Balz, Kilian, Islamic retail finance in Europe: Market potential and legal challenges,
In: *Integrating Islamic Finance into the Mainstream: Regulation, Standardization and Transparency*,
edited by Ali, S. Nazim. Cambridge, Massachusetts: Harvard Law School, ILSP, Islamic Finance Project, 2007, pp.119-132

Islamic Retail Finance in Europe: Market Potential and Legal Challenges

Kilian Bälz[1]

This paper investigates the market potential and legal constraints for *shari'a*-compliant retail products in Europe, focusing on the United Kingdom and the German markets. The paper grew out of my involvement in designing *shari'a*-compliant retail products for the German domestic market. Compared to the development of Islamic retail finance in the United Kingdom, developments in Germany are significantly lagging behind. Islamic retail products, particularly Islamic home finance, have been an integral component of the product range of English banks for several years now, and in 2004 the Islamic Bank of Britain commenced operation as the first fully *shari'a*-compliant bank in Europe, followed by the European Islamic Investment Bank that commenced operation in 2006.[2] In contrast, in Germany there are currently no Islamic retail products available, despite a Muslim population that exceeds 3 million.[3] Although there have been some deliberations regarding the establishment of an Islamic bank in Germany, these projects are still far away from implementation. While the English market is booming, the German market is close to non-existent. The (almost) complete lack of Islamic financial products holds true for most other European markets: Islamic retail finance in Europe is by and large confined to the United Kingdom.

This issue sets the framework for the question that will be pursued in this paper: Why is it so difficult to introduce Islamic retail products in

---

[1] Partner, Gleiss Lutz: Frankfurt, Germany.

[2] For further information on these two banks, see http://www.islamic-bank.com/islamicbanklive/GuestHome/1/Home/1/Home.jsp; and http://www.eiib.co.uk/html.

[3] This is with the exception of certain investment funds, which are registered for public distribution in Germany. In particular, there are no *shari'a*-compliant home financing schemes, current accounts, or consumer loans available.

European markets outside the United Kingdom? Why do countries such as Germany and France seem to be not susceptible to Islamic finance, despite considerable domestic Muslim populations?

Considering the attention that Islamic finance has attracted over the last few years among the German public, the answer cannot be one of disinterest or lack of information. There has been extensive media coverage on the potential of Islamic finance both in the general and financial press, focusing on how German institutions might take advantage of the global trend. The reasons why the development of Islamic finance has been so slow regardless of public attention, therefore, must lie somewhere else.

In the following, the argument is put forth that development in the field of Islamic finance must be analyzed within a broader framework. First, Islamic financing transactions must be integrated into and adapted to the overall legal and regulatory framework. This task is of particular importance in relation to retail products that are based on the industrialization of the banking business. In Germany, regulation works differently than in the United Kingdom, and the German regulatory framework may be less responsive to the needs of ethnic and religious minorities, making it difficult to introduce Islamic products to the German market. Second, and perhaps more importantly, *shari'a*-compliant retail products must also mirror the needs of the respective Muslim community (or communities). While a global market for "big ticket" Islamic financing transactions may have evolved, this does not hold true for Islamic retail products, which are neither universal nor based on globally uniform standards. The success of Islamic retail products therefore is dependent on a double cultural accommodation: adjusting the product to the requirements of local laws as well as the specificities of local Muslim communities. The latter depends on certain institutional arrangements, which in the past have been more favorable in the United Kingdom than in Germany.

WHY CARE ABOUT IT?

The underlying assumption of the analysis presented here is that it is indeed a good idea to push the development of Islamic retail finance in Europe further. Although this assumption may be widely shared within the Islamic finance community, it is far from being uncontroversial. This is not due just to the general skepticism and criticism that is raised against Islamic finance, both the concept and its implementation. In a German setting, one often encounters the argument that further development of Islamic retail products is neither required nor desirable. The latter

approach is particularly prominent among those who have difficulty conceiving of Germany as a multi-ethnic and multi-religious society, and among those who openly advocate a "hegemonial culture" (*Leitkultur*).[4] From this perspective, there is no need to foster the pluralization of the financial system by offering products that target Muslims. The financial system should be one and the same for all, in order to prevent the development of so-called "parallel societies" (*Paralellgesellschaften*). Thus consumer credit is one means of promoting integration, compelling people to adapt to mainstream society, as far as financial services are concerned. Proponents of integration often refer to several *fatawa* (legal opinions) issued over the last decade, in which Muslim scholars exempted European Muslims from the prohibition of *riba* in consumer finance. The argument normally goes that as long as Muslims are living in a non-Muslim country and no Islamic financial services are available, Muslims may use conventional modes of finance (in order to avoid a situation in which the Muslim population is excluded from financial services altogether). This leads some to conclude that Islamic retail finance is not only undesirable, but also unnecessary.

