CHAPTER 1

Introduction

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Islamic finance is an ethical financial system based on Islamic Law. It has spread beyond the Muslim world, but with various theoretical and practical implications. It has potential for high growth, especially in Europe. Beyond its intrinsically religious character, this sector of activity is open to every client, without religious discrimination.

According to the International Monetary Fund (IMF), the assets involved in this specific finance rose from \$200 billion in 2003 to \$1.8 trillion in 2013.[1] The IMF 2013 report reveals that 80% of Islamic financial assets were bank assets, while *ṣukūk* accounted for 15% of the total amount.[2] The Islamic Financial Services Board (IFSB) Stability Report 2017 indicated that the global issuance of *ṣukūk* has increased significantly over the last decade: the value of *ṣukūk* in circulation was \$270 billion at the end of 2013, which represented less than 1% of global bond markets, and has grown to \$318.5

[1] International Monetary Fund, *Islamic finance: Opportunities, Challenges, and Policy Options*, April 2015, pp. 13–14, online on: https://www.imf.org/external/pubs/ft/sdn/2015/sdn1505.pdf

[2] *Ibidem.*

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billion at the end of 2016.[3] The latest estimates are also optimistic: the 2016 Islamic Research and Training Institute (IRTI) report mentions that Islamic banking assets have exceeded $1.9 trillion.[4]

Islamic finance is obviously marginal on the scale of the world economy. However, its continued growth and "relative" resilience in the face of the 2008 crisis[5] have attracted significant attention. The characterization of this industry and its viability in legal and economic regimes therefore become a necessity.

Islamic finance can be defined as the practical application of legal and economic principles flowing from the *Sharīᶜa* which means "the way to go". This way must begin with one's submission to the will of God. It encompasses three main disciplines: Islamic Law (*Fiqh*), Islamic belief (*ᶜAqīda*) and the spiritual science of soul purification (*Tazkiya*).[6]

Thus, the *Fiqh* is the set of rules of conduct governing all facets of human life, in the form of a hierarchical body of law. The *Fiqh* regulates several legal disciplines: worship, commercial transaction law, family law, criminal law, administrative and constitutional law as well as international relations law. The originality of this legislation lies in its intimate and inseparable relationship with the purification of the soul, which gives it its moral and spiritual depth. Thus, Muslim law, in addition to its legal nature, constitutes a moral code of conduct for private and social life.

As for Islamic finance, it draws its legal rules in the section entitled "*Fiqh al-Muᶜāmalāt*", which can be translated by the law of commercial transactions. *Fiqh al-Muᶜāmalāt*, in its classical form, essentially regulates the legal relationship between individuals who enter into a particular type of contract while relying on legal theories of Islamic Law, such as the theory of *ribā*[7] and that of *gharar*.[8]

[3] IFSB, *Islamic Financial Services Industry Stability Report 2017*, May 2017, p. 3, online on: https://www.ifsb.org/docs/IFSB%20IFSI%20Stability%20Report%202017.pdf

[4] IRTI, *Global Report on Islamic Finance 2016, Islamic Finance A Catalyst for Shared Prosperity?*, p. 3, online on: http://www.irti.org/English/News/Documents/438.pdf

[5] IMF Working Paper, *The Effects of the Global Crisis on Islamic and Conventional Banks: A Comparative Study*, September, 2010, online on: http://www.imf.org/external/pubs/ft/wp/2010/wp10201.pdf

[6] Kuwait Ministry of Awqaf and Religious Affairs, *The Kuwaiti legal encyclopaedia*, vol. 1, pp. 16–17.

[7] Literally, increase, addition or growth. Legally, a surplus granted to a contractor but having no legal counterpart. Cf. Al-Jurjānī, *The definitions*, Beyrouth: Dār al-kutub al-ʿilmiyya, p. 109.

[8] What has an unknown fate, without anyone knowing if it exists or not. *Ibidem*, p. 161.

Thus, any action of introducing Islamic financial operations into another legal environment leads to an interconnection of Islamic Law with the positive law governing the territory in which the said operations will take place. Implementation of Islamic finance into a pre-existing legal framework surely is a matter of comparative law. It may seem then that legal challenges are the main challenge to be dealt with in implementing Islamic finance. Such view would be overly simplistic, as Islamic finance is a comprehensive approach, encompassing both Islamic Law and positive law, as well as community development, local customs and traditions.

The study of this interconnection between the different legal, economic and financial systems is extremely complex in terms of its comparative aspect and its transversal and interdisciplinary nature. This complexity appears in the practice of Islamic finance at the level of Muslim and non-Muslim countries. However, introducing Islamic finance in Europe implies an additional difficulty, particularly at the societal and even political level.

In the course of history, Europe and the Arab-Muslim world have fostered several types of exchange and mutual influences that have been reflected in the legal, economic or social disciplines. The appearance of Islamic finance in its current form during the twentieth century and its entry into the practice of business mark a new form of cultural exchange between the two shores of the Mediterranean.

The challenges that banking and Islamic finance pose in Europe have been much in the news. Through this work, we aspire to find ways of a serene integration of Islamic finance in European countries, whose practice will be put at the service of the citizen and society as a whole. European societies are losing steam in a neoliberal capitalism aimed solely at maximizing profits at the expense of a non-negligible number of ethical values in terms of investment. The world needs a new lease of life that is offered by the ethical finance of Islamic finance.

