



Australian Federation  
of Islamic Councils

# **Islamic Finance In Western Markets:** Adaptation and Potential with Dr Michael J.T. McMillen

Lecture summary prepared by:  
Imam Mohammad Trad  
AFIC Da'wa and Iftaa Manager

## Lecture presented at 3:00-4:20 AM (AEST) 7 October 2021

In this excellent lecture. Dr McMillen shared the culmination of his 25 years of study and experience into the field of Islamic Finance and the US market. Because the focus was the US market the comparison offerings may not be accurate for the Australian market. The key points are reproduced below:

You can access the 83-minute lecture at:

<https://www.youtube.com/watch?v=v5lxMiMrpDk>

You can also access Dr McMillen's paper on the topic at:

[https://www.researchgate.net/publication/256065225\\_Sequelae\\_of\\_the\\_Dow\\_Jones\\_Fatwa\\_and\\_Evolution\\_in\\_Islamic\\_Finance\\_The\\_Real\\_Estate\\_Investment\\_Example](https://www.researchgate.net/publication/256065225_Sequelae_of_the_Dow_Jones_Fatwa_and_Evolution_in_Islamic_Finance_The_Real_Estate_Investment_Example)

And His book:

<https://www.barnesandnoble.com/w/islamic-finance-and-the-shariah-michael-jt-mcmillen/1117896697>

### Islamic finance and enforceability of Shariah in Western markets.

- Many US banks have Islamic finance options, with Keybank being the first to have an offering. The amount of shariah compliant finance in the US is huge, with the main areas being real estate and equity.
- Why the US? Because it is a diverse, stable and predictable environment.
- Globally *Sukook* are the largest part of the Islamic finance market. There are a few in the US but not many.

### When looking at Islamic Finance we consider 4 areas:

- Banking: extremely expensive and unfeasible to start one from scratch
- Finance
- Investments
- Takaful (Islamic equivalent of Insurance. According to Dr McMillen Mutual insurance is the western equivalent)



## A brief comparison to western markets

- The discussion is normally between replication and accommodation of current systems.
- An emphasis was made on the idea that financial institutions do offer services that are Shariah compliant but just don't have the label. A lengthy comparison was made between financial services offerings at regular banks and currently understood shariah compliant financial services offerings and there was a large degree of similarity.
- There is lots of mimicry of western systems but that is not necessarily bad as there are some fundamental areas that are workable within a shariah compliant system.
- *Ijarah* transactions are similar to a leverage lease. Financial institutions do them all the time. If you ask them to offer you an *Ijarah* transaction, unless they know what you're talking about they'll tell you they don't do them. But if you talk about a leverage lease they will confirm that they do have them.

## The challenges

- There are some disadvantages to shariah compliant ventures in the market (taxing structures, startup costs, and the exclusion of haram investments), so the question becomes how do we level the playing field?
- Taxing structures: On interest loans the US government taxes the interest only but not the principal. The Islamic finance mechanism used does not have interest and so they are taxed on the entire amount.
- The exclusion of haram investments: the example of investing in a commercial building and excluding tenants who trade in impermissible goods or services was given. So to remain shariah compliant the owner would exclude a bar or other premise that sells alcohol. This is explained further with the Dow Jones Fatwa

## The Dow Jones Fatwa (1998)

- This was a monumental fatwa that opened up many doors for shariah compliant investment
- There were 5 scholars who primarily worked on this fatwa and it took a considerable time to finalise as well as many consultations. One of these scholars is Mufti Taqi Uthmani, for whom Dr McMillen has a long running professional relationship. Other authors included Sheikh Yusuf Talal DeLorenzo and Sheikh Nizam Yaqubi.
- One of the prevailing stipulations is that a risk/reward model must be adhered to for all transactions. This is the case with Islamic finance generally.



- The Dow Jones fatwa led the way for the development of a Dow Jones Islamic market index
- The Dow Jones fatwa allowed for some variance (impurities) in non-controlling investments. If your investment is significant enough for a controlling interest then it must be entirely halal.
- The Dow Jones Fatwa had within it 3 tiers of tests
  - The instrument itself must be compliant, eg. No preferred stocks
  - The business activity of the entity must be permissible. A burden of proof mechanism was built into the fatwa. It was later considered that if the problem activity is not a major contributor to the business then it is usually okay. If you can identify the problem amount, then donate it.
  - The 3rd test was multilayered based on the quantum and nature of the return on the investment.

## Capital markets

- In capital markets you have a debt side and an equity side.
  - With Islamic finance, a lot is being done with the debt side, with *Sukook* being the largest opportunities. *Sukook* are often misconstrued for bonds. They are not bonds. They are securitised assets. The US is currently the best place for private sector *Sukook* (securitisations).
  - The question then becomes, how do you develop the equity side of it? This is an area that needs more work.

## Measuring risk – interest

- Profit rate – rate of return that will induce you to participate in a venture
- Nominate contracts: sales based or partnership based.
- *Murabahah* is the most frequently used Islamic investment product.
- Rent is taxed for both principal and interest
- If you take an interest-bearing loan from off-shore, there is no tax on the repayment of the principal.
- A lease in *murabahah* is equivalent to a loan in the US for tax purposes
- This is similar to a bifurcated lease structure
- This allows a food wholesaler to finance inventory for halal foods
- Most shariah compliant investment in the US is from foreign investors
- Portfolio investment: from a shariah perspective paying yourself interest is okay.



## Further notes on Islamic Finance

- In the banking sector the traditional Islamic experience is an *Amanah* system. This wasn't finding much demand because people wanted to profit from their deposits. So *Mudarabah* then became the prevailing model.
- One of the matters that were traditionally not acceptable in Islamic finance was having multiple contracts within one transaction. A monumental shift occurred when a fatwa was released allowing for multiple contracts in the one transaction so long as you do not defeat the purpose for each one.
- *Ijarah* is promising within the Islamic finance sector.

## Boards for financial institutions with shariah compliant offerings:

- Ultimately there are 3 types of Islamic scholars who operate in the Islamic finance space: Internationalist, regional and local. Ideally you want representation from all 3 types in a board for a financial institution.

### **Sheikh Mohammad Trad**

AFIC Da'wa and Iftaa Manager

Authorised by:

Dr Rateb Jneid  
AFIC President

The Most Eminent Imam Abdul Quddoos Al Azhari  
National Grand Mufti of Australia





Australian Federation  
of Islamic Councils

[www.afic.com.au](http://www.afic.com.au)