I advocate the opposite approach and promote the idea that developing Islamic retail finance is recommended. The reasons are several. First, from a business perspective the German Muslim population of more than 3 million has not, until recently, been the focus of any German retail bank. This market, considering the sheer number of Muslims living in Germany, obviously has potential. Second, the development of niche markets conforms to the predominant marketing strategy in the German financial services industry today, where attention has shifted back to the domestic retail market. Here, banks are seeking to diversify their product range in order to better reach customer groups that have been neglected in the past. Third, and perhaps more significantly, there is a strong trend toward socially responsible and ethical finance that has also been endorsed by more recent legislative enactments. Financial services no longer are ethically neutral, but are expected to also conform to certain non-economic criteria, such as environmental friendliness, sustainability, and other green or social criteria. This opens a window for financial transactions conforming to Islamic principles as well, provided one is ready to accept Islamic finance as one form of ethical or faith-based finance (compared to the conventional model based exclusively on economic parameters). Finally, from a policy perspective, it has been acknowledged that the goal of granting as many people access to financial services as possible is an

[4] The concept of "hegemonial culture" is similar to the thesis put forth by Samuel Huntington. See Huntington, *Who Are We? The Challenges to America's National Identity* (New York: Simon & Schuster, 2004).

important one. Access to financial services ("financial inclusion") is increasingly being perceived as a civil rights issue.[5] Based on this perception, one may argue that members of the Muslim community should not be barred from enjoying financial services simply due to their faith. In turn, financial institutions should not escape from regulation because of their Islamic orientation.[6] Financial inclusion, therefore, also helps achieve effective regulation of the German market. Thus, from a policy perspective, systematically developing the Islamic finance market is recommendable.

STRUCTURING ISLAMIC RETAIL PRODUCTS: *SHARI'A*, STATE LAW, AND ECONOMIC COMPETITIVENESS

Islamic retail products must comply with very different and at times contradicting requirements from different social and legal fields. This makes the structuring of Islamic retail products challenging. First, and from the customer perspective most importantly, a product must conform to the principles of the Islamic *shari'a*. This is what makes an Islamic financial product different in the eyes of the target group. Second, the product must comply with the laws and regulations of the jurisdiction it is implemented in. It must conform, for instance, to consumer protection laws as well as to the rules of banking regulation. As will be discussed in more detail in the following pages, European legal systems, with very few exceptions,[7] do not provide for any special treatment of Islamic financial transactions (and it is unlikely that such special rules will be enacted in the near future). Islamic financial products thus must be made to fit into the normal regulatory and legal framework. Third, the product must, from an economic perspective, be competitive. One may be able to argue that people have a certain willingness to also invest in their faith and may be prepared to deal with some disadvantages provided that the financial product conforms to their religious principles. However, the economic

[5] See, e.g. the U.K. Financial Inclusion Taskforce, http://www.financialinclusion-taskforce.org.uk/default.htm.

[6] See, e.g. Bundesministerium der Finanzen, "Der Missbrauch des Finanzsystems duch 'Underground-Banking'–Bestandsaufnahme und Gegenmaßnahmen," http://www.bundesfinanzministerium.de/cln_01/nn_17844/nsc_true/DE/Service/Downloads/Abt__I/27145__0,templateId=raw,property=publicationFile.pdf.

[7] Most noticeably the United Kingdom has implemented special regulatory and tax rules in order to accommodate Islamic financial transactions. More such rules are announced to be implemented in the course of 2007. See the press release in connection with the 2007 Islamic Finance Summit in London, at http://www.hm-treasury.gov.uk/newsroom _and_speeches/press/2007/press_12_07.cfm.

burden of transacting in accordance with the *shari'a*, in particular adverse tax effects triggered by certain Islamic structures, must not be excessive since this deters potential customers.

