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Development of the Islamic Banking System

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Abstract

This paper will illustrate the historical development of Islamic banking industry. In addition, it will provide information about the Islamic banking development in many countries around the world. This information provides important context for understanding modern-day financial practices.

Keywords: Development, Historical, Islamic banks, Regulators, Region

JEL Classification: G21; F37; P120

1. Introduction

Islamic banks can be defined as a financial institution that (a) abides by *shariah* principles in all of its activities through its role as a financial intermediary between savers and investors;(b) provides banking services within the framework of legitimate contracts; and (c) achieves a balance between economic and social return. And the beginnings of Islamic banking, in its wider sense, date back to the early days of Islam and the rise of the Islamic Empire. The boom in the internal and external trades in the dawn of Islam led to the creation of Islamic financial tools such as deposits, money transfers, checks, bills of exchange, and so forth to cope with these commercial developments. Later, the Europeans adopted these Muslim practices and continued to evolve them until modern days. In Islamic countries, Islamic financial practices withered gradually due to the weakening of the Islamic empire, until these practices were replaced by the Western financial model in the early 20th century. However, Islamic financial practices emerged again in the middle of the of the same century. In this paper we try to track the development of the Islamic banking industry and to see if there are a real boom in the industry worldwide.

2. Historical Development of Islamic Banks

The origin of Islamic finance dates back to the dawn of Islam 1,400 years ago. Historical books written during the early years of Islam indicated that during the 1stcentury of Islam (AD 600), some forms of banking activities existed that were similar to modern banking transactions. Furthermore, these ancient books revealed that Al-Zubair bin Al-Awam, one of the most famous personalities in Islam, was accepting deposits from people as loans and investing that money. At the time of his death, his debt had reached 2,200,000 dinar[2], as counted by his son Abduallah. Also, he had several branches in different parts of the Islamic

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[2] The dinar was in the era of the Prophet, peace be upon him, equal to 12 dirham's. The dinar at present time equals to four grams and a quarter of gold (24 carat). branches Al-Zubair Bank. This form of banking transaction took place5 centuries prior to the first documented banking transactions in Italy, which many researchers consider the origin of modern banking. In addition, during the rule of Marwan bin Al-Hakam (the fourth Umayyad caliph) in the 1stcentury of Islam (8th century AD) goods sukuk were widely used as a method of payment to the state's soldiers and employees (Al-Marwyne 1985; Nasser 1996, p.9).

Empire to return deposits to their owners—some contemporary scholars call this collection of Furthermore, the writings of Al-Djahshiyari (1938), Al-Kubaisi (1979), Al-Ali (1953, 1981), Al-Duri (1986, 1995), Fischel (1992), and Al-Hamdani (2000) show that there were bankers called *sarraffeen* or *sayarifah* (singular *sarraf*) or *jahabidhah* (banks called *dawawin al- jahabidhah*) in the Islamic Empire. (Chachi 2005). in the Islamic Empire. Also, according to Chachi (2005), during the Abbasid-*caliphs* period (from the 8th century) the term *sarraffeen* was used to refer to financial clerks, experts in matters of coins, skilled money examiners, treasury receivers, government cashiers, money changers, or collectors to designate the well- known, licensed merchant bankers in those times. In addition, the first check in history was drawn by a *sarraf* in Baghdad in the 4th century AH (10th century AD), and it was cashed by the prince of Aleppo, Saif Al-Dawla Al-Hamadani. Perhaps De Roover (cited in Chachi 2005) says it most clearly:―There can be no banking where there are no banks‖ (p. 10). Indeed, the historical records indicate that there were banks in those days.

Nasser (1996, pp. 15–16) argues that Muslims contributed greatly to the development of banking practices because, during the Islamic empire, there was

1. a legislative system, which included firm rules and regulations to govern all transactions;
2. a strong judicial system, which was capable of enforcing all legitimate contracts;
3. different kinds of commercial papers and banknotes that were widely accepted, such as promissory notes (*reqaah al-sayarifah*), bills of exchange (*suftaja*), and goods *sukuk*; and
4. licensed bankers, who had offices or agencies in different parts of the Islamic Empire and accepted deposits, assigned debt(*hawalah*), exchanged money, issued banknotes, and performed many other services.

Udovitch (cited in Chachi 2005) discussed some of these transactions as well: ―The *suftaja* always and the *hawala* usually occurred as a written obligation, and were thus the first and most important forms of commercial credit papers in the Medieval Near East‖ (p. 12). Beginning with the decline of the Islamic Empire from about the 12th Century BC, the rule of the *sarraffeen* began to weaken. Their loss of power within society can be attributed to several internal and external factors. This allowed Western influence to increase throughout Islamic countries, especially through colonization. Under European influence, many Islamic countries began to adopt a Western banking model in the 19th century. This started by opening branches of foreign banks or by establishing banks within countries. For instance, in Egypt, the first conventional bank opened its doors in 1856 under the name Bank of Egypt. This bank was a branch of an English bank but was closed in 1911. The National Bank of Egypt was established in 1898 by Ralph Suarez and Constantine Salvagos (Jewish businessmen) with an English partner; the bank is still in operation today(Nasser 1996; National Bank of Egypt 2009).

