

Islamic Finance and Conventional Financial Systems

Turin Islamic Economic Forum
17 november 2014

Angela Di Maria – Paolo Voltattorni
Banca d'Italia

The views expressed are our own and
do not necessarily reflect those of Banca d'Italia



OUTLINE

❖ ISLAMIC FINANCE IN EUROPE

- ❖ Where and how?
- ❖ Why?
- ❖ Future developments and key challenges

❖ A CENTRAL BANK'S PERSPECTIVE

- ❖ What has been done in the EU?
- ❖ Monetary policy and regulatory challenges



BANCA D'ITALIA
EUROSISTEMA

Questioni di Economia e Finanza

(Occasional Papers)

Finanza islamica e sistemi finanziari convenzionali.
Tendenze di mercato, profili di supervisione e implicazioni
per le attività di banca centrale

di Giorgio Gomel (coordinatore), Angelo Cicogna, Domenico De Falco,
Marco Valerio Della Penna, Lorenzo Di Bona De Sarzana, Angela Di Maria,
Patrizia Di Natale, Alessandra Freni, Sergio Masciantonio, Giacomo Oddo e
Emilio Vadalà

Ottobre 2010

Numero
73

http://www.bancaditalia.it/pubblicazioni/econo/quest_ecofin_2/QF_73/QEF_73.pdf

<http://www.ecb.europa.eu/pub/pdf/scpops/ecbocp146.pdf>



EUROPEAN CENTRAL BANK
EUROSISTEM

OCCASIONAL PAPER SERIES

NO 146 / JUNE 2013

ISLAMIC FINANCE IN EUROPE

By Filippo di Mauro, Pierluigi Caristi,
Stéphane Couderc, Angela Di Maria,
Lauren Ho, Baljeet Kaur Grewal,
Sergio Masciantonio, Steven Ongena
and Sajjad Zaher

The background features a complex, abstract geometric pattern. It consists of various shapes, including rectangles, squares, and lines, in two primary colors: a light teal and a light purple. The shapes are arranged in a way that creates a sense of depth and movement, with some elements overlapping others. The overall effect is a modern, minimalist aesthetic.

Islamic Finance in Europe

Where? How?

ISLAMIC FINANCE IN EUROPE – WHERE? (1/2)

- **UK and Luxembourg key financial centres**
- **Ireland's increasing importance**
- **Some other initiatives:**
 - **France**
 - **Germany**





ISLAMIC FINANCE IN EUROPE – WHERE? (2/2)

- **Issuing and negotiation of sukuk**
 - **2 sovereign sukuk (UK, Luxembourg)**
- **Management of Islamic funds**
- **Retail banking is still at its infancy and limited to the UK**

The background features a complex, abstract geometric pattern. It consists of various rectangular shapes, lines, and squares in shades of purple and teal, arranged in a way that creates a sense of depth and movement. The shapes are layered, with some appearing to be in front of others, creating a 3D effect. The overall composition is balanced and visually appealing.

Islamic Finance in Europe Why?



ISLAMIC FINANCE IN EUROPE – WHY?

DEMAND SIDE:

- **Potential demand from a growing Muslim population**
- **Strong ethical underpinnig and link to real sector (attractive also to non-Muslims)**



ISLAMIC FINANCE IN EUROPE – WHY?

SUPPLY SIDE:

- **Public debt financing**
- **Possibility of attracting funds from Middle Eastern countries**
- **Increased know-how by financial institutions**
- **Potential for financial intermediation for international business**

MAIN CHALLENGES

- **Lack of**
 - product standardisation
 - harmonisation of Islamic rules
 - transparent and harmonised standards
 - reliable data
- **Differences in**
 - policy position
 - regulatory and supervisory approaches
- **Tax barriers**
- **Liquidity management**
- **Education and training of IF experts**
- **Communications/marketing**
- **Ethical dimension**
- **Low profitability and sub-optimal size**

The background features a complex, abstract geometric pattern. It consists of various rectangular shapes, lines, and squares in shades of light purple and teal. Some shapes are solid, while others are hollow, creating a layered, architectural feel. The overall composition is balanced and modern.

A Central Bank's Perspective What Has Been Done in the EU?

WHAT HAS BEEN DONE IN THE EU?

- **Government task forces**
- **Legislative amendments in some EU countries**
- **Approaches taken by Central Banks and supervisory authorities**

The background features a complex, abstract geometric pattern. It consists of various rectangular shapes in shades of purple and teal, arranged in a way that creates a sense of depth and movement. The shapes are layered, with some appearing to be in front of others, creating a 3D effect. The overall composition is balanced and modern.