From this it follows that the development of Islamic retail products poses challenges in different areas. In the following I will look closer into some of them, including the formulation of *shari'a* principles, the adjustment of Islamic finance to consumer protection laws, the avoidance of adverse tax effects, and the issue of dispute resolution. I will not focus on doctrinal details, but will rather place emphasis on the problem-solving procedure. The aim is to discuss, in the light of the experience in the U.K. market, how one may approach these issues in other jurisdictions. I argue that the success of structuring Islamic retail products depends on a certain institutional arrangement, which facilitates a dialogue between financial institutions and representatives of the regulator and the Muslim communities. This also requires taking local specificities seriously, as institutional arrangements vary between one country and the other.

Local Retail Products, Global Islamic Principles? Why there is no "one size fits all" in the Islamic Retail Market

A bank intending to offer a *shari'a*-compliant product has various options for validating its claim to comply with Islamic principles. The most straightforward method for an entrant to the German market may be to simply copy a successful product offered by a competitor in another EU market, and bring it to Germany. This is indeed the origin of many (perhaps most) financial innovations that have evolved over the last few years in Germany. With regard to *shari'a*-compliant products, however, copying a successful product is not actually a feasible alternative. An Islamic financial product gains its competitive advantage not only through its commercial terms, that is, by providing the customer with funds at competitive cost or promising an attractive return on investment; the product is also dependent on an ethical (non-economic) claim, namely compliance with Islamic law and the principles of the Islamic religion. Islamic legitimacy cannot be generated simply by copying a product, but rather depends on the target community. As will be further elaborated below, Muslim communities vary from one European country to another. This requires that they must also be approached in different ways.

With regard to consumer products, another alternative to copying the product of a foreign competitor would be to seek guidance from internationally accepted standards. The most prominent organization developing standards in the field of *shari'a* compliance is the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), a

non-governmental organization based in Bahrain that has been active for some 15 years in formulating *shari'a* rules (and other standards) for the Islamic finance industry.[8] The work of AAOIFI is extremely valuable for anyone concerned with Islamic finance. The focus of AAOIFI, however, has so far been more concerned with the big-ticket market than with retail. In addition, AAOIFI does not develop products, but simply establishes a framework within which they can be developed. Third, even those institutions relying heavily on AAOIFI would, in addition to referring to the AAOIFI standards, normally also consult a *shari'a* board, internal or external, to supervise compliance with those principles. As a result, standardization in the fashion carried out by AAOIFI may help, but will not suffice in solving the problem.

What remains is to develop a product tailored specifically to the particular market. This is how most Islamic financial products have been developed in the past. Normally, the product is developed in cooperation with a team of scholars who also approve a concrete model transaction. Over the last few years a number of institutions and individuals have earned a reputation as *shari'a* advisors. It is a commonplace, however, that over the centuries the *shari'a* has been a discursive legal system with a fair degree of pluralism (which may be perceived, from the perspective of the practicing lawyer, as uncertainty at the level of black-letter rules).[9] This is also reflected in the present day discourse among *shari'a* scholars regarding Islamic financial innovations. Consequently, the authority that a certain scholar enjoys may vary according to affiliation with a particular school of law, a respected Islamic institution, and even ethnic origin. This is not to negate that big-ticket Islamic financing transactions have generated a new kind of Islamic transnational *lex mercatoria* (a kind of transnational law merchant that has evolved through trade practice, to a large extent independently from state law). Neither is it to question that there is a global discourse among Islamic scholars, particularly on the internet, that can also be observed in the area of Islamic banking. On the local level, however—and this is the level that is ultimately relevant when structuring Islamic retail transactions—regional and ethnic differences play a significant role that must be taken seriously.

This means that at least to some extent, *shari'a* certification has a local component. Here, the differences between the United Kingdom and

[8] See the AAOIFI website, at http://www.aaoifi.com.

[9] First, legal doctrines in Islamic law have, as in all legal systems, evolved over time. Second, and maybe more importantly, there are differences of opinion with regard to certain legal questions between (and at times within) the different schools of law (*madhahib*); for a comparative evaluation see, e.g. [Jazîrî].

