The Adoption of the UK Finance Bill Proposals on Islamic Finance into Islamic Banking in Australia

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Abstract: Bank regulation is now integrated with general financial regulations in most countries, though countries may differ as to the particular approach they adopt – for example the unitary model in the UK compared to the multilateral in Australia. Since the working mechanism of Islamic finance is different than the conventional finance, accommodation of this into the current regulative framework can pose certain difficulties in countries such as UK and Australia. The underlying objective of this paper is to explore how the existing UK regulatory framework for Islamic banking and finance practice would be adopted into Islamic finance in Australia and, thus, make it a truly viable alternative system of financing for Muslims in Australia. To achieve this objective the paper examines the appropriateness of the UK regulatory approach for Islamic banking and finance for adoption into Australia.

I. Introduction

The major departure of Islamic finance from conventional finance is the prohibition of pre-determined fixed returns for the use of money commonly referred to as 'interest'. It goes without saying that Islamic finance regards profit as the backbone of its operation, while conventional finance considers interest as the kingpin of its system.

Since Islamic finance is part of the financial system, accommodation of Islamic banks within the existing legal and regulative environment may pose

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Review of Islamic Economics, Vol. 10, No. 1, 2006, pp. 41–57.

some difficulties in particular in the current times, in which bank regulation is a global affair, with much of it emanating from the Bank for International Settlements (BIS) through its Basel Accords. Almost all Central Banks of the world in one way or another comply with the proclamations of these rules of Bank Governance. Unlike the UK's Financial Services Authority (FSA) who as the single statutory regulator is responsible for the regulation of the whole of its financial system, the Australian Prudential Regulatory Authority (APRA) is responsible for prudential supervision, with a focus on banks and insurance companies, while another authority, the Australian Securities & Investments Commission (ASIC), is assigned with conduct-of-business regulation and market oversight, and only the oversight of the payments system is left to the Reserve Bank of Australia (RBA) – the country's central bank.

Islamic finance is an important part of life for the Muslims in the UK totalling around 1.8 to 2 million, which is available to both Muslims and non-Muslims (HM Treasury, 2005b). London has become the largest international centre for Islamic finance outside the Muslim World, largely as a result of the City's role as a centre for Middle Eastern and Asian banking. The UK is one of the Western world's most developed financial markets for Islamic banking and has evolved relatively sophisticated regulatory frameworks to accommodate a growing Islamic finance industry. Islamic Bank of Britain is the latest high profile arrival, which marked the first time that Britain's Muslims have had access to banking facilities from a British bank that is wholly operated in accordance with *Sharīʿah* principles. A number of conventional banks such as HSBC, LloydsTSB, Barclays Capital, ANZ Grindlays and West Bromwich Building Society have already been offering specialized *Sharīʿah*-compliant financial services, with Yorkshire Bank known to be among those following (Wilson, n.d.).

The underlying objective of this study is, therefore, to explore how the existing UK regulatory framework for Islamic banking and finance practice would be adopted into Islamic banking in Australia so as to make it a truly viable alternative system of financing for Muslims in Australia. To achieve this objective the paper examines the appropriateness of the UK regulatory approach for Islamic banking for adoption into Australia.

The paper is divided into six parts. Following an introduction section 2 deals with the regulatory framework for Islamic finance in the UK; section 3 discusses the policy objectives of the UK legislation vis-à-vis the UK requirements for Islamic Finance; section 4 examines the UK's Tax

Proposals for *Sharīʿah*-compliant products on Islamic financial services providers and their users; and section 5 provides a tentative examination of the relevance of the UK approach to the Australian experience in Islamic Banking. Section 6 concludes the study by evaluating the findings of the research undertaken in this paper.

II. The Regulatory Framework for Islamic Finance in the UK

The UK's Financial Services Authority (FSA) has been vested with responsibility by the Parliament under the Financial Services and Markets Act 2000 (FSMA), to regulate the financial services and markets of the country. It is accountable to Treasury Ministers and through them to Parliament. Its aim is to maintain efficient, orderly and clean financial markets and help retail consumers achieve a fair deal.

The FSA is directly responsible for the regulation of the whole of its financial system as the Bank of England Act 1998 now transfers from the Bank of England to the Financial Services Authority the Bank's former banking supervision functions. Given this responsibility, the FSA is the single UK statutory regulator, who regulate the whole range of banking, insurance and investment products. It is also the UK competent authority (the Listing Authority) for the admission of securities to the official list.

