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# From fundamentalism to social responsibility: The construction of Islamic finance as an alternative in times of financial turmoil

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Eddy S. Fang, PhD (Cantab)
Xi'an Jiatong – Liverpool University, CN
International Business School Suzhou
eddy.fang@liverpool.ac.uk

## Abstract

In the late 1990s, Islamic finance started to attract international attention as it expanded outside of the traditional Muslim world, increasingly engaging non-Muslim individuals, institutions and regulators. While the newly acquired legitimacy of *Shariah* compliancy is now widely recognized at the international level (independently of particular nuances on its perceived nature and purpose), this paper devotes particular attention to tracing its evolving conceptualization as a financial alternative in global (non-Muslim) markets over the period of interest. This analysis hence builds on archival data comprising 918 news reports and articles published between 1985 and 2011 by major news agencies in the UK to trace the framing of Islamic financial practices in conventional markets. Based on content analysis and configural frequency analysis (CFA), it is argued that two interpretive breaks can be found over the decade under investigation. The first notable change in attitudes towards this alternative occurred at the end of the millennium, when Islamic finance began to be increasingly 'mainstreamized' into an acceptable culture-specific replica of conventional practices. The second break emerged with the advent of the subprime financial crisis. The idea of a religion/ethics-based alternative has since found resonance with the contemporary social resentment against financiers and the search for alternative ways to govern global finance. The paper concludes on the reflexive aspect of our understanding of the 'alternative'.

Key words: Islamic finance, subprime crisis, business ethics, social constructivism, social psychology, media analysis

# 1. Introduction

In the last fifteen years, Islamic finance (IF) has grown rapidly across the world, consistently recording double-digit annual growth rates, not only within, but also outside of the Muslim economies (see e.g. Nazim and Ibrahim, 2012).[1] It has now become part of the global financial landscape, and Islamic economic values are starting to have a direct and tangible impact on the global flow of capital. The literature has followed suit by turning its attention to this emerging trend in global finance. In recent years, a substantial number of papers, books, websites and guides have been published on the topic, and over thirty periodicals are now dedicated almost exclusively to IF (Warde, 2010). The wealth of contributions in this area (among many others, Ayub, 2007; Azarian, 2007; Abdullah and Chee, 2010; Aziz, 2011; Rethel, 2011; Jensen, 2008; Ahmad, 2008; Aydin, 2009, Nienhaus, 2011; Metwally, 1997; Hayat and Kraeussl, 2011) covers a wide range of issues, ranging from comparisons between Islamic and conventional financial products (Beck et al., 2010) to religious discussions on the implementation of the *Shariah* in modern finance (Usmani, 2002). The present investigation, however, concentrates on a parallel topic, which has not yet attracted significant attention in the literature: the international expansion of IF, and more specifically the diffusion of *Shariah*-based financial ideas among non-Muslim 'global' agents. Indeed, while IF started out as a largely discredited and obscure set of culturally specific practices in the 1980s and early 1990s (often associated with Islamic fundamentalism and terrorism; Warde, 1997; Maniam et al., 2000), recent surveys among Western financial agents (Fang and Foucart, forthcoming) are recording the increased association of IF with ethical financial products.

The purpose of this project focuses on retracing the process through which IF has acquired legitimacy in the international markets, propelling it to its current position as a quasi-mainstream option for global investors. Building on the findings of Fang and Foucart (forthcoming), 918 news articles published on the topic of IF in the UK are analyzed. This paper then argues that two interpretive breaks can be found over the three decades under investigation (1995-2011). The first notable change in attitudes towards this alternative occurred at the end of the millennium, when IF began to be increasingly 'mainstreamized' into an acceptable culture-specific replica of conventional practices. The second break emerged with the advent of the subprime financial crisis. The idea of a religion/ethics-based alternative has since found resonance with the contemporary social resentment against financiers and the search for alternative ways of governing global finance. The paper concludes on the reflexive aspect of global financial agents' understanding of the 'alternative'.

# 2. Attitude change

As previously mentioned, IF has grown rapidly in the past fifteen years and has become, since the beginning of the 2000s, one of the most topical developments in global financial markets. We start by providing a brief picture of the interpretive environment before *Shariah*-based finance came to the fore as the latest financial innovation. Thus, this section first discusses some 'stylized facts' derived from

[1] 37.5% of the growth in Islamic banking assets over the past two years was recorded in non-Muslim economies (Nazim and Ibrahim, 2012).

contemporary surveys on Islamic financial practices among Western economic agents in the mid- to late-1990s. International interest in this alternative financial industry was just starting to emerge at this point, and only two investigations (Warde, 1997; Maniam et al., 2000 - WM hereafter) could be found that explored conventional financial agents' attitudes towards and understanding of *Shariah*-compliant practices. These two contributions are then contrasted with the most recent survey among the same population (Fang and Foucart, forthcoming)

Maniam et al. (2000) collected 150 survey entries from a population of Western economic agents (a typical respondent was a 23-year-old, single, white, Christian male) and found that sixty percent did not consider the Islamic financial system to be a viable alternative, and only eighteen percent found IF to be 'good' or 'better' when compared to the conventional systems. One of the main factors advanced by the authors to explain these 'disappointing' results was the lack of familiarity of the respondents with the concepts and methods of IF before taking part in the survey. Another explanation, they argued, could be a potential cultural bias, despite the fact that respondents were explicitly told to consider *Shariah*-compliant financial practices from a strictly economic and financial standpoint. Maniam et al. then carried out an analysis of the respondents' receptivity to alternative payment methods, on which Islamic financial products are structured. Once again, they found that the majority did not believe that the *Shariah*-compliant payment structures – used to circumvent *riba* in financial transactions (e.g., progressive payment methods similar to diminishing *musharaka* structures or 'diminishing ownership') – were valid. The only exception to this general skepticism towards alternative payment methods was found in the case of humanitarian loans. This was the only rationale under which the respondents could accept an alternative financing structure in which the interest paid by the borrower was not pre-determined.

Warde (1997, 2000: pp. 12-15), on the other hand, conducted a more targeted survey among European and American bankers in the same period. His findings also revealed that a large majority of respondents were only vaguely aware of the existence of financial practices based on Islam. This survey also put forward the idea of the entanglement of IF with popular Western stereotypes about the Muslim world, and most specifically, with 'political' Islam. The most common concepts associated with 'Islamic finance' thus included words such as 'monolithic', 'rigid', 'anti-Western', 'incompatible with modern finance', 'archaic', 'oil money', 'BCCI',[2] 'terrorism' and 'Arab' (2000: p. 13). Besides recording the lack of knowledge of IF among Western financial agents, Warde's investigation also provides us with an account of conventional agents' appraisals at that time of the distinctive features of *Shariah*-compliant practices. Two different attitudes were identified among those agents who were aware of the main tenets of IF. The first held that Islamic financial products were intrinsically similar to their conventional counterparts since they also charged interest for their services, albeit under a different name. This view therefore confirmed the efficiency of conventional modes of financing, and at the same time provided an explanation for the Islamic financial phenomenon as based on a cultural differentiation of a product that was ultimately the same. The second view, on the other hand, emphasized the non-viability of IF, based on the idea that an interest-free system 'cannot possibly work'. Interestingly, Warde notes that, every time this second view was encountered, the 'interviewer would invariably find himself on the receiving end of a lecture on the role of interest rates in finance' (ibid).