Germany come into play.[10] In the United Kingdom the following can be observed:

1. The majority of Muslims are of Pakistani origin, a country that officially endorses Islamic economic principles and the prohibition of riba;
2. There are a fair number of Muslim think tanks and Islamic scholars versed in financial matters, as well as an indigenous (British) *shari'a* discourse;
3. There is a tradition of academic research in Islamic law with a practical orientation (such as at the Department of Law at the School of Oriental and African Studies);[11]
4. English is widely understood, making *shari'a* know-how from abroad accessible.

In Germany, by contrast:

1. The majority of Muslims are of Turkish descent, and in the past lived in a secular state with a rigorous separation of state and religion and a non-Islamic economic order;
2. Muslim think tanks did not exist until recently, and Islamic scholars are often not interested in economic matters, producing a very limited indigenous *shari'a* discourse;
3. There is a rich tradition of scholarship in the area of Islamic law, associated with big names such as Ingnaz Goldziher (1850–1921) and Joseph Schacht (1902–1969), but it is mostly academic in nature;
4. Only very few internationally renowned *shari'a* scholars speak German, causing German discussions to be isolated from international developments.

This comparison reveals the difficulties in attempting to reproduce the English experience in Germany, where there is a shortage of local scholars willing to engage in the discourse on the one hand, and difficulty in bringing in foreign *shari'a* expertise on the other. As a result there is a lack of competent *shari'a* advisors who are able to participate in the development of Islamic financial products. This situation can only be resolved in the long run by increasing awareness regarding financial issues

[10] For a comparative overview of Muslim communities in different European countries, see e.g. Jan Rath et al., *Western Europe and Its Islam* (Leiden/Boston/Cologne: Brill, 2001); and Silvio Ferrari and Anthony Bradney, *Islam and European Legal Systems* (Aldershot: Ashgate Darmouth, 2000).
[11] See http://www.soas.ac.uk/centres/centreinfo.cfm?navid=17.

on the one hand, and improving practical education in *shari'a* on the other.[12]

Mandatory Consumer Protection Laws versus Islamic Legal Principles: Liability of Banks Under *Murabaha* Agreements

If there is one single asset that is closest to the heart of the average English person, it is probably the home. In contrast, in automotive Germany the car may be a more important identity token. For this reason the following practical example is taken from the area of automobile finance.

In countries with developed Islamic retail markets such as the UAE or Malaysia, most car finance schemes are based on *murabaha* contracts. The bank acquires the car selected by the customer, who then purchases it from the bank on a cost-plus basis, paying the purchase price in deferred installments. From a *shari'a* perspective, the transaction is a contract of sale. From an economic angle, it resembles a financing transaction, where the bank facilitates the customer's acquisition. As most banks do not intend to take on any responsibility for the potential defects of the car selected by the client, the structure depends on an exclusion of warranty claims on the side of the bank. The bank in turn assigns the warranty claims to the customer who, if so required, can bring them directly against the car dealer. The structure is somewhat similar to the one under a financial lease.

From the perspective of European consumer protection rules, such a structure, under a sales contract, gives rise to concern. Pursuant to Article 3 of the Directive 1999/44/EC of 25 May 1999 on the Sale of Consumer Goods, a seller acting in connection with his business may not exclude its warranty claims if it sells a new chattel to a consumer. It also may not refer the consumer to a third party to bring these warranty claims in lieu of discharging the warranty claims itself. From this it follows that the bank, under a *murabaha* structure, may have to fully assume the position of a car dealer, also dealing with any defects of the car during the warranty period. This is a risk that banks are normally not willing to take. Banks are not fond of trading in cars, nor are regulators very enthusiastic when financial institutions engage in such activities.

In the United Kingdom, a Muslim seeking *shari'a*-compliant car finance presently has two options: a communal one and a commercial one.

---

[12] It is worth mentioning that over the last few years several German universities have established positions for "Islamic studies" that are intended to train Islamic religious instructors. One may hope that they will enhance an indigenous *shari'a* discourse that will also contribute to financial affairs. See, e.g., the Chair for Islamic Religion at the University of Münster, http://www.uni-muenster.de/ReligioeseStudien/ Islam/Personen.

