THE IMPOSSIBLE, HIGHLY DESIRED ISLAMIC BANK

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ABSTRACT

The purpose of this Article is to explore, and explain the stubborn persistence of, a central paradox that is endemic to the retail Islamic bank as it operates in the United States. The paradox is that retail Islamic banking in the United States is impossible, and yet it remains highly desired. It is impossible because central features of modern banking regulation conflict with fundamental aspects of shari'a *as it is understood in modernity in the context of finance. It is unimaginable that regulators will create exceptions to, or somehow significantly amend, the modern financial regulatory system in the radical fashion necessary to accommodate Islamic finance. Yet notwithstanding such impossibility, Islamic banking is also highly desired in that there is a preoccupation with finding a way to enhance the very limited Islamic commercial banking opportunities that exist in the United States.*

The paradox endures because the Islamic bank, and the accommodation of it within the U.S. regulatory sphere, is a powerful symbol for the accommodation of the broader, pious Muslim public. The pious Muslim eager to see an Islamic bank open in her neighborhood is at best only partly interested in adherence to religious doctrine. The Islamic bank is more importantly a reflection of a broader recognition of her space in the American fabric.

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INTRODUCTION

The purpose of this Article is to explore, and explain the stubborn persistence of, a central paradox that is endemic to the retail Islamic bank as it operates in the United States. The paradox is that retail Islamic banking in the United States is *impossible,* and yet it remains *highly desired.*[1] The reason for its persistence is that the desire to see Islamic banking expand in the United States stems from the strong desire to accommodate Muslims in the broader American fabric, and acknowledging its doctrinal impossibility would seem directly contrary to that strong and salutary impulse. Hence, the impossibility is ignored, and the paradox remains.

To be clear, I do not mean the bank is "impossible" in the sense that an institution holding some sort of banking charter and claiming to be "Islamic" could not possibly exist—some already do, albeit to a very limited extent.[2] I mean instead that an institution claiming to be an American Islamic retail bank violates on a regular basis core aspects of *shari'a*[3] (at least as *shari'a*

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[1] *See infra* notes 2–10 and accompanying text.

[2] *See infra* Part II.E.

[3] I use the term *shari'a* herein to refer to the corpus of extensive, overlapping and oft-conflicting rules developed by Muslim jurists, medieval and modern, from Islam's sacred foundational texts, the Qur'an, as revealed word of God, and the *Hadith,* or statements, utterances, and actions of the Prophet Muhammad. I am often intelligently and thoughtfully criticized for defining this vast and contradictory body of norms and rules developed by medieval jurists as *shari'a*, rather than *fiqh*. *See, e.g.*, Patrick S. O'Donnell, *Divine Law (Shari'ah) and Jurisprudence (Fiqh) in Islam*, RATIO JURIS: LAW, POLITICS, PHILOSOPHY (June 26, 2009, 10:58 AM), http://ratiojuris.blogspot.com/2009/06/divine-law-shariah-jurisprudence-fiqh.html. It is true that the latter term is often used to describe the substantive rules derived by jurists while the *shari'a* conveys a more idealistic sensibility. *See* FRANK E. VOGEL & SAMUEL L. HAYES, III, ISLAMIC LAW AND FINANCE: RELIGION, RISK AND RETURN 23–24 (1998) (distinguishing between *shari'a* as the immutable Divine Law and *fiqh* as human efforts to capture that law through scholarly interpretation); Asifa Quraishi, *What if Shari'a Weren't the Enemy?*: *Rethinking International Women's Rights Advocacy on Islamic Law*, 22 COLUM. J. GENDER & L. 173, 203 (2011) (noting a similar distinction). The problem is that if *shari'a* refers to nothing beyond a perfect and immutable Divine Law separate and apart from any human effort to understand that law, then almost as a matter of epistemological necessity it means precisely nothing that is of value to lawyers. Moreover, if *shari'a* were truly divorced from human understanding of Divine Law, it would render clauses like the one contained in Article 2 of the Egyptian Constitution declaring "the principles of the *shari'a"* to be "the principal source of legislation" entirely baffling. CONSTITUTION OF THE ARAB REPUBLIC OF EGYPT, 11 Sept. 1971, *as amended*, May 22, 1980; *see* Jill I. Goldenziel, *Veiled Political Questions: Islamic Dress, Constitutionalism, and the Ascendance of Courts,* 61 AM. J. COMP. L. 1, 17 (2013) (describing the content of Article 2 of the Egyptian Constitution). Hence I find my definition, while contestable, more appropriate under the circumstances.

is understood within the industry)[4] because fundamental and indispensable parts of United States banking regulation require as much.[5]

Notwithstanding such impossibility, Islamic banking is also highly desired in that there is a preoccupation—an obsession one might say—with finding a way to enhance the very limited Islamic commercial banking opportunities that exist in the United States. Law review articles,[6] government issued policy reports,[7] trade publications,[8] and Islamic finance outlets themselves[9] have discussed—and in some cases advanced—such initiatives at one time or another. Unsurprisingly, these have led largely nowhere because,

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[4] I do not claim the derivations of *shari'a* put forth by modern clerics respecting core Islamic prohibitions in commerce and finance are the only plausible interpretations of Islam's sacred texts that can be developed in those fields. In fact, in earlier work, I pointed to contrary interpretations that are plausible. Haider Ala Hamoudi, *Muhammad's Social Justice or Muslim Cant?: Langdellianism and the Future of Islamic Finance,* 40 CORNELL INT'L L.J. 89, 128–30 (2007) (describing efforts by Arab jurist Abdul Razzaq al-Sanhuri to cast the traditional Islamic prohibition on *riba* as only tangentially concerned with lending money at interest). The point here, however, is that whether or not other plausible interpretations of *shari'a* exist, Islamic finance as an industry has developed its own specific set of prohibitions from the *shari'a*. Any financial institution purporting to act as a retail bank in the United States would necessarily be in violation of more than a few of them, several of which are quite central. Given that an Islamic bank could not credibly disregard broad industry consensus respecting what the *shari'a* does and does not allow in favor of its own (self-serving) interpretations, this presents a rather serious problem.

[5] *See infra* Part II (exploring this in detail).

[6] Roberta Mann, *Is Sharif's Castle Deductible: Islam and the Tax Treatment of Mortgage Debt,* 17 WM. & MARY BILL RTS. J. 1139, 1166–69 (2009). There are also a number of well-written law review notes that argue in favor of regulatory adjustment to accommodate Islamic finance. *See generally* Sulman A. Bhatti, Note, *The Shari'ah and the Challenge and Opportunity of Embracing Finance "Without Interest,"* 2010 COLUM. BUS. L. REV. 205, 207 (2010); Mushfique Shams Billah, Comment, *Arab Money: Why Isn't the United States Getting Any?,* 32 U. PA. J. INT'L L. 1055, 1058 (2011); Kyle Gaffaney, Student Article, *Buying a Home Can Be Difficult for Muslims in the United States,* 21 LOY. CONSUMER L. REV. 557, 565 (2009).

[7] Thomas C. Baxter, Jr., Exec. Vice President and Gen. Counsel, Fed. Reserve Bank of N.Y., Speech Before the Seminar on Legal Issues in the Islamic Financial Services Industry: Regulation of Islamic Financial Services in the United States (Mar. 2, 2005), *available at* http://www.newyorkfed.org/newsevents/speeches/2005/bax050302.html; SHAYERAH ILIAS, CONG. RESEARCH SERV., RS22931, ISLAMIC FINANCE: OVERVIEW AND POLICY CONCERNS 8 (2010); Shirley Chiu et al., *Islamic Finance in the United States: A Small but Growing Industry*, CHI. FED. LETTER No. 214 (Fed. Reserve Bank of Chi.), May 2005, *available at* http://www.chicagofed.org/digital_assets/publications/chicago_fed_letter/2005/cflmay2005_214.pdf.

[8] *See, e.g.*, Vikram Modi, *Writing the Rules: The Need for Standardized Regulation of Islamic Finance*, 29 HARV. INT'L REV. 38, 41 (Spring 2007).

[9] *See, e.g.*, Abdi Shayesteh, *Islamic Banks in the United States: Breaking Through the Barriers*, NEWHORIZON, Apr.–June 2009, at 1.

as noted above, the project is an impossibility. There is no credible *shari'a* compliant banking institution to facilitate. Instead, there are only compromises to be made, inevitably on the side of the Islamic bank, and plain *shari'a* violations to endure.[10]

If this is so, and the next two Parts of the Article will be devoted to demonstrating that it is, then it is worth investigating why there is such interest in Islamic retail banking. Regulators *could,* after all, figuratively shrug their shoulders and inform Islamic banking enthusiasts that American law and regulation can no more accommodate the practice of Islamic banking than it can accommodate a group of people who refuse to pay income taxes for purportedly religious reasons.[11] Islamic banking enthusiasts could see the reality for what it is, resign themselves to the current state of affairs, and give up on an Islamic bank, at least in the short to medium term, given the fundamental incompatibilities it presents to American regulation. Instead there is the endless repetition of a charade, where one side pretends to care about accommodation, and the other pretends to find a way to work within accommodations provided, when it is perfectly clear that on the plains of doctrine, the two sides cannot possibly meet.

In fact, there is ample reason the efforts continue.[12] But to understand it, we must look beyond the legal doctrine underlying Islamic retail banking on the one hand, and American regulation of financial institutions on the other. In fact, the matter has relatively little to do with the niceties of banking regulation on its own terms, Islamic or American. Instead, the bank, and the accommodation of it within the U.S. regulatory sphere, merely represents a symbol for the accommodation of the broader, pious Muslim public.[13]

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[10] *See* McKean James Evans, Note, *The Future of Conflict Between Islamic and Western Financial Systems: Profit, Principle and Pragmatism*, 71 U. PITT. L. REV. 819, 820 (2010) (predicting that "accommodations made by Western systems will be primarily formalistic, while the compromises made by the Islamic system will come mainly from principle.").

[11] Numerous individuals have claimed, and continue to claim, that the payment of income taxes violates their religious conscience and therefore applying the tax laws to them is a violation of the Free Exercise Clause, the First Amendment to the U.S. Constitution, and the Religious Freedom Restoration Act, 42 U.S.C.A. §§ 2000bb to bb-4 (West 2013). Courts invariably reject such claims because of the compelling government interest in "maintaining a sound tax system, free of myriad exceptions flowing from a wide variety of religious beliefs." Hernandez v. Comm'r, 490 U.S. 680, 699–700 (1989) (citations omitted). *See also* United States v. Lee, 455 U.S. 252, 257–58 (1982) (stating the same with respect to social security taxes); Jenkins v. Comm'r, 483 F.3d 90, 92 (2d Cir. 2007) (rejecting a similar claim under the Religious Freedom Restoration Act). The governmental interests in maintaining a sound financial system are surely no less strong, particularly following the financial crisis that began with the collapse of Lehman Brothers in 2008.

[12] *See infra* Part II.E.

[13] *See infra* Part III.A.

The pious Muslim, eager to see an Islamic bank open in her neighborhood, earn a national charter, and offer products and services, including demand deposit services, is at best only partly interested in adherence to religious doctrine. At the very least, with the slightest bit of inspection, that Muslim will surely discover practices at stark variance with some of the core rules of Islamic finance and almost in direct opposition to the purported principles of the practice.[14] Yet, the Muslim remains eager because the Islamic bank is a reflection of a broader recognition of her space in the broader American fabric.[15] Her religion is not only recognized, but her financial practices are respected and indeed legitimized by the relevant American legal and regulatory regime. She is, in this sense, comfortable being both thoroughly American and thoroughly Muslim.

As for American regulators and most policymakers, part of the nation's elite, they instinctually prefer messages of inclusion to those that appear xenophobic or intolerant, and they are predisposed to help find a way to accommodate this broad Muslim desire.[16] Hence, members of the Department of the Treasury assure us in remarks and publications that such efforts at accommodation are underway.[17] Federal regulators regularly appear at Islamic finance conferences.[18] Several participated in a workshop sponsored by the Islamic Finance Project of Harvard Law School in 2004 dedicated specifically to discussing regulatory concerns, and the keynote speaker was the Undersecretary for the Treasury.[19] In 2005, the Federal Reserve Bank of New York sponsored a conference in Kuwait City on a similar topic.[20] In 2008, the Department of Treasury sponsored a seminar in Washington, DC entitled "Islamic Finance 101."[21] In addition to scheduling and attending all of these conferences, in 2004, the Department of the Treasury initiated a "scholar in residence" program to help the Department better understand Islamic finance and named its first scholar in residence.[22]

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[14] *See infra* Part III.A.

[15] *See infra* Part III.A.

[16] *See infra* Part III.A.

[17] *See* Baxter, *supra* note 7, at 1–3; Chiu et al., *supra* note 7, at 3–4.

[18] It is rare for any Islamic finance conference or seminar in the United States, among the many that I have attended, not to have a speaker on a panel who serves in some regulatory capacity in the federal government. *See, e.g.*, Baxter, *supra* note 7, at 2.

[19] *Program of Sixth Harvard University Forum on Islamic Finance*, ISLAMIC FINANCE PROJECT OF HARVARD LAW SCHOOL, ifp.law.harvard.edu/login/view_pdf/?file=forum6th .pdf&type=forums (last visited Jan. 12, 2014) [hereinafter *Program*].

[20] William L. Rutledge, Exec. Vice President, Fed. Reserve Bank of N.Y., Remarks at the 2005 Arab Bankers Association of North America (ABANA) Conference on Islamic Finance: Players, Products & Innovations in New York City (Apr. 19, 2005), *available at* http://www.newyorkfed.org/newsevents/speeches/2005/rut050422.html.

[21] Shayesteh, *supra* note 9, at 2.

[22] Baxter, *supra* note 7, at 2. For reasons that are somewhat unclear, the Department of the Treasury selected as its first scholar in residence, Mahmoud El-Gamal, a critic of Islamic

The purpose of all of this engagement—undertaken under both Democratic and Republican administrations—is hardly to develop useful consensual solutions to outstanding regulatory concerns. The Department does not need a "scholar in residence"[23] or an "Islamic Finance 101" seminar to do that.[24] It surely is aware of the premier regulatory issues and obstacles. If its staff did not learn them sufficiently at the Islamic Finance Project seminar in Harvard Law School in 2004,[25] in New York City in 2005,[26] or at the Islamic Finance 101 conference in 2009,[27] it is hard to imagine they will learn them now. In any event, as explored further below, it really matters little what the Treasury Department actually knows about Islamic finance. This is because it is perfectly clear that accommodating an Islamic bank is impossible, doctrinally unthinkable given the central purposes of banking regulation in the United States.

Rather, dialogue and engagement help to demonstrate something else; namely, that the government is *determined* to help to find space for the pious Muslim in the United States, *respectful* of the pious Muslim's religious commitments and *aware* of the Muslim's ability to function both as Muslim and as American simultaneously. Thus, the dialogue and engagement for the most part occurred after September 11, 2001, when the position of Muslims in the United States was the most vulnerable. Yet, by that time, the Department of the Treasury had already made the major substantive accommodations it was willing to make to integrate Islamic finance into the rubric of American banking regulations. This was done in the form of two interpretive letters issued by its Office of the Comptroller of the Currency (OCC), in 1997 and 1999, respectively.[28] In other words, the actual accommodations preceded the dialogue and the engagement precisely because the government was not engaging in dialogue in order to overcome remaining obstacles through some sort of further accommodation, but rather to demonstrate a desire to integrate Muslims into the broader American fabric.[29]

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finance so severe that he describes existing Islamic finance practices as being a form of "*shari'a* arbitrage" and compares the collection of the fees and expenses gathered by those that design and bless *shari'a* compliant transactions to the medieval practices of selling indulgences. MAHMOUD A. EL-GAMAL, ISLAMIC FINANCE: LAW, ECONOMICS AND PRACTICE 1 (2006).