A Central Bank's Perspective Monetary Policy Issues

MONETARY POLICY ISSUES

Monetary policy instruments are not shari'ah compliant

In the Euro Area:

- OMO, standing facilities and minimum reserve requirements
- Sukuk are not ECB eligible collateral

The background features a complex, abstract geometric pattern. It consists of various rectangular shapes, lines, and squares in shades of light purple and teal. Some shapes are solid, while others are hollow, creating a layered, architectural feel. The overall composition is balanced and modern.

A Central Bank Perspective Supervisory and Regulatory Challenges

The reasons behind bank regulation (1/2)

Ensuring the correct and prudent conduct of financial institutions



- ➔ Enhancing financial stability – crisis prevention
- ➔ Protecting the interests of depositors
- ➔ Promoting fair competition – keeping down financial costs for customers

The reasons behind bank regulation (2/2)

The Bank of Italy carries out checks of varying intensity on intermediaries.

➔ Documentary checks

➔ Inspections

Checks are performed on different aspects of the business:

➤ fulfillment of the requirements to engage in it;

➤ capital stability

➤ sound and prudent management

quality of management;
control of risks;
capital adequacy;
compliance with transparency/AML
usury law.

Islamic banking vs traditional banking (1/3)

Islamic banks are subject to compliance with the precepts of the Islamic religious law (Sharī'ah)



Prohibition of Ribā' (interest payment)



Prohibition of investing in activities that imply:

- Gharār (excessive uncertainty/ambiguity)
- Maysīr (speculation)
- Harām (behaviours forbidden by the Koran)

As a consequence, Islamic banks present some peculiarities compared to traditional intermediaries

Islamic banking vs traditional banking (2/3)

Assets structure

Islamic banks

- Cash (interest-free)
- Contracts based on PLS/AB transactions
-
-

Traditional banks

- Cash (interest bearing)
- Credit products (mortgages/leasing/personal finance....)
- Financial products (derivatives/interest-bearing assets...)
-
-

Liabilities structure

Islamic banks

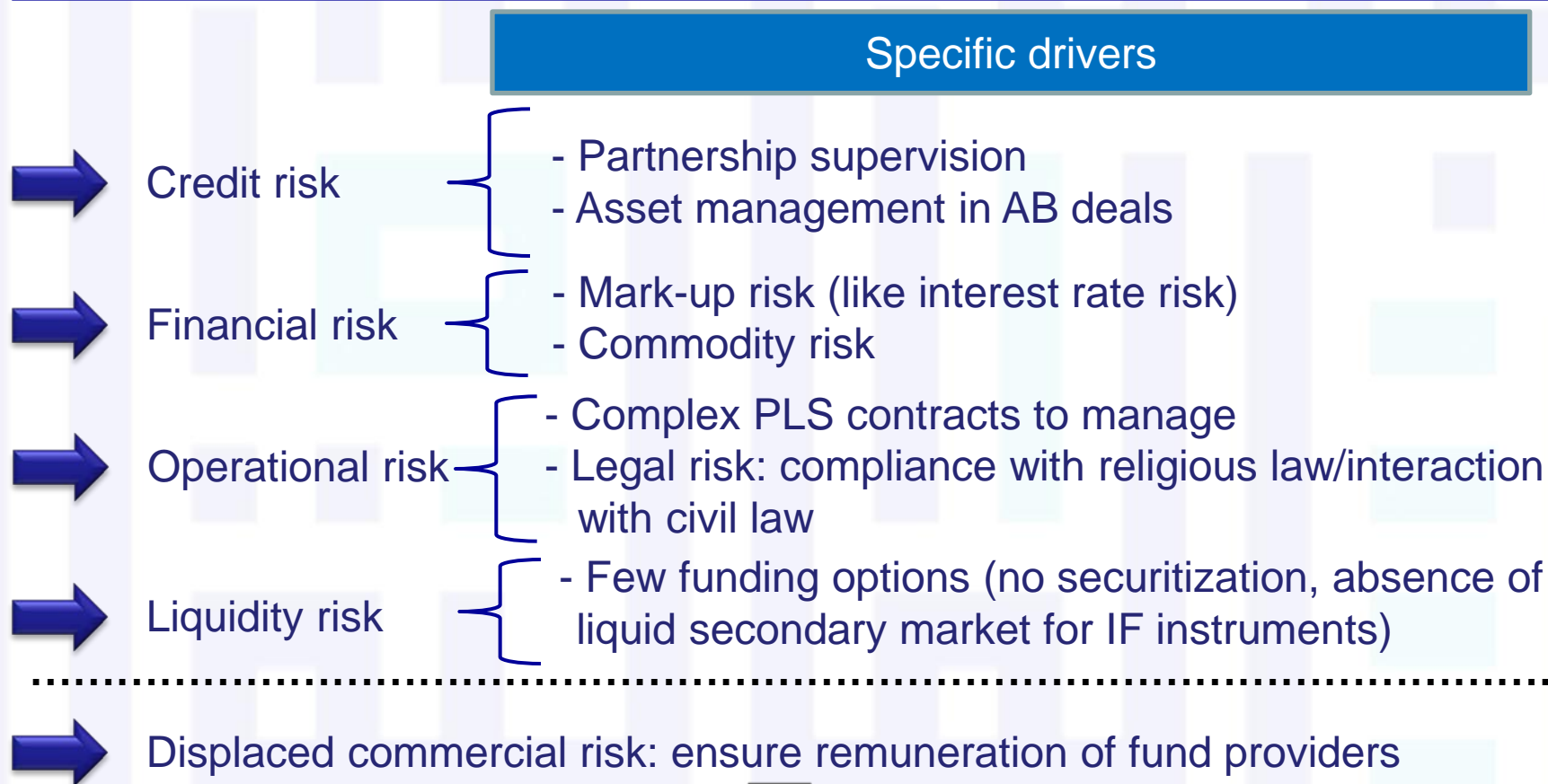
- Deposits
 - Current accounts (interest-free)
 - Saving accounts (PLS)
- Equity