Under the communal option, offered by Ansar Finance for example, the person joins an association, makes certain regular contributions, and is then entitled to take out a *qard hasan* (an interest-free loan).[13] This scheme seems to be an effective way of organizing credit within a certain community, and also resembles nineteenth-century credit cooperatives. The disadvantage of this scheme is that it is not suited to serve the community at large. It can only serve a limited number of people. In addition, it relies on personal trust and is not suited for the "industrialized" business of retail banking. A typical commercial scheme, in contrast, would be the one offered by the Islamic Bank of Britain.[14] There, consumer credit is based on a *tawarruq* structure. Under this structure, the bank trades in commodities on behalf of the client, who then receives funds for a purpose of its choice. If acquiring a car, the bank is not to be involved in purchasing the car at all. Instead it carries out a commodity transaction, though with much more foreseeable risks. Although this may seem to be a pragmatic approach for Islamic banks to take toward consumer credit, the Islamic legitimacy of *tawarruq* transactions remains in dispute. The permissibility of *tawarruq* is based on a formalist understanding of *shari'a*, whereas many Islamic scholars favor a more substantive approach that requires financial institutions to take on the business risk and be involved in the concrete transaction.[15]

Approaching the issue from the German angle, there are two possible solutions. The first is to search for a doctrinal exemption for *murabaha* transactions, attempting to use doctrinal concepts of German law in order to find a niche for an Islamic finance product. As understood by the courts, the provision banning the exclusion of warranty claims does not apply to financial leases with a purchase option (although the result of such a transaction is the acquisition of a certain asset, thus effectively working like a sales contract from an economic perspective).[16] In view of this, it would be possible for the bank to use a *murabaha* structure, but lease the car during the warranty period to the customer, who would be under an obligation to purchase it once the period has lapsed. This *murabaha-ijara* structure may help to get around the restrictions of consumer protection law. It is based on the interplay of Islamic and secular legal principles, intending to bring both legal systems into harmony (taking advantage of a certain regulatory arbitrage between the two systems).

---

[13] See http://www.ansarfinance.com.

[14] See http://www.islamic-bank.com/islamicbanklive/Personal/1/Home/1/Home.jsp.

[15] See, e.g., the critical discussion in Mahmoud A. El-Gamal, *Islamic Finance: Law, Economics and Practice* (New York: Cambridge Universtiy Press, 2006), 69-70.

[16] See the leading case of the German Federal Court (*Bundesgerichtshof*) of 21 December 2005, *Neue Juristische Wochenschrift* 2006, 1066-1068.

Alternatively, the issue could be addressed on the level of the bank–dealer relationship. Here, the bank could enter into an agreement with certain selected car dealers pursuant to which they (1) will hold the bank harmless from any and all warranty claims raised by the customers, and (2) provide the free repair services required during the warranty period. The latter approach has the downside that the bank will be dependent on an ongoing relationship with selected car dealers. This may be an option for certain banks specializing in car finance, because often such institutions are affiliated to a certain manufacturer. It may be less attractive for commercial banks, which try to get involved in car deals as little as possible.

Legislative Exemptions versus *Shari'a* Innovations: The Issue of Double Transfer Taxes

Perhaps the most prominent instance where Islamic retail transactions are at odds with secular law is the issue of double transfer taxes (or double stamp duty, as the issue is referred to in the United Kingdom). This issue is normally triggered by Islamic home financing schemes.

The underlying issue is straightforward. Under a *murabaha* transaction, there is a double transfer of legal title (as from the *shari'a* perspective, there must be), first from the seller to the bank, and second from the bank to the customer. Although the bank will normally own the property for a logical moment only, this suffices to trigger transfer taxes, both under U.K. tax laws and section 1(1) no. 1 of the German Real Estate Transfer Tax Act (*Grunderwerbssteuergesetz*). The result is that under an Islamic home financing scheme double transfer taxes will be due, which is detrimental to the economic competitiveness of such transactions.

The British approach to this issue is well known. In order to discuss this and other issues, the U.K. regulator, the Financial Services Authority (FSA), called a working group consisting of regulators, *shari'a* scholars, bankers, accountants, lawyers, and representatives of the Muslim communities. The working group discussed how to integrate Islamic financing transactions into the British legal framework. As one of the consequences an amendment to U.K. tax law was enacted, which explicitly exempts Islamic home finance from the double stamp duty. The result is a partial exemption of Islamic financing transactions from British law.[17] This exemption is restricted to a well defined, singular matter. It is not the starting point for a parallel regulatory system for Islamic financial

[17] See sections 72 and 73 of the Finance Act 2003 (the *ijara* and *murabaha* transactions are referred to in the act as "alternative property finance").

institutions, such as exists in Malaysia and Bahrain, for example.[18] It is limited to exempting Islamic financial transactions from specific provisions of British law that have an unintended discriminating effect.

