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Islamic Windows

A Solution for Muslim Community Banking in the United States

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ABSTRACT

Community banking for Muslims in the United States is not an affinity or cluster play akin to marketing financial products and services to ethnic Chinese, Indian physicians, or people with pets. The oft-invoked law of necessity (*darura*) in the West must be gradually eroded with real *shari^c^a*-compliant products. The National Commercial Bank and Al-Rajhi Investment and Banking Corporation may be seen as successful "community banks" with established business models for addressing retail needs with *shari^c^a*-compliant products. Citigroup has a dedicated wholesale Islamic unit in Bahrain, and as the largest financial institution in the world, it should have "Islamic windows" in the U.S., where there is an established Muslim population and Islam is the fastest-growing religion. However, only HSBC Amanah Finance has had the vision to set up an Islamic window for the U.S. market. One must ponder why Islamic banks in the Middle East have not entered the U.S. market, and one must also analyze the real obstacles to Islamic community banking for demand-based products in the U.S.

I. INTRODUCTION

At this juncture, Islamic financial institutions in OECD countries tend to come across a multitude of clients at the retail level who are not interested in funds, but in basic necessities such as mortgages, charge cards, education loans, *takaful*, etc. For these needs to be met, community banking needs to be properly established and widely offered. There are a number of things that are necessary for successful *shari^c^a*-compliant community banking in OECD countries, specifically in the U.S. market.

There are many commonalties between *shari^c^a*-compliant finance and other faith-based initiatives, such as Catholic funds, etc. People involved with these other faith-based finance initiatives have done a significant amount of work at different levels, and are considerably ahead of Islamic finance in many regards. The Islamic finance sector thus has the luxury of learning from their work and implementing their findings into its own.

Looking at the UCBH model, which has served the ethnic Chinese community since 1974, one can see that basically community banking is nothing more than affinity banking and cluster marketing with respect to addressing Muslims at the community level. It is affinity marketing, but with a *shari^c^a*-complaint structure. Basically, community banking involves recycling local capital in the same local community, taking deposits and making loans in very simple terms. For Muslims, this must all be done in compliance with the laws of the *shari^c^a*.

Much work has been undertaken by MSI, and institutions such as the United Bank of Kuwait, and the end result has been *shari^c^a*-compliant products, *shari^c^a*-compliant structure, and education at the state and federal level. However, this is not banking according to the technical definition, as are the institutions serving the ethnic Chinese community. Since the late 70s and early 80s the community banking service model has been in effect in the U.S. MSI was the pioneer out of Texas, and was involved in mortgages, collecting money from the community, pooling it and allowing clients to apply for *shari^c^a*-compliant loans. A major problem currently facing institutions operating under this model is that demand vastly exceeds the supply of capital. Another shortcoming at the institutions level is the shortage of professionals trained in Islamic finance: the institutions are unable to staff the whole nation from a local or a few offices.

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II. FUTURE DIRECTIONS AND PROBLEMS

There are three possible models for addressing Muslim needs in a *shari*^{c}*a*-compliant way for Islamic community banking.

The first model involves using branches of banks that are already established in Muslim countries. These banks may set up offices in major U.S. cities such as Los Angeles, Chicago or New York. Indeed, this has already been done by some banks addressing the Muslim community's conventional banking needs, such as the National Bank of Pakistan, National Bank of Kuwait, Mashreq Bank. The community affiliation and convenience attracts retail depositors and those needing the services offered by this institution. Commonalties of culture, language and affiliation are all strengths that these institutions possess. Clients have already had experience with these banking institutions in their home countries, and are familiar these institutions' services. Those offerings include residential loans, LCs, travelers' checks, etc. A number of banks have tried to push the initiative further, saying that they consider the Islamic financing sector only the start of a wider initiative. The higher levels of these banks have considered the idea of Islamic financing very seriously. The United Bank of Kuwait was the first initiative of this sort, and its model is very instructive.