MW hence suggest that the pre-2000 period was characterized by a broad rejection

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[2] In the early 1990s, the now-collapsed London-based Bank of Credit and Commerce International (BCCI) was reported to have provided accounts to international terrorists. Millions of dollars were reported to have passed through BCCI to finance terrorist groups such as Abu Nidal or the Hezbollah to finance operations against Western targets (Tuohy, 1991).

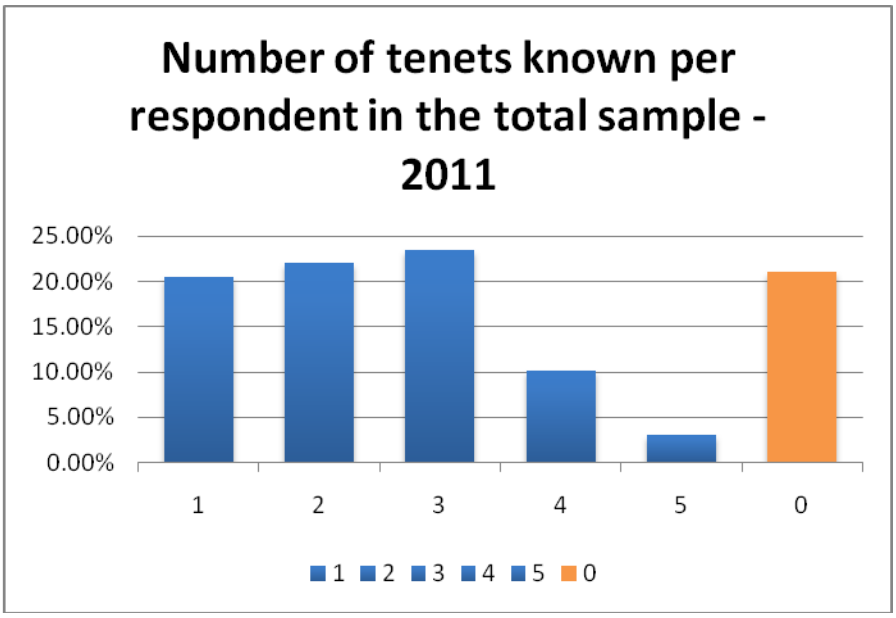
of IF as an alternative in the global economy. In addition to the lack of awareness recorded by both studies, the skepticism of those familiar with the tenets of *Shariah*-compliant practices highlighted the reluctance and/or the inability of respondents to accept an alternative method of financial governance.

A little more than a decade later (2012), Fang and Foucart (forthcoming) conducted a similar investigation, within the same respondent group composed of European and American bankers and financiers. They have identified an important ethical dimension in Western financial agents' understanding of IF (through principal component analysis), and their survey findings stand in sharp contrast to those of MW.

The first observation that comes out of this new survey is that awareness of IF among conventional agents has increased significantly. While the lack of recognition of the existence of IF in the past was argued to contribute to the negative perceptions of the industry, the current situation is markedly different; only one fifth of the respondents had never heard of this financial and economic alternative. Out of those who were aware of IF (79.8%), 54% declared that they had at least a 'good' knowledge of its main tenets, while the remainder felt they possessed a 'rough' understanding.

The depth or 'quality' of knowledge about IF has also improved.[3] More than 75% of the respondents were able to name at least one major defining characteristic of IF. As illustrated in Figure - 4, the mode of the distribution is actually on the group of agents who could name three tenets of *Shariah*-based finance (23.5%). When analyzed independently, the prohibition of interest and of illicit activities can be identified as the most well-known attributes as far as Western financial agents are concerned; respectively 58.6% and 50% of the respondents were familiar with these concepts. These two are followed closely by the prohibition of speculation (38.9%) and the socially responsible aspects of IF (33.3%); the asset-based requirement appears to be the least-known characteristic (10.1%).

**Figure 1 - Tenets known per respondent - 2011**

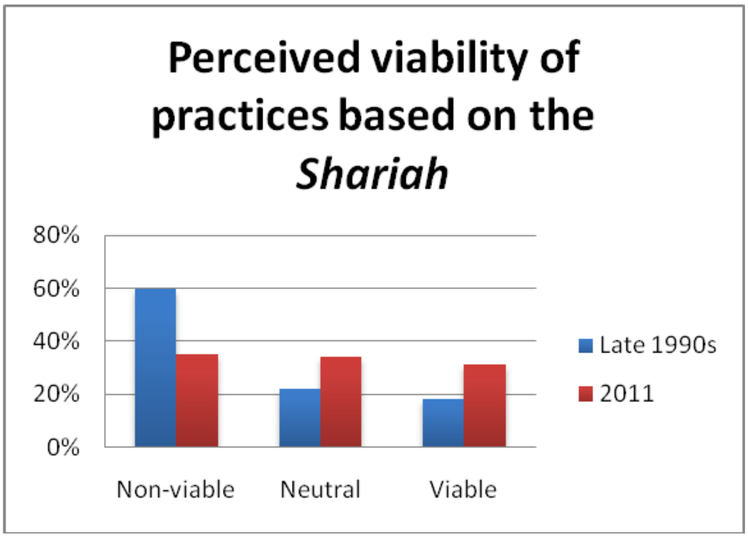



Compared to the findings of Maniam et al. (2000), opinions on the viability of

[3] These comparisons must be taken as indicative only, as the methodology and sample composition of the two previous surveys were not disclosed.

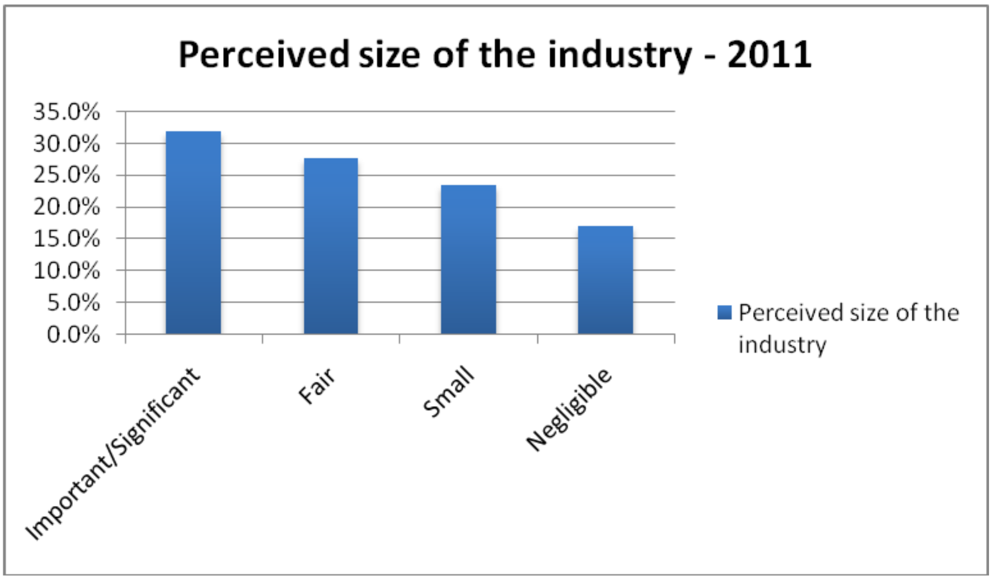
alternative practices based on the *Shariah* has also evolved in the past decade (Figure - 5). The percentage of agents who did not consider IF viable went down from 60% to 35%, and on the other hand, the ones who did, grew from 18% to 30.1%. These changes also suggest that the number of individuals who are neutral towards to the emergence of this financial alternative has also increased over the same period, which was most likely explained by a transfer from the 'skeptical' to the 'neutral' group.