The FSA has the following four statutory objectives under the Act (FSMA, 2000), though within that framework of objectives, the legislation gives regulators a considerable degree of flexibility to adapt and amend regulations to meet the objectives.

(i) maintaining confidence in the financial system;
(ii) promoting public understanding of the financial system;
(iii) securing the appropriate degree of protection for consumers, and
(iv) reducing financial crime.

Regarding the conditions for authorization of Islamic Banks, historically, the regulatory view of Islamic banks in the UK was that, while it is a perfectly acceptable mode of financing, it did not fit within the UK definition of a bank. It did not take deposits within the definition of banking legislation. Banks seek to provide capital certainty for their depositors, primarily through investment in fixed rate instruments, which are highly liquid and may provide cover for day-to-day losses arising from banking business, whereas Islamic banking is based on the concept of Profit/Loss Sharing (PLS) between the customer and the bank. Of course, the PLS has no

guaranteed return. However, in order to be authorized under the FSA's requirements in the UK new applicants, whether they are Islamic banks or conventional ones must meet five conditions - what they call threshold conditions - for authorization as an institution entitled to take deposits in the country. Schedule 6 to the Financial Services and Markets Act 2000 and *COND,* which set out the *threshold conditions* in full, are as follows.[1]

(i) *Threshold Condition* 1: Legal status. This sets out a number of conditions for legal form. A *credit union* by definition will comply.

(ii) *Threshold Condition* 2: Location of offices. A regulated *UK credit union* must have its head office and registered office in the UK. This requirement is aimed at ensuring that *firms* are organised in a way that can be effectively supervised.

(iii) *Threshold Condition* 3: *Close links.* This condition requires the *FSA* to be satisfied that it can effectively supervise a *firm,* taking into account the structure of the *group* to which it belongs or the other *firms* to which it has *close links.* This will have little relevance to *credit unions* because of the way they are constituted.

(iv) *Threshold Condition* 4*:* Adequate resources. The adequate resources condition has a wide meaning. The *FSA* will interpret the term 'adequate' as meaning sufficient in terms of quantity, quality and availability, and 'resources' as including all financial resources, non-financial resources and means of managing its resources; for example, capital, provisions against liabilities, liquidity and human resources… The *FSA* will consider whether a *credit union* is ready, willing and organised to comply with these requirements when assessing if it has adequate resources for the purposes of this *threshold condition.*

(v) *Threshold Condition* 5*:* Suitability. Essentially, this condition requires the *FSA* to be satisfied that a *credit union* is 'fit and proper' to be *authorized* and permitted to carry on the relevant activities. It will therefore have regard to all relevant matters. These will include whether there are any indications that the *firm* will not be able to meet its debts as they fall due, and whether the *firm* has taken reasonable steps to identify and measure any risks of regulatory concern" (FSA, 2001: 44-46).

Some of the conditions mentioned above, such as the legal status of a bank, its location *etc.*, are entirely straightforward. No bank should have

difficulty meeting them. The two key conditions are that a bank must have adequate resources and must have reasonable systems and controls to manage the type of business it wishes to undertake in a reasonably sound and prudent way. That will include systems to guard against money laundering.

In the context of the UK's increasingly integrated financial services industry, in which distinctions, between banks, building societies, investment intermediaries, insurance companies and so on, have become increasingly blurred, there is an argument for moving away from a fragmented supervisory and regulatory structure (in which banks were separately regulated), to a centralized form of regulatory control under the Financial Services Authority.

The major development in the realm of Islamic finance in the UK has been the opening of the Islamic Bank of Britain under the Financial Services and Markets Act 2000, which has been fully implemented from midnight on November 30, 2001. This Act authorized the first purely Islamic bank in Europe, the Islamic Bank of Britain, to offer *Sharīʿah*-compliant financial products to the UK's 1.8 to 2 million Muslims. The Islamic Bank of Britain has also started a sister bank - the European Islamic Investment Bank (which incorporated in January 11, 2005 to become Europe's first Islamic investment bank), along with the Bahrain-based Islamic Joint Venture Partnerships and has approached the FSA for a license (VIPLoan, n.d.).