[23] *See* Baxter, *supra* note 7, at 2.

[24] *See* Shayesteh, *supra* note 9, at 2.

[25] Program, *supra* note 19.

[26] Rutledge, *supra* note 20.

[27] Shayesteh, *supra* note 9, at 2.

[28] *See* Rutledge, *supra* note 20. The interpretive letters are also discussed in greater detail in the next section.

[29] *See id.*

The symbolic power of Islamic finance as a form of welcoming a Muslim presence in the United States is not lost on those who view the growing Muslim presence on American soil as some sort of existential threat. Thus, just as there are efforts at accommodation on the part of executive officials, there has also been a widespread, sustained and multipronged attack on Islamic finance, precisely on the (erroneous and in fact inane) grounds it helps to fund terrorism and *jihadism* and otherwise threatens American security.[30]

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[30] This is very much an effort directed at Muslim exclusion. Islamophobic elements, for example, began a well-nigh incoherent campaign to remove halal meat from stores in France. Dale Hurd, *Muslim Halal Food Sales Supporting Terrorism?,* CBN NEWS (Jan. 9, 2011), http://www.cbn.com/cbnnews/world/2011/January/Muslim-Halal-Food-Sales-Supporting-Terrorism/. The effort might be deemed quixotic, but, more successfully, in the state of Oklahoma, a state amendment to the constitution was passed that read in relevant part as follows:

> The Courts [in] exercising their judicial authority, shall uphold and adhere to the law as provided in the United States Constitution, the Oklahoma Constitution, the United States Code, federal regulations promulgated pursuant thereto, established common law, the Oklahoma Statutes and rules promulgated pursuant thereto, and if necessary the law of another state of the United States provided the law of the other state does not include Sharia Law, in making judicial decisions. The courts shall not look to the legal precepts of other nations or cultures. Specifically, the courts shall not consider international law or Sharia Law. The provisions of this subsection shall apply to all cases before the respective courts including, but not limited to, cases of first impression.

The Tenth Circuit upheld a preliminary injunction against implementation of the amendment on the grounds that the amendment is in violation of the Establishment Clause. Awad v. Ziriax, 670 F.3d 1111, 1117-18 (10th Cir. 2012). The Western District of Oklahoma then entered a permanent injunction in August of 2013 on the same grounds. Awad v. Ziriax, No. CIV-10-1186-M, 2013 WL 4441476 (W.D. Okla. Aug. 15, 2013). For an excellent and thorough discussion of the amendment and its potential implications concerning *shari'a,* international law, and the conflict of laws, see generally John T. Parry, *Oklahoma's Save Our State Amendment and the Conflict of Laws,* 65 OKLA. L. REV. 1 (2012).

Other legislative efforts exist as well, including Tennessee's proposed anti-shari'a measure. This bill defines a *shari'a* organization as two or more persons practicing *shari'a,* defines *shari'a* as rules "emanat[ing] directly or indirectly from the god of Allah and the Prophet Mohammed," and indicates that to offer material support to a *shari'a* organization designated by the Attorney General as having a terrorist intent is a felony carrying a 15 year minimum prison sentence. S.B. 1028, 107th Leg. (Tenn. 2011), §§ 39-13-904(1)-(2), 39-13-906(a)(1)(B). Because the primary sources of Islam encompass rules of worship, such as prayer, this means that a *shari'a* organization is any two individuals who gather for group prayers whom the Attorney General decides have terrorist intent. N. J. COULSON, A HISTORY OF ISLAMIC LAW 12 (1964). To offer these individuals a place to pray would then, under this bill, constitute a felony punishable by a minimum of fifteen years in prison. Unsurprisingly, few Muslims find comfort in the bill's simultaneous assurance that it "neither targets, nor incidentally prohibits or inhibits, the peaceful practice of any religion, and in particular, the practice of Islam by its adherents." S.B. 1028, 107th Leg. (Tenn. 2011) § 39-13-903(4).

Just as the hopeless and impossible-to-satisfy efforts to accommodate Islamic banking arise more out of a wellspring of tolerance and inclusion, so the efforts to end all forms of Islamic finance arise more out of a desire to exclude Muslims than they do out of any reasonably articulated doctrinal objection to Islamic finance per se.[31]

There are broader lessons we can glean from the story of Islamic banking in America. One important lesson concerns the surprising resilience and indeed expansion of Islamic finance across the globe. It is no secret that the global Islamic finance industry has made significant compromises of its own. Many commentators have pointed out that it has departed from its own idealistic visions to achieve something that looks more like a mimicry of conventional finance to comply with narrow and highly formalistic prohibitions.[32] This criticism has become something of a mainstay in conferences devoted to Islamic finance and in discussions about the practice.[33] Despite the extensive

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Finally, of course, there are the efforts to prohibit mosque buildings in various parts of the United States. The media explosion surrounding the building of a so-called "Ground Zero Mosque"—in fact a Muslim community center several blocks away from the site of the terrorist attacks on September 11, 2001—is well known. *See* Robert Farley, *Fact Checking the 'Ground Zero Mosque' Debate,* POLITIFACT (Aug. 20, 2010), http://www.politifact.com/truth-o-meter/article/2010/aug/20/fact-checking-ground-zero-mosque-debate/. Less well known is the opposition that greets proposed mosque-building projects as far from Ground Zero as Murfreesboro, Tennessee. Robbie Brown & Christine Hauser, *After a Struggle, Mosque Opens in Tennessee,* N.Y. TIMES (Aug. 10, 2012), http://www.nytimes.com/2012/08/11/us/islamic-center-of-murfreesboro-opens-in-tennessee.html. In addition, one member of Congress has declared that America already has "too many mosques" and 85 percent of the existing mosques are controlled by extremists. *Rep. Peter King: There are 'too many mosques in this country,'* POLITICO (Sept. 19, 2007, 7:22 PM), http://www.politico.com/blogs/thecrypt/0907/Rep_King_There_are_too_many_mosques_in_this_country_.html.

31 *See infra* Part III.B.

32 *See, e.g.*, Hamoudi, *supra* note 4, at 94 ("Proponents of Islamic finance often repeat ... functional objectives of fairness and social justice, but do not employ appropriate methodological techniques to achieve these goals."); Mahmoud A. El-Gamal, *"Interest" and the Paradox of Contemporary Islamic Law and Finance*, 27 FORDHAM INT'L L.J. 108, 127 (2003) ("On the assets side, Islamic banks avoid the risks of profit and loss—sharing investment arrangements by engaging mostly in cost—plus trading and lease financing .... [B]oth forms of finance mimic conventional bank financing to a very high degree, with few technical details."); Nazim Zaman & Mehmet Asutay, *Divergence Between Aspirations and Realities of Islamic Economics: A Political Economy Approach to Bridging the Divide*, 17 IIUM J. ECON. & MGMT. 73, 74 (2009) ("[T]he Islamic banking and finance (IBF) industry ... unfortunately has not realized the goals and aspirations put forward by the pioneers in the 1960s and early 1970s. Rather, the ... industry seems to have grown as part of the conventional financial sector in the global capitalist economy.").

33 Zubair Hasan, *Islamic Banking at the Crossroads: Theory Versus Practice*, *in* ISLAMIC PERSPECTIVES ON WEALTH CREATION 11 (Munawar Iqbal & Rodney Wilson eds., 2005); Zaman & Asutay, *supra* note 32, at 74.

dialogue and expressions of concern both within and outside the industry, the practice has not changed,[34] and more importantly, it has not needed to. The practice is quite capable of expanding at dizzying rates using almost exclusively narrow and formalistic techniques that even widely respected proponents of the practice do not defend with any degree of vigor.[35]

This is another riddle, one that is related to the paradox concerning the mystifying interest in the impossible American Islamic bank. One might expect less interest in Islamic finance as it grew increasingly narrow, formalistic and mimicking. Specifically, to quote one prominent Islamic scholar who is a leader in the industry, the fear would be that "[i]f the system does not make significant progress" in realizing its own articulated vision of what Islamic finance is supposed to achieve, "it will lose credibility in the eyes of the Muslim masses and the rapid progress that it has been making may not be sustainable."[36] That statement was made in 2008, when Islamic finance was estimated to involve $500 billion in assets.[37] An Ernst & Young report suggested at the end of 2012 that in 2013, Islamic finance would surpass the $1.8 *trillion* mark.[38] The resilience demands explanation, and extralegal considerations of the sort discussed in the context of the American Islamic bank help to explain it.

Part I of this Article discusses in greater detail the practice of Islamic finance, and outlines its vision of profit and loss sharing. This Part also describes the broad deviation from the ideal practice that generally occurs irrespective of regulatory obstacles. Part II sets forth precisely why American laws and regulations not only render the ideal vision unrealistic, but also would force fairly central violations of *shari'a* onto an Islamic bank, thereby making it impossible to credibly claim that it is a *shari'a* compliant institution. Having demonstrated the impossibility of the Islamic banking enterprise, Part III offers an alternative explanation for the broad Muslim desire for more Islamic banking in the United States and the reason the Department of the Treasury has gone through such great efforts to engage with it to no obvious fruitful

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34 *See, e.g.*, MUFTI MUHAMMAD TAQI USMANI, AN INTRODUCTION TO ISLAMIC FINANCE 161–69 (2d ed. 2008) (expressing dismay at the failure of Islamic banks to adhere to the principles of Islamic finance as they expand). *See generally* M. Umer Chapra, Speech at Eighth Harvard University Forum on Islamic Finance: Innovation and Authenticity 11–14 (Apr. 19, 2008), http://ifp.law.harvard.edu/login/view_pdf/?file=Ummer_Chapra.pdf&type=forums.

35 Chapra, *supra* note 34, at 11–14 (describing the respective positions of Usmani and Chapra on some of the artifices used to evade core *shari'a* prohibitions).

36 *Id.* at 12.

37 Isam Salah, *Islamic Finance in the Current Financial Crisis*, 2 BERKELEY J. MIDDLE E. & ISLAMIC L. 137, 138 (2009) (citing a study and projection undertaken by Moody's in 2008).

38 *International Connectivity Vital for Further Growth of the Islamic Banking Industry*, BAHRAINI NEWS AGENCY (May 20, 2013, 3:04 PM), http://www.bna.bh/portal/en/news/561535 [hereinafter *Future Growth*].

end. This is a quest for greater Muslim belonging, a sentiment on both sides to seek Muslim inclusion in the broader national fabric. This Part also shows the manner in which opposition to Islamic finance in the United States is better understood as an effort to exclude and isolate Muslims than as any sort of principled objection to the practice on its own terms. Finally, the Conclusion presents summary thoughts on why taking account of extra-doctrinal considerations, of the sort explored in this Article not only sheds light on why there is such interest in Islamic banking in the United States, but also why Islamic finance continues to expand at such dizzying speeds globally, notwithstanding its own compromises.

I. PROFIT AND LOSS SHARING: THEORY AND PRACTICE

It is quite difficult to find an account of Islamic banking—whether in an academic publication, a trade journal or a newspaper article—that does not at least start with the canard that Islamic finance relies upon the principle of profit and loss sharing, strictly forbidding the interest-based return on which conventional banks rely.[39] Hence, early Islamic finance advocates posited the ideal form of the Islamic bank as a two-tiered silent partnership.[40] At the lowest end of the system were the portfolio investments, where a bank, as "silent partner," supplied necessary finance and an entrepreneur did the necessary labor, thereby justifying an agreed upon division of profits and losses for each of them based on a ratio they set between themselves.[41] Then, as the ventures made (or lost) money, the bank's portion of the profits (or losses) generated would be funneled through the bank and its depositors.[42] In this second silent partnership, it is the bank effectively doing the labor vis-a-vis the depositors, who are the silent partners.[43]

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[39] For representative examples of this, *see* ABDULLAH SAEED, ISLAMIC BANKING AND INTEREST 1 (2d ed. 1999) ("The theory of Islamic banking ... maintains that Islamic banking is interest-free banking based on the concepts of *mudāraba* and *mushāraka,* that is, Profit and Loss Sharing (PLS)."); USMANI, *supra* note 34, at 27–28; Abbas Mirakhor & Iqbal Zaidi, *Profit-and-Loss Sharing Contracts in Islamic Finance*, *in* HANDBOOK OF ISLAMIC BANKING 49 (Hassan & Lewis eds., 2007) ("The main difference between an Islamic or interest-free banking system and the conventional interest-based banking system is that, under the latter, the profit is fixed in advance or is a simple linear function of some other benchmark rate, whereas, in the former, the profits and losses on a physical investment are shared between the creditor and the borrower according to a formula that reflects their respective levels of participation."); Chiu et al., *supra* note 7, at 1 (indicating that Islamic finance "is based on a profit and loss structure rather than a lender-borrower arrangement").

[40] VOGEL & HAYES, *supra* note 3, at 130–31.

[41] *Id.* at 129–30.

[42] *Id.* at 130.

[43] *Id.* at 130–31.

At the portfolio level, this is in sharp contradistinction to conventional loans, which involve an obligation to pay back the lender an additional amount corresponding to interest irrespective of the extent to which the borrower has profited or lost money from the underlying enterprise. Islamic finance sharply decries such a practice, declaring interest in all forms to be absolutely prohibited under the *shari'a*.[44] The chief justification for this interest ban offered by Islamic finance advocates is precisely that lending at interest does not call for sharing in gains and losses, but rather requires one party to bear the losses even as the other earns profit.[45]

A sample bank portfolio might then involve, for example, credit offered to homeowners to fund the purchase of homes. However, where in conventional finance the bank would simply loan the money to a homeowner and expect repayment at interest, in an Islamic system, the bank and the putative homeowner would buy the home together.[46] When the home was sold, they would then share in the profits or losses from the sale, as the case may be.[47] Hence, if the home was purchased for $100,000, with the homeowner supplying a down payment of $10,000, then rather than the bank lending the $90,000 balance, it would own 90 percent of the home. If the home were instantaneously resold, profits or losses would be divided between the homeowner and bank based on their respective ownership percentages.[48]

Of course, in most situations, the parties do not immediately resell the home because the point of the transaction was not speculation but because the homeowner wanted to live in the home. In such circumstances, the homeowner would be living in a house that the bank primarily paid for. Obviously, the bank, whether Islamic or otherwise, is a profit making institution and

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[44] MUHAMMAD NEJATULLAH SIDDIQI, BANKING WITHOUT INTEREST 7 (1983) (describing the position permitting some forms of interest as "defeatist"); SAEED, *supra* note 39, at 50 (describing this position prohibiting interest as "dominant" and "the basis of Islamic banking theory as well as practice."); Muhammad Uzair, *Impact of Interest Free Banking*, 3 J. ISLAMIC BANKING & FIN. 39, 40 (1984) ("By this time, there is a complete consensus of all ... schools ... and among Islamic economists, that interest in all forms, of all kinds, and for all purposes is completely prohibited in Islam. Gone are the days when people were apologetic about Islam and contended that the interest for commercial and business purposes, as presently charged by banks, was not prohibited by Islam.").

[45] Haider Ala Hamoudi, *The Muezzin's Call and the Dow Jones Bell: On the Necessity of Realism in the Study of Islamic Law*, 56 AM. J. COMP. L. 423, 456–58 (2008).

