

“Those who charge riba are in the same position as those controlled by the devil’s influence... As for those who persist in riba, they incur Hell, wherein they abide forever” – Qur’an 2:275

This much is clear – the Qur’an has very strong words against ‘riba’, which loosely translates as interest.

This poses a clear difficulty for Muslims in Australia who want to take out a mortgage while still following Islamic law. There were more than 340,000 Muslims in Australia in 2006, and the population is growing. Many of these residents want to live the Australian dream and own their own home. But when borrowing with a traditional lender, they must pay back interest and thus violate Sharia (or Islamic) law.

“The difference between Islamic and Western banking is the notion of interest rates,” says Nail Aykan, marketing manager with the Muslim Community Cooperative of Australia (MCCA).

“In the Islamic beliefs, the interest rate is forbidden; hence there must be an alternative.”

One way to avoid interest payments would be to pay for a property entirely in cash, but few can afford to do this in Australia. Another option would be to borrow from friends, but that also is usually not practical.

In order to get around the challenge, the MCCA has followed the lead of other lenders abroad by offering Islamic finance – essentially a process that avoids charging interest by entering into a partnership with each homebuyer and sharing purchase risk.

Instead of making interest payments, buyers pay rent to the MCCA until they are granted full ownership of the property.

Slow start in Australia

Founded in 1989, MCCA is the first and one of the leading providers of Islamic finance in Australia, which is a small but growing market. There’s little competition other than a few other organisations such as Sydney-based Iskan Home Finance. While Islamic finance has taken off in Western countries such as Britain and the US, it’s still relatively small here. Aykan says there are about 1,500 MCCA members, membership which equates to just under 2% of the estimated 80,000 Muslim families across the country.

Part of the problem in attracting customers is that the MCCA doesn’t offer the multitude of services and products that larger banks do.

“If we had real banking services, I believe we could easily penetrate 20% of the Muslim market,” says Aykan. He goes as far as to say that 50% of the Muslim market may eventually be committed to Islamic finance in Australia. And the MCCA aims to reach non-Muslim customers as well.

In addition, the Muslim community isn’t a homogenous group. Among Australian Muslims there are more than 60 countries of birth and 55 languages spoken, according to the MCCA.

Another major reason that growth in Islamic finance has lagged in Australia is that the sector doesn’t have the connections to the Arab world that the US and UK do, says Bala Shanmugam, a professor who holds the Chair of Accounting and Finance at Monash University’s Malaysian campus.

“Britain and the US have always viewed themselves as a major destination for petro dollars – a repository for Arab funds,” says Shanmugam. “Hence, they’re taking steps to do what’s necessary to maintain their stand. Australia, on the other hand, isn’t exactly a centre for such

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funds, so I don’t see a rapid take-off in that direction.”

Perhaps the largest issue, however, is the fact that many Australian Muslims see the traditional lending method with banks to be both easier and cheaper and therefore preferable.

“Research shows that Muslims as well as non-Muslims view returns as a more important factor in a financial transaction,” says Shanmugam. “This variable outweighs religion in terms of importance for patronising types of banking. Therefore, unless people see actual benefits in terms of returns, the extent of patronising will be nominal.”

Case study

However, there are some Muslims in Australia who place religion first.

WHAT HAPPENS IF YOU DEFAULT FROM AN ISLAMIC FINANCE AGREEMENT?

A problem with some Islamic financing is that if the client defaults on payment at the due date, the price can’t be increased. With an interest-based loan, the amount of loan keeps on increasing according to the period of default. But in ‘murabahah’ Islamic financing, once the price is fixed, it can’t be increased.

While there can be a fee levied for a missed payment, compound interest can’t be added. Rather, if a month is missed, that month is added to the end. So if, for example, the period over which a loan must be repaid is 300 months and one month is missed, the total number of months owed is still 300, says Nail Aykan, marketing manager with the Muslim Community Cooperative of Australia (MCCA). If a payment is late by more than a couple months, the MCCA will likely investigate the situation more thoroughly.

