamic bonds issued, sovereign entities represented 21%, and quasi-sovereign entities represented 15%.[34] Malaysia is the world's biggest *sukuk* market. It is the source of over 40% of global *sukuk* issuances. The next largest source is the UAE. Other major issuers of *sukuk* are Saudi Arabia, Bahrain, and Sudan. Most of the *sukuk* from Malaysia tends to be in the oil and gas sector, while most of the *sukuk* from Gulf countries is concentrated in real estate.[35] In recent years, the Islamic bond market has expanded to other countries as well.[36]

Global issuance of *sukuk* increased more than five-fold from 2004 to 2007. Peaking in 2007 at around $35 billion (although higher according to some estimates), sales of new Islamic bonds dropped to about $15 billion in 2008 and rose to $20 billion in 2009 (see **Figure 1**).[37]

Sukuk issuance began slowing down in late 2008, partly due to the global economic turndown. The international *sukuk* market faced lower levels of liquidity, resulting from declines in oil prices and reduced confidence from investors. Global issuance of Islamic bonds also may have slowed due to concerns raised by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI, discussed above) about the *shariah*-compliance of some *sukuks*.[38] In

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Products," press release, April 6, 2010, http://www.moodys.com/cust/content/content.ashx?source=StaticContent/Free%20Pages/Products%20and%20Services/Downloadable%20Files/Derivatives%20in%20Islamic%20Finance%20Needs%20Innovation.pdf.

[29] "Global Takaful - Lack of Shariah Uniformity May Hold Back Islamic Finance - Regulators," *Middle East Insurance Review*, August 1, 2010.

[30] Emmanuelle Smith, "Islamic Finance: Investment Strategy About More Than Faith," *Financial Times*, June 21, 2010.

[31] Liz Gooch, "Asia-Pacific Universities and Islamic Finance Slots; Institutions Respond to Shortage of Skills Professional in Sector," *International Herald Tribune*, September 27, 2010.

[32] Islamic bonds are constructed as profit-sharing or rental agreements that are tied to physical assets, such as property.

[33] Jennifer Jacobs, "Special Focus: Islamic Finance Gains Ground," *The Edge Malaysia*, October 25, 2010.

[34] International Islamic Financial Market, August 2009.

[35] Anita Hawser, "Market Forces: Islamic Finance in Asia," *Global Finance*, June 2010, p. 76.

[36] David Oakley, "Sukuk: Islamic Bonds Go the Way of the World," *Financial Times*, November 24, 2008.

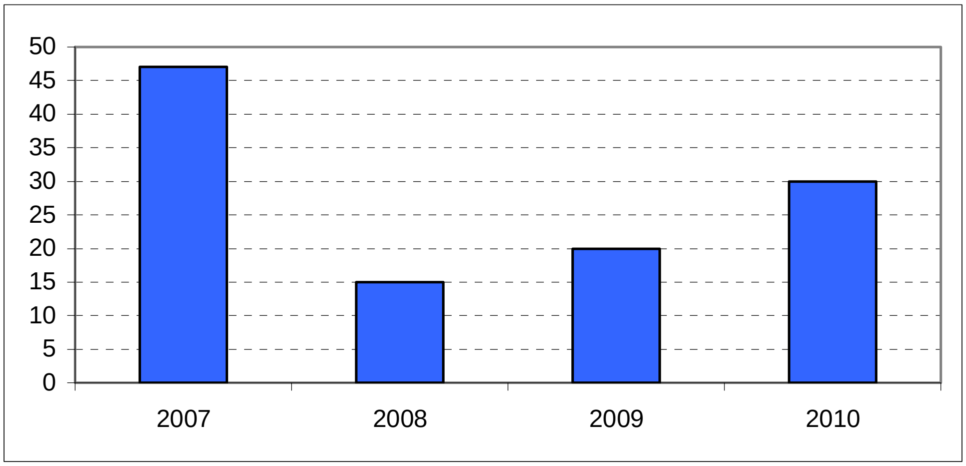
[37] Andreas Jobst, Peter Kunzel, Paul Mills, and Amadou Sy, "Islamic Bond Issuance - What Sovereign Debt Managers Need to Know," IMF Discussion Paper, PDP/08/3, July 2008. "New Sukuk Issuance Falls to 3-Year Low," *Business Times*, January 10, 2009. Reuters, "Islamic Finance Set to Cross $1 Trillion: Moody's," *The Economic Times*, October 21, 2010.

