



SPECIAL WORKSHOP  
HARVARD LAW SCHOOL - MARCH 19, 2005

## THE SUPERVISION AND REGULATION OF ISLAMIC FINANCIAL INSTITUTIONS IN THE UNITED STATES: A SHORT REPORT

On Saturday March 19, 2005, the Islamic Finance Project of the Islamic Legal Studies Program hosted an all-day interactive workshop entitled “The Supervision and Regulation of Islamic Financial Institutions in the United States.” The workshop was one of the first of its kind to allow key industry players among financial institutions and representatives from many of the relevant regulatory bodies to directly address their respective concerns regarding the establishment of Islamic financial product markets in the United States. In addition to the representatives from the institutions and regulatory bodies, Professor Frank Vogel of Harvard Law School, Professor Samuel Hayes of Harvard Business School, and Professor Clement Henry of the University of Texas at Austin were also in attendance.

The workshop was divided into three separate sessions. The first session was devoted to investigating the level of demand of Islamic financial products and the need for regulation of Islamic financial institutions. This initial session included a presentation by Aziz Bakar, a Harvard Business School student, on the current demand for Islamic financial products, and another presentation by Michael Hanlon, CEO of the Islamic Bank of Britain, who discussed the details of his experience starting a national Islamic bank in the United Kingdom. The second session was allotted to regulators to give responses to the first session and to raise their own concerns. This second session was prefaced by a discussion on the current regulation of Islamic financial institutions in the United States by Professor Ibrahim Warde of the Fletcher School at Tufts University. The final event of the day was a goal-setting session, which offered representatives from each institution and regulatory body an opportunity to specify their long and short-term goals and expectations.

There were four main points that seemed to be raised by nearly everyone:

1. A need for a more comprehensive study about the demographics and demand for Islamic finance in the United States
2. Better educational opportunities for regulators about Islamic finance
3. More cooperation between Islamic finance institutions
4. Standardization: for regulators, Islamic financial products, and understanding of Islamic law (*shari‘a*)

A summary of each goal is given below:

### **Need for a Comprehensive Demographics Study**

Despite some preliminary studies that have attempted to gauge the demand for Islamic finance in America, no comprehensive study is available that reflects the cultural and religious differences among the various ethnic groups and localities. Some participants noted that Islamic financial institutions have begun to focus more on the local population, and the demand for Islamic finance products is dictated more by what these local Islamic financial institutions offer than by what can theoretically be available. A better understanding of market demands and the legal aspects (both religious and state/federal regulations) of Islamic finance products will help both regulators and institutions. Regulators will understand the products better and institutions will benefit from effective regulation of their products.

### **Improved Educational Opportunities for Regulators**

Islamic finance is a developing field with which regulators are not fully familiar. The benefits to educating the regulators are obvious. A more complete understanding of Islamic finance will allow regulators to better gauge the demand

for the product, understand the needs of the institutions, and become more capable in offering alternatives and suggestions to work with the current regulatory scheme while maintaining the integrity of Islamic law.

There are very few books available that concisely and accurately describe Islamic finance, and some efforts should be made in order to compile this information and release it to regulators. Workshop participants representing regulatory agencies also seemed very open to the idea of having an informal gathering where an “Islamic Finance 101” session would be conducted. The research team at the Islamic Finance Project has already begun to consult with Richard Todd (Federal Reserve Bank of Minneapolis) and other regulators in order to achieve this goal in the near future.

### **More Cooperation Among Institutions**

Because Islamic finance is a field that is still in its developing stages, cooperation among the current institutions is imperative to the future success of this industry. Some participants pointed to a collective action problem that many of the institutions independently face. Efforts made by one institution would be used at a much cheaper cost by other institutions. No institution would therefore want to take a leading role, preferring to wait until another institution took the initiative. Alternatively, when institutions have made some efforts that all institutions could benefit from at a cheaper cost, the leading institution will avoid revealing that information in order to keep its investment to itself.

It was determined that this problem could only be resolved through cooperation between institutions. The workshop offered an opportunity for extensive discussion about how to make this happen. One possibility discussed was to form a group with representatives from each of the respective institutions and a representative from one neutral body to maintain cohesion between the participants. The group would meet periodically to facilitate open communication and dissemination of information regarding Islamic finance in the industry.

### **Standardization**

There was significant discussion during the workshop about the possibility of starting an Islamic Bank of USA. As many participants pointed out, it is a huge leap from the current status of Islamic finance in America, but it can be achieved as was demonstrated by Michael Hanlon, of the Islamic Bank of Britain, (albeit with a different, yet very similar, regulatory body).

Before such a goal can be accomplished there are some intermediary steps that will need to be taken. First, Islamic finance products and the Islamic law that supports them would need to be standardized. Islamic scholars may disagree on approaches to Islamic finance, but some general type of standardization must be reached and implemented among the various institutions. This is a goal that would be much easier to reach if point three (institutional cooperation) were accomplished, especially if cooperation is achieved between an established group of representatives from Islamic financial institutions. This would not only make it easier for regulators to understand Islamic finance and its demand, but it would likely help customers feel more comfortable with Islamic finance as an alternative to conventional financing. Second, the regulation of Islamic finance, which varies significantly depending on region, should be brought into line. Workshop participant Richard Todd suggested convening more informal gatherings, which would facilitate communication between the regulators and establish more standardized regulation of Islamic finance products.