In fact, Islamic banking and financial practice has become widespread in Europe. It began with the creation of the first Islamic retail bank—the Islamic Bank of Britain—in 2004 in the United Kingdom, which confirmed its position as the Western leader in Islamic finance by becoming the first non-Muslim country to issue a *ṣukūk* sovereign. Similarly, Luxembourg has benefited from its reputation as a mutual funds management center in Europe to attract Islamic asset management expertise and gain experience. More broadly, every European country has approached Islamic finance in an idiosyncratic way, reflecting its own socio-cultural, political, economic and regulatory constraints and comparative advantages.

After the global financial crisis in 2008, new sources of funding were necessary to restore growth. Many additional reasons have driven European countries to seek a growth driver in Islamic finance, such as targeting potential growth with clientele of more than 20 million Muslims living in the European Union, as well as completing their supply with a new range of financial products available on the global market, not to mention the societal interconnections between Islam and the West.

Furthermore, Islamic finance is characterized by a few specificities that mark the minds, as it stimulates and affects the real economy, promotes individual initiative and enhances cooperation between economic actors, especially actors which were set aside by the conventional financial system. Taking into account the essence and ethical dimension of Islamic finance, these characteristics find their counterparts in European legislation, particularly in microcredit, crowdfunding, social and cooperative banks and socially responsible investments. Despite the similarities between, on the one hand, ethical, solidarity and social investments and, on the other hand, Islamic financing, there are several differences that could be described as "serious". They are at the level of philosophical, legal and economic values, which are accentuated by the difficulties arising from the governance of Islamic financial institutions in the positive legal framework.

These serious reasons deserve a careful study and an overview of Islamic finance in Europe, trying to take into account its social dimension in aspirations of the public, as well as practical implementation by stakeholders. The actual practice of Islamic finance is at the heart of this work. Integrating aspirations and practice makes a difference in comparison to classic studies and statistical reports published by famous organizations such as EY, Thomson Reuters, Zawaya and others.

This collective work is based on a comprehensive and interdisciplinary vision of Islamic finance. Thus, we will focus on presenting the state of Islamic finance in European countries by focusing the presentation and analysis on four main axes.

1.1 Interconnection Between Society and Islam

Knowledge of the customer base of Islamic finance is different from one European country to another: for instance, France prohibits religious and "ethnical" statistics. We thus need to establish consistently the place of Islam in European countries. This will allow us to assess the perspective of sustainable development of Islamic finance in these countries. It is therefore a question of presenting the sociological and demographic aspects that reflect the perspectives of the development of Islamic finance in each country.

1.2 Legal Framework of Islamic Activity

The practice of Islamic finance is generally limited by legal constraints that arise from the incompatibility between the principles of Islamic finance and certain national legal rules. Thus, in order to accommodate Islamic finance operations, the legal framework may be tuned by the legislator or by the regulatory authorities, if the practitioners themselves did not find appropriate applicable material provisions. Indeed, the freedom to contract is sufficient to structure a banking and financial transaction in accordance with the principles of Islamic finance as long as it is not contrary to public order.

These legal arrangements are the center of our inquiry in this axis. To carry it on consistently, we will study legal texts which have undergone modifications to allow exemptions from the common legal framework. Similarly, the analysis of a given national legal framework for certain transactions may lead to the formulation of proposals to amend this framework in order to accommodate optimally the particular characteristics of Islamic financial transactions.

1.3 Current Situation of Islamic Finance

In every chapter, this section puts the current situation of the Islamic financial sector in perspective with the history of Islamic finance for every country considered. This will help to understand the strengths and weaknesses of an industry in the making by presenting the state of the market. This axis of research differentiates developments affecting each sector of activity such as Islamic banking, Islamic insurance (*Takāful*), other Islamic financial institutions or the market for the issuance of Islamic financial securities called *ṣukūk*.

1.4 Academic Situation

The study of the academic situation of Islamic finance in each country will allow to know more precisely the ideas that are conveyed about this new industry. Indeed, it will provide sharp criteria for the evaluation of its social and moral anchoring in each country. It will also discuss the specialized courses in Islamic finance and academic studies.

This book will not be limited to a study of countries belonging to the European Union or the Council of Europe. We decided to review *significant* countries, from the point of view of either supply or demand. On the demand side, it is easy to figure out that we are interested in countries with a significant Muslim population (e.g. Turkey,[9] Germany, France, Russia, the United Kingdom). On the supply side, some countries have expressed their benevolence to accommodate Islamic financial operations or demonstrated a remarkable expertise in some products: to these categories belong, for instance, the Republic of Ireland and Luxembourg.

However, since the majority of the countries studied are part of the European Union, an introductory chapter will analyze the degree of compliance of the rules governing Islamic finance with European Union legislations. It will then follow various contributions, that is, an article—or two articles depending on the importance of the subject—for each country studied.

[9] One may argue Turkey is only marginally in Europe, but the Turkish financial sector is mostly headquartered in Istanbul, that is, in Europe, geographically, as is the large Muslim community in Russia, which demonstrated a definite interest in Islamic finance since more than a century; cf. Zaripov I. 2013. "ИКЪТИСАД" – ПЕРВЫЙ РОССИЙСКИЙ ЖУРНАЛ ПО ИСЛАМСКОЙ ЭКОНОМИКЕ; Iktisad, the first Russian magazine on Islamic economics, *Philology and Culture*, 31.