Under German law, this issue remains unresolved, but there are several avenues that may be pursued. First, one can think of an approach similar to the one in the United Kingdom and create an ad hoc exemption. This would be consistent with the approach that German law has taken to Muslim affairs in other instances, such as ritual slaughtering. Although ritual slaughtering is prohibited by law under the German Animal Protection Act (*Tierschutzgesetz*) and is deemed as cruelty toward animals, Section 4a(2) now provides for an exemption if it is "required by the needs of members of certain religious communities . . . whose mandatory principles of their religious community prescribe religious slaughtering." Based upon this, ritual slaughtering is now permissible as required by *shari'a*.[19] A similar exemption could be introduced into the German Real Estate Transfer Tax Act. However, there is presently no equivalent to the FSA working group in Germany, so it may be difficult to get the parliamentary and ministerial support required to enact such a solution. To date, the dialogue in Germany among professional groups regarding Islamic finance is only slightly developed. This makes it difficult to coordinate the efforts toward amending existing tax laws. In view of this, it may be worth considering other ways of approaching the issue. In particular, one could think about whether the Islamic notion of "legal title" is entirely the same as the notion in German civil law. If it is possible to argue that the bank acquires legal title only under Islamic law, and not under German law, it may be an option to argue in favor of an exemption to the transaction from double stamp duty, without amending existing tax laws. The transaction would take advantage of the regulatory arbitrage between the Islamic and the German legal system.

Shari'a Appellate Bodies versus State Courts: Dispute Resolution

Among the unresolved issues in Islamic finance is the issue of dispute resolution. Despite some scattered case law, mostly from English and Malaysian courts, the question of how to deal with disputes arising out of Islamic financing transactions remains to be tackled. The limited case law

[18] However, the U.K. Treasury has more recently announced that it will implement more such rules in order to further facilitate growth of the Islamic finance industry in the United Kingdom and develop London into an Islamic finance hub.

[19] For a discussion of the tensions between protection of animal welfare and freedom of religious practice, see Hans-Georg Klufe, "Das Schächten als Testfall des Staatszieles Tierschutz," *Neue Zeitschrift für Verwaltungsrecht* 2006, 650-655.

of the English courts (there are no German cases yet, to the best of my knowledge) shows how difficult it is for a secular court to come to terms with an Islamic financing agreement.[20]

The reason is twofold. First, Islamic financing transactions are structurally different from conventional transactions. They can be difficult to grasp for a court that is neither versed nor interested in *shari'a* matters. Second, particularly in a retail transaction, the parties may enter into Islamic transactions with a very special expectation: they expect to transact pursuant to *shari'a* rules. Yet it is questionable whether a state court will be prepared to give an opinion on that issue. On the other hand, especially to the extent that consumers are concerned, parties also expect the same level of protection that they would enjoy if the dispute was handled by a state court. From what I can see, there are three options for taking things forward.

The first and most obvious option is to vest the state courts with the competence to decide in such disputes. This would be consistent with the general approach in consumer matters. The problem with this approach is that, at least as far as Germany is concerned, there is little knowledge of *shari'a* among the members of the judiciary. There are certain precedents that suggest that judges, particular concerning family disputes, are willing to take *shari'a* rules seriously and spend considerable effort in determining their content. However, in disputes involving foreign law[21] the outcome is difficult to predict, given the absence of any established case law. In addition, it is expected that courts will attempt to avoid dealing with the details of *shari'a* issues. As a result, the courts may settle the individual dispute on a commercial level, but it cannot be expected that the decision will necessarily enjoy authority in the circles concerned.

The second option would be to refer the dispute to arbitration. Arbitration tribunals, as a general tendency, are freer regarding the rules they apply to the dispute. If the parties so wish, an arbitration tribunal can also decide a dispute according to the principles of the Islamic *shari'a*. A

---

[20] I have discussed this in Kilian Balz, "Islamic Financing Transactions in European Courts," in S. Nazim Ali, ed., *Islamic Finance: Current Legal and Regulatory Issues* (Cambridge: Harvard Law School Islamic Finance Project, 2005), 61.