This trend continued in all Islamic countries until the middle of the 20th century, when the calls to establish Islamic financial institutions gained momentum with the independence of some colonized Islamic countries. In Islamic societies, scholars have three opinions regarding the European banking model (Nasser 1996, pp. 23–24):

1. All bank activities are *halal* (adhere to *shariah*). Supporters of this opinion, such as the founders of Bank of Egypt, use weak arguments to present their points of view.
2. Bank activities are *haram* (contradictory to *shariah* principles) but necessary. Some scholars argue that banks play an important role in the economy and therefore they see no harm in establishing banks based on the European Model, even though some of their activities are *haram*. This argument is strong because it is based on one of the basic Islamic juristic rules:*al-drurat tubeah al-mahdurat* (necessity knows no law).
3. Bank activities are necessary, but *riba* is not necessary for bank operations. Supporters of this opinion argue that Islamic jurisprudence has many forms of contracts that allow Muslims to avoid *riba* and can be implemented by banks. Among Muslims worldwide, this is the most acceptable of the three arguments because many people are not using banks regularly.

In general it can be said that the first and second opinions had the loudest voices in the mid 1900sdue to the political and social climates of the times (Nasser 1996, p. 25). In addition, the Western banking model was well established and no Islamic alternative existed; this was because Muslims did not have enough knowledge about the Islamic banking practices from the golden age of Islam (Nasser 1996, p. 25).

However, in the1940s, the third opinion gained momentum, especially on an intellectual level. This trend continued in the 1950s and 1960s, when the first Islamic banks in the modern history were established. This implies that modern Islamic banks have undergone three phases of development.

2.1 Phase 1: Interest-Free Banking as an Idea[3]

This stage began in the early 1900s and was marked by the writings of Abul Aala Maudud (1937), Hasan Al-Banna (1939), Hifz Al-Rahman (1942), Muhammad Hamidullah (1944), Anwar Qureshi (1946), Naiem Siddiqi (1948), and Mohammad Yousuf Al-Dean (1950). The number of published studies on this topic totaled 31 from 1940 to 1974 (Al-Ansari, Hasan & Metwaly 1988, pp. 24–25). The first work devoted to the subject of interest-free banks was Muhammad Uzair‘s research in 1955 (Gafoor 1995).

2.2 Phase 2: The Emergence and Establishment of Islamic Banks (1963–1976)

This stage involved tremendous development at both the intellectual and implementation levels. The early banks became pillars for the continued development of the Islamic financial system. The following points summarize the events that took place during this period.

1. Local savings banks were established in Mit Ghamr, Egypt, in 1963. Many researchers consider these banks to be the first banks without interest in Islamic society. However, these banks merged with government banks in 1967 for political reasons (Al-Marwyne 1985; Wilson 1983).
2. In the following years, more studies dedicated to Islamic banks began to emerge. A short list of these studies includes Abdo (1970), Araby (1967), Al-Najjar (1971), Gelani (1965), Khurshid and Farrukh (1970), Nejatullah Siddiqi (1961, 1969), and Shalbi (1969; Al-Ansari, Hasan&Metwaly 1988).
3. Institutional involvement also increased. Some examples include the Islamic Research Academy Al-Azhar conference, the Finance Ministers of the Islamic Countries conference held in Karachi in 1970,the First International Conference on Islamic Economics in Makkah in 1976, the International Economic Conference in London in 1977, and an Egyptian study in 1972 (Gafoor 1995; Nasser 1996, p. 30).

In the Karachi conference, delegates from Egypt proposed that an international Islamic bank be established, and delegates from Pakistan proposed that an international union for Islamic banks be established.

4. Nasser Social Bank was established in Egypt in1971 by Presidential Decree 66. The bank‘s charter clearly identified that it was an interest-free bank. Also, Act 13 of the decree stated that the bank would not be subject to the regulations applied to conventional banks. The purpose of the bank was to broaden the social solidarity among citizens and to create a competent and just society. The bank‘s capital was formed from funds allocated by the president of the republic from outside the state budget resources specified for this purpose. In addition, money was allocated from public bodies and economic units. However, the Nasser Bank Law did not mention that the bank had to adhere to *shariah*. Still, because the bank was a member of the International Union of Islamic banks, it was considered an Islamic bank (Al-Marwyne 1985).
5. In 1974, the finance ministers of all Islamic countries held a convention on the establishment of the Islamic Development Bank (IDB). The IDB was considered to be the first international Islamic bank that was established, albeit in part, by members of the OIC. The bank began operating in 1977, and since then it has played a pivotal role in the development of the Islamic banking and finance industries. The purpose of the bank is to foster the economic development and social progress of member countries and Muslim communities individually as well as jointly in accordance with the principles of *shariah*. As of June 1992, the bank‘s paid-up capital was 2billion Islamic dinars (an IDB accounting unit that is equivalent to one special drawing right of the International Monetary Fund). From July 1992 to December 2000, the bank increased its capital to 6billion Islamic dinars. In 2001 the bank increased its capital from6 billion to 15 billion Islamic dinars (USD 20.55 billion).

[3] However, before this period there was an effort to establish an interest free institutions in the southern India, which can be traced back to the 1890s. This was mainly a welfare association collecting donations and animals sacrificed from the public to provide interest free loans to the needy.