[46] *Id.*

[47] *Id.*

[48] Technically, this arrangement would not be a *mudaraba,* or silent partnership, where one party supplies the labor and the other the capital, as would be the case, for example, if a bank supplied capital to a chef to open a restaurant. Rather, it is a *musharaka,* because each party contributes capital to the enterprise. USMANI, *supra* note 34, at 47 (describing the distinction between *mudaraba* and *musharaka*).

is therefore hardly in the business of offering its customers free housing indefinitely. Thus, as part of the overall transaction, the homeowner would have to agree to pay rent for the privilege of living in the home, with the proceeds of such rent accruing partially to the homeowner and partially to the bank based on their respective ownership proportions.[49] In other words, if the parties set the rent to the homeowner at $1,000 a month, then $900 of it would run to the bank, and $100 would belong to the homeowner because the homeowner owns 10 percent of the house. That portion of the rent accruing to the bank is profit to the bank, to be shared with its depositors based on the sharing percentages to which they agreed.[50] The balance of the rent is also paid over to the bank by the homeowner for the purpose of purchasing a very small ownership stake from the bank. Thus, after one monthly payment, the homeowner has paid $900 in rent to the bank and purchased a $100 ownership stake, or .1 percent of the value of the home, so that its ownership stake is now 10.1 percent and the bank's is the balance, or 89.9 percent.

Over time, as the ownership percentage of the homeowner increases, the homeowner uses more of the monthly payment to purchase an ownership percentage, and less profit is thus given to the bank (and derivatively, its depositors). To see why this is so, assume after some number of monthly payments, the homeowner's ownership percentage in the home has increased from 10 percent to 20 percent. At this point, if the rent remains $1,000, then only $800 is due the bank because it only owns 80 percent of the home, and the remaining $200 is directed to home purchase, meaning the monthly payment now secures a .2 percent increase in the homeowner's ownership percentage. Eventually in such a case, over the course of some number of years, the homeowner will own the home outright. By adjusting the rent figures, it would not be difficult for the parties to fix that term as the same thirty years used in conventional mortgages.[51]

At a superficial level, this seems to resemble a conventional mortgage in many ways. The homeowner pays a set amount for thirty years and at the end owns the home clear of any cloud on the title. However, there are quite significant differences with conventional finance given the bank's continuing ownership of part of the home. For one thing, the bank would have a strong interest in insuring a suitable resale price of the home. After all, if the $100,000 home rose in value to $150,000 and it was sold, the bank would share in the $50,000 profit based on its percentage ownership. Likewise, if

[49] VOGEL & HAYES, *supra* note 3, at 138–39.

[50] In Islamic parlance, such a leasing arrangement is referred to as an *ijara*. *See id.* at 9.

[51] This entire transaction is referred to as a "diminishing *musharaka*" because of the reduction and ultimate elimination of the bank's ownership share as the homeowner purchases it. *See* Mann, *supra* note 6, at 1150.

the property dropped in value to $50,000, and the parties chose to sell the home, they would likewise share in the loss of $50,000 at the same rate.

Moreover, those same profits and losses funnel through to the depositors in the bank. Let us assume the bank shares profits and losses with its borrowers such that its borrowers collectively receive half of the profits and losses in the joint venture, with the bank receiving the other half. In that case, the sale of the home for $150,000 would lead to the bank's total gain of $45,000 (assuming it owned 90 percent of the home at the time of sale). This gain would be shared equally by the bank, which would receive $22,500, and its depositors, who would collectively receive $22,500 as well, divided pro rata based on the size of their deposits. If the house were sold at a $50,000 loss, then the depositors and the bank would share their losses in the same amounts.

While advocates of Islamic finance have heaped no shortage of praise upon this method of financing,[52] it suffers from one significant drawback. It does not work, and for reasons quite apart from regulatory constraints.[53] For one thing, depositors with demand deposit accounts are not likely to be particularly patient for very long if they see their deposit amounts reduced because of bank losses. This leaves the bank quite susceptible to a bank run as depositors rush to withdraw their funds before the cash runs out.[54] Moreover, the bank would need to be much more involved in the monitoring and management of its portfolio investments if it were to be sharing in their profits, rather than just earning a fixed return.[55] This would not be cheap, and would reduce the returns of the depositors, leading the bank to be uncompetitive.[56] For these and many other reasons, those banks which initially tried profit and loss sharing—in jurisdictions where bank regulation presented no obstacle—failed rather miserably at it, and alternative models began to develop.[57]

These alternative models have traditionally been based on the artifice known as the *murabaha*, which works out to a credit sale with a markup.[58]

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[52] *See, e.g.*, Mirakhor & Zaidi, *supra* note 39, at 49 ("[P]rofit-sharing contracts have superior properties for risk management, because the payment the entrepreneur has to make to the creditor is reduced in bad states of nature."); USMANI, *supra* note 34, at 27–28; Chapra, *supra* note 34, at 4 ("Instead of making the bankers as well as depositors share in the risks of business, the conventional financial system almost relieves them of the risks. The ability of the market to impose the required discipline thus gets impaired and leads to an unhealthy expansion in the overall volume of credit, to excessive leverage, to even subprime debt, and to living beyond means.").

[53] VOGEL & HAYES, *supra* note 3, at 135.

[54] *Id.* at 134.

[55] Hamoudi, *supra* note 4, at 117.

[56] *Id.*

[57] *Id.* at 117–18.

[58] VOGEL & HAYES, *supra* note 3, at 135.

Essentially, the bank purchases the *entire property*, and then sells it immediately to the homeowner at a markup, with the homeowner paying $10,000 immediately, and the balance over the course of thirty years.[59]

It should not be difficult to see how this replicates a fixed rate mortgage in its economic effects much more closely than it does a profit and loss sharing model. For a fixed rate thirty-year mortgage, at an interest rate of 3.770 percent, a $90,000 loan for a $100,000 home (with the homeowner paying the balance as a $10,000 down payment) would require a total payment of $150,417.39, divided into equal monthly installments of $417.83. However, if the bank were not to loan the money at all, but purchase the home on the market for $100,000, then it could sell it to the homeowner for $160,417.39. Of this sum, $10,000 is due immediately and the balance, of $150,417.39, would be due to the bank, with the homeowner paying it in monthly installments of $417.83. This amount would not be subject to change if the value of the home increased or decreased, because the bank had already sold the home to the homeowner for a price certain. The primary risks to the bank—the bankruptcy or delinquency of the homeowner—are those that exist as to a conventional lender as well. There is simply not very much profit or loss sharing to speak of. Still, the *murabaha* is one of the two premier contracts used in Islamic retail banking.[60]

Despite the obvious departure from the profit and loss sharing principle, industry advocates provide two reasons for the permissibility of the *murabaha*. First, while it is hardly the ideal instrument to be used to bring about Islamic banking in its purest form, it is characterized by leading Islamic finance expert M. Taqi Usmani as a "transitory step taken in the process of the Islamization of the economy," necessary given the hegemony of conventional banking methods and techniques.[61] This notion that Islamic finance is neither of a size nor in a setting necessary to enable it to carry through on its true principles of profit sharing is a rather popular one.[62] It is used to justify almost any compromise that the industry makes from the values it articulates respecting profit and loss sharing.[63]

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[59] *Id.*

[60] Hamoudi, *supra* note 4, at 119. *See also* Umar F. Moghul, *No Pain, No Gain: The State of the Industry in Light of an American Islamic Private Equity Transaction*, 7 CHI. J. INT'L L. 469, 471 (2007). The other major form of financing is lease financing, through the *ijara.* I have not discussed lease financing here as used in the industry extensively for reasons of space, but it suffices to say for these purposes that Islamic financing through *ijara* relies no more on profit and loss sharing than the *murabaha* does. *Id.*; *see also* El-Gamal, *supra* note 32, at 129.

[61] USMANI, *supra* note 34, at 72.

[62] Haider Ala Hamoudi, *The Surprising Irrelevance of Islamic Bankruptcy*, 19 AM. BANK. INST. L. REV. 505, 517 (2011).

[63] *See, e.g.*, Moghul, *supra* note 60, at 471–73.

The second justification for the *murabaha,* and the more pertinent one for our purposes, is that when properly administered, it is different from a conventional loan even if it is not very much of a profit and loss sharing instrument.[64] This is because the bank does own the home for the period of time between purchasing it, and eventually transferring it to the homeowner via a resale. This element of possession, physical or constructive is described by the widely respected M. Taqi Usmani as "the only feature of *murabaha* which can distinguish it from an interest-based transaction[.]" He insists that it "must be observed with due diligence at all costs," emphasizing the point by placing this proviso in bold letters.[65]

To be clear, this incidence of ownership does not create a risk if administered by any reasonably competent bank manager.[66] Admittedly, if the period of time that the bank happens to own the real estate before it has been transferred to the homeowner was significant, then a risk might indeed exist. That risk would not be that the homeowner would somehow refuse to purchase the property because that sale contract would have been concluded before the bank initially purchased the property. Rather, it would be that during the period that the bank owned the home, the home might be destroyed by fire or other natural disaster, that the value of the property would diminish dramatically for any other reason, triggering a buyer default, or that any of the other risks incident to the ownership of property might come to pass.

Yet while he does not say this, surely Usmani realizes as well as anyone else how easy it is to reduce that risk to such an extent that it is infinitesimally small and entirely meaningless by any effective measure.[67] If the bank's sole risk lies in holding the property for some period of time, and yet *no minimum period of time is specified,* the obvious solution would be to reduce the time period of such ownership. The chance of a zoning change taking effect over a particular piece of property on a given day might be small, but the chance that it occurs in a five minute period is even smaller, and over five seconds smaller yet. Render the period one one-thousandth of a second, and only marginal risks remain.

Thus, even without regulatory constraints, we see that Islamic finance exists in a considerably straitjacketed form, one that claims that the basis of the industry is profit and loss sharing, but also one that has by its own admission relied instead heavily on artifice and mimicry to grow into the size that it has.[68] A primary justification offered in defense of such artifice, at least

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[64] *Id.*
[65] USMANI, *supra* note 34, at 75.
[66] *Id.* at 166.
[67] *Id.*
[68] *Id.* at 162.

with respect to the *murabaha,* is that the fact of property ownership involved therewith distinguishes it in important ways from a conventional transaction, even if the risks associated with that ownership may be quite small.[69] The next section will demonstrate how regulatory constraints require Islamic banks to downplay and almost dismiss the latter formal distinction on which such emphasis is placed. The section will further show how other, central violations of *shari'a* likewise become necessary in order to comply with fundamental U.S. regulatory rules.

II. On the Illegality of Bank Profit and Loss Sharing

Per U.S. regulation, banks are not supposed to operate under profit and loss sharing principles.[70] In fact, profit and loss sharing principles are the antithesis of how banks are supposed to operate. A number of laws and regulations make this amply clear.[71] This section will describe a series of subject areas in the field of financial regulation and further show the extent to which the relevant rules in these respective areas make *shari'a* compliant banking absolutely impossible. I begin with the most straightforward of the regulatory limitations, which prohibit the ownership of real estate outright.

A. Regulation and Asset Ownership

The National Banking Act generally bars a bank from owning real estate.[72] The purpose of the real estate ban seems obvious enough—a bank should not be subject to the risks of real estate ownership, from the potential decline in housing values to risks associated with rezoning or natural disaster.[73] Hence, as an exception, a bank may own the real estate on which it places its branch offices, and it may hold real estate for up to five years when the real estate was secured by a mortgage issued by the bank.[74] In the former case, the bank would not be at any significant risk given the relatively small amount of real property at issue. In the latter case, the circumstances make ownership

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[69] *Id.* at 166.

[70] *See infra* Part II.A–C.

[71] *See infra* Part II.A–C.

[72] 12 U.S.C.A. § 29 (West 2013).

[73] Obviously, any bank that lends money to future homeowners is secondarily vulnerable, to some extent, to the same risks as a homeowner because the homeowner who is subjected directly to those risks is more likely to be delinquent in making mortgage payments when there is a problem. Still, the risks of real estate ownership are most directly felt by the owner rather than the institution that lent the owner the money necessary to make the purchase. Or at least Congress appears to have so concluded by virtue of its enactment of the real estate ownership ban for banks contained in 12 U.S.C.A. § 29.

[74] 12 U.S.C.A. § 29.

unavoidable—the bank must foreclose on the property that secured its initial loan if it is to get its money back—but are minimized to the extent realistic by requiring a resale within five years of taking possession.

Highly idealized profit and loss sharing schemes such as those described in the previous section are therefore unthinkable because they run directly afoul of the letter and the spirit of the real estate ownership prohibition.[75] Interestingly, even the highly formalistic *murabaha* artifice seems to be encompassed within the ban as well, even if it does not involve a noticeable risk to the bank by virtue of ownership. This is because the ban itself is not conditioned upon any assumption of risk, but instead flatly prevents a bank from being able to lawfully "purchase, hold and convey real estate."[76] In a *murabaha* transaction, it would be doing all three prohibited acts, *purchasing* the real estate on behalf of the buyer, *holding* it for an infinitesimal period of time, and then *conveying* it to the buyer.[77] Yet, without being able to engage in this practice, one of the premier profit-making instruments of the Islamic bank would be taken away, and it could not function.

The solution was to treat the ownership as fiction, and indeed *to condition permissibility on the maintaining of that fiction.*[78] The specific context of that solution arose in 1999, when the Islamic Bank of Kuwait sought to issue *murabaha* facilities in the United States notwithstanding the real estate prohibition.[79] In so doing, it made a series of representations respecting the nature of the *murabaha* that ultimately made their way into the OCC's interpretive letter #867 of 1999 and on the basis of which the interpretive letter permitted the practice notwithstanding the statutory prohibition.[80]

Hence, for example, the interpretive letter describes the transaction as one in which the customer identifies the property, negotiates the price with the seller, and applies to the bank for financing.[81] If the bank approves, then the bank simultaneously enters into a purchase agreement with the seller and a *murabaha* with the buyer. The bank then purchases the property from the seller and *simultaneously* sells it to the buyer at a markup which is 'typically'

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[75] *Id.*

[76] *Id.*

[77] USMANI, *supra* note 34, at 166.

[78] Victoria Lynn Zyp, Islamic Finance in The States: Product Development and Regulatory Adoption 19-20 (Apr. 21, 2009) (unpublished M.A. thesis, Georgetown University), https://repository.library.georgetown.edu/bitstream/handle/10822/552821/ZypVictoriaLynn.pdf?sequence=1.

[79] *Id.* at 10–11.

[80] *Id.* at 15, 20.