Traditional banks

- Deposits (interest bearing)
- Equity

Islamic banking vs traditional banking (3/3)

Islamic and traditional banks basically face similar risks, although with some differences due to their balance sheet structure



Islamic banks should be subject to prudential regulation!!!

The background features a complex, abstract geometric pattern. It consists of various rectangular shapes, lines, and squares in two primary colors: a light teal and a light purple. These elements are arranged in a way that creates a sense of depth and movement, with some shapes overlapping others. The overall effect is a modern, minimalist aesthetic. The text 'Islamic Finance in Italy?' is centered within this pattern.

Islamic Finance in Italy?

The Italian legal framework

Supervision is regulated by a body of provisions that is continuously evolving in response to the growing integration of markets and intermediaries, driven by the internationalization of finance and the ever greater complementarity between banking and financial products

The regulatory framework for supervision rests on:

- ➔ International rules (EBA, ESMA, ecc.)
- ➔ Community laws (Directives/Regulations)
- ➔ Primary (TUB-1993 Banking Law)
Secondary (BoI regulations) domestic laws

Regulatory challenges (1/2)

Credit institution means an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account (CRR, art. 4)



Islamic banks seem to fall into the definition (even if a case-by-case valuation could be required). As a consequence, should an IB enter into the Italian market, it would be subject to the Italian regulatory framework for supervision.



Main challenges



Deposit guarantee scheme: essential to operate in Italy



Governance: role of the Sharī'ah supervisory board

Prudential rules require:

- a clear definition of the responsibilities of internal functions/bodies;
- avoidance of redundant structures;
- fit and proper/interlocking assessments for management/supervisory boards

Regulatory challenges (2/2)



Main challenges



Classification of Islamic bank operations with respect to relevant prudential regulation:

- Limits for direct investments in real estate
- Outsourcing
-



Transparency rules: lack of product standardization



Tax regime

- Double stamp duty on property purchase
- Lack of deduction for funding costs (passive interests)
- VAT on Murabaha mark-up

Final remarks

1 Islamic banking doesn't look strictly incompatible with the existing regulatory framework



At any rate, solutions should be found to adapt the peculiar business model of Islamic banks to the regulatory environment.

2 Islamic finance is gaining momentum, but raising awareness on the topic remains important



Benefits may arise from the creation of an inclusive financial system and from the attraction of Middle Eastern investments.

3 The lack of a unified regulatory framework has limited the expansion of the Islamic banks in Europe.



The progressive convergence to a European prudential regulation and the centralization of banking supervision should lead to a common approach to Islamic banking supervision and foster IB diffusion in the EU.

THANK YOU

Angela Di Maria
Directorate General for Economics,
Statistics and Research
Banca d'Italia
angela.dimaria@bancaditalia.it

Paolo Voltattorni
Banking Supervision 1 Directorate
Banca d'Italia
paolo.voltattorni@bancaditalia.it

*The views expressed are our own and
do not necessarily reflect those of the Banca d'Italia*