6. The Dubai Islamic Bank was established as a joint stock company. The main founders were Saeed Lootah, Nasser Lootah, Sultan Lootah, Mohammed Lootah, and Abdallah Saeed. The governor of Dubai, Sheikh Rashid Al-Maktoum, issued the Amiri Decree, which allowed the bank to be established as of March 12, 1975 (Al-Marwyne 1985). The bank's capital was 50 million Arab Emirate dirham (AED) dividedby100 thousand shares with a face value of AED500 each. The founders bought 10 thousand shares with a value of AED5 million, paid in full (Al-Marwyne 1985). This bank is generally considered to be the first private Islamic bank. Also, some researchers refer to it as the first Islamic bank.

2.3 Phase 3: The Spread of Islamic Banks, 1977 to Present

During this phase, the number of Islamic banks around the world boomed, and many of the banks established in the early 1970s and 1980s are still in operation today (Abdeen & Shook 1984, p. 167; Shehata 2006, p.18).[4] Also, many conventional banks have established Islamic windows, and still other conventional banks have fully converted to Islamic banking. Furthermore, several Islamic bodies were established to regulate and promote the Islamic finance industry. Finally, Iran and Sudan Islamized their entire financial systems. The following sections discuss these and other key events in this period.

1. The International Association of Islamic Banks was established in 1977. The CEOs of the Islamic banks agreed to establish the International Union of Islamic Banks in 1997, with the headquarters in Makkah. The aim of this union was to strengthen cooperation and increase coordination among Islamic banks. However, although the union still exists, it has not begun operations (Shehata 2006, p. 19).This changed in July 1999 when the International Association of Islamic Banks was reorganized and renamed the General Council for Islamic Banks and Financial Institutions (CIBAFI), Bahrain was chosen as itsheadquarters. The council opened its doors at the end of 2001 as one of the organizations of the Organization of the Islamic Conference (Taqi Al-Dean 2005; El-Shiekh 2010). By 2012 there were 114 council members, including 66 key members and 48 observers.

2. The Faisal Islamic Bank of Egypt was established as an Egyptian joint stock company by Presidential Decree 48 in 1977 and by a decree from the Egyptian Ministry of Finance. The bank's capital was USD 8 million, divided into 80,000 shares with a face value of USD 100 each. The Egyptian side owned 51% of the capital, and they were authorized to offer 25%of their share to the public.

The Saudi side owned 49% of the capital and had the right to offer some of it to the public. Since then, the bank has increased its capital several times. The bank charter indicates that the bank must comply with *shariah* in all of its transactions (Al-Marwyne 1985).

3. The Faisal Islamic Bank of Sudan was established in February 1976 when Prince Mohammed Al-Fisal and some Sudanese businessmen obtained approval from the Sudanese president. The bank was established as a public joint stock company by Presidential Decree 9 on April 4, 1977. A gathering of 86 people from Sudan, Saudi Arabia, and others from the Gulf State countries made the bank's establishment possible, and they offered to provide half of the bank's capital. The bank's capital was 6 million Sudanese pounds divided into 600 shares with a face value of 10 Sudanese pounds. The Saudis owned 40% of the bank, the Sudanese owned 40%, and the remaining 20% was offered to the public in other countries. The bank capital increased in 1981 and 1982. In addition, the bank was excused from some of the laws that applied to other banks and was exempted from paying taxes (Al-Marwyne 1985).

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[4] Nasser Social Bank (Egypt, 1971), Islamic Development Bank (Saudi Arabia, 1975), Dubai Islamic Bank (Dubai, 1975), Faisal Islamic Bank (Sudan, 1978), Faisal Islamic Bank (Egypt, 1978), Kuwait Finance House (Kuwait 1978), Jordan Islamic Bank for Finance and Investment (Jordan, 1979), Bahrain Islamic Bank (Bahrain, 1979), Dar Al-mal Al-Islami Group (Switzerland, 1981), Tadamon Islamic Bank (Sudan, 1981), Al-Baraka Banking Group (Worldwide, 1985). The author checked those banks and they still in operation by the end 0f 2012.

4. The International Institute of Islamic Banks and Islamic Economics was established in1981by the International Union of Islamic Banks in response to sustained growth in the number of Islamic banks and the need for qualified staff (Arabic and Islamic universities were unable to provide such individuals to fill the shortage). The Turkish Federative State of Cyprus was chosen to be the headquarters of the institute for political reasons (Shehata 2006, p. 19).
5. The establishment of the Supreme Supervisory Commission on *Fatwa* and *Shariah* was established in 1983. According to Shehata (2006, p. 20), the commission had several primary objectives. First, the commission aimed to examine all the *fatawas* released by the supervisory boards and *fatawa* committees of the Islamic financial institutions that were members of the International Union of Islamic Banks and to give opinions regarding their adherence to *shariah* principles. The second objective was to monitor the activities of the members of the International Union of Islamic banks to ensure their compliance with the provisions of Islamic *shariah* and alert stakeholders to any deviation from *shariah* principles. To be able to play this role, the committee was granted jurisdiction to review the laws and regulations of those institutions.

The third main aim was to give legal opinions from a *shariah* perspective as requested by the financial institutions that were members of the union, their supervisory boards, or the secretariat of the union. Ultimately, the commission ceased its activities for several reasons, and each Islamic financial institution established its own *shariah* supervisory board.