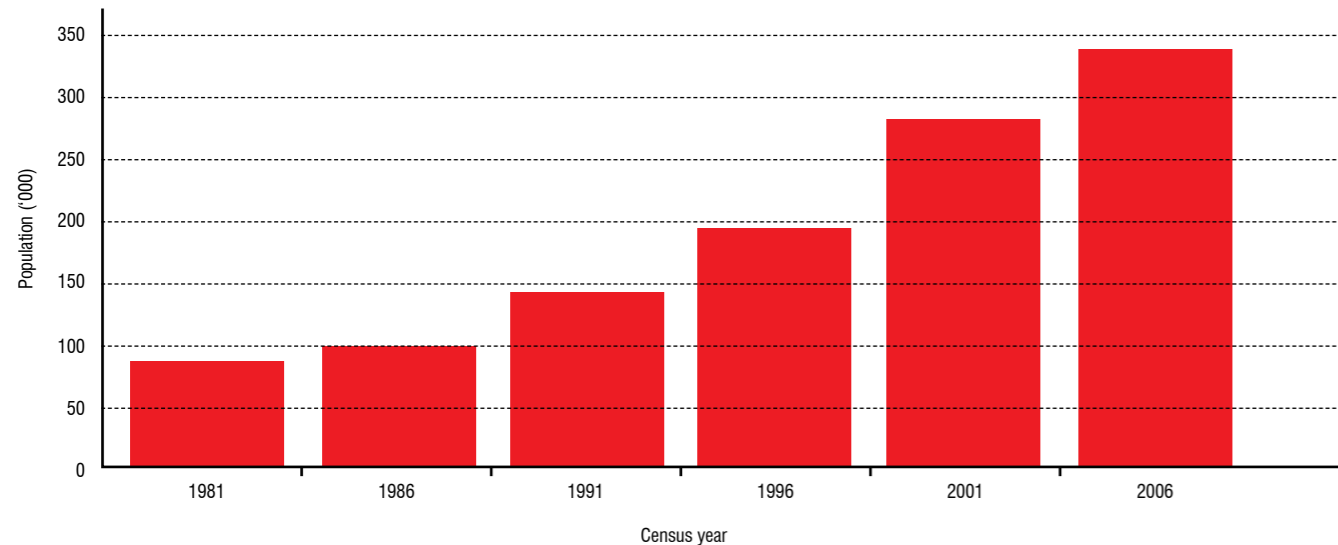
“There have to be legitimate circumstances in order to miss payments, otherwise people will take advantage of you,” says Aykan. “We’re a business, after all.”

As for ultimate recourse, the bank can eventually claim the property back if payments in arrears reach a certain point, although this would proceed with due process.

A new way of lending in Australia

Some Muslims won’t accept standard loans offered in Australia because Islamic law forbids the charging of interest. Islamic finance, which offers ways of lending that stay within Muslim beliefs, is growing internationally to the tune of nearly US\$1trn. Soon it could become a force in Australia as well. **Kit Kadlec** reports

Muslim population in Australia



Source: ABS

sum or based on a percentage. This payment must be a fixed amount.

In another option, Ijarah Muntahia Bittamleek, the payments can be either fixed or variable, and ownership of the property is transferred to the client with the last instalment. There are another three MCCA products, and other lenders, such as Iskan Home Finance, have other offers, and all aim to be Sharia compliant.

In his particular case, Tabiaat will pay rent for 180 weeks, which ultimately equates to \$288,000, plus the \$54,000 deposit. While not everyone can afford such high weekly rents of \$1,600, it's common to have borrowers pay off the amount owed quickly with Islamic finance, says Aykan.

The MCCA has taken on some of the risk in this transaction, as it essentially has made the purchase on behalf of Tabiaat. According to the MCCA, the mortgage can either be seized by the funder or left with the borrower, given that it's registered for full mortgage securities entitlement to the funder. It's also permissible to use a third party's property as security for the mortgage.

Tabiaat says he realises it would have perhaps been easier to use a traditional Western bank, but he prefers to follow Islamic law.

"It's an individual choice," he says. "Some people are really conscious about

what rate they're paying, whereas others don't mind paying the extra amount to do it in a compliant way."

How much more is it that one must pay in Islamic finance? Aykan says it often is a very similar bottom line.

"An Islamic bank and a traditional bank may be offering the same rates, but it's how it's processed that makes the difference," he says.

Profit or interest?

The MCCA and other Islamic finance lenders often define the amount of money they take above the purchase price as 'profit'. Since charging interest is forbidden, the word 'interest' is avoided in most cases, although the Australian government still requires it to be used in the paperwork.

Aykan says while the MCCA aims to offer something under religious guidelines, in the end they can't offer loans without making their own profit.

"You have to remember that it's a business at the end of the day; it's not a charity," he says.

"But it's more ethically and morally based banking than just interest based, where it's just greed. Islamic banking has certain religious values and guidelines."

The word 'profit' is often used to describe the amount paid by an MCCA customer. But that's not what they'll see on their official paperwork.

"What the MCCA has experienced, because the whole conventional system is based on the understanding of interest, is that our funders, our regulators and a whole heap of other bodies always use the word interest," says Aykan. "They don't know an alternative word."

Yet he says he's hopeful that in the next few years a new term will be allowed on the official forms for Islamic finance.

"We're not engaging in [charging] interest, but that term is still there, whether we like it or not," Aykan says.

Which means an explanation must be given to customers, and Aykan says the term is little more than a formality.

Shanmugam says he's unsure why there's even an issue with the wording.

"I'm not sure why the mere usage of the word 'interest' can cause a conflict between Sharia and Aussie law," he says. "Islamic finance has devised ways and means of not utilising the interest payment or charging mechanism to undertake financial transactions."

"However, in places such as the UK and Singapore, amendments have been made to existing legislation to cater for Islamic finance."

Tabiaat says he'd like to see Australia adopt the changes in language sooner rather than later.