III. The Policy Objectives of the UK Legislation

3.1. Key objectives of financial regulations in the UK

Under the UK's existing regulatory environment many individual Muslims are able to choose from a range of *Sharīʿah*-compliant financial products, all of which must meet the following three key objectives (Foot, 2003).

(i) The products and firms involved must meet the basic European Union (EU) Directive requirements that are set in place to protect consumers and investors;

(ii) Those involved – whether as shareholders or customers – must understand what exactly is being offered (There will only be long-term damage to the cause if unrealistic expectations are created of what can be achieved);

(iii) Those providing the services must be wholly professional and competent in what they do. There can be no benefit to anyone (and certainly neither to devout Muslims nor to regulators!) from the

slightest suggestion that the probity and competence with which *Sharīʿah*-compliant products are provided are in any way less than those of conventional financial products.

3.2. Applying the objectives of the UK's financial regulations to Islamic Banking

The powers given to a bank within the EU are so considerable that, inevitably, regulators need to spend a good deal of time and effort with an applicant bank, trying to establish whether indeed it has the capital, the systems and the competence to run the bank successfully. Most importantly, the regulator needs to spend considerably more time with a prospective bank testing out these strengths than it would have to do with a financial organization that was set on providing a much more limited range of financial services.

Many *Sharīʿah*-compliant financial products are provided within the EU by companies that are not banks. This is just as, in the conventional sector, many banks offer residential or commercial mortgages but there are, equally, many mortgage lenders who have never been and who have no interest in being a bank. Unlike the pre-1998 period, the Financial Services Authority being a single regulator is now responsible for the regulation of the whole range of banking, insurance and investment products in the UK. Therefore, the FSA is able to help address Muslim aspirations across the whole range of financial services (Foot, 2003).

3.3 Islamic finance: The UK requirements

For a loan to be *Sharīʿah*-compliant, the following principles need to be observed.

(i) The loan must be free from a requirement by the borrower to pay interest. This does not, however, mean that *Sharīʿah* prohibits the concept of borrowing – rather the reverse, provided that the loan stimulates productivity in the economy, i.e. goods and services rather than the making of more money from money;

(ii) The loan needs to demonstrate that the risks are shared fairly between the parties. A pre-determined return to the lender, regardless of whether the transaction makes a profit, will not be *Sharīʿah*-compliant;

(iii) The loan must provide assistance to society by helping in the production of trade services and most commodities. Certain commodities are strictly banned, such as pork or alcohol;

(iv) Finally, no part of the loan must allow uncertainty. Loans relating to certain speculative deals will therefore not be allowed.

In compliance of the above requirements, the following four main types of Islamic financing schemes have been resorted to by providers of Islamic financial services in the UK.

(i) Partnership Finance, which requires the lender to participate in the equity of the transaction. This scheme imposes undue risk for a bank.

(ii) Asset Finance, which involves the lender purchasing the asset back to back with a sale of the asset to the borrower at an increased price. This increased price reflects the interest otherwise payable, payment of such price being deferred. This scheme would give rise to double stamp duty as well as, in all probability, capital gains tax.

(iii) The *Ijārah Lease Scheme* requires the bank to acquire the property, leasing it to the borrower in return for a rental payment and then transferring it to the borrower once all payments have been paid. The bank must be responsible for major repairs and insurance, thus sharing the risk. By way of a separate management agreement, the borrower can be appointed as managing agent for the bank and, in that capacity, undertake repairs/ insurance, reclaiming the cost from the occupational tenant, assuming the tenant of the occupational lease permits the landlord to reclaim such cost from that tenant. On the face of it, the *ijārah* lease arrangements also have stamp duty problems.

(iv) Mortgages: The first *Sharīʿah*-compliant mortgage product in the UK was offered in 1997. Before legislation in 2003 to remove the double payment of stamp duty land tax on such products, however, the size of the market was limited and there were no other providers (Foot, 2003).

The financial institutions that have been offering Islamic financial products in the UK are Islamic Bank of Britain and *Sharīʿah*-compliant units of HSBC and Lloyds TSB, Barclays Capital, ANZ Grindlays and West Bromwich Building Society. However, in recent years there have been a number of prominent developments in the UK Islamic finance market, and there is now considerable interest in developing and marketing a wide range of products. *Sharīʿah*-compliant current accounts, savings accounts, and house purchase facilities are also now available.