6. The AAOIFI was established in 1990.The objective of this organization is to prepare accounting, auditing, governance, ethical, and *shariah* standards for Islamic financial institutions and the Islamic finance industry.
7. The Islamic Financial Services Board was established in 2002. It issues guiding principles and standards for the Islamic financial industry to ensure its soundness and stability.
8. The Islamic International Foundation for Economics and Finance was established in 2004 as one of the bodies of the Muslim World League. The foundation‘s headquarters are located in Riyadh, Saudi Arabia, and according to the foundation‘s website (Islamic International Foundation for Economics and Finance 2006, translated from Objectives section), its objectives are to

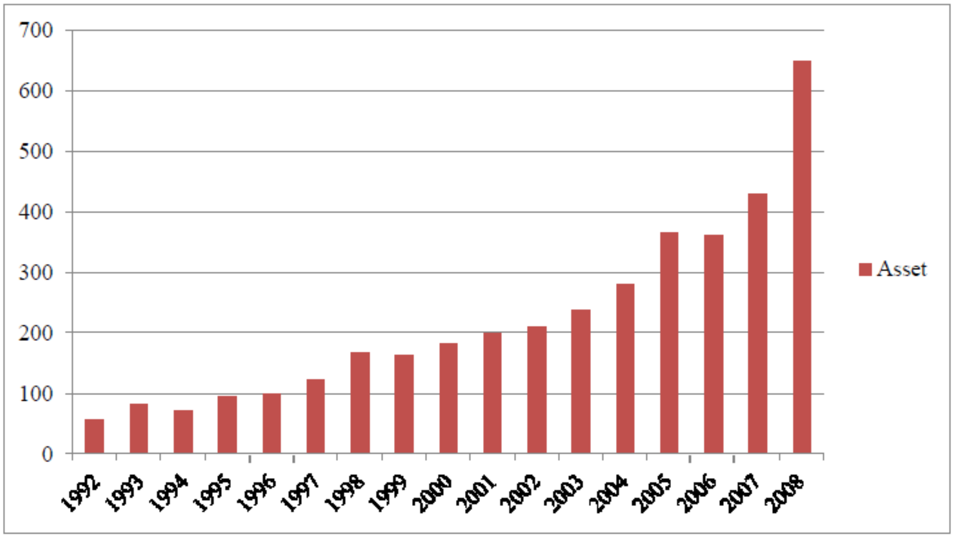
a support for the coordination and integration among scientific research institutions in the field of Islamic economics;
b. found a scientific body dedicated to developing Islamic economic theory;
c. explore the future applications of Islamic economic theory;
d. develop the Islamic economic model;
e. discover tools, models, and products that will assess the application of Islamic economic theory; and
f. contribute to finding alternative solutions to the problems of the traditional economic system.

9. The International Islamic Centre for Reconciliation and Commercial Arbitration (IICRCA) was established in April 2005 through the concerted efforts of the Islamic Development Bank, the General Council for Islamic Banks and the Financial Institutions and the United Arab Emirates in the host country. The IICRCA is an independent international non-profit organization that specializes in arbitrating and conciliating settlement disputes regarding Islamic *shariah* provisions.

The agency‘s main objective is to settle financial and commercial disputes that arise among financial and commercial institutions that operate according to Islamic *shariah*. In addition, many countries in Asia, Africa, Europe, and the Middle East have enacted laws allowing Islamic banks to operate more efficiently. Furthermore, Dow Jones has also introduced the Dow Jones Islamic Market Index of 600 companies worldwide that adhere to *shariah* principles. In OIC countries, Islamic retail banking assets have grown by an average of 42% since 1992, and by the end of 2008, their worth reached USD 648.6 billion (2005 dollars; see Figure

1).Many reports predict that this trend will continue. For instance, a recent report released by Deutsche Bank (2011) projects that global Islamic banking assets could reach $1.8 trillion by the end of 2016, from $939 billion in 2010 (90% increase; Partington 2011).

Figure 1: Assets of Full-Fledged Islamic Retail Banks in OIC Countries (2005 USD prices, in Billions)



Source: Constructed by the author.

3. Recent Developments in Islamic Banking

The development of the Islamic banking industry is moving at a fast pace, and almost every country now has some form of Islamic financing. This section will give a brief description about the development of the Islamic banking industry in Asia-Pacific region, Africa, Middle East and Turkey Region, and North America.

3.1 Trends of Islamic Banking in Australia and the Asia-Pacific Region

The Asia-Pacific region has established itself as a strong hold for Islamic finance. The industry is growing rapidly in many parts of this region, and this growth has been supported by a Muslim population that now makes up 62% of the region's total population. Table 1 shows the percentage of Muslims in major countries in the region. Even some of the Asia-Pacific nations with small Muslim populations, such as Australia and Singapore, have begun to engage in Islamic finance as well. The early efforts to establish an Islamic financing institution not in the region but in the world began in this area, specifically in southern India as mentioned earlier. However, laws in India did not allow the Islamic financial industry to flourish, and the institutions there remained small and do not satisfy the needs of Indian Muslims. However, the opposite took place in Pakistan, it started to Islamize its financial system since the late 1970s. Given that the Islamic financial industry in the country began to boom. Going to Malaysia which considered as a hub of the Islamic finance industry, the first Islamic financial institute in the country was Tabugn Haji (August 1962) as a pioneering effort to give Muslims the opportunity to invest their money in interest-free bank accounts. Currently, Islamic financial institutions operate alongside conventional financial institutions in the country, but the country has separate legislation and regulations for each. Indonesia engaged in the Islamic finance industry in 1992, laws issued to promote the Islamic finance industry and ever since the industry starts flourishing in the country.