**Figure 2 - Viability of Islamic financial products**




Another interesting point relates to the perceived importance of IF in terms of industry size (Figure - 2). While the global Islamic financial industry was estimated at about US$1 trillion in 2010, representing less than 1% of global bank assets (Aziz, 2010), it is interesting to note that 31.9% of the conventional agents who were aware of IF considered its size to be 'important' or 'significant' and 27.7% considered it to be 'fair', while 23.4% and 17% respectively saw it as 'small' and 'negligible'. The findings not only reflect the respondents' appraisal of the industry but also, and perhaps more importantly, suggest that the increased attention recently paid to IF has led to a potentially inflated view of the size of the industry.

**Figure 3 - Perceived size of the IF industry**



In order to provide comparative grounds for Warde's (1997, 2000) survey, in which he summarizes the main concepts associated with IF in the late 1990s (i.e. 'monolithic', 'rigid', 'anti-Western', 'incompatible with modern finance', 'archaic', 'oil money', 'BCCI', 'terrorism' and 'Arab'), an open question was added to the present survey to allow the respondents to express freely and in their own words their understanding of IF. In addition to the obvious comparative purpose, this question also served as a confirmatory tool for the conceptual questions in the second section of the survey (which were designed based on the smaller sample of the pilot study).

The first and most obvious observation that can be made about these open answers is the high frequency of two main concepts: 'no interest' and 'social responsibility'/'ethics'. Compared to Warde's findings, it is immediately apparent that conventional agents now focus on elements that are part of the actual definition of Islam-based finance, rather than pulling into the discussion ideas related to cultural or political Islam. The integration of 'ethics' as one of the defining concepts of IF is revealed as an important change over the decade. In sharp contrast to Warde's findings, IF is now associated with a range of practices that are desirable in the global economy. On the other hand, while the interest-free aspect of IF is, by now, almost used as a synonym for the field, its meaning seems to be less straightforward. Indeed, depending on the individual answers given here, 'no interest' seems to be either conceptualized as a positive trait, in which case it is often viewed in line with 'social responsibility', or as a deceitful trait, in which case it is placed alongside concepts such as 'hypocrisy'.

Another set of secondary concepts appeared, including (i) the geographical associations of IF, for example 'oil', 'Dubai', or 'Malaysia', and (ii) the prospects for the industry, for example 'growth', or 'high potential'. The skepticism and stereotypes of the last decade, while marginal in the sample under investigation, can however still be observed. Concepts such as 'terrorism', 'extremism' and 'danger' are still present in the feedback to this open question, but were mostly offered by those respondents who were unaware of the existence of *Shariah*-based financial practices before taking part in this survey.

## 3. Media analysis

This investigation on the diffusion of Islamic finance begins from the position that the financial and economic media both reflect and shape contemporary economic representations. On the one hand, the media provides an accurate representation of topical developments and issues at any point in time due to the very nature of its reporting activities. The selection of topics of interest and their appraisal can thus be seen as direct expressions of the dominant understandings and concerns. On the other hand, the media also plays an important political role as a broker and interpreter of ideas, by selecting the facts and shaping the narratives it presents, and which in turn constitute our reality. For these reasons, it is argued here that the financial and economic media provides an appropriate means to investigate the process by which IF has been integrated into the realm of legitimate economic possibilities in Western markets.

The most important characteristic of the media's agency from this paper's point of view resides in its active and interpretive role in redefining the boundaries of legitimate economic action through mechanisms such as agenda setting (Cohen, 1976; McCombs and Shaw, 1972), indexing, priming (Iyengar and Kinder, 1987: p. 63), and/or framing, which has its roots in the fields of psychology and sociology (Pan and Kosicki, 1993).

## a. Data

The empirical work conducted in the framework of this paper consists of archival research based on media publications that were available to financial agents in the UK from 2001 to 2011. In choosing media outputs, online and printed news articles were given primacy while other sources such as radio and television broadcasts were omitted.

The documents collected were published in four major online or printed news channels, which were mentioned by respondents in the pilot study and, at the same time, hold complete archives for the period under investigation: *The Economist* (Econ), *The Financial Times* (FT), *The Guardian* (GU) and *BBC News* (BBC). The last two are entirely available online while the others can be found in their respective historical archives on the Dowjones FACTIVA database. The dataset was generated by entering the keywords 'Islamic finance', '*riba*' and '*Shariah* finance' and obvious duplicates were eliminated directly by the search engine.

Collectively, the four sources provided a total of 818 documents published over the ten-year period (2001-2011).