There are currently two broad types of *Sharīʿah*-compliant home purchase arrangements available in the UK: *murābaḥa* and *ijārah*. On 31 October 2004, the FSA assumed responsibility for the regulation of mortgages, including mortgage backed equity release products and *murābaḥa*. However, neither home reversion plans nor *ijārah* products fall within the framework of financial services set out by the Financial Services and Markets Act 2000 and are, therefore, not within the scope of FSA regulation. The Government recently consulted on whether *ijārah* products should be included in the legislation to bring home reversion products into FSA regulation and the majority of respondents agreed that they should. Legislation to bring Home Reversion schemes into the scope of FSA regulation will be brought forward as soon as Parliamentary time allows.

The market in *Sharīʿah*-compliant financial products is extremely dynamic, with the result that, providing the FSA gives approval, a range of new products are likely to be offered in the UK marketplace over the next few years. Given that legislation can only apply to the underlying contract in each transaction, some products (if they involve new forms of contract) will require legislation to remove inequality or uncertainty in tax treatment.

A review mechanism has been established to identify: the extent to which legislation has or has not succeeded in its objectives; the uptake of *Sharīʿah*-compliant financial products by UK Muslims and other interested parties; remaining discrepancies in the tax treatment of these products, and the development of new *Sharīʿah*-compliant financial products.

IV. The UK Tax Proposals for Islamic Financial Products

Under *Sharīʿah* law the receipt and payment of interest is expressly forbidden and in order to ensure that this criteria is not breached financing arrangements are often structured such that they do not result in the payment of interest. This can, obviously, lead to difficulties with payments often being regarded for taxation purposes as a distribution as opposed to interest.

A revised proposal of the Budget Bill originally presented in 2003 has been presented in 2005 addressing tax issues specific to Islamic financial products. In this proposal, the UK relevant authority has confirmed its intention to place *Sharīʿah*-compliant financial products on an equivalent basis to other conventional financing products with a view to ensure that taxpayers entering into such arrangements are not unduly disadvantaged. The new measures which have been announced by Gordon Brown, the

Chancellor of the Exchequer in this regard are as follows (HM Treasury, 2005a).

(i) "Corporation Tax, Income Tax and Capital Gains Tax rules are to be changed. This will allow the Islamic equivalents of loans and deposit accounts – based on *murābaḥah* and *muḍārabah* contracts – to receive the same tax treatment as equivalent banking products;

(ii) The removal of multiple payments of Stamp Duty Land Tax (SDLT) will be made more accessible in Scotland and will cover a newly available *Sharīʿah*-compliant product, known as diminishing *mushārakah*. This will help house-buyers who want to finance their purchase without taking an interest-bearing mortgage."

The above mentioned measures announced in the Tax Proposals included important changes to remove the tax impediments to *Sharīʿah*-compliant Islamic finance products. The first proposal fixed a problem with the way in which stamp duty affected *Sharīʿah*-compliant mortgages. The second Bill Proposal extends the benefits of that change and alters the rules for income tax, corporation tax and capital gains tax to remove impediments to *Sharīʿah*-compliant saving and loan products.

The British government in yet another move launched a consultation paper on proposals to help council tenants in the UK wishing to use non-standard mortgage products[2] to purchase their homes but also can not do so under current Right to Buy (RTB) rules.[3] The consultation paper is about giving tenants more choice and falls under the social and financial inclusion policies of the government which wants to widen the choice available to tenants who want to buy their own home, whatever their faith. But it also wants to make sure that tenants are not exploited by lenders or private companies in the process (Arab News, 2005).

The revised proposal of the Budget Bill seeks to address an existing inequality in the tax treatment of *Sharīʿah*-compliant financial products, and to promote fairness by contributing to the Government's financial exclusion and asset saving objectives. Furthermore, moves towards removing possibly disadvantageous tax treatment for *Sharīʿah* compliant products will extend product flexibility and consumer choice. They may also have the effect of encouraging investment in banks advertizing themselves as ethical.