In another Asian country, Bangladesh, the Islamic Economics Research Bureau, the Bangladesh Islamic Bankers Association, and the Muslim Businessman Society played a pivotal role in implementing Islamic banking in the country. Also, the government supported the movement toward Islamic banking. The first Islamic bank in the country Islami Bank Bangladesh was incorporated on March 14, 1983. Regarding other non-Islamic countries in the region such as Maldives, Philippines, Seri Lanka, Singapore, and Thailand all has Islamic financial institutions operating on it and issued laws to govern the Islamic financial industry to allow it to operate efficiently. Table 2 shows the trend of Islamic finance in major countries in Asia-Pacific region

Table 1: Potential Market Size in Asia-Pacific Region for Islamic Banks

Country	Population	Muslim population	Percentage of Muslim population
1.7[a]	370,034	21,766,711	Australia
89.5	141,920,629	158,570,535	Bangladesh
13.4	159,349,169	1,189,172,906	India
86.1	206,873,780	240,271,522	Indonesia
47.0	7,295,515	15,522,373	Kazakhstan
75.0	4,190,582	5,587,443	Kyrgyzstan
100.0	394,999	394,999	Maldives
95.0	177,975,585	187,342,721	Pakistan
5.0	5,091,697	101,833,938	Philippines
7.6	1,617,577	21,283,913	Seri Lanka
14.9	706,370	4,740,737	Singapore
4.6	3,069,127	66,720,153	Thailand

Source: Constructed by the author using data from the CIA Fact Book (population in July 2011), except where otherwise noted.

[a] Data from Australia‘s 2006 census.

Table 2: Shows the Trend of Islamic Finance in Major Countries in Asia-Pacific Region

Country	No. of Islamic banks / Islamic financial institutions	Laws governing Islamic finance industry
Australia	Five small firms offering Islamic products	No
Azerbaijan	Two Islamic banks and one investment firm	No
Bangladesh	Six Islamic banks and conventional banks also offering Islamic financial solutions.	Yes
Brunei	Two Islamic banks (this is the total number of all commercial banks in the country)	Yes
India	Nine firms operating until today offering Islamic products	No
Indonesia	Seven banks and conventional banks also offering Islamic financial solutions	Yes
Maldives	Maldives Islamic Bank and conventional banks also offering Islamic financial solutions	Yes
Malaysia	16 Islamic banks and conventional banks offering Islamic financial solutions	Yes
Pakistan	Six Islamic banks and conventional banks offering Islamic financial solutions.	Yes
Philippine	One Islamic bank	Yes
Singapore	One Islamic bank	Yes
Sri Lanka	One Islamic bank and conventional banks also offering Islamic financial solutions	Yes

2.2 Trends of Islamic Banking in Africa

Africa is the second-largest continent. Its 1.2 billion people make up 15% of the world‘s population. Muslims make up half of the continent‘s population. Therefore, the region has promise for the growth of Islamic banking. Table 3 lists the Muslim populations of many African countries. Nasser (2005) gives a detailed account of Islamic banks in Africa. One of the early attempts to establish Islamic banks in Africa (with the exception of Sudan) took place in 1982, when the international Islamic finance organization Dar Al-Maal Al-Islami Trust (DMI)[5] filed an application to the central bank of the Monetary Union of West Africa. In 1982, the union consisted of seven countries (Benin, Gabon, Guinea, Ivory Coast, Mail, Niger, and Senegal), some of which contained majority Muslim populations (Niger, Mali, and Senegal).

[5] Dar Al-Maal Al-Islami Trust which means ―House of Islamic Funds‖, was established in the Commonwealth of the Bahamas on July 27, 1981 by prince Mohammed Al-Fisal Al-Saud. Its main business is Islamic banking, Islamic fiancé, and Islamic insurance.

Table 3 Potential Market Size in Africa for Islamic banks

Country	Population	Muslim population	% of population Muslim
99.0	34,644,987	34,994,937	Algeria
50.0	8,375,727	16,751,455	Burkina-Faso
53.1[a]	5,712,999	10,758,945	Chad
33.9	30,806,197	90,873,739	Ethiopia
90.0	1,618,074	1,797,860	Gambia
85.0	9,010,857	10,601,009	Guinea
10.0	4,107,093	41,070,934	Kenya
90.0	12,743,913	14,159,904	Mali
100.0	3,281,634	3,281,634	Mauritania
16.6	216,417	1,303,717	Mauritius
80.0	13,175,108	16,468,886	Niger
50.0	77,607,786	155,215,573	Nigeria
94.0	11,885,171	12,643,799	Senegal
1.5	735,060	49,004,031	South Africa
70.0	31,533,251	45,047,502	Sudan
35.0[b]	14,961,317	42,746,620	Tanzania
98.0	10,416,602	10,629,186	Tunisia

Source: Constructed by the author using data drawn from the CIA Fact Book (population in July 2011), except where otherwise noted.

[a]1993 census.

[b]35% in mainland (more than 99% of the population in Zanzibar).