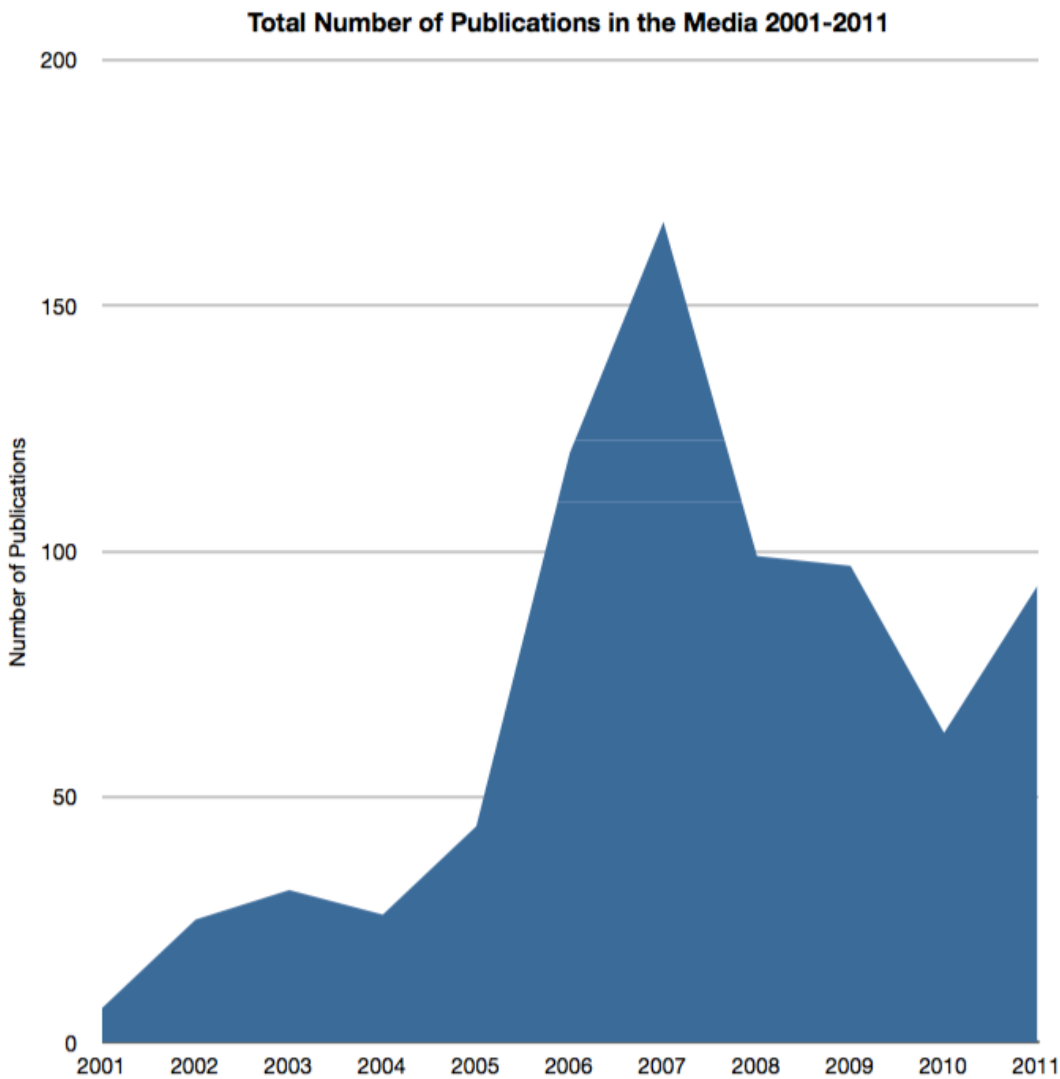



Figure 4 - Total number of publications in the media 2001-2011

The documents collected for this archival work cover a period of increased growth in the interest in IF among the Western media. As shown in Figure - 4, the attention paid to *Shariah*-based practices grew almost continuously from 2001 to 2007. After the advent of the subprime financial crisis and the ensuing economic downturn, the number of documents on IF started to diminish, as they were crowded out of mainstream publications by reports of defaults and systemic failures in the global economy. During 2011 and the first two quarters of 2012, media attention picked up again.

Outside of this ten-year frame, earlier, supplementary documents were recovered when available. Then, articles from the same source published between 1980 and 2000 were combined into a control sample to assess the media input/influence that prevailed prior to the period under investigation. This exercise enabled an investigation of the relation, if any, between the media and perceptions of IF at a time when Western finance professionals were known to show resistance towards its alternative ideas. As expected, the search generated few documents, just 56.

Another geographical control sample was put together, to take into account potential interpretive differences on opposite sides of the Atlantic. This provides information on the extent to which developments in the United Kingdom are representative of changes at the global level. For this sample, 44 articles were recovered from *The Wall Street Journal* (WSJ) (1996-2011), which brings the total number of documents collected and analyzed in this chapter to 918.

## b. Narratives of Islamic finance

### 1980-2000

While this paper focuses primarily on the decade between 2001 and 2011, it seems appropriate to start the discussion with a brief overview of the years preceding the period that is assumed to have fostered the cognitive change. The idea is to investigate the knowledge at a time when IF was not perceived as a challenger in international finance, but as a culturally specific and peripheral set of economic practices.

As the turn of the century is argued to be characterized by significant skepticism among conventional finance professionals about Islamic financial practices, the two decades leading up to that point naturally provide us with an interesting example of the (lack of) influence from the media. From the few documents recovered from that period, it appears that information on IF, when available, was largely associated with cases of fraud and fundamentalism in the Middle East. It is only in the second half of the 1990s that a more positive view of *Shariah*-compliant ideas slowly started to surface. The resistance recorded before the new millennium, from conventional markets towards Islamic financial ideas, thus seems to coincide with both a lack of visibility of *Shariah*-based practices in the media and the unfortunate association with cases of 'irrational' behavior.

The 1980s were characterized by many milestones in the development of IF in the Muslim world. It was in 1983, for instance, that the Sudan and Iran fully 'Islamized' their banking systems (Zaher and Hassan, 2001). During the same year, 'special finance houses' (Islamic banks) appeared in Turkey and were granted special privileges (e.g. in terms of reserve requirements) that were not available to their conventional counterparts (Hardy, 2012). At around the same time, Malaysia implemented its first legislation on IF, creating the Bank Islam Malaysia Berhad (BIMB), a fully-fledged commercial bank controlled by the Malaysian government and the Tabung Haji pilgrims fund board (IDB, 1995). Despite these developments, the documents analyzed from this period show that the information available in Western markets concentrated on the Egyptian 'pyramid' fraud schemes operated by informal investment houses, which were referred to as 'Islamic finance houses' (FT, 11.11.1988). The ensuing high-profile arrests and the regulatory impact on Egypt's capital market were mentioned recurrently in the Western media in association with IF until well into the next decade.

It was only in the mid-1990s that the general direction of news reports on IF started to take another turn. In 1995, the decision of Citibank to 'open the first full-fledged Western Islamic bank … and subscribe to the Koran's prohibition on dealing in interest' became sensational news for the simple reason that 'the bank is Citibank' (FT, 07.04.95). After this, other influential conventional financial institutions, such as ANZ Grindlays and Goldman Sachs, were also included in reports of the 'new' Western embrace of IF. This sudden increase in interest, however, did not reflect any significant change in the activities of these conventional firms in the Middle East. By the mid-1990s, Western banks were already channeling an estimated 10% of all *Shariah*-compliant capital in the Middle East alone (FT, 07.10.1994). Citibank had been availing itself of cheap Islamic deposits in the region since the early 1980s. ANZ, on the other hand, had arranged ten Islamic financing projects between 1988 and 1995, together worth more than US$100m. What the increase in reported interest meant, however, was that the negative image associated with IF in the 1980s was beginning to be replaced with a new discourse of legitimate diversification and expansion. In the words of one commentator: 'A few years ago, foreign bankers involved in Islamic banking treated it like a secret, avoiding any public discussion on their role in the market. Today, the same western bankers are eager to talk [about their connections with IF]' (FT, 28.11.1995). From this perspective, it appears that the middle of the 1990s marked the beginning of an incremental transition towards a new interpretation of IF in the West. The injection of legitimacy brought about by the association with influential names from the conventional financial world – such as Citibank – kick-started a new trend, which increasingly cast IF in the role of a potential market to be conquered.

The remaining years of the decade saw the depictions of IF as fraudulent and irrational make way for attempts to redefine the new practices and ideas based on the *Shariah* in conventional terms. Negative articles, such as those describing money-laundering scandals in Turkish IF houses (FT, 14.03.1997) became scarcer, and positive articles, mainly announcing inter-cultural ventures, became the new norm.