V. The Relevance of the UK Approach to the Australian Experience in Islamic Banking

Islamic finance in Australia has been growing rapidly since it was first introduced in 1989 with the Muslim Community Co-operative (Australia) Limited, better known as MCCA. Since then, a number of Islamic Financial Services Providers have come into existence in the Australian financial services market during the past decade and some international financial institutions are also considering the introduction of Islamic banking branches and subsidiaries, such as HSBC and CitiBank (see Datamonitor Report, 2004 September). No formal legal and regulatory framework or infrastructure existed in Australia for guiding and supervizing the functions of Islamic banks and other financial institutions operate in line with the precepts of the *Sharīʿah*.

The legal and regulatory framework of the financial sector in Australia unlike in the UK, consists of a multiplicity of bodies. These include: (1) the Reserve Bank of Australia (RBA);[4] (2) the Australian Prudential Regulation Authority (APRA);[5] and (3) the Australian Securities and Investments Commission (ASIC).[6] The coordinating body for these agencies is the Council of Financial Regulators (Australian Bankers' Association Fact Sheets, n.d.). It contributes to the efficiency and effectiveness of financial regulation by providing a high level forum for co-operation and collaboration among its members (The Council of Financial Regulators, n.d.).

Under subsection 9(3) of the *Banking Act 1959* an authority to carry on all kinds of banking business in Australia was granted by the Australian Prudential Regulation Authority (APRA) to the then Muslim Community Credit Union Limited (MCCU) in December 1999.[7] Australia's new community banks (which have emerged largely due to the closure of traditional branches in smaller towns and are funded and operated by local townspeople), and community-based Islamic co-operative financial institutions were registered and given licenses to carry on cooperative businesses under the Cooperatives Act 1992.

Although Islamic finance is different from conventional forms in terms of missions, objectives and its practice the operation of Islamic financial institutions in Australia is still subject to basically the same laws and regulations as their conventional peers, and apply the same conventional interest-based framework for regulatory and supervisory activities. Like the FSA in the UK, a uniform regulatory and legal framework supportive of an Islamic financial system has not yet been developed in Australia. This is a

paramount need as the absence of such a supportive framework obstructs Islamic finance in its effective and smooth functioning in accordance with Islamic principles. Thus, in order to support operational soundness, Islamic banking and finance should be equipped with a proper set of regulatory and supervisory instruments that fit its operational activities, and the elimination of a multiplicity of stamp duty and other transfer taxes. On this matter the UK model would be the best practice for Australia. While new regulations have been developed and foundations for regulatory instruments have been laid by the Australian banking regulatory authorities in this regard, it still has a long way to go compared to the United Kingdom.

According to a recent report published in the VIP News, the authorities from the Canadian and Kenyan Central Banks visited the FSA and met with representatives of the local banks who have taken the steps of starting Islamic banking operations like the Islamic Bank of Britain (IBB), ABC International Banks, Lloyds-TSB and HSBC Amanah. These two central banks are planning to adopt the UK model for enabling investors to start Islamic banking practices in their own countries. They will also issue licenses in their countries for stand alone Islamic banks. Both the banks will then approach the market through private placements to raise further equity funding (VIPLoan, n.d.). Given the success of Islamic banking and finance practice under the existing legal and regulatory environment in the UK, and its growing global trends it is most important that consideration be given to the adoption of the UK model of regulatory framework for Islamic banking and finance into Australia. In this regard, regulations are needed to be developed by the Australian regulatory regime so as to make Islamic finance a viable alternative system of financing for Muslims in Australia. Some of the challenges confronting the regulation of Islamic banking and finance practice in Australia are as follows:

(i) The levy of double and triple stamp duty on Islamic mortgages

In the simplest of many possible examples of a typical Islamic financial arrangement, the financier would buy the property and resell it to the client at a profit on a deferred payment basis over a fixed period. This requires legal title in the property to be transferred twice: once to the financier, and subsequently to the client which means there is double stamp duty to pay. In all states of Australia except for Victoria the problem of double stamp duty payment on Islamic housing finance exists. Islamic housing finance relies on the involvement of a financier who buys the property, and then sells it on to

the buyer and collects instalment payments (similar to traditional mortgage payments) for the repayment of the capital. Instead of charging interest, the financier often sells the property for the same price but then charges additional rent on it for a specified period of time. Stamp duty is therefore charged twice – as the ownership of the property transfers twice – once to the financier, and once to the ultimate buyer. This has necessarily been reflected in the price of the mortgage finance. Re-mortgaging also presents a problem because the old lender has to sell the property to the new lender and thus incur another stamp duty charge.