The central banks of the countries in the Monetary Union of West African monetary formed a committee to gather information about the possibility of establishing Islamic banking in their countries. Information was gathered and analyzed from June 13, 1982, to August 13, 1982. After the committee submitted its report to the seven countries' governments, a council made up of finance ministers from the seven countries amended the third paragraph of Article 2of the monetary union's provision on central bank laws, which allowed union-member governments to grant exceptions to Islamic financial institutions. The amendment was signed into law on September 22–23, 1982. This led to the establishment of several Islamic financial institutions: Faisal Islamic Bank of Niger (February 22, 1983),the Islamic Investment Company of Niger (March 9, 1983), Faisal Islamic Bank of Senegal (February 22, 1983), and the Islamic Investment Company of Senegal (March 9, 1983).

Sudan, another country in the African continent, had an idea to Islamize its entire financial system and this initiated when Omdurman University introduced the subject of having an Islamic economy as the primary method of business in 1966. The process went through three phases before the whole financial system became Islamic. The first phase of the Islamization of Sudan's banking system took place from 1983 to 1985. In this phase, interest was abolished in the country, and the banks faced several difficulties due to the lack of experience in forming Islamic contracts and converting conventional contracts to Islamic contracts (Muhammed et al. 2006). The second phase occurred from 1985 to 1989. In 1985, the government passed an act that allowed banks to offer Islamic and conventional products. This continued until the middle of 1989, when the new government issued some laws that led to the elimination of the dual- bank system. The third phase started in 1989 and ended in 2005. This phase marked the real implementation of Islamic banking in the country. The government issued several laws in the 1990's that made Islamic banking the only method of banking allowed in the country. Other countries in Africa will follow the steps of Sudan in Islamizing their entire financial system such as Libya, and this triggered by the Arab spring (Arab spring started on December 17, 2010). In general, the Islamic banking industry is thriving in the African continent as even countries with small Muslim population began to offer Islamic banking to its citizens. Examples of those countries are Ethiopia, Kenya, Tanzania, Mauritius, and South Africa. Table 4 shows the trend of Islamic finance in major countries in Africa.

Table 4: Shows the Trend of Islamic Finance in Major Countries in Africa

Country	No. of Islamic banks / Islamic financial institutions	Laws governing Islamic finance industry
Algeria	Two Islamic bank and conventional banks also offering Islamic financial solutions	No
Gambia	One Islamic Bank	Yes
Guinea	Two banks and one investment firm	No
Kenya	Two Islamic banks	No
Mauretania	One Islamic Bank	No
Mauritius	One Islamic bank and conventional banks also offering Islamic financial solutions	Yes
Niger	One Islamic bank	No
Nigeria	One Islamic bank	Yes
Senegal	One Islamic bank	No
South Africa	Two Islamic banks and conventional banks offering Islamic financial solutions.	No
Sudan	16 Islamic bank (the entire financial system in the country Islamized)	Yes
Tanzania	One Islamic bank and conventional banks offering Islamic financial solutions.	No
Tunisia	One Islamic bank	No

2.3 Trends of Islamic Banking in Europe

Islamic finance is developing rapidly in Europe, and many European financial intuitions perceive it as a profitable opportunity to create new business. The first attempt at Islamic banking in the Western world took place in Luxembourg in l978 when the Islamic Banking System International Holding was established. Dar Al-Maal Al-Islami Trust, made Switzerland its headquarters and this was 1981. In the same year, Al-Baraka Intentional Company was founded in the United Kingdom (Bekkin 2007). Also, the International Islamic Bank of Denmark incorporated in 1983 (the bank liquidated in 1986 due to excessive financing exposure to a single client; Bekkin 2007; Grais & Pellegrini 2006). Bosna Bank International Sarajevo was established on October 19, 2000. In February 2001, ABCIB Islamic Asset Management was established as a wholly owned subsidiary of ABC International Bank, it located in the UK. In August 2004, the Islamic Bank of Britain was established in the UK, making it the first full-fledged Islamic bank to operate in the country. Islamic Bank of Britain was authorized and is regulated by the British government's Financial Services Authority. Also, the European Islamic Investment Bank was incorporated in January 2005 and received authorization from the Financial Services Authority in March 2006. Later that year, Bank of London and the Middle East incorporated and received authorization from the Financial Services Authority in July.

This trend continued all over Europe, as full-fledged Islamic banks or branches of established Islamic banks emerged in different countries. There are several reasons for the growing interest in Islamic banking across Europe. First, the number of Muslims in Europe is estimated to be 15 million. This number continues to grow and is already large enough to attract financial-service providers. Second, demand is growing for ethical products and socially responsible services. Islamic finance fits conveniently into this, as Islamic principles prohibit trade in debt and ensure that all financial activities are related to the real sector of the economy. Another reason is that some countries wish to attract investors from Islamic nations. Yet another reason is diversification: Many investors are looking for new instruments, products, and asset classes that are unrelated to existing products and services to diversify their portfolios. Islamic finance provides this for those investors. Finally, the current financial crisis has played a role by reducing the relative strength of the conventional banking system. Islamic banks have managed to avoid the effects of this crisis, which has strengthened their position and financing model (Husain 2005; Nouri 2009).Europe offers huge potential for Islamic banks to grow, especially because there are significant Muslim populations in several countries (see Table 5). There are great potentials for Islamic finance industry in European soil. Many countries in Europe are considering issuing laws to promote Islamic banking industry. Countries like France, Germany, and Italy are taking positive steps to implement Islamic finance on it. Table 5 shows trend of Islamic finance in some countries in Europe.