## 9/11 and Islamic Finance

The first theme of interest in the decade under investigation is the impact of the terrorist attacks of September 11th 2001 on Western attitudes to IF. This topic is widely discussed in the academic literature, and the political and economic consequences of the attacks are argued to have both restrained and helped the development of the Islamic financial industry (Ali and Syed, 2010; Warde, 2004). The data gathered in this investigation suggest that the impact of the attacks was mostly positive from a cognitive perspective, due to the increased media attention that differentiated IF from terrorism, thereby ridding the former of its previous negative image. Moreover, the media articulation of the role of 9/11 in changing the flow of Muslim capital is argued here to have promoted a specific view and understanding of IF, revolving around oil money and high-net-worth individuals.

Given the well-documented negative effect of 9/11 on non-Muslim attitudes towards Islam and the Muslim world (FSA, 2007; Imam and Kpodar, 2010), it would be unrealistic to assume that the Islamic financial industry was any exception. However, the archives consulted for this investigation suggest that an almost negligible part of the Western media connected IF directly with terrorism or held negative discourses on the topic in the years following 9/11. This observation is in line with the findings of Ali and Syed (2010), who also conduct a media analysis but focus specifically on the impact of the terrorist attacks of 2001 on the Islamic financial industry.

Yet, the minimal criticism from the media cannot be interpreted as a sign that the concepts were clearly defined at this point. In fact, the sudden increase in attention brought upon Islam and fundamentalism created a significant amount of confusion about the nature of IF, which added to the associations and misconceptions of previous decades. The words 'Islamic finance' were sometimes misused to refer to the financing of the activities of Muslim extremists or organizations. This is epitomized in the former US National Security Adviser Sandy Berger's statement that it would be difficult to track down Bin Laden's money because it was hidden in 'underground banking, Islamic banking facilities' (WSJ, 01.10.01). Similarly, it took a series of meetings in the Middle East for the former Treasury Secretary Paul O'Neil, in charge of the financial war on terror, to learn that IF was 'a legitimate way of doing business' (WSJ, 12.03.02 in Warde, 2010).

Nevertheless, it is contended in this section that, overall, the image of IF in the West improved in this period. While there were some confusion as to what IF actually was and how it related to terrorism / religious fundamentalism, a much louder voice emerged to emphasize the distinction between the two and defend the legitimacy of economic practices based on the *Shariah* by separating political Islam and Islamic finance. In the process of defending its specificity and methodological foundations, proponents of the IF movement raised significant awareness and understanding by contributing to a debate that was at the center of public attention. It is thus argued here that one of the main outcomes of 9/11 on the representation of IF in the West was that it allowed the industry to shed its association not only with fraud, but quite surprisingly, also with fundamentalism and terrorism. This does not mean that IF has been conceptualized since then as a smoothly functioning body of practices but the events did nevertheless displace the locus of the debate from outside to within the boundaries of acceptable practices.

The terrorist attacks of 2001 also influenced financial agents' conception of IF in another, indirect yet significant, way. One common narrative used to explain the recent global expansion and exponential growth of the Islamic financial industry has its roots in the post-9/11 political and economic pressures that squeezed Muslim capital out of the USA. As Arab businessmen were 'being subjected to all sorts of questions about the sources of their funds' (FT, 13.08.03), an increasing amount of Middle Eastern capital remained at home in the Middle East. Due to the lack of appropriate investment outputs in local markets, this excess of Muslim capital provided the impetus for both European regulators and conventional financial firms in the Middle East and in Europe to tap into it by 'repackaging' business solutions in a *Shariah*-compliant manner. Following this understanding of modern Islamic finance, *Shariah*-compliant initiatives in global markets were believed to be motivated by the need to supply attractive investment options to channel accumulating Middle Eastern oil revenues. As a consequence, IF was described as a profit-driven endeavor of conventional firms, its growth fuelled only by the involvement of high-net-worth Muslim individuals (BBC, 31.01.02). The ideas and knowledge behind *Shariah*-compliant practices, on the other hand, were in most cases relegated to a secondary level of importance, almost considered as culturally-specific constraints on the laws of supply and demand in global markets.

## *Shariah*-compliant Retail Banking in the UK

The next phase in the integration of IF into Western constructs involved the introduction of *Shariah*-compliant retail products into Europe. A significant proportion of the publications on IF between 2003 and 2006 were dedicated to this subject. This new avenue of introducing Islamic financial ideas to secular Western financial agents stood in sharp contrast to the previous conceptualization centered on high-net-worth investors. *Shariah*-based practices now became much more tangible and intelligible to Western agents as they were injected directly into their everyday economic reality. Islamic economic governance was introduced to cater to the needs of the Muslim population in Europe. While the core logic remains economically 'rational' (i.e. locating an under-supplied market), accounts in the media also refer to arguments about social equity as justifying the inclusion of alternative banking practices. Interestingly, this narrative was not reversed when major conventional banks in the UK started to retreat from the *Shariah*-compliant retail market in mid-2010. The media virtually ignored the economic failure of these projects. This can perhaps be explained by the fact that the debate had already moved on to discussing the normative rather than the economic contributions of IF.

Within the media accounts emerging between 2003 and 2006, the most visible events of the period were (i) the abolition of the double stamp duty in the UK and (ii) the ensuing involvement of high street banks (such as HSBC, Lloyds TSB and Barclays) in offering Islamic retail alternatives to conventional mortgages.[4] Indeed, the abolition of the double stamp duty on Islamic mortgages in 2003 was a central factor in the growth of Islamic retail banking in the UK. This regulatory amendment effectively reduced the cost of borrowing as the multiple changes of ownership incurred under the *Shariah*-compliant financing structure were officially recognized for tax purposes as being part of a single transaction. As a result, Islamic mortgages were put on the same footing as conventional finance and could thereby be competitive in the mortgage market.

It was in this context that HSBC entered the market in 2003 after initiating a successful pilot scheme in New York for some 800,000 Muslims (GU, 13.07.03). In addition to home purchasing plans, HSBC Amanah – HSBC's Islamic branch – launched an Islamic current account with no overdraft and no credit card facility (BBC, 01.07.03). A year later, HSBC started offering *Shariah*-compliant pension funds to UK customers. Lloyds TSB, another high street bank, followed closely behind, launching a pilot scheme in 2005 in Birmingham and Luton and, by 2006, having caught up with HSBC by offering a comparable range of retail products. In the same year, both HSBC and Lloyds TSB expressed the intention to sell *takaful* (Islamic insurance) products.

While the bulk of the media attention seems to have mainly focused on the alternative offerings of conventional banks, another significant milestone in the development of Islamic retail banking in the UK was the creation of the first fully-fledged Islamic bank – the Islamic Bank of Britain (IBB) – in 2004. The IBB was established with the support of the UK's Financial Services Authority, which showed a significant willingness to adapt the UK banking regulations to fit *Shariah* requirements.

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[4] While these banks were not the first in the UK to offer Islamic mortgages, their involvement was taken by the media as a sign of the 'mainstreamization' of Sharia-compliant finance in the country. Indeed, since as early as 1998, Ahli United Bank, formerly known as the Bank of Kuwait, has been offering interest-free home finance schemes. The West Bromwich Building Society also set up a pilot scheme in 2002 aimed at Muslims in the West Midlands. However, it was only with HSBC's involvement in 2003 that the retail trend really started.

Authorization of the bank still took almost two years to complete, however, as even central concepts such as 'deposits' had to be redefined to fit both frames of understanding.