[81] Office of the Dist. Counsel, Comptroller of the Currency, Adm'r of Nat'l Banks, *Interpretive Letter #867*, at 2 (Nov. 1999), http://www.occ.gov/static/interpretations-and-precedents/nov99/int867.pdf [hereinafter OCC Letter 867].

based on LIBOR, a standard benchmark interest rate.[82] The letter requires the bank to represent that the transaction is "functionally equivalent" to a secured loan and indeed relies on this representation to permit the practice.[83]

Given the simultaneous purchase and resale by the bank, the matter of its ownership then becomes almost metaphysical in nature. How does one go about "owning" an item for no time at all? If this were not enough, additional provisions reduce any risks of ownership to the real estate that might remain. Specifically, the interpretive letter requires the bank's representation that the risks in the transaction "are *identical* to the risks in a conventional mortgage or loan transaction."[84] Rather incoherently, the customer must also have already made its down payment before the first sale to the bank takes place, meaning that the purchaser has paid an institution to purchase property from it that it does not own. Moreover, no representations or warranties may be given by the bank as to the underlying property.[85] Finally, the bank agrees it "will not operate the property, pay taxes, insurance, or other charges, maintain upkeep of the premises, make repairs when necessary, assume liability for injuries or other accidents on the property, or otherwise exercise dominion or control over the property."[86] In sum, in all legal and economic respects, the ownership by the bank—that one facet that Usmani indicates distinguishes the *murabaha* from prohibited interest[87]—must be legally and economically meaningless in its entirety if the transaction is to be legal. The bank must disclose this or it may not operate lawfully.[88]

Even the definition of title, the single formal indicium of ownership left for the bank to cling to, is stripped bare in the context of the interpretive letter's legal discussion. Not only does the legal discussion dismiss the issue of bank ownership as being completely irrelevant to the economic substance of the transaction, and repeat that at some length, but it also refers to the bank holding only "legal" title.[89] Lest the reader be confused as to what "legal title" constitutes, the letter supplies a definition taken from Black's Law Dictionary, to the effect that legal title creates an "apparent right of ownership and possession" but "no beneficial interest therein."[90] The distinction as between legal title and beneficial interest is a natural and common one in trust

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[82] *Id.* at 2–3.
[83] *Id.* at 1–2.
[84] *Id.* at 3 (emphasis added).
[85] *Id.* at 4.
[86] *Id.* at 5.
[87] USMANI, *supra* note 34, at 75.
[88] *Id.* at 75.
[89] OCC Letter 867, *supra* note 81, at 8.
[90] *Id.*

law; where one person may own the assets, but may not be permitted to benefit from them or their usufruct, even as another has a beneficiary interest, but no legal title.[91] In the context of a credit sale such as the *murabaha*, however, its use is rather bizarre. It suggests that the bank never has an equitable right in the property.[92] As a legal matter, it cannot do anything with the property; the bank is merely the "apparent owner" with someone else (at first the original seller and then the final purchaser), at all times holding all beneficial interests in the property. Thus, the bank's ownership is entirely meaningless.[93] So as to underscore the matter, the letter concludes its legal section by indicating that "despite the *appearance* of the Branch briefly holding real estate," the transaction is in substance that of mortgagor and mortgagee.[94]

This letter, it must be emphasized, establishes the legal basis of *all murabaha* transactions undertaken by Islamic banks in the United States involving real property.[95] The compromise made by the banks to comply with applicable laws and regulations could not be starker. Not only must they abandon every pretense at profit and loss sharing, they must also explicitly disclaim the sole distinction that exists between the *murabaha* and the conventional loan, the fact of bank ownership. They cannot even credibly claim very much in the way of *formal ownership*.[96] To paraphrase from the interpretive letter, all that is left for them is the *appearance* of the bank holding real estate.[97] Usmani's distinction between the *murabaha* and the fixed interest loan has thus collapsed into semantics: the bank is the owner only in the sense that it claims ownership at the same moment it is transferring the property.[98] But for this entirely semantic claim, which the OCC is willing to humor, the transaction is interest based.[99]

Though this Article focuses primarily on use of the *murabaha* under U.S. law, it is worth noting that a second interpretive letter, one dealing with lease financing, was issued two years earlier in 1997, which also relied rather heavily on the "largely cosmetic" nature of legal title and the fact that it does not relate to the "indicia of ownership."[100] That case largely involved permission for a rent to own arrangement similar to the one discussed in the

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[91] *See, e.g.*, BLACK'S LAW DICTIONARY 828 (8th ed. 2004) (defining beneficial interest as distinguishable from legal title and offering a trust as an example).

[92] OCC Letter 867, *supra* note 81, at 8.

[93] *Id.*

[94] *Id.*

[95] *Id.*

[96] *Id.*

[97] *Id.*

[98] *Id.*

[99] *Id.*

[100] Office of the Dist. Counsel, Comptroller of the Currency, Adm'r of Nat'l Banks, *Interpretive Letter #806* (Dec. 1997), http://www.occ.gov/static/interpretations-and-precedents/dec97/in t806.pdf [hereinafter OCC Letter 806].

previous Part except that in economic substance, the bank does not "actually own real estate."[101] The bank does not even own the property in any recognizable legal sense. Nor does it maintain the property or pay property taxes.[102] Instead, it records its interest in the property *as if it were an ordinary mortgage,* and its rights upon the owner's default are not those of a co-owner, but of a secured lender.[103] It is hard to even know what legal title constitutes under such an arrangement, where the title documents themselves do *not* suggest the bank is the legal owner, and where all of the bank's *legal and economic* rights are identical to those of a secured lender, not a mortgagor.

B. Problems of Prepayment

While the real estate ownership ban renders the practice of Islamic banking rather problematic, an Islamic bank might nonetheless insist that there is some (bare) form of *shari'a* compliance at work given the OCC accommodations. The argument is a difficult one given the rather strained definition of title and the OCC demand that risks be identical to a conventional loan. This is particularly important in light of Usmani's insistence that the incidence of ownership supplies the basis of the distinction as between a *murabaha* and a loan.[104] However, it is sustainable, in the highly abstract sense that the bank "owned" the asset (albeit for no time at all given the simultaneous transfer), and the OCC acknowledged that some type of legal title transfer took place.[105] The same is not true for several other regulatory hurdles that make Islamic banking impossible. The most obvious of these hurdles relates to prepayment.

When a borrower prepays under a conventional loan, the amount of interest due on the loan is correspondingly reduced. That is, the borrower in our previous section, who took out a thirty year $90,000 fixed interest mortgage at 3.770 percent, owes a net amount of $150,417.39 if each payment is made on time. If the borrower manages to make a first monthly payment of $30,000, effectively prepaying part of the principal of the loan, the total amount due will be reduced. This is because interest will not be collecting on the principal that the owner has already paid. While banks can offer mortgages with "prepayment penalties" that impose fees on borrowers who wish to pay their mortgage in advance of its due date, the bank must disclose such fees to the prospective homeowner.[106]

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[101] *Id.*
[102] *Id.*
[103] *Id.* at 2.
[104] USMANI, *supra* note 34, at 73.
[105] OCC Letter 867, *supra* note 81, at 6.
[106] 12 C.F.R. § 226.18(k) (2012). *See also* Ornstein et al., *Prepayment Penalty Disclosure Under the Truth in Lending Act*, 61 CONSUMER FIN. L. Q. REP. 278 (2007) ("Regulation Z

However, under a *murabaha,* a prepayment should have no effect at all on the total sum due. The homeowner in the case of the *murabaha* has already committed to pay a purchase price. In our example above, that purchase price, not counting the down payment, is $150,417.39. While the buyer is not *obligated* to pay this sum in advance of the due date of the installments, the buyer is also not relieved of its obligation to pay the total sum by virtue of prepaying.[107] In fact, classical jurists generally, and the contemporary Islamic Fiqh Academy specifically, forbid the conditioning of any prepayment of a *murabaha* on the receipt of a discount for that prepayment.[108] To quote al-Zuhayli, one of the most prominent and well-known scholars of the modern era: "a reduction of liability based on prepayment is very similar to increasing it based on deferment."[109] The latter is almost the very definition of prohibited money interest, meaning that to reduce a sum due and owing because of a prepayment is to stand in opposition to *shari'a,* at least as it is understood among the jurists and clerics who define the practice of Islamic finance.

There is, however, an exception that Islamic banks could claim to be exploiting, though it is not a particularly plausible one. Usmani indicates that a *voluntary* rebate by a seller, one that was not conditioned by the buyer's prepayment, is acceptable upon a buyer's prepayment so long as the buyer cannot claim it by right and it is not a condition of the prepayment by contract.[110]

This exception appears quite far from the practice of one of the largest Islamic banks operating in the United States, University Bank. It does not even attempt to justify its commitment to forgive part of the buyer's purchase price if it is prepaid. On its own website, in the "Frequently Asked Questions" section, the following question and answer appear:

> 7. Can I pay off my contract early? Is there a penalty for doing this?
>
> Our Murabaha contract does not have any pre-payment penalties. You can pay off the remaining acquisition balance at any time you wish.

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requires that in interest-bearing consumer credit transactions, such as most residential mortgage loans, creditors must disclose in the final TIL disclosure whether there may be a penalty for prepayment of the loan. Model Form H-2 suggests that the following statement be included in the final TIL disclosure: 'If you pay off early, you [may] [will not] be required to pay a prepayment penalty.' A TILA violation will occur if the creditor checks the wrong box or fails to check a box altogether.").

[107] USMANI, *supra* note 34, at 99–100.

[108] *Id.* at 99–100; Mohammad H. Fadel, *Riba, Efficiency, and Prudential Regulation: Preliminary Thoughts*, 25 WIS. INT'L L.J. 655, 659–60 (2008) (citing Averroes for the principle of forbidding the prepayment of a *murabaha*).

[109] Fadel, *supra* note 108, at 660 n.21 (quoting WAHBAH AL-ZUHAYLI, FINANCIAL TRANSACTIONS IN ISLAMIC JURISPRUDENCE 311 (Mahmoud A. El-Gamal trans., Dar al-fikr, 2003)).

[110] USMANI, *supra* note 34, at 143.

> Profit portion is prorated, and UIF agrees to accept lesser profit should you choose to pay off the contract early.[111]

This is to some extent obfuscating, as in fact the issue with a *murabaha* is not that there is a "penalty" for prepaying. Rather, what the bank describes as an "acquisition price"—the purchase price paid by the homeowner—is being reduced by the bank virtue of the homeowner's early payment. Moreover, this reduction is hardly "voluntary" and noncontractual, as demanded by Usmani. The bank has committed to this on this website and in its promotional material. It would be patent fraud not to forgive part of the "acquisition price" on this basis of this whenever a prepayment occurred. In other words, a prepayment of a *murabaha* to the University Bank will operate *precisely* as a prepayment of a loan would as a matter of contract and in plain violation of the *shari'a* as enunciated by such luminaries as Averroes, Zuhayli, Usmani and the Islamic Fiqh Academy.

If the bank truly wanted to reflect a voluntary undertaking of the sort that Usmani described as narrowly permissible, it would have to phrase the paragraph quoted above in the following manner:

> 7. Can I pay off my contract early? Is there a penalty for doing this?
>
> We are not obligated under Shariah guidelines to collect less than the full acquisition price *and indeed we are prevented under Shariah guidelines from guaranteeing or otherwise promising in any fashion that an early payoff amount will reduce the full acquisition price*. However, consistent with Quranic encouragement to be kind to debtors, we *may* voluntarily accept an early payment and forgive the portion of the acquisition price that would correspond to a prepayment penalty in a conventional loan. We may also forgive less than this, or more, or forgive none of the acquisition price at all, as the decision to forgive any amounts, while recommended by the Qur'an, must be entirely voluntary on our part or it is Islamically invalid.

This would certainly be the type of rebate that was voluntary, though it is also one that is contrary to applicable law unless the prepayment penalty rate is disclosed. And if it is disclosed, it is hard to imagine many Muslim homeowners wanting to own a home on such unfavorable market terms. *Shari'a* compliance is, as the University Bank's own documents inescapably prove, impossible if compliance with applicable U.S. law is to be achieved.

C. On the Acceptance of "Interest" as Profit

Prepayment is not the only obstacle that renders Islamic banking impossible in the United States. More problems arise in the interest deduction for

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[111] *Home Financing—Murabaha—Frequently Asked Questions*, UNIVERSITY ISLAMIC FINANCIAL, http://www.myuif.com/faq-forms/home-financing-faq/murabaha-faq/ (last visited Jan. 12, 2014).

mortgages. Under U.S. law, a homeowner may deduct any interest paid on a mortgage from their income on their annual tax returns.[112] While a homeowner could legally forgo this quite valuable home interest deduction, it would render the Islamic home financing market dramatically uncompetitive relative to its conventional counterpart. The market would not be sustainable under those conditions.

In order for the homeowner to take advantage of the deduction, however, the homeowner must be paying *interest.* In fact, the amount that the homeowner deducts is precisely the amount that appears in Box 1 on Form 1098 issued by the Internal Revenue Service, which corresponds to "[*m*]*ortgage interest received by a payer(s)/borrower(s)*."[113]

The University Bank is aware of this, as is apparent from the following excerpt from its "Frequently Asked Questions" section:

> If there is no interest on the Murabaha transaction, will I still get a 1098-INT statement for income tax purposes?
>
> As a financial institution, we are only able to show profit on the financing of a home in one fashion. Thus we will issue a 1098-INT which you may choose to use to deduct from your taxes.[114]

Though the bank is careful not to describe explicitly any payments made by a homeowner as "interest," this deliberately elliptical answer necessitates that conclusion, given that the Form 1098 makes absolutely clear that it is calculating mortgage interest, not any other form of profit. Any given individual buyer, of course, is free to take the deduction, or not, though this in the end matters little.[115] The bank's return is "interest" and is characterized under United States law as "interest," whether or not a buyer wishes to describe it as such on the buyer's own tax return.[116]

This further adds to the woes of the Islamic bank that is seeking to operate on a *shari'a* compliant basis. The point of Islamic banking was to act as an alternative to interest based finance based on profit and loss sharing.[117]

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[112] 26 U.S.C.A. § 163(h)(3) (West 2013).

[113] *See* IRS, FORM 1098 (2014), *available at* http://www.irs.gov/pub/irs-pdf/f1098.pdf (emphasis added).

[114] *Home Financing—Murabaha—Frequently Asked Questions*, UNIVERSITY ISLAMIC FINANCIAL, *supra* note 111.

[115] It is hard to see why a buyer would not do so. Surely if a pious Muslim buyer finds a tax form in her mail indicating she has paid interest over the course of the year and finds that unobjectionable, she will likewise find a claiming of the deduction to be unobjectionable.

[116] 26 U.S.C.A. § 163(a) (stating a deduction shall "be allowed," but not mandating one be taken); *see also infra* note 120 and accompanying text.

[117] USMANI, *supra* note 34, at 162.

When this proved to be difficult, the practice then at least claimed to be involved in the buying and selling of assets. Rules on real estate ownership largely stripped this possibility away, except for semantic niceties permitted by the OCC respecting "apparent" ownership by virtue of "legal" title.[118] In the context of the mortgage deduction, the Islamic bank does not even have the comfort of semantics—it is *forced* to describe its profits as interest to have any hope of remaining economically viable in the United States.[119]

Finally, the requirement that Islamic banks abandon any semantic pretense that they are involved in anything other than the issuance of commercial loans at interest extends far beyond the mortgage interest deduction. The Federal Reserve has issued a series of stringent disclosure rules—set forth in Regulation Z and issued in furtherance of the Truth in Lending Act—to which every lender must adhere when offering loans to consumers, including home mortgages.[120] The core of these regulations require disclosure to the homeowner of the cost of credit—namely, the annual percentage rate and the finance charge.[121] That is, the bank cannot engage in its core business without describing to its constituency that it is not *shari'a* compliant.

D. Profit and Loss Sharing Between Bank and Depositor

We have seen that when making the bulk of their portfolio investments, Islamic banks must disclaim any significance to the one element that distinguishes their credit mechanism from that of a conventional loan, namely their purchase and sale of the underlying asset for which they are extending credit.[122] We have also seen that the banks must describe their profit as interest, and that they must effectively treat it as interest for purposes of prepayment, rather than as a purchase and sale.[123] This Article, however, has not yet touched upon the greatest violation of the *shari'a* to which an Islamic bank is subject under relevant financial regulation. This is the fact that, far

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[118] OCC Letter 867, *supra* note 81, at 8.