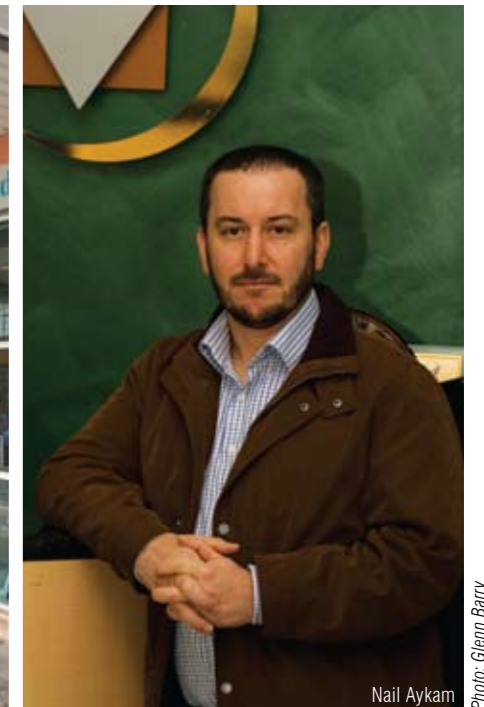
"Why not adopt these changes and open your heart to it?" Tabiaat queries. "Look at it as a benefit. If you change

How does one qualify for Islamic finance?

You don't need to be a Muslim to qualify for a loan in Australia with Islamic finance and you don't have to have any set of beliefs. Just like a Halal butcher in Australia will sell meat in Australia to any client, regardless of their beliefs, so too will an Islamic bank finance anyone wishing to borrow money to purchase a property.

There's also little difference in qualifying for the loan. Those looking to borrow money must have a solid employment with a salary large enough to cover the payments. A credit check also applies. But the qualifications are roughly the same as any standard bank would require.

One difference is that the desired property must first be purchased by the Islamic bank before it can be 'rented' to you. Thus, the bank will require you to sign a note promising to commit to purchasing the property before it purchases the property itself. The deed is then transferred to the borrower from the onset to provide a tax benefit.



Nail Aykan Photo: Glenn Barry

the law, it will bring more investment into this country."

However, no matter how it's worded, not all Muslims see Islamic finance institutions as true followers of Sharia. Instead, say critics, they're the same as the banks they claim to offer an alternative to, taking a profit, cloaking 'interest' under a different name and using external funders that don't practise Sharia. There are numerous websites in Australia whose authors take shots at the MCCA and others, claiming these essentially have the same practices as traditional banks but under a different guise.

"This is a matter of opinion," says Shanmugam. "The same criticism is often levelled at Malaysia as well, from the Middle East. When religion becomes the guideline for economic activity, such comments may be expected, as religion can be interpreted differently by liberals and conservatives."

While a uniform regulatory and legal framework supportive of an Islamic financial system has not yet been developed in Australia, there's some overseeing. Community-based Islamic finance institutions are registered and given licences to carry on cooperative businesses under the *Cooperatives Act 1992*, and they're subject to basically the same rules and regulations as other lending institutions.

However, there has been a push for more uniform rules and greater level of overseeing specifically aimed towards Islamic finance.

The future

To Shanmugam and other experts, there's no doubt Islamic finance will begin to expand in the coming years.

"Islamic finance has been around for a good 40 years, but after 9/11 it has seen astronomical growth, largely due to a consolidation of Muslim interest, sort of an Islamic renaissance," he says. "With time, it has gained momentum and is progressing at full steam. With complete support from resource-rich Arab nations, I don't see Islamic Finance as a passing phase. It's here to stay."

Since there's a greater risk in the lending sense, Islamic finance banks often are more careful in what they invest in. That has no doubt helped them, while some traditional banks – especially in the US – have collapsed or needed billions of dollars in government funds after taking on too many bad loans.

Aykan says the MCCA has its sights set on not just filling a small niche, but eventually taking a stake in the mainstream Australian market in the long run.

A lot of it comes with just educating the customers in what Islamic finance is, he says. "At the moment, there isn't a

great awareness about Islamic banking in the Muslim community," he adds. "Once you have resources and services, word will spread, branches will open up in every city and a domino effect will start."

Outside of Australia, Islamic banking isn't limited to cooperatives and small businesses. Even some unusual suitors are lining up for Islamic finance. Most recently, South Korea and Malta were among those countries expressing strong interest in opening branches. Major global banks have also signed on.

"Major global players such as HSBC and Citibank have embraced Islamic finance in one way or the other," says Shanmugam. "This has come about due to economic demand and supply factors. If Aussie banks see sizeable profit margins or variable critical masses, then they may consider offering this alternate form of financing."

NAB has already planned its effort, although it doesn't offer any Islamic finance products yet. Since 2007, it has offered an annual \$25,000 scholarship to allow young Australian Muslims to continue their studies in finance. The scholarship includes an offer of employment at NAB and has the aim of improving the bank's understanding of Islamic banking.

"There's an incredible potential in this market," says Aykan. "It's growing globally and the only way is up." YM