The Islamic retail banking projects in the UK have not, however, been commercially successful. By the summer of 2010, IBB had to be bailed out by its largest shareholder, Qatar International Islamic Bank, to cover the continuous losses it had incurred since its launch. Lloyds TSB withdrew from the UK market for Islamic mortgages a couple of months earlier, while HSBC was said to be looking at concentrating its *Shariah*-compliant retail efforts on Muslim communities overseas (Goodway, 2010). The failure of the Islamic retail experiment in the UK did not, however, initiate a reaction in any way comparable to the excitement and interest in its commencement. In fact, the declining economic performance of the three main banking institutions went virtually unnoticed. This can be explained by a range of factors, including, for instance, the economic downturn and its adverse effects on financial institutions in general, and the contemporary interest in IF's ethical and social foundations rather than its economic performance. No matter the causes, the point of interest in this section resides in the cognitive footprint left by this episode. The consequences of this incursion into the UK retail market have had a significant influence at both the regulatory and the cognitive level.

In the period from 2003 to 2006, as can be seen from the paragraphs above, knowledge of *Shariah*-based financial ideas was disseminated among Western financial agents through the introduction of alternative retail products for Muslim savers. Compared to the previous narrative, which centered on private banking and finance, *Shariah*-based financial products were now brought within the reach and understanding of all financial agents in the market. This marked a new phase in the diffusion of IF, based on the perceived proximity of these alternative practices. The 'mainstreamization' that often characterized the involvement of high street banks in the period (GU, 29.06.05: 14.06.06; FT, 04.07.05), therefore not only relates to the integration of foreign and exotic practices within conventional finance, but also describes the vertical expansion of IF, from a niche to a more popular position.

Besides this conceptual relocation, however, the basic motivation behind the integration of Islamic finance did not significantly differ from the previous phase, as it appealed to the same basic ideas. Indeed, while reporting on the decision of high street banks to step into the Islamic retail market, the media still justified the decision by highlighting the latent and unfulfilled demand for *Shariah*-compliant products in the UK (or in Europe). The strategic move from conventional banks is hence mainly explained in terms of the economic return while the ethical and normative aspects of the products being sold are mostly ignored. The first and foremost rationale given for the opening of this new retail market is thus financial innovation rather than concerned with the essence of the products themselves. The new ideas that define this alternative body of practices are therefore introduced, once again, as a culture-specific requirement necessary for entering a certain subsection of the banking market.

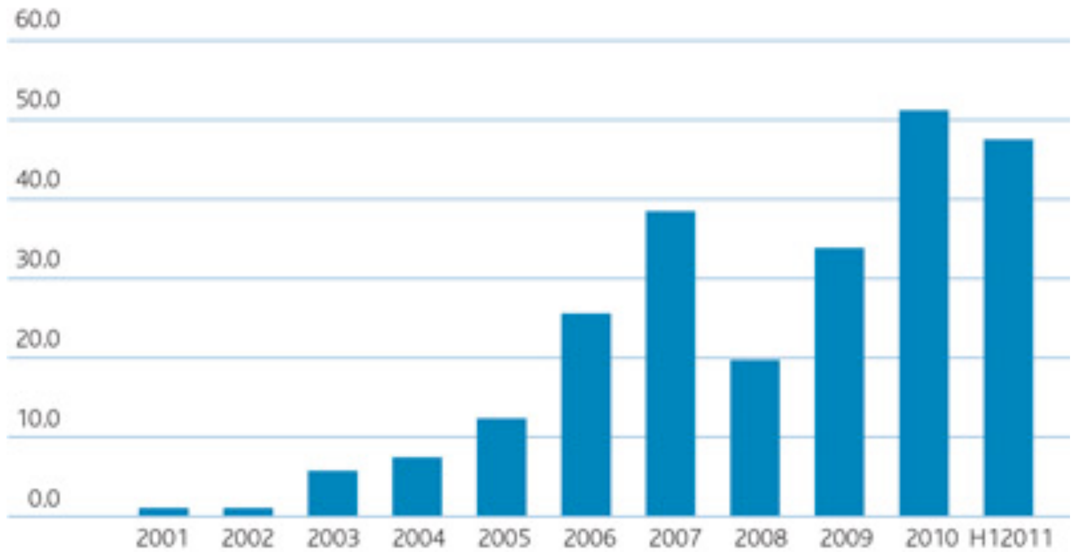
It should be noted that, in some accounts, servicing Muslim communities with *Shariah*-compliant financial products was also described as being motivated by social equity. For Muslims living in interest-based economies, the only choices available to them were previously either to stay away from conventional banking products and services or to go against their faith. Providing them with a choice that is in line with Islam was portrayed as a democratic and fair thing to do. However, it is very difficult to actually dissociate these two motivations for providing *Shariah*-compliant products as, in this case, the conventional banks were indeed making a profit from servicing the Muslim population.

## Further Growth of the Industry

The years between 2005 and 2008 roughly correspond to a transition period during which previous trends were steering the integration of *Shariah*-based knowledge and, at the same time, setting the background for the changes to come. Incidentally, they also correspond to years of increased innovation and growth within the Islamic financial industry both in Europe and within the Muslim world. The new developments reported at this time can be organized into three main topics, which contributed in different ways to increasing the legitimacy of IF in the West.

The first and perhaps the most important topic relates to the introduction of the Islamic bond or *sukuk* market. The issuance of *sukuk* was by no means a novelty – the first attempts to sell Islamic debt trace back to the early 1980s – yet the sporadic reports from the Middle East about these practices did not catch the mainstream attention until the middle of 2005 (although the Islamic bond market actually took off a couple of years earlier; see Figure 5).

**Figure 5 - Global *Sukuk* Issuance 2001-2011 (USD billion)**




Source: World Federation of Exchanges

Expansion into the *sukuk* market was often articulated as the 'next step' (after the introduction of Islamic retail products) in the development of an alternative financial system based on the *Shariah*. Indeed, following reports of the emergence of Islamic current accounts, pension funds and *Shariah*-compliant insurance, the arrival on the market of wholesale products and services such as Islamic bonds and hedge funds reinforced the 'mainstreamization' narrative that had started earlier in the decade. From a small incursion into the everyday lives of Muslim financial agents, the Islamic financial movement had expanded to an even broader audience by appealing to Muslim and non-Muslim institutional investors alike.

