



The “Islamic” brand name,
and the future of Islamic
Banking

Mahmoud A. El-Gamal
Rice University



On religious brand names

Martin Luther:

“A Christian cobbler does not
make a Christian shoe.
He makes a *good* shoe!”

The current state of “Islamic” banking I

On the “liabilities” side

- Islamic banks rely on *Mudaraba* profit-sharing instead of interest earning deposits
- Profit-Sharing Investment Account holders:
 - Lack the protection of deposit-holders (bank debtors) ensured by bank prudential regulation
 - Lack the protection of shareholders whose representatives (board) ensure that the manager’s incentives are aligned with theirs

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Slide #3 of 17

The current state of “Islamic” banking II

On the “liabilities” side

- The only threat to Islamic bankers is losing investor accounts:
 - They create a special internal accounts for smoothing paid profit shares to mimic market interest rates
 - To please shareholders: managers will take more risks in bad times and less risks in good times – shareholders are risk-cushioned by PSIA-holders – and engage in gains-trading

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Slide #4 of 17

The current state of “Islamic” banking III

On the “assets” side: A loan by any other name ...

- OCC #867, 1999 : “... lending takes many forms ... Murabaha financing proposals are functionally equivalent to, or a logical outgrowth of secured real estate lending and inventory and equipment financing, activities that are part of the business of banking.”
- OCC #806, 1997: “Today, banks structure leases so that they are equivalent to lending secured by private property... a lease that has the economic attributes of a loan is within the business of banking. ...Here it is clear that []’s net lease is functionally equivalent to a financing transaction in which the Branch occupies the position of a secured lender...”

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Slide #5 of 17

The current state of “Islamic” banking IV

Worse yet: Shari`a arbitrage

- **Arbitrage:** capitalizing on price differences by buying an item where it is cheap and sell it where it is expensive to make a profit while bearing minimal risk
- **Shari`a Arbitrage:** You work for a large bank.
 - You notice that you can charge observing Muslims a higher interest rate than your bank can charge others (a premium).
 - You convince your bank to extend you a line of credit, use it for “Islamic finance”, share premium
 - You get your “Shari`a board” to approve this

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Slide #6 of 17

The current state of “Islamic” banking V

Shari`a arbitrage: my view

There are many ways to sell your soul to the devil

...

The worst of all such ways may be exploiting the religious in the name of religion!

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Slide #7 of 17

Advice for dealing with “Islamic” Banks

10. Ask how much of *their* own wealth they are putting into it ... and how much of *your* wealth are they asking you to tie to that industry!

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Slide #8 of 17

Advice for dealing with “Islamic” Banks

9. Beware of “scholars” with no credentials + much fan-fare...

Hint: meet them away from “the industry” and see if they dress, talk and act differently!

Advice for dealing with “Islamic” Banks

8. Ask what regulatory agency oversees their operations. Your tax-dollars pay for those regulators’ protection...

Hint: Tell me again why you are licensed in the Cayman’s?

Advice for dealing with “Islamic” Banks

7. Ask what they are doing differently, and what are their advantages and disadvantages.

Hint 1: There is no free lunch!

Hint 2: If they talk about the Shari`a, start again from #10

Advice for dealing with “Islamic” Banks

6. Beware of bankers and money managers who appear suddenly to sell their “Shari`a compliant” products ...

Hint: Is it an old power-point with added Shari`a slides?

Advice for dealing with “Islamic” Banks

5. Ask them: If the difference is Shari`a compliance, what is the objective served by the relevant Shari`a restrictions?

Then ask: would you abide by those restrictions in any case?

Advice for dealing with “Islamic” Banks

4. Be suspicious of bankers and consultants offering “Shari`a-compliant products”

Hint: Would you pay more for a “Shari`a-compliant” salad because pork is forbidden?

Advice for dealing with “Islamic” Banks

3. If they can explain to you how their operations abide by the Shari`a, ask them: then why do you have a Shari`a board?

If it's not so clear, then ask: are your “scholars” CPA-certified?

Advice for dealing with “Islamic” Banks

2. Ask if they are advertising their products only to Muslims. If not, ask why not.

Hint: would you eat at a restaurant only because its meat is *Halal*?

Advice for dealing with “Islamic” Banks

1. If you are satisfied with issues
10-2, ask:

Why do you call it “Islamic”?

(Why isn't it just a good shoe?)