[119] Unfortunately for buyer and bank alike, as Mann demonstrates in a thorough analysis of the matter, it is far from clear that the IRS accepts the characterization of the bank's profit amounts as deductible interest. Mann, *supra* note 6, at 1152–57. This creates a rather delicious irony. For tax purposes, it may well be the Islamic bank and the Muslim homeowner who insist that their transaction is interest based, while the IRS insists that, in fact, the bank's profit is substantively different from that which attaches to a conventional financing and, therefore, the buyer is not entitled to a deduction.

[120] 12 C.F.R. §§ 226.1–.4 (2011).

[121] Matthew A. Edwards, *Empirical and Behavioral Techniques of Mandatory Disclosure: Socioeconomics and the Quest for Truth in Lending,* 14 CORNELL J.L. & PUB. POL'Y 199, 213 (2005).

[122] *See supra* Part II.A.

[123] *See supra* Part II.C.

from sharing profits and losses, federal law and regulation, as set forth below, effectively *require* Islamic banks to insure that bank depositors suffer no losses at all under any circumstances.[124] This, of course, is precisely what occurs with an interest bearing account.

To be defined as a bank under the Bank Holding Company Act (BHCA), an institution must meet one of the two criteria: either (1) the bank must be federally insured by the Federal Deposit Insurance Corporation (FDIC), or (2) it must *both* be in the business of offering commercial loans *and* it must offer demand deposits, thereby enabling the depositor to withdraw the money in the account at any time without prior notice.[125]

The second of these criteria is not possible for an Islamic bank if it wishes to be *shari'a* compliant because the bank is not engaging in the business of making commercial loans. Indeed, the whole point of its existence is to avoid the taking of interest, which is an inherent feature of commercial loans.[126] Moreover, because of the fear of a bank run each time that property values drop, it is unclear whether a bank could tie up substantial amounts of its funds in assets as illiquid and uncertain as ownership in real property and still offer demand deposits.[127]

In any event, the matter of compliance with the second criteria is largely academic because the practice of offering FDIC insurance is so widespread that, as a practical matter, it is hard to imagine a banking institution of any significant size being able to operate without it.[128] To the extent that those seeking to expand Islamic finance in the United States are imagining Islamic retail banks of significant size, they surely must be contemplating those with national charters that are members of the Federal Reserve and thus have FDIC insurance.[129] Hence, University Bank, the only Islamic bank with demand deposit services in the United States, is federally insured.[130]

Moreover, government insured deposits are a cornerstone of financial regulation in the United States, and, indeed, in any jurisdiction with a mature

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[124] *See infra* Part II.E.

[125] 12 U.S.C.A. § 1841(c)(1) (West 2013). Certain exceptions are offered under § 1841 (c)(2).

[126] *See* USMANI, *supra* note 34, at 6.

[127] *See* VOGEL & HAYES, *supra* note 3, at 134.

[128] *See generally* RICHARD SCOTT CARNELL, JONATHAN R. MACEY & GEOFFREY P. MILLER, THE LAW OF BANKING AND FINANCIAL INSTITUTIONS 73–76 (4th ed. 2009) (describing the process for receiving regulatory approval to charter a bank).

[129] A bank with a national charter by definition is a member of the Federal Reserve and therefore has insurance from the Federal Deposit Insurance Corporation. *Id.* at 76.

[130] *Business Shariah-Compliant Profit-Sharing Savings Accounts*, UNIVERSITY ISLAMIC FINANCIAL, http://www.myuif.com/banking/business-shariah-compliant-profit-sharing-savings-accounts/ (last visited Jan. 12, 2014).

financial system.[131] A bank regulator's primary concern is a bank panic caused by nervous depositors who are aware that most of the funds of the bank are engaged in assets, and who might therefore withdraw their funds from a healthy bank while the bank still has liquid assets available for distribution if others are doing the same.[132] The decision of one group of depositors to do this would lead other rational depositors to do the same until the bank would have no liquid assets.[133] This would result in a liquidity crunch for the bank because it is unable to satisfy remaining demands despite having substantial non-liquid assets (such as bank mortgages).[134] Bank default would follow. The default of one bank might lead to panic among depositors in other banks, resulting ultimately in a financial collapse.[135] There is, in this sense, a certain instability in the financial system that requires attention.

Federal deposit insurance avoids this problem because it obligates the government to pay the depositor back if the bank cannot somehow supply the funds.[136] Thus, there is no reason for any rational depositor to "panic" and withdraw its funds even if the bank finds itself in a difficult economic situation. Government insurance, in other words, is the premier means used by mature financial regulators to prevent a bank panic.[137]

The stark variance with the *shari'a* thus becomes unmistakably clear. It is true that an Islamic bank's portfolio investments have shifted from silent partnership arrangements to credit sales and lease finances, as we have seen.[138] However, the bank deposits have remained structured in the form of the silent partnership.[139] Few things are clearer in Islamic finance than that

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[131] Julie Andersen Hill, *Bank Capital Regulation by Enforcement: An Empirical Study,* 87 IND. L.J. 645, 647, 649 (2012).

[132] Daniel R. Fischel et al., *The Regulation of Banks and Bank Holding Companies,* 73 VA. L. REV. 301, 307–08 (1987).

[133] *Id.*

[134] *Id.* at 308.

[135] Helen A. Garten, *Banking on the Market: Relying on Depositors to Control Bank Risks*, 4 YALE J. ON REG. 129, 160–62 (1986).

[136] Fischel et al., *supra* note 132, at 313. As will be shown, the United States ordinarily has hard dollar limits on the amount that the FDIC is obligated to insure per account. *See infra* note 153 and accompanying text.

[137] Government insurance is not the only manner in which bank regulation limits the possibility of a liquidity crunch. The government also sets minimum capital requirements to ensure that the assets of a bank exceed its liabilities by a minimum "cushion," thereby avoiding the possibility of a loss to depositors. *See supra* note 131. Because this presents no impediment to Islamic banks, I do not discuss it in the main text.

[138] *See supra* notes 57–59 and accompanying text.

[139] El-Gamal, *supra* note 32, at 126–27 ("Islamic banks have kept to the generally accepted principle of profit and loss-sharing ... in principle if not in practice. Thus, depositors in Islamic banks do not earn any return on their deposits while those holding 'investment

the rules of the silent partnership, consistent with the principles underlying Islamic finance, require profits *and losses* be shared between the parties thereto.[140] Indeed, the central objection that Islamic finance proponents have been making for decades against the taking of conventional interest is specifically that it does not permit sharing as between profits and losses as a proper Islamic system would through mechanisms such as the silent partnership.[141] It is thus hard to imagine a more central violation of the rules of the silent partnership than one that permits a depositor to have back the full amount of the deposit, even as the depositor's silent partner, the bank, with whom the depositor was supposed to share all profits and losses, descends into bankruptcy. It simply defies logic for an institution to provide for this, and for a depositor to accept it, while still claiming to be adhering to the *shari'a* as it has been understood in Islamic finance over the past half century.

E. Regulatory Accommodation?

Of course, the mere fact that there are obstacles to the creation of a truly *shari'a* compliant Islamic bank does not mean on its own that such a bank is necessarily impossible. After all, as the Introduction demonstrated, the federal government has undertaken extensive efforts at dialogue and engagement with proponents and practitioners of, and experts in, Islamic finance.[142] Therefore, it is worth asking whether, by working together, Islamic finance and U.S. banking regulators might find a way to a mutually satisfactory accommodation. The answer, it seems rather plain, is no.

As an initial matter, there is the fact that despite all the dialogue and engagement, there have been no significant accommodations made as to Islamic

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accounts' earn a share of the profits and are exposed to potential losses.... On the assets side, Islamic banks avoid the risks of profit and loss-sharing investment arrangements by engaging mostly in cost-plus trading and lease financing.").

[140] USMANI, *supra* note 34, at 38 (indicating that in a silent partnership, or even an ordinary partnership, "[a]n investor/financier must share the loss incurred by the business to the extent of his financing."). *See also* M. UMER CHAPRA, TOWARDS A JUST MONETARY SYSTEM 68 (1985) ("Islam requires profit-and-loss sharing in an equitable manner, whereby the financier shares in the losses, if any, in proportion to the capital in the business, if he wishes to have a share in the profit."); SIDDIQI, *supra* note 44, at 11; Seif I. Tag El-Din, *Towards Optimal Risk Management for Profit-Sharing Finance*, ISLAMIC PERSPECTIVES ON WEALTH CREATION 188, 189 (Munawar Iqbal & Rodney Wilson eds., 2005).

[141] Chapra, for example, objects to interest because it relieves the financing party of any obligation to concern itself with the success of the venture it finances. *See* Chapra, *supra* note 34, at 4. This is in contrast to Islamic finance's partnership vehicles, which encourage profit and loss sharing. *See also* Mirakhor & Zaidi, *supra* note 39, at 49; Tag El-Din, *supra* note 140, at 189 (citing references offering supposed economic benefits of profit and loss sharing mechanisms such as the silent partnership).

[142] *See supra* Introduction.

finance since 1999.[143] Surely, if mutually acceptable solutions could be found, the players would have at least found some of them by now.

That said, some of the simpler and more straightforward problems might be addressed. It is not impossible to envisage a revised Regulation Z, for example, that does not require an Islamic bank to disclose to a potential borrower an effective "interest" rate, but perhaps instead an "Islamic bank profit rate." As with the 1999 OCC interpretive letter, which describes the asset purchases that are part of a *murabaha* as nominal and the risk profile as being functionally equivalent to a commercial loan,[144] the relevant disclosure would have to indicate something similar. It could state, for example, that the Islamic rate of return in the agreement is a guaranteed rate, that the consumer will be forced to pay it, and that the consumer undertakes the same risks, rights, and obligations with respect to this transaction as any borrower would on any interest-bearing loan. The accommodation, in other words, would be semantic, but would at least avoid the problem Islamic banks and borrowers face when being required to describe their returns as "interest." Whether federal regulators would want to go through the necessary time and expense of amending relevant regulatory rules to accommodate a practice of relatively limited size is a separate matter, but at least from a theoretical perspective, a solution is not difficult to contemplate.[145]

The matter of the interest deduction presents greater difficulties if we assume, as seems reasonable, that Congress will not repeal the home mortgage interest deduction at any point in the near future.[146] Islamic banks will

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[143] 1999 was the year that the OCC issued its second interpretive letter permitting the *murabaha* under certain strict conditions notwithstanding prohibitions against real estate ownership. *See* discussion *supra* Part II.A.

[144] OCC Letter 867, *supra* note 81, at 2.

[145] According to a 2010 study, there are approximately 2.6 million Muslims who are "adherents" of congregations. Ass'n of Statisticians of Am. Religious Bodies, *Maps and Charts for 2010*, *in* 2010 U.S. RELIGIOUS CENSUS: RELIGIOUS CONGREGATIONS & MEMBERSHIP STUDY, *available at* http://rcms2010.org/maps2010.php?sel_denom=267&sel_map%5B%5D=4&confirm=confirm (last visited Jan. 12, 2014). Although the number of Muslims is almost certainly larger, it would be fair to assume that, overwhelmingly, Muslims who did not belong to any congregation would be less religious and therefore less interested in Islamic finance opportunities. This renders the potential size of the Islamic finance market relatively small in the United States. In addition, regulators could be concerned that any single accommodation might very well lead to demands for more accommodation from other faith based communities. Regulators might thus avoid the effort on this ground alone. In any event, this Article does not address comparatively less significant practical concerns surrounding accommodation of Islamic banking, but rather the broad conceptual reasons federal regulation could not possibly accommodate the practice as a general matter.

[146] James A. Fellows, *The Mortgage Interest Deduction: The Tax Court Brings Clarity,* 41 REAL EST. L.J. 338, 338 (2012) (describing any attempt to repeal the deduction as

have to jettison the *shari'a* and describe their profits as interest to enable homeowners to take advantage of it, as the University Bank currently does.[147] It may seem at first glance that the IRS could issue a private letter or revenue ruling that resembled the OCC letters of 1997 and 1999 by indicating that some of the more common instruments deployed in Islamic finance resemble interest in economic substance, and that the IRS will treat them as such. However, this is not so simple.[148] Specifically, it will be difficult to issue a ruling that is of sufficient generality to be of use to Islamic banks, while not creating a series of additional problems relating to what constitutes debt for tax purposes in broader settings.[149] This is to say nothing of even knottier problems relating to even more complex tax issues ranging from depreciation to passive activity loss rules.[150] Hence, one prominent commentator stated that were he the IRS, he would seek to know as little as possible about these religious-based transactions.[151] The IRS appears to have heeded the advice.

No obvious solution arises as to prepayment either, where the *shari'a* violation requiring a corresponding reduction in principal seems unavoidable and quite serious. However, it is in the area of deposit guarantees where the impossibility of Islamic banking is by far the most apparent. For it is as anathema to *shari'a* to guarantee a silent partnership against loss, as it is important to federal regulators that such insurance be firmly in place. On this matter, the United States is moving in the *opposite* direction from Islamic finance, particularly after the financial crisis of 2008, as demonstrated by the

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"political suicide" akin to eliminating benefits such as Social Security and Medicare). To be clear, many have articulated sound reasons that Congress *should* eliminate the home mortgage deduction. Some have argued that by incentivizing debt secured by a mortgage over investment in real estate, the deduction has encouraged homeowners to overleverage. *See* Rebecca N. Morrow, *Billions of Tax Dollars Spent Inflating the Housing Bubble: How and Why the Mortgage Interest Deduction Failed*, 17 FORDHAM J. CORP. & FIN. L. 751, 754–60 (2012). Others point out that the deduction is regressive, and favors those both wealthy enough to afford a home and with a significant enough income to have higher marginal tax rates. *See* Anthony Randazzo & Dean Stansel, *Unmasking the Mortgage Interest Deduction: Who Benefits and By How Much?,* REASON FOUNDATION (July 28, 2011), http://reason.org/studies/show/the-mortgage-interest-deduction. For a particularly interesting additional objection relating to discrimination against Muslims and others who do not believe in taking interest, see Mann, *supra* note 6, at 1166. The point for these purposes, however, is that irrespective of the merits of repeal, the deduction is likely to remain for some time to come.

[147] *See supra* notes 114–17 and accompanying text.

[148] *See* Joel S. Newman, *Islamic and Jewish Perspectives on Interest*, 89 TAX NOTES 1311, 1316–18 (2000); Mann, *supra* note 6, at 1160–65.

[149] Mann, *supra* note 6, at 1163–65.

[150] Newman, *supra* note 148, at 1318.

[151] *Id.*

enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act.[152] Among the many things the Act does is *increase* the deposit insurance available per bank account to $250,000, from $100,000.[153] During the height of the crisis and through 2012, the FDIC-insured qualifying bank deposit accounts were without limit.[154]

Of course, the financial sector's troubles in the recent financial crisis related much more to troubles at investment banking outfits undertaking excessive risk than to depositor panic at traditional banks.[155] However, since the repeal of the Glass-Steagall Act, investment banking and commercial banking have often operated within different divisions of the same conglomerate bank holding company.[156] In light of this, federal regulators and Congress seem to have found it necessary to increase limitations on deposits, without limit when the crisis was particularly acute. This was precisely to avoid the problem becoming worse through depositor panic as investment banking divisions in bank holding companies found themselves in increasingly difficult circumstances.[157] It is unimaginable that these same regulatory bodies and Congress will not only reverse themselves, but also provide exceptions to the very principle of insurance merely to accommodate Islamic banking.