The increase in the range of market actors reported to be involved and interested in IF at this point helped confirm the growth and legitimacy of the field. On the one hand, the involvement of Middle Eastern investors indicated the high potential of *sukuk*, as they were reported to be one of the key instruments that could provide a way out of the Middle East for accumulating sovereign wealth funds (FT, 17.08.2006). The post-911 narrative connecting IF with excess capital in search of *Shariah*-compliant investment outputs was then revived by the increased attention paid to the Islamic bond market. On the other hand, the arrival of several non-Muslim institutional entities on the *sukuk* market generated significant interest from market observers, confirming the view that the market had economic potential. In this context, the *sukuk* issued by the Texas-based oil group, East Cameron, the German state of Saxony-Anhalt and the World Bank were recurrently mentioned in the media, signaling the embrace of IF by non-Muslim institutions (BBC, 02.07.2004; FT, 24.11.2006). On the same front, the UK announced its intention to issue the first sovereign *sukuk* from a non-Muslim country in 2007 (GU, 23.04.2007). The news spread rapidly and was used for months to support the legitimacy of an expanding *Shariah*-based financial industry. The UK's plan, however, was postponed the following year due to uncertainty brought about by the outbreak of the international credit crisis. Another possible explanation for Britain shying away from issuing the first European sovereign *sukuk*, was the limited success of previous offerings from non-Muslim institutions (e.g. the World Bank's Islamic bond). Similarly to the case of the Islamic retail market, it appears that instances of failure do not attract the same level of attention. While this can be argued to be a common reporting bias, it nonetheless helps to maintain the narrative of 'continuous growth' in the Islamic financial phenomenon; reporting on its success and growth (with or without obstacles) seems to be the norm.

The second locus of interest during this transition phase is closely related to the spread of *sukuk* to non-Muslim markets, as it pertains to the signaling provided by central figures in conventional finance on the legitimacy of IF. Indeed, one after another, local governments and monetary authorities in Asia and Europe have announced their intentions to become leading international financial centers for IF. While London has been ahead of the trend for more than two decades, many others have attempted to follow in its footpath. Singapore signaled its intention to attract Islamic ventures in 2006 (FT, 12.04.06), despite its close proximity to the buoyant Islamic market in Kuala Lumpur. Hong Kong chief executive Donald Tsang announced in 2007 that the territory would pursue the provision of *Shariah*-compliant products. Paris took several measures aimed at attracting Islamic funds in 2008, in the hope of rivaling London as the western center for IF (FT, 13.05.2008), and, more recently, Ireland amended its tax laws and financial regulations so as to host *Shariah*-compliant ventures (GU, 02.06.2011). This international 'scramble' for Islamic business provided financial agents with a clear message: IF is the next 'big thing' and economic entities that were once major proponents of Western conventional finance are now fighting for the first-mover advantage in this new field.

Finally, the third point of interest in this section is the emergence of international Islamic financial institutions to support the growing industry. From the perspective of Western financial agents, this development came as another natural step in the growth of a fully functional Islamic financial system. Indeed, after the emergence of retail and wholesale products and services, these supporting institutions provided another element that financial agents could easily fit into the familiar image of the existing financial system. Institutions such as the Auditing and Accounting Organisation for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB) were set up as international standard-setting organizations.[5] These institutions allowed one of the main concerns of conventional observers to be tackled, namely, that the lack of international norms in the industry left it as 'little more than a collection of national strongholds' (McKinsey, in the FT, 23.05.2007). While IF's potential to globalize its

[5] The AAOIFI was set up in 1991 and the IFSB in 2002. However, it was only in 2006 when media attention started to focus on the Islamic financial industry in a more systematic manner that these supervisory bodies started to receive significant attention.

activities through standardization was perceived to be a measure of its success, the convergence of standards in this industry is actually much more intricate than in the secular economy. Standardizing Islamic practices would not only ensure more efficient operations at the global level but would also entail a normalization of religious interpretations, which are known to vary significantly across and even within borders. Hence, despite the emergence of Islamic standard-setting authorities with official support from international financial institutions (IFIs), such as the IMF and the World Bank, it was understood that significant improvements to the standardization of Islamic financial products were still required before the alternative financial system could continue growing.

## Islamic Finance in Crisis

After a long period of increased interest in the development of IF, 2008 marked the beginning of a series of difficulties that hindered the perceived potential for 'exponential growth' in the phenomenon. This section covers the two major obstacles that affected the growing and popular *sukuk* market: (i) the Dubai crisis and (ii) prominent *Shariah* scholar Sheikh Muhammad Taqi Usmani's statement that most modern *sukuk* were not *Shariah*-compliant. It is argued here that the bad publicity brought about by these events was ultimately handled in a neutral to positive manner by the media. While the narrative of growth and expansion could easily have been shattered at this point, responsibility for the Dubai debt crisis was apportioned to local economic management rather than to the financial instruments used, while Sheikh Usmani's intervention emphasized the difference between IF and conventional finance at a time of systemic crisis. These two issues will now be discussed in a little more detail.

In the first months of 2008, following three years of exceptional growth (the global *sukuk* issuance had increased by 217% between 2005 and 2007 - see Figure 5), the Islamic bond industry was seized by religious doubt. Sheikh Muhammad Taqi Usmani, one of the most respected religious scholars and chairman of the *Shariah* board at the AAOIFI, declared that 85% of the outstanding *sukuk* was not *Shariah*-compliant since Islamic bonds structured under the *musharaka* and *mubaraba* schemes were breaking two key principles of Islamic law (FT, 19.06.2008). First, they offered investors a repurchase undertaking where the issuer promised to pay back the face value of the bond when it matured or in the event of a default. In practical terms, this amounted to a guaranteed return, which goes against the spirit of IF which says that buyers should share in both risk and profit. Second, the deals were criticized for not always transferring the assets from the borrower to the lender, which once again raised the question of whether the risk was being shared in the financial transaction. *Ijarasukuk* on the other hand, which were dominant before 2005, involves a sale and leaseback arrangement and therefore escaped criticism as material assets (usually a building or other real estate) are used to raise money. Despite an outcry from the industry, Sheikh Usmani's views essentially prevailed when the *Shariah* board of the AAOIFI subsequently met to discuss the issue. In a testimony to the Sheikh's influence, the drastic drop in *sukuk* issuance experienced in 2008 was attributed equally to the global credit crisis and to his condemnation of contemporary bond structuring. However, in the following year, *sukuk* issuance picked up again, the structuring trend reversed, and *Ijarasukuk* once again took over as the dominant type of Islamic bond.

Sheikh Usmani's intervention was undoubtedly a turning point in the evolution of modern IF. The debate he opened was not only about what is and is not considered *Shariah*-compliant, but also about determining structures of authority in a hybridized

Islamic financial system. It is therefore unsurprising that this episode was characterized as the 'debate over the soul of Islamic finance' in media representations since it was basically a standoff between *Shariah* scholars and leading conventional banks over the direction of the industry. The reaction from the market at that point appears to have been largely in favor of the more conservative view of Sheikh Usmani, as illustrated by the reversal of the trend in the *sukuk* market. From the perspective of Western observers, this episode also emphasized the *Shariah*'s appraisal of risk and risk sharing in the framework of economic and financial transactions. Descriptions of the tenets of IF had seldom delved into the justification for the ban on interest before this time. Reporting and explaining Sheikh Usmani's denunciation, therefore, necessitated a deeper conceptual description of the rationale behind IF's 'simple' ban on usury. Hence, knowledge of IF was widened as not only its cultural but, more importantly, its conceptual distinctiveness were emphasized.