[38] Standard & Poor's, "Sukuk Market Decline Sharply in 2008, But Long-Term Prospects Remain Strong," January 14, 2009.

addition, in recent months, there have been several high-profile defaults of Islamic bonds. In May 2009, the Kuwait-based Islamic firm Investment Dar became the first company in the Gulf region to default on a major *sukuk*. Other *sukuk* defaults have included Kuwait's International Investment Group and the U.S. energy firm East Cameron.[39]

Figure 1. Global Issuance of Islamic Bonds (Corporate and Sovereign), 2007-2010

Billions of U.S. Dollars



Source: Standard and Poor's, Ernst & Young, and Kuwait Finance House.

Note: The 2010 global issuance level is estimated.

Despite current challenges, many analysts believe that the long-term viability of the Islamic bond market appears strong, owing to the growing popularity of Islamic financial products, increased government interest in Islamic finance, investment and financing needs of the Gulf countries, and financial institutions seeking greater diversification.[40]

Islamic Finance in the United States[41]

In the United States, there is growing interest for Islamic finance and business opportunities for lenders. Some have suggested Islamic finance may be an attractive option for investors as conventional finance faces challenges from the U.S. subprime lending crisis and recession concerns.[42]

[39] "Default Woes May Reshape Islamic Finance," *MIST News*, August 5, 2010. Liau Y-Sing, "Default Woes May Spell Islamic Finance Turning Point," *Reuter News*, August 5, 2010.

[40] Ibid.

[41] Certain issues related to Islamic finance, particularly the regulation of Islamic financial products, may raise First Amendment concerns under the Establishment Clause, which prohibits government actions that show preferential treatment to one religion over another. See Epperson v. Arkansas, 393 U.S. 97 (1968). For an overview of First Amendment rules generally, see CRS Report RS22833, *The Law of Church and State: General Principles and Current Interpretations*, by Cynthia Brougher.

CRS Report RS22833, *The Law of Church and State: General Principles and Current Interpretations*, by Cynthia Brougher.

[42] Peter Apps, "Global Financial Centers Battle for Islamic Markets," *International Herald Tribune*, July 25, 2008.

In the United States, *shariah*-compliant finance largely exists in personal home mortgages. Since its establishment in 2002, Guidance Residential (Reston, VA), an Islamic home finance company, has provided over $1.5 billion in *shariah*-compliant home financing in the United States.[43] Other financial intermediaries that provide Islamic-based home mortgages include University Islamic Financial (Ann Arbor, MI), Devon Bank (Chicago, IL), and American Finance House Lariba (Pasadena, CA). HSBC is the only large commercial bank that offers U.S. Islamic finance, and is focused on New York.[44] The Federal National Mortgage Association (Fannie Mae) and the Federal Home Mortgage Corporation (Freddie Mac) purchase *shariah*-compliant mortgage contracts from financial intermediaries, allowing providers to originate further mortgages. In 2007, Freddie Mac reportedly purchased more than $250 million in Islamic home loans, a small but notable fraction of the enterprise's $1.77 trillion in business activities.[45]

Other forms of *shariah*-compliant services are offered in the United States as well. For instance, Devon Bank and Zayan Finance offer SCF for commercial real estate. *Shariah*-compliant mutual funds are offered by intermediaries such as the Amana Mutual Funds Trust, Azzad Funds, and the Dow Jones Islamic Fund.[46]

International financial intermediaries also provide SCF in the United States. Muslim investors from the countries of the Gulf Cooperation Council (GCC) have sought to diversify their financial portfolios geographically and to invest their wealth in U.S. assets. For instance, the Bahrain-based Arcapita Bank has structured *shariah*-compliant transactions in private equity and real estate in the United States.[47]

U.S.-based companies also have taken advantage of alternative funding sources through Islamic financing abroad.[48] For example, in November 2009, General Electric became the first major U.S. company to sell an Islamic bond. It sold a five-year, $500 million Islamic bond in order to attract international investors who want to invest according to Islamic principles.[49]