[21] One question is whether *shari'a* rules will, from the perspective of English and German law, formally qualify as "foreign law." Under the established doctrines in private international law, the notion of "law" is synonymous with "state law." This means that transnational legal principles, such as the *shari'a* principles applied by Islamic banks, would not qualify as law at all. Nevertheless, in determining the substance of those rules, the courts would rely on experts, both in England and in Germany. The major difference may be that an English court would expect the parties to present expert evidence, while a German court would also appoint a respective expert ex officio.

state court, in contrast, cannot be expected to apply anything but state law. However, in many jurisdictions, there is reluctance submit consumer disputes to arbitration.[22] The vast majority of arbitration institutions are targeting commercial parties and are better equipped to handle large scale disputes among enterprises (as opposed to hearing "petty matters" arising out of consumer credit transactions or mortgages). In jurisdictions such as Germany, where the courts of first instance are easily accessible at reasonable cost, inserting an arbitration clause may have the effect of depriving a consumer of the possibility to enforce his or her rights. Therefore, there are certain restrictions imposed on arbitration clauses entered into with consumers.[23] The legislator normally is concerned that arbitration tribunals are not best suited to protect the interests of the weak, as mandatory laws of prime importance in the area of consumer protection are only hesitatingly applied by arbitration tribunals.

The third option represents the middle-ground position: a permanent appellate body dealing with Islamic financial disputes, which is subject to scrutiny and review of the courts. Such an appellate body has the advantage that, as an arbitration tribunal, it would be freer with regard to the legal principles it applies, and more flexible with regard to the judges it appoints. It would be a permanent body, and therefore would be expected to be better equipped to take care of consumer concerns than an arbitration tribunal proceeding according to rules designed for commercial disputes. It would be expected to publish its decisions, and as in court, its proceedings could be made accessible to the public. Its activity would be supervised by the state courts, to which any party may appeal if it feels aggrieved by the decisions of the appellate body.

THE WAY FORWARD

The analysis and suggestions of this paper can be summarized as follows:

- There is no one-size-fits-all approach in Islamic retail finance. Islamic retail finance transactions always have to be adjusted to the local environment in which they operate. This differentiates retail

[22] See, e.g., W. Luarence Craig,William Park, and Jan Paulsson, *International Chamber of Commerce Arbitration,* 3rd ed. (Dobbs Ferry, NY: Oceana Publications, 2000), 69-70.
[23] See, e.g., section 1030(2) of the German Code of Civil Procedure exempting landlord–tenant disputes from arbitration and section 1031(5) of the Code of Civil Procedure, setting up additional formal requirements for arbitration clauses entered into with consumers.

finance from the international "big ticket" transactions, which, at least to a considerable degree, are based on globally unified standards.

- The local environment comprises the state regulatory framework, such as tax laws and mandatory consumer protection rules. The state regulatory framework differs from one jurisdiction to another. It also extends to *shari'a* issues. An Islamic retail product must be tailored with a view to a specific Muslim community. There are no globally accepted *shari'a* standards for retail products.
- In order to adjust Islamic retail transactions to local markets, it is also advisable to initiate a process of "professionals in dialogue." This applies in particular to jurisdictions such as Germany. Assembling problem-solving capabilities will help to foster innovative solutions, both in the area of *shari'a* law and the legal framework in which Islamic retail transactions work. Only the cooperation of professionals representing different areas of expertise (*shari'a*, accounting, tax, regulation, legal) will allow us to break the present deadlock.
- Innovation will always depend on taking advantage of the specificities of both the *shari'a* and the respective national legal order. Using regulatory arbitrage can be a way to reconcile *shari'a* requirements with mandatory state law. This requires engaging in discourse between local lawyers and *shari'a* scholars who are versed in the respective jurisdiction and close to the Muslim community.
- The discursive development of Islamic retail products must be mirrored on the dispute resolution side. *Shari'a* appellate bodies, established by the industry and supervised by the state judiciary, may be the most efficient way to tackle that issue. Such appellate bodies are best suited to combine an understanding of *shari'a* matters with the required level of protection for consumers.