In 2009, despite showing decent growth in the midst of the global credit crisis, the Islamic financial industry was shaken once again by Dubai's announcement of a debt standstill. While Dubai's economic turmoil was not directly related to IF, the emirate had previously advertised itself as a pioneer in the field by, among other things, issuing the world's biggest *sukuk* (US$3.5bn). Dubai was hence strongly associated with Islamic financing in international markets. As a consequence, the industry was put into the spotlight as soon as the state-owned conglomerate Dubai World requested a standstill agreement with creditors over claims of around US$26bn. One of the focal points of the media attention in the Dubai crisis fell upon Nakheel, Dubai World's property developer, as there was considerable doubt as to its ability to repay a *sukuk* due to mature in December 2009.[6] The possibility of a *sukuk* default came almost as a surprise after years of continuous growth and projected expansion. Creditors were faced with significant uncertainty as it was unclear which would lose out in any restructuring of the US$3.5bn of Islamic debt.

The Dubai crisis has perhaps been the clearest setback to the Islamic financial industry to have occurred over the period under study as the narrative of the growing industry had to face very tangible setbacks concerning the legal framework under which *sukuk* are issued. The advent of the Dubai standstill drew attention to the uncertainty and immaturity of the Islamic bond industry, previously overshadowed by projections of an ever-growing market. These concerns were quickly set aside, however, when reports started to separate Islamic bonds from Dubai's debt turmoil. The reports pointed out that, as much as Dubai sold itself as the regional center for IF, it only represented about 10% of its outstanding debt in 2009 and, most importantly, most of the debt caught up in the standstill was not Islamic (FT, 14.12.10). Moreover, the *sukuk* issued by Nakheel was repaid on time and in full in the end, without any restructuring or delay (ibid.). Within a couple of months, most reports and commentators agreed that the fallout of the crisis would hit the Middle Eastern region rather than the Islamic financial industry. Within less than a year, market confidence was back, opening the door once again for Dubai to raise capital on both the conventional and Islamic financial markets.

**Islamic finance and the subprime crisis**

In the midst of the subprime financial crisis, there emerged a new perspective on IF, which came to complement existing understandings. While it carried on the discourse of the expansion and growth of *Shariah*-based practices, it was nonetheless based on a

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6 Nakheel is best known for the construction of the palm-shaped islands off the coast of the United Arab Emirates.

quite different approach. This narrative starts with the failure of several high-profile conventional financial institutions (e.g. Lehman Brothers, Bear Sterns, AIG), which were dragged down by their exposure to 'toxic' securitized assets. The ensuing economic downturn and credit crunch spread throughout the global economy, causing significant resentment among financial agents. One observation made in this context was that the IF industry had been relatively, although not completely, immune to the effects of the US subprime problems and the subsequent economic troubles. The reason behind this was straightforward: the toxic assets were simply forbidden by the *Shariah* under the ban on usury and speculation. This is not to say that Islamic financial institutions were not affected by the crisis at all; the effect came a couple of months later, in 2008, when the real economy was hit and investors began to refrain from investing, regardless of religion. However, because they did not lose capital in the midst of the financial turmoil, Islamic financial institutions came out of this episode in better shape than their conventional counterparts (FT, 07.06.2009).

In this context, a number of articles that emerged from 2008 onwards built on the contemporary unrest to reverse the trend and start exploring the substance of *Shariah*-based finance rather than merely looking at its form. Indeed, through the financial crisis, it appeared that it was the religious specificity of IF that allowed its financial institutions to stay clear of trouble. The underlying ideas of IF therefore became more than mere culturally specific requirements for a niche market, and showed potential for a wider appeal. In the process of questioning the essence and organization of global finance, the media then started to cast *Shariah*-based finance in the role of a safer and more stable haven, not only for Muslim savers and investors, but also for conventional secular ones.

In this time of crisis, ideals of stability and morality took precedence over growth and profitability, prompting the re-articulation of IF. These ideals became a potential source of guidance for a fairer and more equitable form of financing, rather than mere instruments for tapping into the Muslim capital pool. This view of *Shariah* finance had been around for quite some time, since *Shariah*-compliant retail products were already being advertised to all segments of the population based on their ethical and anti-speculative character (BBC, 17.12.2006). A significant amount of interest was only generated, however, after the outbreak of the financial crisis in 2007, as these ideals came to resonate with criticism of the modern economy. Now, the case of IF was often brought into discussions on the lack of morality in the financial markets, as it provided commentators with a tangible instance of a growing and successful industry, based on ethical considerations (GU, 20.10.2009; BBC, 07.01.2011).

While this new view on IF only represented one narrative among several concurrent ones, it seems to have played quite a potent role in the dissemination of *Shariah*-based knowledge among Western financial agents. IF was once again put under the spotlight as it contributed to the topical debate on the essence and future direction of the global financial system. *Shariah*-compliant financial ideas thereby not only gained significant exposure, but most importantly, were granted a conceptual distinctiveness based on ethics and morality.

## 4. Conclusion

The main purpose of this paper has been to provide an explanation for the change in attitudes towards IF in global markets in the past two decades. Simply put, in the 1990s IF was seen by conventional financial agents as an obscure set of financial practices but a little less than two decades later it had secured its position as the most successful financial alternative in the global economy.

The identified narratives on IF in Western media during this period reveal the existence of two interpretive breaks that contributed to the building of its legitimacy in global markets. The first break occurred at the turn of the millennium and opened the way for an 'evolutionary phase' in which *Shariah*-based economic practices were integrated through the reproduction of existing narratives from neoclassical economics. The borders of 'legitimate' finance were pushed further by including *Shariah*-compliant practices as a cultural-specific extension to the modern global economy. This new perspective on IF supplanted the skeptical positions recorded among conventional bankers in the 1990s, as signals of the involvement of leading financial institutions spread to the West. The media then started to disseminate a novel image of IF as a growing and promising industry, given the potential demand for such financial products and services. The increased legitimacy was built on a market-led rationale, and emphasis was put on the potential economic success of *Shariah*-based products rather than their essence.

Interestingly, a second interpretive break occurred with the advent of the subprime financial crisis. This started a 'revolutionary' phase in which *Shariah*-based ideas were framed as a way of effecting systemic change from within the global financial system. In this period, the new form of legitimacy for Islamic financial ideas was based on elements traditionally left outside of the economic realm. The scope for *Shariah*-compliant products, previously limited by faith, became increasingly blurred as the social and moral aspects of Islamic financial governance started to come to the fore. The crisis environment in which this competing appraisal of IF emerged played a central role in highlighting the social essence and universal applicability of these alternative practices.

One obvious observation in this context is the importance of the contemporary cognitive frames that are prevalent among conventional financial agents in shaping their appraisal of alternative practices. Indeed, the previous sections have shown that, in times of growth and expansion, alternatives tend to be construed as natural extensions of the dominant practices; thus ideas from across the global economy are normalized based on conventional ones. In periods of recession and crisis, however, those same alternatives can be granted significant legitimacy and even considered potential sources of guidance. While this observation stands to reason when considering the psychological and sociological sides of economic agents, it does however question the assumption of economic rationality, which directly links material reality to economic knowledge and behavior. This investigation of the integration of *Shariah*-based knowledge into Western markets thus not only provides an account of the legitimation of IF but, more importantly, emphasizes the constructed – or, to borrow from the constructivist literature on 'imagined economies', the imagined – character of this financial alternative based on Islam (Cameron and Palan, 2004; Herrera, 2010).

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