U.S. Policy Interests in Islamic Finance

As Islamic finance activities grow in the United States, critics raise concerns about the related capital adequacy and system risks. Proponents of Islamic finance assert that the ban on risk-taking mitigates many concerns. Some also view the integration of ethics and values into finance as a positive development, especially in light of recent U.S. business corruption scandals. Many investors reportedly consider *shariah*-compliant finance to be more resilient to global economic and financial crises than conventional finance. However, others point out that Islamic financial

[43] N.C. Aizenman, "A Higher Law for Lending," *The Washington Post*, May 13, 2008. Guidance Residential, "Guidance Residential Nominated For "Best Islamic Home Finance Provider" Award," press release, October 30, 2009, http://www.guidanceresidential.com/about-us/news-and-events/176-october-30-2009-guidance-residential-nominated-for-best-islamic-home-finance-provider-award.

[44] Shirley Chiu, Robin Newberger, and Anna Paulson, "Islamic Finance in the United States," *Society*, September/October 2005.

[45] N.C. Aizenman, "A Higher Law for Lending," *The Washington Post*, May 13, 2008.

[46] "Islamic Finance Gaining Traction in the U.S.," *Dinar Standard*, November 22, 2007.

[47] "Ali: Islamic Banking is a Rapidly Growing Industry," Council of Foreign Relations interview, June 8, 2007.

[48] Standard & Poor's, "The Islamic Financial Industry Comes of Age," Commentary Report, October 25, 2006.

[49] Joanna Slater and Kate Haywood, "GE Capital Enters Sukuk Market," *The Wall Street Journal*, November 20, 2009.

markets are still tied to the world economy and are not completely sheltered from the ups and downs of international markets.[50]

The growth of Islamic finance in the United States may have implications for congressional oversight. Congress may be interested in evaluating the relationship between the current U.S. banking legal and regulatory framework and Islamic finance. Current U.S. laws and regulation may be broad enough to accommodate some aspects of Islamic finance. Others aspects of Islamic finance may pose some unique challenges to U.S. laws and regulations, such as applying rules created for conventional, interest-based products to Islamic products.[51] There is debate about whether or not, or the extent to which, regulators should apply rules on conventional products to Islamic product counterparts.[52]

Some U.S. financial institutions express concerns about the possible ties of some Islamic institutions to terrorist finance networks.[53] According to this viewpoint, there is the possibility that Islamic banking transactions may channel funds to terrorists or enable terrorists to access funds. Others assert that the risks of Islamic finance are not significantly greater or different than those from conventional finance and that the majority of recent terrorist financing cases related to SCF have been thrown out of court. In congressional testimony, one observer stated "there is no reason—in theory—to suspect that Islamic finance would be particularly immune or particularly vulnerable to abuse by money launderers or terrorist financiers."[54]

Some proponents also assert that security-related concerns about Islamic finance stem from a lack of understanding of SCF or from stereotyping.[55] There may be a "conflation" of Islamic finance with *hawala*, an informal trust-based money transfer system prominent in the Middle East and many Muslim countries. *Hawala* transactions are based on an honor system, with no promissory instruments exchanged between the parties and no records of the transactions. Some analysts consider the *hawala* system particularly susceptible to terrorist financing.

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[50] Peter Apps, "Global Financial Centers Battle for Islamic Markets," *International Herald Tribune*, July 25, 2008.

[51] Thomas C. Baxter, "Regulation of Islamic Financial Services in the United States," Remarks Before the Seminar on Legal Issues in Islamic Financial Services Industry, March 2, 2005.

[52] Vikram Modi, "Writing the Rules: The Need for Standardized Regulation of Islamic Finance," *Harvard International Review*, Spring 2007.

[53] "Islamic Bonds Improve LSE Standing," *Oxford Analytica*, March 8, 2007.

[54] Mahmoud A. El-Gamal, "Islamic Finance in the Middle East," testimony prepared for U.S. Senate Committee on Banking, Housing and Urban Affairs, "Money Laundering and Terror Financing Issues in the Middle East" hearing.

[55] Michael Silva, " Islamic Banking Remarks," *Law and Business Review of the Americas*, Spring 2006, 12, 2.