Even the United Kingdom, a veritable hub of Islamic finance,[158] is not willing to offer much accommodation. The United Kingdom's premier financial regulator, the Financial Services Authority (FSA), will not countenance a deposit account subject to loss.[159] Instead, with respect to only one Islamic bank, the Islamic Bank of Britain (IBB), the FSA will merely *permit* the depositor to absorb a guaranteed loss if it chooses to do so at the time of the

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[152] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of 12 U.S.C.).

[153] *Id.* § 335, 124 Stat. 1540 (codified as amended at 12 U.S.C. § 1821(a)(1)(E)) (defining the maximum amount of deposit insurance as $250,000); Fischel et al., *supra* note 132, at 312-13 (referring to earlier limit of $100,000).

[154] 12 C.F.R. § 330.16(a) (2013).

[155] FINANCIAL CRISIS INQUIRY COMMISSION, CONCLUSIONS OF THE FINANCIAL CRISIS INQUIRY COMMISSION, xviii–xx (2011), *available at* fcic.law.stanford.edu/report/conclusions.

[156] *See* Gramm-Leach-Bliley Act, Pub. L. No. 106-102 § 101, 113 Stat. 1338 (1999) (repealing sections 20 and 32 of the Glass-Steagall Act (codified as amended at 12 U.S.C. §§ 78, 377)); Jonathan R. Macey, *The Business of Banking: Before and After Gramm-Leach-Bliley*, 25 J. CORP. L. 691, 709, 715–16 (2000).

[157] *See supra* note 156.

[158] Theodore Karasik, Frederic Wehrey & Steven Strom, *Islamic Finance in a Global Context: Opportunities and Challenges*, 7 CHI. J. INT'L L. 379, 389 (2007) ("London has become the largest international center for Islamic finance outside the Muslim world ….").

[159] MICHAEL AINLEY ET AL., ISLAMIC FINANCE IN THE UK: REGULATION AND CHALLENGES, FINANCIAL SERVICES AUTHORITY 14 (2007), http://www.fsa.gov.uk/pubs/other/islamic_finance.pdf.

loss and not earlier.[160] In other words, the IBB *must* insure against losses and *must* offer the depositor the return of the deposit in the event of losses.[161]

The legal requirements are precisely what they would be as to a conventional bank and an unambiguous repudiation of *shari'a* as articulated by Islamic finance. However, the FSA has indicated that "after the event"—meaning after it becomes necessary to pay the depositor back his full deposit, notwithstanding the bank's loss—the depositor has the *right* to decline the repayment and accept the loss for its own account.[162]

Despite the broad praise given to the FSA accommodation among student commentators,[163] its rather limited scope should be apparent. The approach seems to permit the depositor to comply with *shari'a* vis-a-vis the deposit, though it is hard to see how the deposit could be said to lie in an *Islamic* bank. Plainly, as an institution, the IBB is consciously and overtly violating *shari'a* on its own terms by offering insured deposits in the first place, and, one must presume, honoring their terms when depositors demand it.

Moreover, it is hard to understand precisely what kind of accommodation it is to permit someone not to accept money being offered to them. Presumably, the depositor would have the "right" to decline compensation for its deposit loss any time it pleased, simply by not cashing the FSA check issued to it, or rewiring the money to whatever account it came from. Finally, it should be noted that the FSA took pains to emphasize that it was not intending to establish a general precedent for Islamic banks, that others might not be given the same dispensation, and that each case would be evaluated on its own merits.[164] It is hard to describe the accommodation as anything more than a gesture, of little real importance. That it has proven successful, notwithstanding its legal meaninglessness, helps to explain why it is that Islamic banking has proven so appealing to Muslim consumers and depositors, notwithstanding its patent impossibility. The next section addresses this matter in much greater detail.

III. AN ALTERNATIVE EXPLANATION

A. Islamic Banks and Muslim Belonging

Based on the foregoing, a devout Muslim in the United States has very little reason to consider engaging in retail Islamic banking if the motivations

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[160] *Id.*
[161] *Id.*
[162] *Id.*
[163] *See, e.g.*, Billah, *supra* note 6, at 1090-92; Shah M. Nizami, Note, *Islamic Finance: The United Kingdom's Drive to Become the Global Islamic Finance Hub and the United States' Irrational Indifference to Islamic Finance*, 34 SUFFOLK TRANSNAT'L L. REV. 219, 229–30 (2011).
[164] AINLEY ET AL., *supra* note 159, at 14.

for doing so are viewed only through the narrow prism of obedience to religious doctrine. This is *not only* because the Islamic bank does not engage in very much profit and loss sharing, *but also* because the risk profile of the instruments it uses in order to engage in Islamic finance must be "identical" to those offered by a conventional mortgage in order to be legal.[165] And it is *not only* the fact the bank's ownership of the asset, in which it claims to be trading, is transitory at best, *but also* the fact that even transitory ownership carries no beneficial interest and merely creates the "appearance" of ownership, with recordings on deeds resembling those of a conventional mortgage entirely.[166] Third, it is *not only* that the bank routinely treats its resale price as including accruing interest, forgiven when principal is repaid, *but also* because it legally obligates itself to do so.[167]

These are only the beginning of the doctrinal problems, as we have seen. The homeowner also ends up taking an interest deduction on something the industry has gone to great lengths to claim is not interest,[168] and the bank discloses on a government required form that it is interest and what the rate of interest is.[169] Finally, and perhaps worst of all, depositors are protected against loss, obliterating any notion of a profit and loss sharing partnership as between them and the Islamic bank and plainly violating the most basic rules of such partnerships as set forth in the manuals of Islamic finance.[170]

In light of this, it might be fair to ask precisely why there is so much comparative interest in expanding the scope and size of such highly compromised institutions. A Muslim who truly found the taking of interest to be the prohibited *riba* of the Qur'an—deeply abhorrent, akin to theft, and a cause for divine punishment in the manner described in the Qur'an[171]—would probably be better counseled to avoid banks altogether than to do business with Islamic banks of this sort. Options do exist for such a person. At one end of the spectrum, the rules of the National Banking Act concerning real estate ownership do not apply to savings and loan institutions or credit unions, for example.[172] Credit unions are also exempt from the definition of "bank"

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[165] OCC Letter 867, *supra* note 81, at 3.

[166] *Id.* at 8; OCC Letter 806, *supra* note 100, at 1.

[167] *See supra* notes 111–112 and accompanying text.

[168] Mann, *supra* note 6, at 1151–52.

[169] Edwards, *supra* note 121, at 213.

[170] *See* discussion *supra* Part II.E.

[171] The Qur'an likens the prohibited practice of *riba,* which Islamic finance associates with the taking of interest, to theft. *See* THE HOLY QUR'AN 4:161 (A. Yusuf Ali trans., 1975) [hereinafter QUR'AN] (promising a painful punishment for those who take *riba* and those who devour the property of others falsely). It elsewhere indicates that those who have engaged in the practice and do not repent and desist from what they have done are among the denizens of hell. *Id.* at 2:275.

[172] *See* 12 U.S.C.A. § 29 (West 2013) (limiting the prohibition to "national banking associations").

under the National Bank Holding Company Act.[173] If the (still substantial) regulations corresponding to these institutions nevertheless prove burdensome, some more committed members of the community might leave the financial system entirely and rely on informal networks to finance their homes. They might choose to invest their money in the equity markets, where profit and loss sharing is generally the norm, and where regulation hence presents less of an obstacle.[174] Yet none of these alternatives—seemingly doctrinally more attractive—has appeared to dampen the enthusiasm for a more prominent Islamic banking presence in the United States.

To understand this demand better, we must look beyond doctrine and consider broader explanations. Specifically, we must consider whether the Islamic bank is offering something else of value to the American Muslim, even if it is plainly not offering compliance with the *shari'a* under the standards set forth by the industry. In fact, it is doing that. The Islamic bank gives the Muslim believer an institution of her own, as a mosque permits her a place of her own within a broader American fabric. That there will be a severe doctrinal compromise is, in this context, beside the point. What is important is the institution is Islamic "enough," bears sufficient features to be identifiable as driven by *shari'a*, even if not, strictly speaking, *shari'a* compliant, and that it is *legal,* meaning the U.S. legal regime confers some legitimacy on it and, *a fortiori,* on those Muslims engaged in business with it.

Much of the material extolling the benefits of Islamic banks seems to betray the salience of this underlying desire. Typical are remarks made in 2005

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[173] 12 U.S.C.A. § 1841(c)(2)(E) (West 2013).

[174] *See* Moghul, *supra* note 60, at 470–71. It is important to note, however, that the equity markets provide problems of their own given the extent to which economic activity is integrated in the modern world. Specifically, it would be nearly impossible to find any investment where interest was entirely absent from its activities. Michael J.T. McMillen, *Asset Securitization* Sukuk *and Islamic Capital Markets: Structural Issues in These Formative Years,* 25 WIS. INT'L L.J. 703, 728 (2008). A salient example might be an equity investment in a massive office complex in which one tenant was a bank with a single ATM machine. Though the amount of money received from the bank by virtue of a single ATM lease would *de minimis,* if one took a prohibition on interest in an absolute fashion, then the investment in the entire office complex would be prohibited. *Id*. at 727 (offering such an example). To deal with this problem, religious scholars active in the area of Islamic finance have developed what is known as the "Dow Jones *fatwa"* permitting equity investment in ventures so long as certain conditions are met that help to ensure that the return on interest in any given transaction is not significant. *See id*. at 728–29. Moreover, to comply with the *fatwa*, an investor must "purify" any amount of any return that is interest based by removing it from the portfolio (and presumably giving it to a charitable cause). *Id*. at 729. Needless to say, there is a significant difference between a person who finds interest to be abhorrent still countenancing *de minimis* engagement with interest out of practical necessity, and one who conducts business with an Islamic bank that regularly and substantially violates *shari'a* on a daily basis in a manner described in the main text.

by Thomas C. Baxter, Jr., then the Executive Vice President and General Counsel of the Federal Reserve Bank of New York.[175] While describing in some detail the efforts made by United States regulatory authorities to address the challenges presented by Islamic banks, Baxter made reference on two separate occasions to the "long and cherished history of religious freedom in the United States."[176] He further indicated this freedom included a state obligation to ensure enforcement of the laws "does not interfere unduly with the religious practices of members of our body politic, including Muslims."[177] To be blind to Muslim needs in the area of Islamic banking would be to act as "enemy" to the United States Constitution, which, Baxter indicates, quoting Chief Justice Burger, "affirmatively mandates accommodation, not just tolerance of all religions, and forbids hostility towards any."[178] To fulfill such accommodation, Baxter concludes, "we will need to continue to exhibit the creativity and flexibility that the OCC showed in approving the *ijara* and *murabaha* financing products."[179]

Yet, as discussed in the Introduction and Part II, federal regulators have done virtually nothing to accommodate Islamic finance since 1999, nor is it clear they could do very much substantively even if they wanted to. Surely, by 2005 the General Counsel to the New York Federal Reserve knew this and yet still found it important to extol not only the virtues, but indeed the obligation of the United States' accommodation of the Muslim population through facilitation of Islamic finance.[180]

This leads to the second, even more telling, problem that lies in Baxter's remarks. In his laudable eagerness to demonstrate Muslims had a place in the American fabric, and the Constitution required that legislators and regulators accommodate Muslim interests and practices, the General Counsel to the New York Federal Reserve *misstated the law*.

First, there is the fact that the Burger quote to which Baxter makes reference is inapposite. Burger's insistence on "affirmatively mandated accommodation" was in the context of a decision concerning the Establishment Clause and, specifically, over the constitutionality of a nativity scene, which a municipality wanted to place on public grounds.[181] The question Baxter poses, however, is not whether regulators are *permitted* to accommodate Islamic finance if they choose under the Establishment Clause, as was the

[175] *See* Baxter, *supra* note 7.
[176] *See id.*
[177] *See id.*
[178] *See id.* (quoting Chief Justice Warren Burger).
[179] *See id.*
[180] *See id.*
[181] *See* Lynch v. Donnelly, 465 U.S. 668, 673 (1984).

case with respect to the nativity scene, but whether they *must* under the Free Exercise Clause. Is it an obligation of the nation's institutions to find a way to make room for Muslims (as well as adherents of other religions, of course) through accommodating them in the general legal and regulatory framework? Burger's dicta may suggest this is so, but since that decision was issued, and long before Baxter made his comments, the Supreme Court ruled directly otherwise.[182] In *Employment Division v. Smith,* the Supreme Court held the state does *not* have the "affirmative[]" constitutional obligation to accommodate religious practice under the Free Exercise Clause when it makes law (or regulation).[183] A neutral, generally applicable law is *per se* immune from constitutional challenge on Free Exercise grounds.[184] It is only when the law is made with the intention of discriminating against religious practice that it is unconstitutional.[185]

In other words, the United States Constitution does not mandate that banking regulatory authorities do a single thing to accommodate Islamic banking within the regulatory scheme so long as the regulations were not themselves issued with the purpose of discriminating against Islamic banking. Religious animus is not a reasonable or fair description of the reasons for the regulations described in this Article. The requirement that interest rates be disclosed in home financings, for example, is undertaken to permit consumers to make informed decisions when taking on debt.[186] The reason that bank accounts must be insured against loss is to prevent bank runs.[187] Home interest deductions are permitted so as to encourage home ownership.[188] The burden on Islamic finance in each case is incidental. Baxter's comments are entirely wrong as a legal matter: regulatory authorities may be as "willfully blind" as they wish to the religious implications of their rulings in these contexts and not run afoul of the U.S. Constitution.

The better legal claim is a statutory one—namely, that the Congress enacted a law known as the Religious Freedom Restoration Act (RFRA), which *does* prevent federal government agencies from imposing a substantial burden on religious exercise unless there is a compelling state interest to do so.[189] Baxter chose not to indicate that a failure to accommodate was *illegal,*

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[182] Emp't Div., Dep't of Human Res. of Or. v. Smith, 494 U.S. 872, 878–79 (1990).
[183] *Id.*
[184] *Id.* at 879.
[185] *See id.* at 878.
[186] Edwards, *supra* note 121, at 210.
[187] Fischel et al., *supra* note 132, at 313.
[188] Mann, *supra* note 6, at 1146–47.
[189] *See* Ira C. Lupu, *The Failure of RFRA*, 20 U. ARK. LITTLE ROCK L.J. 575, 578 (1998) (criticizing RFRA for failing to offer justification for the extension of its scope to the federal government).

but rather, that it ran *contrary to the Constitution*. Based on the Court's rulings, Baxter's statement simply is not true.

But to say as much is to miss the point. General Counsel Baxter's speech was not about legal niceties or the interpretation of Supreme Court precedent. It was about the place of Muslims in American society, made at a time when the United States was deeply involved in two wars in Muslim countries,[190] the standing of the United States in the Muslim world was extremely low,[191] and a culture war regarding the place of Muslims in American society had just begun to brew.[192] And how much more compelling, how much more authoritative, how much more powerful a demonstration of compatibility between Islam and America could exist than for a leading lawyer to call the *Constitution* to one side to support the *Qur'an* on the other? How better to locate a Muslim in America than to tell that Muslim *not only* is Islamic banking accommodated, but also it *must be*; not because of a law passed by the Congress in 1993 which was mostly invalidated,[193] but because the nation's founding document, in which its highest ideals are articulated demands it?