Table 5: Potential Market Size in Europe for Islamic Banks

Country	Population	Muslim population	Percentage of Muslim population
4.2	345,125	8,217,280	Austria
70.0	2,096,266	2,994,667	Albania
40.0	1,848,865	4,622,163	Bosnia and Herzegovina
4.0[a]	417,259	10,431,477	Belgium
18.0	201,688	1,120,489	Cyprus
2.0	110,597	5,529,888	Denmark
France	65,312,249	3,265,612 6,531,224	5.0 10.0
3.7	3,014,457	81,471,834	Germany
2.1[a]	1,250,000	61,016,804	Italy
1.8[a]	9,000	503,302	Luxembourg
3.0[a]	1,400,000	46,754,784	Spain
5.0[a]	454,436	9,088,728	Sweden
4.3	328,518	7,639,961	Switzerland
2.7[b]	1,692,855	62,698,362	UK

Source: Constructed by the author using data are from CIA World Fact Book (July2011), except where otherwise noted.

[a] Data from International Religious Freedom Report (2010).

[b] Data from 2001 Census.

Table 6: Shows the Trend of Islamic Finance in Some Countries in Europe

Country	No. of Islamic banks / Islamic financial institutions	Laws governing Islamic finance industry
Bosnia and Herzegovina	One Islamic bank	No
Luxembourg	One Islamic Bank	No
United Kingdom	Five Islamic Banks	Yes

2.4 Trends of Islamic Banking in the Middle East and Turkey

The first attempt to establish a modern Islamic bank in the world took place in this region (Egypt) in 1963 when the late Ahmed Al-Najjar created a series of savings and investment houses in a few small rural towns in northern Egypt. The first branch incorporated in a town called Mit Ghamr, which inspired the name of the company. The number of branches reached 53, with 85,000 customers (all Muslim) before the government required that the branches be liquidated and merged with conventional banks in 1967 (Shehata 2005). The Egyptian government‘s action was attributed to its feud with the Islamic groups at that time. The second commercial Islamic bank in the world incorporated in United Arab Emirates in 1977. Like Sudan, Iran the Islamization of the banking system in Iran has gone through three phases. The period from 1979 to 1982 marked the first phase, when the banking system nationalized, restructured, and reorganized. The second phase began in 1982 and lasted until 1986. The defining events in this period were the approval of the Usury-Free Banking Operation Law on September 1, 1983, and its implementation on March 21, 1984. The third phase began in 1986 and continues today. The Usury-Free Banking Law was enacted 3 years after the war with Iraq broke out. The banks were given 1 year from the date of the law‘s passage to convert their deposits to the new system and 3 years to convert all other operations. The region‘s population is almost all Muslim (see Table 7) though the Islamic banks were flourishing in the region. The Islamic financial market in the Middle East has been concentrated mainly in GCC countries, which account for 41%of the total *shariah*-compliant assets in the world. Global *shariah*-compliant assets stood at USD 639.1 billion in 2008, and the non-GCC Middle East and North Africa (MENA) region accounted for 38.8%of the total market (Timewell and DiVanna 2008).Table 8 shows the percentage changes of Islamic assets in the MENA region.

Table 7: Potential market size in Middle East and Turkey for Islamic banks

Country	Population	Muslim population	Percentage of Muslim population
81.2	986,340	1,214,705	Bahrain
90.0	73,871,672	82,079,636	Egypt
98.0	76,333,395	77,891,220	Iran
97.0	29,487,584	30,399,572	Iraq
92.0	5,987,609	6,508,271	Jordan
85.0	2,206,283	2,595,628	Kuwait
59.7	2,473,431	4,143,101	Lebanon
97.0	6,400,021	6,597,960	Libya
98.7	31,552,772	31,968,361	Morocco
75.0	2,270,969	3,027,959	Oman
75.0	1,926,416	2,568,555	Palestinian territories (West Bank)
77.5	657,212	848,016	Qatar
100.0	26,131,703	26,131,703	Saudi Arabia
90.0	22,067,395	22,517,750	Syria
98.0	10,416,602	10,629,186	Tunisia
99.8	78,627,976	78,785,548	Turkey
96.0	4,942,717	5,148,664	United Arab Emirates
100.0	24,133,492	24,133,492	Yemen

Source: Constructed by the author using data are from CIA World Fact Book (July2011), except where otherwise noted.

Table 8: Islamic Finance Assets in GCC and non-GCC MENA Region (USD, Figures in Billions)

2007	2008	% change	Region
47.5	262.7	124.78	GCC
40.4	248.3	100.31	Non-GCC MENA

Source: Data drawn from Timewell and Di Vanna (2008).

Table 9: Shows the Trend of Islamic Finance in Major Countries in the Middle East and Turkey

Country	No. of Islamic banks / Islamic financial institutions	Laws governing Islami finance industry
Bahrain	24 Islamic banks (6 retail and 18 wholesale) and conventional banks also offering Islamic financial solutions	Yes
Egypt	3 Islamic Banks	No
Iran	17 Islamic banks	Yes
Iraq	11 Islamic banks	Yes (under revision)
Jordan	3 Islamic Banks	Yes
Kuwait	3 Islamic Banks	Yes
Lebanon	4 Islamic banks	Yes
Oman	1 Islamic bank and conventional banks also offering Islamic financial solutions	Yes
Palestine (Gaza Strip)	5 Islamic banks	Yes
Qatar	3 Islamic banks	Yes
Saudi Arabia	4 Islamic bank and conventional banks also offering Islamic financial solutions	No
Syria	3 Islamic banks	Yes
Turkey	4 Islamic banks	Yes
United Arab Emirates	7 Islamic banks and conventional banks also offering Islamic financial solutions	Yes
Yemen	4 Islamic banks and conventional banks also offering Islamic financial solutions	Yes

2.5 Trends in Islamic Banking in North America

The exact number of Muslims in North America is unknown because the government statistics in the US and Canada cannot collect religious affiliations, by law. This is done to prevent discrimination based on religion. Table 10 gives an indication of the number of Muslims in North America.

