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Banking Act Prevents Islamic Financing from Taking Off

Rules on interest, real estate, and overcoming apprehension from both within and without the Muslim community make it tricky for Sharia-inspired banks to set up in Canada.

For the last 30 years, the Islamic financial services industry has expanded tremendously in many parts of the world. There are currently 300 Islamic financial institutions in 75 countries with assets worth more than $300 billion (US) and another $400 billion in investments. But experts say it is still in its nascent stages of development in Canada, a country with a Muslim population of 750,000.

One success story is that of Omar Kalair, a Toronto entrepreneur, who three years ago established UM Financial, a housing finance company offering interest free loans. In the short time that UM Financial has been in business, it has investments close to $200 million, with about $150 million in residential mortgage products. With eight branches in Ontario and 20 employees, the future looks good for UM Financial.

"To introduce this product takes a while," said Mr. Kalair.

Last week, investors in Islamic financial services gathered for a two-day conference in Ottawa. Among them was Yahia Abdul Rahman, a veteran investor who launched a Shariah-compliant financing company called Lariba in the United States in the 1980s. He concedes there are many reasons for the slow take off of the Islamic financial industry in North America.

"It is true there are about five to six million Muslims in the U.S. and almost a million in Canada, [but] that's not a big market to raise capital," said Mr. Rahman in an interview.

Islamic financial systems operate on the basis of Islamic law known as Sharia. At the core of it, Sharia forbids the collection of interest or riba, or investments derived from gambling or other products such as pork and alcohol that are considered illegal or haraam in Islam.

Nevine Hassan, a business lawyer with Stikeman Eliot in Toronto, said one of the reasons Islamic financial services haven't expanded in Canada is because there is lack of experience in adapting to Canada's regulatory environment. Slight regulatory restrictions in the Banking Act also hinder the development of the Islamic financial industry.

The act has a stipulation that doesn't encourage financial institutions to hold real estate, which in turn forces Islamic financial institutions to find partnerships with other banks, said Mr. Kalair. The banks work on interest and Mr. Kalair said this in turn requires a rewording of all documents.

The other challenge Islamic financial institutions face stems from the apprehension of non-Muslims, especially after Sept. 11, 2001, said Mr. Rahman, adding that the interest-free aspect of Islamic finance is attractive to non-Muslims, as evidenced by the rapid growth of the industry in the United Kingdom, but that is not happening in North America.

Another challenge is that some Muslims are also skeptical about the Sharia-compliance of the services being offered.

"You have to convince the client that there is no element of doubt," said Mr. Kalair, whose own institution has a Sharia board to certify to potential Muslim clients that all services are legitimate or halal.

Because they don't charge interest, financial services, like mortgages, offered by Islamic institutions tend to be higher priced than those from secular institutions and Mr. Kalair said this could distract potential customers. However, he said as the market expands, prices will ultimately drop to rates comparable to those found in non-Islamic institutions.

But despite the challenges the Islamic financial industry faces, the future looks bright, said Stuart Carruthers, a business lawyer with Stikeman Elliot in Toronto.

"We expect that there will be a lot more Shariah-compliant products offered in Canada, may be not in the immediate short term, but certainly in the medium term," he said.