Having established this ground, how much more important than to carry through, how understandable the insistence that more be done to actually expand Islamic banking in the United States, because this is what Constitution and Qur'an demand? The inconvenient facts respecting the impossibility of Islamic banking are shunted aside in deference to these powerful social

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[190] In 2005, the United States had troops both in Iraq and in Afghanistan and was conducting active combat operations in both. Alan McLean & Archie Tse, *American Forces in Afghanistan and Iraq*, N.Y. TIMES (June 22, 2011), http://www.nytimes.com/interactive/2011/06/22/world/asia/american-forces-in-afghanistan-and-iraq.html?_r=0.

[191] Richard A. Clarke, *No Returns: Why More Democracy Won't Mean Less Terrorism*, N.Y. TIMES MAG., Feb. 6, 2005, at 20 (referencing low standing of the United States in the Muslim world based on numerous opinion polls).

[192] While much of the more heated rhetoric regarding the place of Islam and Muslims in America erupted after the announcement to open a Muslim community center in lower Manhattan in August of 2010, the aftermath of the 9/11 attacks did lead to an outbreak of reported hate crimes against Muslims and the creation of a counterterrorist apparatus that was largely directed at Muslims. *See, e.g.*, Sahar F. Aziz, *Caught in a Preventive Dragnet: Selective Counterterrorism in a Post-9/11 America,* 47 GONZ. L. REV. 429, 432–33 (2011) (describing the counterterrorist focus on members of the Muslim community); William B. Rubenstein, *The Real Story of U.S. Hate Crimes Statistics: An Empirical Analysis,* 78 TUL. L. REV. 1213, 1235 (2004) (describing the rise in hate crimes against Muslims after the 9/11 attacks).

[193] As originally envisioned, RFRA was supposed to constrain the states and thus effectively overrule *Smith* on the question of the deference to be given to religious practice by neutral laws. Lupu, *supra* note 189, at 581. This was explicitly rejected by the Supreme Court in *City of Boerne v. Flores*, where the Court held Congress could not determine the meaning of the Free Exercise Clause to the derogation of the Court's own interpretation. City of Boerne v. Flores, 521 U.S. 507, 536 (1997).

and cultural forces, in favor of religious freedom and cultural accommodation on the side of the regulators, and from a desire for belonging on the side of American Muslim adherents. To do otherwise—to suggest that federal law and applicable regulation *will not* and *cannot* tolerate Islamic banking—sounds positively intolerant in such a milieu. And few in the United States wish to find themselves portrayed as such.

B. Islamophobia and Islamic Finance

As the previous section indicates, it is plainly true that few within the United States would seek to describe themselves as *intolerant*. Yet it is equally clear there are significant forces that view Muslims and Islamic practices as a threat to the core fabric of the United States and very much include, and indeed target, Islamic finance as part of this effort.[194] This section demonstrates that the core objections of this movement against Islamic finance relate far more closely to Muslim presence in the United States than anything having to do with Islamic finance on its own terms.

But in the process of demonstrating this, it is important to point out the fundamental quandary that an adherent to a view of Islam as an existential threat to the United States faces. In most cases, such an adherent will almost surely resist the description of intolerance as much as anyone else. Still it is hard to avoid the charge while appearing to engage in an effort to denigrate the world's second largest religion and its 1.6 billion followers.[195]

Therefore, it is somewhat important to such adherents to be understood to be attacking some sort of totalitarian political movement rather than a religion. This was the premise of the opposition to the building of a mosque in Murfreesboro, Tennessee.[196] The appeal of this premise is perfectly obvious. If Islam is a religion, then to oppose the building of a mosque in Tennessee is to engage in religious bigotry, but if Islam is a totalitarian ideology, then the opposition to an Islamic center seems far more principled. The effort in Tennessee ultimately failed, and the mosque did open.[197] However, the matter received enough attention and consideration to lead to the extraordinary decision of the United States Department of Justice to file an amicus brief

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[194] *See supra* note 30 and accompanying text.

[195] Drew Desilver, *World's Muslim Population More Widespread Than You Might Think*, PEW RESEARCH CENTER (June 7, 2013), http://www.pewresearch.org/fact-tank/2013/06/07/worlds-muslim-population-more-widespread-than-you-might-think/.

[196] Bob Smietana, *Legitimacy of Mosque at Heart of Tenn. Mosque Suit*, USA TODAY (Oct. 4, 2010, 12:48 PM), http://usatoday30.usatoday.com/news/religion/2010-10-05-mosque04_S T_N.htm.

[197] Brown and Hauser, *supra* note 30, at A9.

in what should have been nothing more than a zoning dispute.[198] The purpose of the brief was to clarify to the Tennessee Chancery Court that the position of the United States is "uncontroverted" and broadly held across all levels of the government—Islam is a religion and thereby entitled to be treated as such.[199]

In any event, even without the Department of Justice intervention, this sort of attack has its limitations. It is difficult to describe Christianity and Judaism as religions and then deny the same status to a creed whose central belief is that God spoke through the Angel Gabriel to Muhammad, who had been chosen by God as Prophet as the Prophets of Israel before him.[200] It is more common to move the discourse away from Islam and Muslims and onto *shari'a.* At one level, the description of *shari'a* as a totalitarian ideology is equally inane: the problem with rendering *shari'a* into legal code is not that it is excessively rigid, but rather it is too pluralistic, encompassing jurists from different schools of thought who come to quite different conclusions on particular matters.[201] Yet there are elements relating to *shari'a* that render it, on balance, fertile ground for a movement seeking to deny Muslims a place in the United States. *Shari'a* is relatively *unknown,* giving those seeking to characterize it as a threat the opportunity to define it as they wish. In this regard, the foreign name helps to fortify a sense of menace, an outside presence threatening to disrupt the American way of life. The corpus of the *shari'a* was derived primarily in medieval times,[202] by jurists with medieval worldviews. As such, it included some limited number of elements, among them harsh criminal punishments,[203] which are easy to describe and, of course, distort. There are Muslims abroad who seem almost eager to help the Islamophobic cause, making a spectacle out of such punishments.[204] Finally, the

[198] *See* Brief for the United States of America as Amicus Curiae, Estes v. Rutherford Cnty. Reg'l Planning Comm'n , No. 10cv-1443 (Tenn. Ch. Ct. Oct. 18, 2010), http://www.justice.gov/crt/about/hce/documents/murfreesboro_amicus_10-18-10.pdf.

[199] *Id.* at 1.

[200] M. Cherif Bassiouni & Gamal M. Badr, *The Shari'ah: Sources, Interpretation, and Rule-Making*, 1 UCLA J. ISLAMIC & NEAR E. L. 135, 147–48 (2002).

[201] It is for this reason one of the earliest Western scholars of Islamic law, the inestimable Joseph Schacht, described the codification of the *shari'a* as a distortion of it. Joseph Schacht, *Problems of Modern Islamic Legislation*, 12 STUDIA ISLAMICA 99, 108 (1960).

[202] Sherman A. Jackson, *Shari'ah, Democracy, and the Modern Nation-State: Some Reflections on Islam, Popular Rule, and Pluralism*, 27 FORDHAM INT'L L.J. 88, 94 (2003); *cf.* Hamoudi, *supra* note 45, at 430, 433 (describing adherence to classical doctrine in modernity as more rhetorical than real).

[203] RUDOLPH PETERS, CRIME AND PUNISHMENT IN ISLAMIC LAW: THEORY AND PRACTICE FROM THE SIXTEENTH TO THE TWENTY-FIRST CENTURY 56, 60, 65 (2005).

[204] John Burns, *A Fittingly Gory Finale to a Sordid Murder Case*, N.Y. TIMES, Aug. 14, 2001, at A4; Adam Nossiter, *Refugees Escape Hard-Liners From North*, N.Y. TIMES, July 18, 2012, at A1.

shari'a is the "way" for religious Muslims to live their lives,[205] constituting the body of rules and norms they follow in carrying out their religious obligations. Given these facts, it is easy to describe large numbers of Muslims, including American Muslims, as threatening because they claim to be devoted to *shari'a,* and to demonize *shari'a* as nothing more or less than the caricature its opponents have made of it.

Under this highly reduced and broadly inaccurate conception of *shari'a,* gone are the primary rules of *shari'a*, which Muslims most often consider and which they rely on in their daily lives—those of worship and diet, including how and when to pray, fast, give alms, and make a pilgrimage, or what foods to eat and what to consider sinful.[206] Instead, for example, one proposed legislative text seeking to deny Muslims status in the United States stated that the *shari'a* is not the "way" for Muslims, but rather a "legal-political-military doctrine."[207] Those who follow it are not "Muslims" but, cleverly, "sharia-adherent's [sic],"[208] as if there were a way to adhere to Islam that disregarded *shari'a*. The goal of *shari'a* adherents, as mandated by *shari'a,* is to "actively and passively support the replacement of America's constitutional republic,"[209] to abrogate, destroy and violate the constitution through violence and criminal activity,[210] and to replace it with "the establishment of a political society based upon sharia [sic]."[211] Little wonder that those who espouse such a view, among them Newt Gingrich, describe *shari'a* as "a mortal threat to the survival of freedom in the United States and the world as we know it."[212]

Given this background, the opposition to Islamic banking becomes clearer. It is part and parcel of opposition to *shari'a,* which is in and of itself an attempt to deny Islam and Muslims the same space afforded to other religious followers. Hence, Gingrich's statement of *shari'a* as a mortal threat was made directly in reference to his opposition to Islamic finance.[213]

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205 Asifa Quraishi, *What if* Sharia *Weren't the Enemy?: Rethinking International Women's Rights Advocacy on Islamic Law*, 22 COLUM. J. GENDER & L. 173, 203 (2011).

206 *See* COULSON, *supra* note 30, at 12 (pointing out that most of the rules from the Qur'an deal with ritual and worship and not "law" as understood in modernity).

207 S.B. 1028, 107th Gen. Assemb., sec. 1, § 39-12-902(2) (Tenn. 2011).

208 *Id.* sec. 1, § 39-13-902(3).

209 *Id.* sec. 1, § 39-13-902(5).

210 *Id.* sec. 1, § 39-13-902(8).

211 *Id.* sec. 1, § 39-13-902(4).

212 *See* Michael Gerson, *Sowing the Wind: Gingrich's Simplistic Fight Against Sharia*, WASH. POST, Dec. 13, 2011, at A29 (quoting Newt Gingrich).

213 Justin Elliott, *Newt: For Shariah Law Before He Was Against It*, SALON (June 8, 2011, 10:01 AM), http://www.salon.com/2011/06/08/newt_gingrich_muslims/ (quoting Newt Gingrich). It is not clear whether Gingrich actually believes such nonsense, or whether his

Alternative objections to Islamic finance, to the extent they are raised, are so implausible they only help to demonstrate the underlying motivation. Many, for example, have alleged Islamic finance is a vehicle for funding terrorists.[214] To believe this one would have to think the instruments employed to conduct artifice in Islamic finance–by such global institutions such as HSBC, Citibank, and AIG[215]–are so enticing to terrorists that they would prefer them to other means of currency transfer, which routinely avoid any reporting requirements at all.[216] More likely, the objection is not actually to *Islamic finance,* but rather to the supposed threat, terrorist or otherwise, posed by *Islam* and *Muslims.*

Other fears respecting Islamic finance are even more bizarre but still entirely consonant with the same fear of *shari'a* as contagion. Hence, there is the suggestion that Hassan Banna, the founder of the Egyptian Muslim Brotherhood, promoted Islamic banking so Islamic banks might penetrate and overtake the conventional finance sector.[217] Banna died in 1949.[218] The first Islamic banks did not begin in earnest until the 1970s.[219] There is no sensible connection between the two of them.

More centrally, however, the irony of the claim is that it has matters entirely backwards. Islamic banks have done absolutely nothing to affect the manner in which the global economy operates. Rather than being the means to penetrate and overtake conventional finance, as Part II and this Part have shown, Islamic finance has conceded to the dominance of conventional

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Muslim baiting is a form of shameless demagoguery. It is clear that in the past Gingrich was quite supportive of the Muslim community in the United States. *Id.*

[214] *See* Eman El-Shenawi, *Islamic Finance is Unclear to Many, Perception Continues That it's Still Linked to Terrorism*, AL ARABIYA (July 4, 2011, 5:09 AM), http://www.alarabiya.net/articles/2011/07/04/155960.html.

[215] HSBC has an Islamic finance desk, as does Citibank. *See Important Notice*, HSBC AMANAH, http://www.hsbcamanah.com/ (last visited Jan. 12, 2014); *Introduction to Citi Islamic Investment Bank*, CITIBANK, http://www.citibank.com/ciib/homepage/aboutus/intro.htm (last visited Jan. 12, 2014). Concerning the involvement of AIG in Islamic finance products, *see infra* this section.

[216] Most prominent among these are the *hawala,* informal currency transfer networks generally used by diaspora communities to send money to relatives at home but easily abused by those seeking to avoid the more elaborate record keeping of licensed banks. *See* Rachana Pathak, *The Obstacles to Regulating the Hawala: A Cultural Norm or a Terrorist Hotbed?*, 27 FORDHAM INT'L L.J. 2007, 2009, 2018 (2004).

[217] Rachel Ehrenfeld & Samuel A. Abady, *Islamic Banking,* WASH. TIMES (Dec. 11, 2008), http://www.washingtontimes.com/news/2008/dec/11/islamic-banking/.

[218] Tariq Ramadan, Op-Ed., *Wither the Muslim Brotherhood?*, N.Y. TIMES. (Feb. 8, 2011), http://www.nytimes.com/2011/02/09/opinion/09iht-edramadan09.html?pagewanted=all&_r=0.

[219] TIMUR KURAN, ISLAM AND MAMMON: THE ECONOMIC PREDICAMENTS OF ISLAMISM xi (2004).

finance, much to the consternation of its own proponents.[220] Or, put differently, Islamic banks and Islamic financial institutions have *assimilated,* violating their own rules in order to find a way to get along.

We thus have a rather confusing phenomenon. Those who view *shari'a* as a foreign menace that may penetrate and overtake the United States *resist* those financial institutions that assimilate and accept, at every level including the semantic, the rules of conventional finance to the derogation of Islamic doctrine. When considered from the perspective of the underlying suspicions of Islamic finance as part of a Muslim threat, however, this is not so peculiar. The doctrine pertaining to Islamic banking is no more relevant to the Islamophobic elements in American society than constitutional law doctrine was particularly important to General Counsel Baxter. The point is not legal and doctrinal consistency. The point, rather, is to portray the enemy, wherever found, as antithetical to what one holds dear, be it the Constitution, republican values or the American way of life, and to keep him there.

There are numerous other examples, indeed there are websites whose sole purpose appears to expose the supposed dangers that arise from Islamic banks and Islamic finance.[221] More instructive for purposes of this Article, however, might be an example of the means by which such Islamophobic elements seek to deploy U.S. legal doctrine in service of this broader aim of eradicating recognized Muslim space in America. To date, the most legally sophisticated attempt to restrict Islamic finance was in the case of *Murray v. Geithner*, and it was not terribly sophisticated.[222] The issue concerned the marketing by the insurance giant AIG through its subsidiaries of an Islamic insurance product known as the *takaful,* from which AIG earned 0.022 percent of its revenue in 2009.[223] Formally, the basis of the suit was that the U.S. government violated the Establishment Clause when it offered AIG bailout funds pursuant to the Troubled Asset Relief Program (TARP) because of AIG's investment.[224] That is to say, the United States government impermissibly advanced the religion of Islam by supporting AIG, which supported *takaful,* and indeed was earning twenty-two-thousandths of one percent of its revenue from it.