Table 10: Potential Market size in North America for Islamic Banks

Country	Population	Muslim population	%
0.6	1,879,392	313,232,044	USA
1.9	646,581	34,030,589	Canada

Source: Data drawn from CIA Factbook (based on the Canadian population in July 2011).

The history of Islamic finance in the United States began with the establishment of the Amana Funds in 1986, located in Washington, and American Finance House-LARIBA in California in 1987. In its first year, the institution mainly provided home financing to American Muslims. In 1998 LARIBA acquired Bank of Whittier. However, research by Dr. Al-Qudah (2005) indicates that LARIBA‘s financing contracts do not adhere to *shariah* principles. The other milestone for Islamic finance in the United States took place in the late 1990s, when the New York branch of United Bank of Kuwait obtained two interpretive letters issued by the Office of the Comptroller of the Currency to offer Islamic retail banking services in the country. The first approval letter was issued in 1997, which involved a residential net lease-to-own home- finance product through an *ijarah wa iqtina* contract. Under this scheme, the Office of the Comptroller of the Currency determined that United Bank of Kuwait would act as –riskless principal‖ because the bank would not buy real estate until the lessee requested it and then rent it to the lessee. The bank would hold the legal title of the property until the payment of the final lease installment, at which point the lessee would take the title of the property. The second letter was issued in 1999 in response to the bank‘s proposal to offer certain *murabaha*- based financing products. Similar to the previous scheme, the Office of the Comptroller of the Currency viewed the bank as acting as –riskless principal‖ in such transactions and therefore permitted the activity. In 1999 the mortgage company HSBC was authorized by the New York State Banking Departmentto offer a *murabaha* product for real estate financing. However, HSBC‘s New York City office had limited success and recently withdrew from the market.

The Islamic financial market in the United States stands at about USD 1.5 billion. The licensed mortgage lender, Guidance Financial, is the current leader in the Islamic residential finance market, operates in 32 states, and to date has sold over 900 million dollars in *musharakah* transactions. Guidance Financial is a one-product company because the *musharakah* structure is not a legal asset for US banks, which restricts the bank from selling this product. Chicago- based Devon Bank, which is owned by a Jewish family, is the major player in Islamic commercial real estate financing and now operates in several states with a USD 20-million portfolio (Ranzini 2007). Another player in the Islamic financial market in the country is banking giant HSBC, which offers several Islamic solutions to its customers. Islamic finance seems to have a great future in the United States and will likely be driven by the growing number of Muslims in the country. From the regulatory side, U.S. regulators have an open mind about Islamic finance, and this should drive the Islamic financial market to grow in the country. In Canada, although there are some Islamic financial products available in Canada, the Islamic financial-services sector is still peripheral and limited, as there are no major financial institutions offering *shariah*-compliant products. UM Financial in Ontario, Canada, is one of the primary Islamic financial providers in the country. UM Financial specializes in Islamic mortgages using *musharakah* contracts in a partnership with the Central Credit Union of Canada. In an 18-month span from 2006 to 2007, UM Financial provided USD 86.1 million in home financings. However, UM had some problems and had to declare bankruptcy, and this might affect the future of Islamic financial intuitions in the country, especially with Canada still lagging behind other countries in promoting Islamic financial products. Several new Canadian banks have applied to the Office of the Superintendent of Financial Institutions in Canada to offer Islamic financial services.

Also, the Canada Mortgage and Housing Corporation, a federal Canadian crown corporation, has shown some interest in Islamic finance by requesting proposals for research reports on the subject (Carruthers 2008).The number of Islamic financial institutions in North America is small (Table 11), and this opens the possibility for more to be established in the future.

Table 11: Islamic Financial Institutions in North America

Laws	Islamic banks[a]	Country
	Arcapita Holdings Broadway Bank of Chicago Cole Taylor Bank	
	Devon Bank Lincoln State Bank Mutual Bank RomAsia	USA
	Bank University Bank HSBC	
	Guidance Financial	
	LARIBA Whittier Bank	
No		
	Chartered Banks of Canada	
	Royal Bank of Canada	Canada
No	UM Financial	

Source: Constructed by the author using data from Shayesteh (2009);
Chiu, Newberger and Paulson (2005) ; Zyp (2009).

[a] Includes fully fledged Islamic banks, Islamic windows, offshore Islamic banking units, finance houses, and Islamic investment banks.

[b] Subsidiary of Arcapita bank (Islamic bank located in Bahrain).

4. Conclusion

There is no doubt that Islamic financial industry is booming world wide, though regulators must react to this by issuing laws to govern Islamic financial institutions operations. This to allow those institutions to operate efficiently, be competitive with its counterparts, and to facilitate its growth.

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