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Banking: Islam waits

As Ottawa mulls licences for Islamic-focused banks, is Canada falling behind?

By [Jeff Sanford](#) 

As the Anglo-Saxon ex-masters of the financial universe struggle to emerge from a perfect storm of bad loans, bad bets and a deep recession, an alternative approach to business transactions is having a moment in the sun: Islamic finance, based on teachings from the Qur'an.

Some governments, including the United Kingdom and Japan, have begun trying to tap into money from the Middle East by floating debt as *sukuk*, or Shariah-compliant bonds. At the retail level, Islamic mortgages and other banking products — based on a no-interest equity-pool form of finance — are becoming more popular. Here in Canada, Standard & Poor's recently set up a Shariah-compliant index that has already led to the proposed creation of the first Islamic ETF in this country.

But as the Islamic finance movement begins to get off the ground, a tug-of-war about how fast this new religious economy should emerge has broken out among those hoping to be players in this market.

The federal government declines to say how many applications it has received from organizations hoping to be the first Canadian institution to set up a licensed Islamic-focused bank in this country. But observers estimate there are about half a dozen applications sitting with the Department of Finance, and some of those asking for consideration are getting impatient with the time it has taken the government to come up with a yes or no.

Steve Watt, a partner with KPMG in Toronto, is involved with one of the applications. (KPMG is also handling another.) He says he's worried Canada is falling behind other countries in its

development of this sector. He points to London, which has decided to be proactive in developing that city as a “centre of excellence” in Islamic finance. “This is the next big shift in retail banking for the Muslim community. Looking to the future, this is going to be great for banks,” says Watt. “What are we waiting for? If this is being done in the rest of the Commonwealth, why can’t it be done here? Why can’t the laws of Canada accommodate this?” A conventional application usually takes up to 12 months; the Islamic applications have been sitting with the government for two to three years.

Watt points out that Islamic finance is one of the fastest-growing sectors in financial services. Authorities have done background checks around the applications; the backing of KPMG helps to ensure the commercial accounting on the applications is up to par. And anyway, despite what some critics argue, the products offered under the Islamic finance banner are not all that unconventional; the techniques used in Islamic finance are the same as or similar to some used at credit unions, in private equity and in venture capital.

Watt argues that the bureaucratic delays are leaving the sector under-regulated. “Mainstream Canadians are protected, but regulation is non-existent in this sector,” he says. “This is about taking something that is currently unregulated and bringing it into the mainstream. We want to show Canadians that they are represented under the regulatory system of Canada.”

Interestingly, the proposals were submitted for approval to the Office of the Superintendent of Financial Institutions, as is typical in such filings. But all the applications were subsequently punted to Finance. What might have held up the approval process? ...

And others in the Islamic finance sector suggest there is no rush to hand out a banking licence. Among them is Omar Kalair, the president and CEO of UM Financial Inc., a company that offers Islamic mortgages and is proposing a new Islamic ETF. UM Financial doesn’t have a banking licence. It offers its services through an agreement with an existing financial services company, Central 1 Credit Union, which provides capital to UM. That and partnerships with other companies allow it to offer a limited number of mortgages as well as a couple of other services, like insurance, and, more recently, a “prepaid”(interest free) Islamic credit card. But as one of the first movers in this space in Canada, Kalair would like to see more development of the market first, before a stand-alone bank is approved. “The market is not yet ready for this,” he says. “The fact that the big Canadian banks are not yet offering these services suggests that.” Kalair assumes the applications with Finance are mainly offshore Mideast groups hoping to set up shop here.

Nevertheless, the rest of the world is moving quickly. According to a report by Stikeman Elliott LLP, the sector has grown by between 20% and 30% a year since 2001. Watt wants to see Canada catch up to the U.K., which speeded the approval process in Islamic finance on the principle of “no obstacles, but no special favours.” That is, the government won’t stand in the way of the sector just because the word “Islamic” is attached. If the products fit into existing regulations, then banks will get a licence.

Watt calls this an enlightened, rational approach that meshes with western traditions of free markets and religious freedom. The idea that technically sound applications would be held up on any other concern would be to undermine western values. “The bureaucrats can’t have their heads in the sand on this. The applicants are making a business case here — nothing more,” says Watt. “They don’t want any special favours. They just want this considered.”

Those in the world of Islamic finance believe that now is the time to strike. One of the key developments in western finance leading to the current meltdown was the 25-year expansion in consumer credit. Deregulation, the rise of the offshore-shadow banking system, cultural attitudes toward debt — all led to a sharp rise in the amount of debt held by each individual. But as formerly non-creditworthy people were offered mortgages, demand in the economy was artificially expanded as well. That worked like a charm for a while — home prices skyrocketed, the auto industry continued to sell cars at a rapid pace, corporate earnings advanced — but once the credit bubble began to deflate, crisis quickly followed.

Proponents of Islamic finance argue that had its principles been followed, the big crash would have been avoided. Not only are profits from pornography and alcohol banned, but so too are unstable debt levels. That is an idea that may find favour with many in the West, especially in the wake of the recent meltdown. Watt suggests that even non-Muslim Canadians, recognizing the advantages, might at some point hope to access these services, just as some non-Muslim Canadians choose to eat halal. “You don’t have to be Muslim to enjoy the benefits. How many Canadians might want that — invest ethically in a system that isn’t debt-based?” asks Watt.

That possibility might soon be tested in the real world. The federal Department of Finance has confirmed that it recently finished its assessments and sent the applications back to OSFI for normal processing.

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