

Islamic Finance (Finally) Taking Root in North America

By Stephen Lange Ranzini

Despite the reported US\$276 billion in assets that Islamic finance holds globally (according to a recent KPMG study), the industry has only recently broken the billion dollar mark in the wealthiest and most diverse nation in the world, which although predominantly Christian, has the largest Muslim population outside the Muslim nations. While the size of the Muslim population in the US and Canada is not known because government statistics, including census data, by law cannot collect religious affiliations to prevent discrimination on the basis of religion, it is estimated by researchers to be nearly 10 million strong.

The estimated 2.8 million Muslim households are larger, younger, more affluent and better educated than the average US or Canadian citizen because legal immigration has been most encouraged for those with advanced degrees. In fact, 47% of all US Muslim adults have a college degree, versus 26% of all Americans. The Muslim population is diverse, with over 70 nationalities represented in North America. Despite these economic and educational advantages, US and Canadian Muslims are less likely to own a home than Hispanic or non-Muslim African Americans. The *American Journal of Islamic Finance* estimates that the demographic gap in home ownership means that in the US alone 420,000 families do not own a home, relative to home ownership rates among their non-Muslim peers.

Why the North American financial services industry has not embraced Islamic banking until very recently is an interesting question that we will return to. However, the US leaders in the industry at this time are Guidance Financial, Saturna Capital's Amana Mutual Funds, University Bank's University Islamic Financial and Devon Bank. Other participants are La Riba Finance House and its affiliate Bank of Whittier. Early participants such as HSBC have now left the market. While Guidance is the clear leader in home finance, and the Amana Mutual Funds are the largest Islamic equity mutual funds, University Bank in December 2005 formed the first US Islamic banking subsidiary in a US\$15.5 million deal that included US\$3 million raised from outside investors, and is the only US bank that offers Islamic bank deposits insured by the US Federal Deposit Insurance Corporation. In total, at this time, the entire universe of Islamic financial services in the US is about US\$1.5 billion. UM Financial, which is pioneering home finance in Canada, has C\$100 million (US\$86.1 million) in assets.

Guidance Financial, a licensed mortgage lender and the current leader in the Islamic residential finance market, owes its early market leadership to a relationship that it forged four years ago with the Federal Home Loan Mortgage Corporation (FHLMC), a US government-sponsored enterprise that specializes in the purchase and guarantee of home financings. Guidance also forged a securitization relationship with Merrill Lynch that allows it to offer a jumbo home financing product for financings larger than US\$417,000. To date Guidance has originated and sold over US\$900 million in Musharakah co-ownership transactions and is currently able to originate the product in at least 32 states. Guidance has a fatwa from leading scholars, however some fatwa against their products have been issued by other scholars, and the customer service and delivery has been of variable quality as a result of their rapid expansion, frequent practice of hiring enthusiastic but under-trained originators and by hiring a conventional mortgage subservicing company to service their Musharakah contracts. The

Musharakah structure is also not a legal asset for US banks to hold, which restrains banks from selling this product. As a licensed mortgage lender, Guidance is a one-product company and does not offer additional Islamic financial services products.

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Saturna Capital's Amana Mutual Fund group has over US\$525 million under the management of Islamic equity mutual funds. Powered by an emphasis on oil stock investments, Amana was the top performing socially responsible mutual fund in 2005. Saturna is the oldest and most profitable of the North American Islamic finance firms. As a result of their excellent performance, the two Islamic Amana Funds are now attracting many non-Muslim investors and are growing by millions of dollars per month. Other smaller competitors to the Amana Funds are Azzad Asset Management and Allied Asset Advisors.

University Islamic Financial, the Islamic banking subsidiary of NASDAQ Listed (Symbol UNIB) University Bancorp, has the largest Islamic balance sheet of any banking institution in the US, with US\$28 million in assets. The leader in deposits, with over US\$18 million of Islamic Mudarabah deposits from Muslim customers nationwide invested in its Ijarah Islamic home financings, it is a distant second to Guidance in the home financing market, having originated US\$25 million of home financings to date, and also has a strategic relationship with FHLMC.

The FHLMC deal, which was announced in mid-February 2006, committed FHLMC to fund up to US\$100 million of Murabahah financings. Its home financing and deposit products have received a fatwa from leading scholars and its management is committed to running the Islamic banking entity in a 100% Shariah compliant way. It is also able to service the financings after origination in a 100% halal way. University Islamic Financial also offers, through its brokerage affiliate, the Amana Islamic Equity Mutual Funds. Having concentrated its home finance efforts to date solely in Michigan, it is expanding its home financing product into additional states and recently started to build a commercial finance product. Future plans include product expansion for additional investment options and Takaful insurance, so that it can be a turnkey supplier of all financial services products, not just to its clients, but to other financial institutions nationwide on a wholesale basis. Current gaps at the moment include that it has not yet secured a financial investor for a securitization conduit for its Ijarah jumbo financings.

Devon Bank, a community bank based in Chicago, owned and run by a locally prominent Jewish family, has been offering Murabahah and Ijarah home financings for a couple of years now, originally in the Chicago area and now in over two dozen states. The clear leader in Islamic commercial real estate finance, with perhaps US\$20 million in its portfolio, it is also offering home equity and equipment lease

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finance, as well as home finance. In addition to the deal it has with FHLMC, it recently announced a deal to sell home financings to the Federal National Mortgage Association (FNMA), the largest US government-sponsored enterprise.

UM Financial in Ontario, Canada, is a notable recent success in North America. In just 18 months almost C\$100 million (US\$86.1 million) in home financings using a Musharakah structure have been originated in a strategic partnership with the Central Credit Union of Canada.

Less successfully, HSBC's New York City office had been offering a Murabahah home financing product, however it had limited success and was withdrawn from the market recently. LaRiba Finance House, which two years ago purchased control of Bank of Whittier, based in Los Angeles, California, has been offering what it claims is Islamic financing since 1987, however the product is not backed by any scholars and a fatwa against the product was issued by certain scholars. This illustrates a problem in the US market in that many of the early leaders in the marketplace offered products which prompted scholars to issue fatwa against these products and as a result the entire concept of Islamic banking in the US obtained an initial level of disrepute and skepticism, which had to be overcome in certain circles of the Muslim community.

Related problems are that until University Islamic Financial was formed, all the products were issued by firms that were not 100% halal and therefore the US scholars in certain communities had spoken out against Islamic banking, as the provider of the product was suspect.

More recent problems have been with products that are halal but are not serviced in a halal manner after the initial closing. As these

challenges are overcome with high quality products sold and serviced in a professional manner, the size of the Islamic banking market in the US and Canada should continue to grow rapidly.

As the market for Islamic financial services in North America grows, opportunities for investment into North American Islamic finance include:

- investors for jumbo Ijarah Sukuk conduits for residential real estate;
- investors for Commercial Real Estate Sukuk;
- investors for US Takaful; and
- equity investors for stock exchange listed Real Estate Investment Trusts (REITs).

The author has been the president and CEO of NASDAQ-listed University Bancorp for the past 19 years. His Ann Arbor, Michigan-based bank primarily serves the cities of Ann Arbor and Ypsilanti of Washtenaw County, Michigan. The community banking operation focuses on local businesses, minorities and non-profit organizations. Other community banking specialties include highly competitive deposit products for business owners, residential mortgages, commercial real estate lending and insurance, investments and money management through its wholly owned subsidiary University Insurance & Investments. In addition to its community banking operations, University Bank specializes in mortgage subservicing through the bank's Houghton-based 80%-owned subsidiary, Midwest Loan Services.



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