Although legislative amendments were made to Victoria's Duties Act 2000 they are considered a very small step in a potentially lucrative direction. The rest of the Australian States have an even longer distance to travel.

(ii) Exemption of the use of the word 'interest'

The use of the word 'interest' is a product of the Australian regulatory regime under the Uniform Consumer Credit Code. As such, the Islamic financial institutions in Australia are legally bound to mention it in several contracts documents of housing finance in order to inform customers that this is mandatory under Australian law. In order to reflect *Sharīʿah*-compliant transactions in which interest is not present it is necessary to enact Federal legislation to exempt from having to use the word 'interest' in all *Sharīʿah*-compliant products. This legislative change will enable Muslims in Australia to increase their adherence to their religious beliefs and practices as also conform to the interest-free Islamic financial system (Ghouse, 2004).

(iii) Mortgages

Although *Sharīʿah*-compliant mortgages already exist, various legal hurdles make them relatively expensive. Regulatory changes are needed to make it easier and cheaper for Muslims in Australia to get mortgage products that do not conflict with their beliefs. This would, in turn, help to make home-ownership more accessible and affordable for Australia's most significant religious minority.

There are also questions relating to legal costs where it has not been clear whether a single solicitor can advise both the financier and the purchaser in the case of an Islamic product - again because of the ownership role of the financier.

VI. Conclusion

With the preceding presentation and discussion in mind, this paper attempted to address the following issues, which are discussed in detail:

(i) Whether the UK has remedied the problem of divergence of the Islamic finance from traditional *Sharīʿah;*
(ii) The extent to which Islamic banking has adapted itself to the UK financial system practice;
(iii) Evaluation of the UK Financial Services Bill Proposals on Islamic Finance by reference to the Australian Banking and Finance Regulation;
(iv) The appropriateness of the new UK model for adoption into Australia.

In relation to the issue about whether the UK has solved the problem of the divergence of Islamic finance from traditional *Sharīʿah* requirements, it is noteworthy that like elsewhere around the globe the sole responsibility of solving this sort of problem goes directly to respective *Sharīʿah* Boards/ Councils of the banks and financial services providers. The following comments made by Michael Foot (2003, footnote 7), the Managing Director of the FSA regarding the issue are worthy of mention:

> "We will no doubt continue to play that role in respect of *Sharīʿah* compliant products too (and in some case our rules will leave us no choice). However, I think it is also true to say that we shall be looking for help from experts wherever we can find them. And I should also add – though it is probably unnecessary for me to say this – we shall have neither the ability nor the desire to monitor a bank's actual *Sharīʿah* compliance. That has to be something for the *Sharīʿah* board and for the institution itself."

Generally, it is under the jurisdictions of the *Sharīʿah* Boards/Councils of respective Islamic banks or the IFSPs to monitor their functions from a *Sharīʿah* viewpoint and to evaluate every new transaction to make sure that it is *Sharīʿah*-compliant. Yet the laws of the *Sharīʿah* are open to interpretation and *Sharīʿah* Boards/Councils often have divergent views on key *Sharīʿah* issues. In this regard, there is no practical guide as to what constitutes an acceptable Islamic financial instrument. A document or structure may be accepted by one *Sharīʿah* Board/Council but be rejected by others.

Regarding the extent to which Islamic banking practice has adapted itself to integrate with the UK's core financial system, personally even if the regulator did not exist or did not require the conditions to be met

to function as Islamic banks they would in any case be necessary for the commercial success of the operation. So, it is of paramount importance for Islamic banking and finance to adapt itself to the mainstream of the core UK financial system. Albeit many of the financial products commonly used in the UK – for example, current accounts and savings products, such as investment funds or unit trusts, or borrowing through leasing or hire purchase products – already have some, at least, of the characteristics consistent with *Sharīʿah* precepts.

The above discussion of the UK Financial Services Bill Proposals on Islamic Finance and the existing Australian Banking and Finance Regulation has demonstrated that for example, the way the Australian *Sharīʿah*-compliant housing finance product is structured would mean that stamp duty would be levied twice on a single property purchase. This additional levy would obviously make the product uncompetitive. Given this unfair treatment with a similar product in different financial systems under the same regulation this study suggests that the government should consider making changes to the stamp duty legislation to recognize this problem and facilitate the levying of a single charge on what in effect is a single purchase. In a similar way, the legal and regulatory authority should take many other measures so as to enable a like-for-like competitive product to be launched. The Australian legislative framework must also address the regulatory issues which so far discourage the launch of Islamic financial products.

