

## Courting Islamic finance

Many hurdles remain

By: Megan Harman | May 31, 2010 | 11:39

Megan Harman

The Canadian financial services industry is still a long way from meeting the specific demands of Canada's growing Muslim population. But some Canadian firms are taking steps to address this potentially lucrative market.

Although previous forays into Islamic investment products have failed, new efforts to develop other financial services for the Muslim population are showing promise.

Islam-based financial products are consistent with Shariah principles, which govern all aspects of a Muslim person's life. From a financial perspective, Shariah prohibits numerous conventional practices, such as the payment and acceptance of interest fees, speculative transactions, highly leveraged investing and investing in sectors such as alcohol, gambling and financial services.

Financial services that satisfy these requirements already represent a US\$1-trillion industry worldwide, with **Moody's Investors Service Inc.** recently estimating that it could eventually reach US\$5 trillion.

"We have a growing Muslim community in Canada that is prominent and increasingly well heeled, and seems to be interested in adopting Islamic finance," says Jeffrey Graham, a partner with the Toronto office of law firm **Borden Ladner Gervais LLP**, who heads the firm's Islamic finance focus group.

Indeed, the one million-strong Muslim population in Canada has roughly doubled in size over the past decade — and financial services firms are eager to tap into that market. A number of firms turned up at the inaugural conference of the Usury-Free Association of North America, an organization committed to promoting Islamic finance.

Centennial College in Toronto launched a certification course on Islamic finance this spring. The first session of the course was filled to capacity with financial services industry employees.

And representatives from several major financial services institutions — including three of the Big Five banks — are participating in an Islamic finance working group of the **Toronto Financial Services Alliance**, which is working to position Toronto as a North American hub for Islamic finance, among its other goals.

“It is an untapped market that has huge potential,” says Omar Kalair, member of the working group and president of **UM Financial**, a Toronto-based firm specializing in Islamic finance.

Despite the widespread interest, however, efforts to promote Islamic finance face a variety of challenges, including regulatory and taxation uncertainties and a general lack of knowledge of the issues.

Indeed, managed Shariah-compliant products in Canada have a dismal track record so far. In April, one of only two managers of Shariah-compliant equity mutual funds in Canada announced that it was terminating the only remaining fund in its lineup — frontierAlt Oasis Canada Fund. That fund, launched in early 2006, had assets under management of less than \$900,000 at the end of 2009.

In 2004, Toronto-based **Royal Bank of Canada** launched a Shariah-compliant equity-linked note that was later terminated due to a lack of market interest. And Toronto-based **Dynamic Funds Ltd.** terminated its Shariah-compliant Dynamic SAMI Fund in 2006.

These failures have raised questions about whether enough demand exists to sustain a larger Islamic banking sector in Canada. But Kalair insists there is plenty of demand for Islamic banking products in Canada. In a survey of Muslim Canadians commissioned by UM Financial last year, about half of respondents said they would embrace Shariah-compliant financial products.

@page\_break@UM Financial plans to launch Canada’s first Shariah-compliant exchange-traded fund this year, in partnership with **Jovian Capital Corp.**

Glenn Moore, vice president of Richmond Hill, Ont.-based **Global Prosperata Funds Inc.**, which manages Global Iman Fund — the only remaining Shariah-compliant equity mutual fund in Canada — says there is strong potential for these types of products.

Global Iman Fund, which was launched in March 2009, is an actively managed portfolio of securities listed on the Dow Jones Islamic market index. The fund has accumulated more than \$3.4 million in AUM and continues to attract interest from dealers and advisors, according to Moore: “We have new dealers coming on board all the time.”

Demand for Shariah-compliant products is not limited to the Muslim community. Global Iman Fund has attracted interest from non-Muslim investors seeking socially responsible investments or less volatile holdings.

Other financial services firms are closely monitoring the market, too. Although RBC’s last attempt to enter the sector was unsuccessful, it continues to watch for opportunities, says Camon Mak, RBC’s senior manager of multicultural markets: “Islamic banking is still an area that is of great interest to RBC. And it is a market that we intend to explore in the coming year.”

Despite the hurdles, supporters say Islamic financing products continue to show strong potential, as very few Shariah-compliant loans and mortgages are available in the Canadian marketplace. Kalair estimates that less than 1% of the Muslim population has access to this type of financing, which must be structured in a way that does not involve the payment of interest, which is prohibited under Shariah.

For instance, Shariah-compliant mortgage products are often structured as equity partnerships, whereby a financial services institution purchases a property and then resells it to the consumer at a fixed profit, which the consumer pays in instalments.

UM Financial is one of the few Canadian financial services institutions to offer Islamic financing products. It has arranged Shariah-compliant mortgages for 500 households under a funding facility of \$120 million from Vancouver-based **Central 1 Credit Union**. Since that funding has run out, UM Financial has generated a waiting list of another 6,000 households seeking this type of mortgage.

Regulatory issues have been another obstacle. A recent report by the alliance’s Islamic finance working group has identified a number of concerns regarding the regulation and taxation of

Shariah-compliant products and services. For example, the financial structures designed to avoid mortgage interest often include two sales — the first to the lender and the second to the buyer at a higher price — so what is essentially one transaction generates two sets of sales taxes.

“Sharia-compliant products generally do not fit within the definitions that currently govern conventional financial products, despite their similar economic features,” a report from the alliance says. “Obtaining clarification on the income and indirect tax treatment of Islamic finance products will be important to the development of Islamic finance in Canada.”

Progress in this area was made in January, when a study commissioned by **Canada Mortgage and Housing Corp.** concluded that Islamic financing products can be accommodated under Canadian legal and accounting rules. But legal experts say that more clarification from the regulators is necessary.

“I don’t think there’s any question that the Canadian system needs to be tweaked to truly accommodate Islamic finance,” says Graham. “There certainly are obstacles, barriers and limitations.” **IE**

---

---