Second, the location of Islamic banks has been problematic. Islamic banks frequently sponsor conferences in OECD countries. They have closed deals in the U.S. by offering a *shari*^{c}*a*-compliant structure and capital, while the counter-party in the United States addresses the regulatory issues. Thus the First Islamic Investment Bank has done a wonderful job with acquisitions and real estate deals with Keycorp. At present, however, the Islamic banks are less interested in addressing retail needs in the United States itself, though this situation is likely to change. The demand is present, and studies show the Muslim community has a higher median income than the average American, and Islam is recognized as one of the fastest growing religions in the country. A number of esteemed bankers have done a good job convincing the regulators at the federal level and the state level that Islamic commercial banking is not very different from the more familiar conventional banking system.

A third aspect of trying to address Muslim retail needs is that they can be met by western financial institutions with Islamic windows. Those institutions include HSBC's HSBC Amanah Finance, Citibank's Citi Islamic Bahrain, etc. These institutions have presence in most of the fifty-six Muslim countries, and they have been involved in Islamic finance for some time. A major breakthrough last year for Muslims in America was the purchase of LARIBA Islamic mortgages by Freddie Mac, hence, providing liquidity and credibility.

The model of the western financial institutions with Islamic windows could serve as an excellent interim solution for Islamic community banking in the U.S. The United Bank of Kuwait started this trend, and it is now is in the capable hands of HSBC Amanah. HSBC Amanah has a solid track record in addressing both internal and external issues, and possesses considerable resources. They have a well-recognized and respected *shari*^{c}*a* supervisor board, trained professionals, and significant resources; they understand the regulatory framework, and work with their lawyers to address tax needs. They have 420 branches in New York state alone, and so are able to address the retail needs through the various communities. It is quite likely that Chase and Citibank will also begin to consider Islamic finance.

A concern that comes to mind with western institutions with Islamic windows is whether one is contributing to the profits of a *haram* institution. Another is the source of money for the consumer retail products. Funds are not, unfortunately, a top priority for Muslims. Dow Jones Islamic Marketing Index has in excess of a billion dollars of money, but all but $20 million is from the Gulf. This leads to the conclusion that Islamic funds in the U.S. may be ahead of their time. Instead, more basic products such as mortgages, vehicles and equipment financing, and education loans are needed. In addition to the secondary trading market, for example, our bankers need to address loans for college and higher education, property insurance, small business loans, community banking: the essences of recycling the money within the community. There are a number of small business owners in these communities, for example, that find it difficult to access *shari*^{c}*a*-compliant loans.

Diversified portfolios are also necessary. There is a disincentive in investing in solely equity products. At this time, there are no Islamic bonds, Islamic money-market funds, Islamic CDs, etc. From a products and process point of view, if a bank has these products, but lacks substance behind them, it risks a serious loss of goodwill. Some Islamic financial institutions in the U.S. who are offering Islamic mortgages have a one year waiting period. Islamic financial institutions need to care for their customers at least as well as their conventional counterparts do, and provide customer service and call centers. Clients have to able to communicate with the offices within the country—each office cannot be entirely independent. For Islamic financial institutions, road shows and things along those lines are definitely necessary. Islamic banks need to reach out to their potential customers more. The bottom line is that more is needed to be done at the marketing level.

III. Conclusion

Community banking aimed at the growing Muslim community in the United States will only grow in the coming years. While tentative steps have been taken in exploring the means by which this relatively specialized form of banking may be practiced in the overwhelmingly interest-based U.S. financial environment, there are still many problems that Islamic finance will have to face in this country. These problems may be unique to the banking model used, such as the moral issue of contributing to the profits of a conventional institution (which arises when a conventional bank opens an Islamic window), or be shared across the board by the Islamic financial industry, such as the shortage of trained professionals. Practitioners of Islamic finance in the United States of America must grapple with these issues in order to succeed in this competitive market.