In line with UK legislation, which has given ethical funds a significant market advantage, an amendment to the Financial Services Reform Bill (FSRB) requiring superannuation funds and funds managers to disclose their policy on ethical investment, was passed by the Australian Parliament in 28 August, 2001. This amendment requires all financial services product disclosure statements to outline "the extent, if any, to which labour standards, environmental, social or ethical considerations are taken into account in the selection, retention or realisation of the investment." (Ethical Investment Association of Australia, EIA, n.d.). The legislation creates an imperative for the investment community to get up to speed on socially responsible investment. Following the UK model, a new Bill Proposal on Islamic Finance may also be adopted in Australia; this by passing legislation in parliament to strengthen Australia's Islamic financial market. If such legislation is passed, it will enable the growing Muslim community in Australia to find a truly viable alternative for banking and finance based on religious and ethical considerations.

It may be argued that since the Australian Muslim community avails itself of existing conventional interest-bearing products, it is unlikely to switch to the new *Sharīʿah*-compliant products offered by the IFSPs of Australia. However, if the *Sharīʿah*-compliant products are properly structured and competitively priced it is expected that many people will switch to reap the benefit of Islamic financial services. Certainly, new buyers would seriously explore these facilities. As the range and scope of these products builds up, the whole saving and borrowing patterns of Australian Muslims are likely to change. And as the volume of financing builds up the underlying ethical base of Islamic financial products will begin to make its mark on the market. At that point, many non-Muslims will also be attracted to these products. In time, these products may then provide a valuable bridge between different communities and interest groups in Australia.

Furthermore, it is expected that if a better and more precise understanding of the Islamic financial products is made and the Muslim community of Australia are encouraged to develop a more consistent – and desirably more standardized – specification of the products they wish to introduce – then, the ways of fitting them into the Australian legal and regulatory framework could surely be found, on a par with its more traditional financial products.

Notes

1. *COND* contains guidance on the threshold conditions. Threshold conditions are the FSA's basic requirements against which an application for authorization will be measured. See for details, FSA (2001).
2. Non-standard mortgage products primarily refer here to Islamic *Sharīʿah*-compliant mortgages, of which there are currently three types available in the UK market. These include mortgages based on the *murābahah* contract (a mark-up); the *ijārah* contract; and the diminishing *mushārakah* contract. Under the *ijārah* mortgage, legal ownership of the property passes from the seller to the lender, who remains the legal owner of the property until the loan is repaid. While the loan is being repaid, the buyer also pays rent to the lender. Once the loan is fully paid, the lender transfers legal ownership to the buyer. The diminishing *mushārakah* mortgage involves joint ownership by the lender and buyer. With each payment by the latter, partial transfer of ownership takes place. As part of the monthly payments, the lender rents the house to the buyer for use of its share over the agreed period while there is shared ownership. Once the buyer has bought the lender's share of the property by the end of the agreed period, the buyer becomes the sole owner of the property.
3. Under the UK's current Right to Buy rules, tenants cannot use non-standard mortgages such as Islamic mortgages. Many UK Muslim council tenants feel they

can not participate in the Right to Buy scheme, simply because the legislation does not consider new financial products, which satisfy the *Sharīʿah*. Also, the Right to Buy legislation assumes the landlord sells directly to the tenant. It does not allow for transitional ownership by a third party.

4. The RBA is responsible for the objectives of monetary policy, overall financial system stability, and the regulation of the payments system. Also, payments system policy is carried out by the Payments System Board within the RBA.
5. APRA is responsible for the prudential supervision of deposit-taking institutions, life and general insurance companies, and superannuation funds. Prudential regulation administered by the APRA is applied where financial risks can not be satisfactorily managed in the market, and where concerns about financial security are utmost.
6. ASIC is responsible for corporate regulation, market integrity, disclosure and other consumer protection issues.
7. Under paragraph 9(4)(a) of the above mentioned Act, the APRA imposed on the MCCU the condition of maintaining a minimum ratio of capital to risk-weighted assets of 15% at all times among other conditions.

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