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[220] *See, e.g.*, USMANI, *supra* note 34, at 16, 23.

[221] *See, e.g.*, SHARIAH FINANCE WATCH, www.shariahfinancewatch.org/blog/ (last visited Jan. 12, 2014).

[222] Murray v. Geithner (*Murray I*), 763 F. Supp. 2d 860, 868-69 (E.D. Mich. 2011). The case was decided in favor of the government, and appealed to the Sixth Circuit as *Murray v. Dep't of Treasury,* where it was affirmed. Murray v. Dep't of Treasury (*Murray II*)*,* 681 F.3d 744, 753 (6th Cir. 2012).

[223] *Murray I*, 763 F. Supp. 2d at 869.

[224] *Id.* at 864.

The Establishment Clause claim was weak, assuming the Plaintiff even had standing to raise it. As such, it was dismissed at both the District Court level on the grounds that funding AIG through TARP was not a violation of the Establishment Clause,[225] and at the Sixth Circuit on the grounds that the Plaintiff lacked standing.[226] On its own, this is not interesting. More interesting is the worldview of the Plaintiff and his legal team, as revealed in the confounding and incoherent positions taken by them in the summary judgment motion and on appeal. The positions clearly reveal the matter had almost nothing to do with religion-state entanglements or the niceties of Islamic finance doctrine.[227] Instead, the real motivation for the suit stemmed from a desire to deny specific space for Muslim accommodation because of the threat that the opponents of Islamic finance believed Islam posed to the United States.[228]

The doctrine was thus a distracting sideshow that the Plaintiff seemed to find rather inconvenient to deal with. A quick review of the legal terrain demonstrates why this is. Courts evaluate statutes for their constitutionality under the Establishment Clause pursuant to the familiar *Lemon* test, first articulated in the case of *Lemon v. Kurtzman*.[229] Under that test, a statute must (1) have a secular purpose, (2) not have a primary effect of advancing or inhibiting religion and (3) not entangle the government excessively in religion.[230] Unfortunately for Plaintiff, this test offered no real opportunity to examine Islamic finance on its own terms, as the test is designed to gauge legislation on the basis of its connection to religion rather than the substance of the religion to which it is so connected.

As such, the Plaintiff did not even seem to try to satisfy the *Lemon* test. It would be quite difficult under any circumstances to show that the purpose of the TARP program funding, when applied to AIG, was somehow motivated by an Islamic purpose, rather than to save the financial system from collapse. But surely a better effort could have been made than what the Plaintiff put forth. Plaintiff merely asserted "a reasonable observer would conclude that the government purchased AIG stock under the EESA with the purpose of advancing religion because 'Defendants intended for AIG to use federal funding to support all of its activities, including [Islamic finance],

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[225] *Id.* at 860.

[226] *Murray II*, 681 F.3d at 747–48.

[227] *See generally id.*; Plaintiff's Brief In Support Of Motion For Summary Judgment, *Murray I*, 763 F. Supp. 2d 860 (E.D. Mich. 2011) (No. 08-CV-15147).

[228] *See Murray II*, 681 F.3d 744; Plaintiff's Brief In Support Of Motion For Summary Judgment, *Murray I*, 763 F. Supp. 2d 860 (E.D. Mich. 2011) (No. 08-CV-15 147).

[229] Lemon v. Kurtzman, 403 U.S. 602 (1971).

[230] *Id.* at 612–13.

which Defendants favorably endorse.'"[231] Surely such a cursory statement requires substantial elaboration to be remotely plausible. The contemporary media reports all related to a need to prevent major financial institutions from failing and causing a wider panic that would force the credit markets to seize. Islamic finance simply was not in the discourse. Yet, Plaintiff seemed willing to rely on its cursory statement, and hence could not establish the first prong of the *Lemon* test.[232]

Plaintiff seemed similarly uninterested in establishing the second prong of the test.[233] One way to establish government aid to a private entity violates the "effects" prong of the *Lemon* test is to show the aid supports religious indoctrination.[234] This of course requires religious indoctrination to exist in the first place, and then to show that the government's aid somehow furthered that indoctrination.[235] AIG is not a not-for-profit institution, such as a church or a parochial school.[236] As such, it could, and did, offer evidence to demonstrate it was not interested in religious messaging at all and that it did not deliver its products with religious instructions or indoctrination.[237] Instead, its mission in delivering these products, which in the end account for a miniscule part of its revenue, was to earn greater profits from those who wished to purchase them, and it was uninterested in the religiosity and indeed the religious affiliation of its purchasers.[238]

To this the Plaintiff offered only that Defendant's claims were "overwhelmingly contradicted by the undisputed evidence and warrant[] no further response."[239] This is a rather unorthodox method of persuasion during summary judgment and prompted a rebuke from the District Court.[240]

Similarly, Plaintiff did not seek to show that whatever government aid existed supported Islamic finance products. In fact, Plaintiff did not even try to demonstrate how much of AIG's business was involved in the marketing of such products, or how much revenue it derived therefrom.[241] For all of this, seemingly crucial to win an Establishment Clause claim, the Plaintiff supplied only cursory or conclusory statements as its "evidence."[242]

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[231] *Murray I*, 763 F. Supp. 2d at 866 (emphasis omitted).
[232] *Id.*
[233] *Id.* at 866–74.
[234] *Id.* at 867.
[235] *Id.*
[236] *Id.* at 868.
[237] *Id.* at 868–69.
[238] *Id.* at 868.
[239] *Id.*
[240] *Id.* at 868–69.
[241] *Id.* at 869.
[242] *Id.* at 868–69.

Instead, Plaintiff's evidence related solely to the supposed danger that Islam in general and Islamic finance in particular presented to the United States, and the extent to which it needed to be utterly exterminated.[243] Obviously, this is legally irrelevant to Plaintiff's claim as a legal matter. Yet, of course, it was the entire point of the effort.

Hence, for example, the Plaintiff submitted as evidence all of the activities that the Treasury Department had engaged in, described previously in Part I, including attending, sponsoring, and hosting Islamic finance workshops and seminars, instituting a scholar in residence program, and posting an article on its website offering an overview of Islamic Finance.[244] With one exception all of these activities preceded the initiation of the program.[245] For that reason alone, the District Court dismissed the evidence.[246]

Plaintiff's other evidence came in the form of expert testimony, which was not brought to prove relevant elements of Plaintiff's claim, including that TARP had a religious purpose, Islamic financial products constituted per se indoctrination, they were a fundamentally important part of AIG's business, or the government sought to support those products in particular when disbursing TARP funds.[247] Instead, Plaintiff's experts had negative testimony about Islamic finance and the threats it presented by way of support for terrorism and *jihadism*, but little as to what any of that had to do with AIG's products or the government's support for AIG through TARP.[248] Neither the District Court nor the Circuit Court seemed to be interested in even discussing this testimony given its near total irrelevance.[249] The notion that an Establishment Clause violation could be sustained based on how "bad" a religion is alleged to be is too ludicrous to be taken seriously.

Even the Plaintiff's standing claim, accepted at the District Court level but rejected on appeal, was more indicative of the culture warrior than one actually interested in winning the case. The Plaintiff's articulated harm was

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[243] *Id.* at 866, 868, 873–74.

[244] *Id.* at 873. The Court also held these activities did not present any sort of endorsement of religion, but were merely designed to promote dialogue and increase awareness of Islamic finance and not actively proselytize in its favor. This was upheld on appeal, where the Sixth Circuit described the same evidence used to support Plaintiff's claim that TARP contemplates support for religious activities to be "unconvincing to say the least," characterizing the actions of the relevant government institutions instead as "a few scattered bureaucratic activities." *Murray II*, 681 F.3d 744, 753 (6th Cir. 2012).

[245] *Murray I*, 763 F. Supp. 2d at 873–74.

[246] *Id.*

[247] *Id.* at 868.

[248] *See* Affidavit of Plaintiff Expert Stephen C. Coughlin, Esq., *Murray I*, 763 F. Supp. 2d 860 (E.D. Mich. 2011) (No. 08-15147); Affidavit of Plaintiff Expert Robert Spencer, *Murray I*, 763 F. Supp. 2d 860 (E.D. Mich. 2011) (No. 2:08-cv-15147-LPZ-MKM).

[249] *See generally Murray II*, 681 F.3d 744; *Murray I*, 763 F. Supp. 2d 860.

that he was a Marine veteran, a devout Catholic, and a taxpayer harmed by TARP's bailout of AIG because this promotes "shari'a law." Shari'a law, according to Plaintiff, is part of a "global jihadist war against the West and the United States" and "sends a message to Plaintiff, who is a [non-Muslim], that he is an outsider."[250] Whatever the merits of Plaintiff's claims regarding standing, it is difficult to see how they have anything to do with his feelings of being an outsider in America on the basis of a U.S. government bailout of an insurance giant.

In any event, the point is quite clear: this case was not really about the Establishment Clause. It was merely a convenient front for the culture war, a forum where those seeking to deny the Muslim her place in the United States could hope to show the threats posed by *shari'a*, and specifically in this context Islamic finance, were pervasive and deep-rooted in large public and private institutions.

In sum, opposition to Islamic finance is merely opposition to Muslim accommodation, in precisely the same way that rhetorical support for Islamic finance is a form of expressed support for Muslim accommodation, notwithstanding its absolute impossibility.

CONCLUSION: LESSONS FOR GLOBAL ISLAMIC FINANCE

The focus of this Article relates to particular reasons an Islamic bank in the United States remains so broadly popular, notwithstanding its doctrinal impossibility. Yet from this narrative springs forth potential explanations for much broader paradoxes respecting the continued explosive growth of Islamic finance.[251] My purpose is not to explore such considerations in depth in this concluding section, as doing so would require a separate article, which I hope to undertake in the future. Nevertheless, there is sufficient space here to identify particular themes from the spread of global Islamic finance for which there is an interesting parallel in the curious and simultaneous impossibility of and desire for American Islamic banking that I have discussed in the preceding sections.

Specifically, the strongest theoretical proponents of Islamic finance have long extolled its attentiveness to peculiarly Islamic notions of fairness and social justice in particularly strident language.[252] Seemingly in broad

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[250] *Murray II*, 681 F.3d at 747.

[251] On the scope of such growth to date, see *Future Growth, supra* note 38.

[252] Three quite distinct Islamic figures, central to the development of Islamic economics, refer repeatedly to notions of social justice and fairness in their descriptions of Islamic economics, and in particular Islamic financial methods. The first of these, Muhammad Baqir al-Sadr, the thoughtful Shi'i Iraqi jurist who authored a highly influential tome on Islamic

agreement on this principle, the primary criticisms of Islamic finance from academics,[253] religious scholars,[254] and Islamic finance insiders[255] are that it all too often mimics conventional finance rather than establishes an economy based in social justice as intended.[256]

To the extent this is true, it is also true that both within and beyond the industry, experts have long suggested Islamic finance is doomed ultimately to failure unless it were to improve its ways and achieve some measure of

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economics, as well as the seminal intellectual contribution to the creation of an interest-free bank in Islam, makes the point repeatedly in his writings. *See* MUHAMMAD BAQIR AL-SADR, IQTISADUNA 58–63 (World Org. for Islamic Services trans., rev. ed. 2009) (describing social justice as one of the cornerstones of Islamic economics); *see also* MUHAMMAD BAQIR AL-SADR, AL-BANK AL-LA RIBAWI FI AL-ISLAM 6–7 (1973) [hereinafter AL-BANK AL-LA RIBAWI FI AL-ISLAM] (referring to a form of distributive justice as being a principal objective of Islamic economics, and to the Islamic bank as being a key component of the economic system). The same can be said for the militant Sayyid Qutb, whose influence on radical Islamic movements remains vibrant. Bernard K. Freamon, *Martyrdom, Suicide, and the Islamic Law of War: A Short Legal History*, 27 FORDHAM INT'L L.J. 299, 348–50 (2003). Finally, the highly influential Pakistani Islamist, Sayyid Abul a'la Maududi, describes taking interest in almost Marxist terms, suggesting it increases maldistributions of wealth and perpetuates class struggle. *See* SAYYID ABUL A'LA MAUDUDI, THE ECONOMIC PROBLEM OF MAN AND ITS ISLAMIC SOLUTION 27–31 (Islamic Publ'ns 2d ed. 1966).

Nor is this perception limited to the revolutionary founders. Usmani, for example, repeats Maududi's claim that the charging of interest leads to massive wealth disparities in contemporary Western societies. USMANI, *supra* note 34, at 11. Chapra states that a central objective of Islamic finance is to do justice, and that Islamic finance achieves this through both requiring that a financier share in the risk of loss of an underlying venture, and that the poor have reasonable access to financing. Chapra, *supra* note 34, at 9. *See also* Timur Kuran, *On the Notion of Economic Justice in Contemporary Islamic Thought*, 21 INT'L J. MIDDLE E. STUD. 171, 174 (1989) (noting the manner in which Islamic finance proponents ground the injunction against interest in a principle of fairness).

[253] El-Gamal, *supra* note 32, at 127; Hamoudi, *supra* note 4, at 94; Zaman & Asutay, *supra* note 32, at 74.

[254] In one notable example, in 2008, several dozen Deobandi scholars in Pakistan issued a collective *fatwa* against Islamic banking, at least partly on the grounds it did not hold to the principle of profit and loss sharing but instead relied on vehicles that mimic, to quote the *fatwa*, "precisely conventional banking." Shoaib A. Ghias, *Juristic Disagreement: The Collective Fatwa Against Islamic Banking in Pakistan*, in CONTEMPORARY ISLAMIC FINANCE: INNOVATIONS, APPLICATIONS AND BEST PRACTICES 103, 107–08 (Karen Hunt-Ahmed, ed. 2012). This was a particular embarrassment to Usmani, who after all is a Deobandi himself and whose prominent role in contemporary Islamic finance can scarcely be gainsaid. *Id*.

[255] Hasan, *supra* note 33, at 11 (describing theory and practice as topics of frequent discussion at conferences on Islamic finance).

[256] *See* Mehmet Asutay, *Conceptualisation of the Second Best Solution in Overcoming the Social Failure of Islamic Banking and Finance: Examining the Overpowering of* Homo-Islamicus *by* HomoEconomicus, 15 IIUM J. ECON. & MGMT. 167, 172–73 (2007).

social justice rather than exclusively engaging in nonsensical formalistic contortions to mimic conventional transactions.[257] The assumption underlying such a prognostication is that Muslim consumers are not interested in Islamic finance because it provides some sort of substantively empty rhetorical gesture while undertaking the economic and legal equivalent of conventional transactions. Rather, they are seeking an alternative economic paradigm because of broad dissatisfaction with the current global economic ordering and they expect Islamic finance to provide it.[258]

Hence, with the unabated growth of Islamic finance, there is something of a paradox that arises again in the global sphere. This is because Islamic finance has hardly become more substantively distinct from conventional finance over the past several years, and there is much evidence that the exercises in mimicry are *increasing* rather than the reverse.[259] Yet at the same time, Islamic finance has exploded in size, from U.S. $5 billion in 1982[260] to $200 billion in 2000,[261] to $500 billion in 2008,[262] to an estimated $1.8 trillion by the end of 2013.[263] If Islamic finance is supposed to represent a broad Muslim desire for an alternative economic arrangement,[264] and if it is plainly not doing that, whether because doing so is economically impossible or for any other reason,[265] then what explains the unimpeded growth of the industry?

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257 *See, e.g.,* Chapra, *supra* note 34, at 12 (arguing Islamic finance might not remain attractive to "Muslim masses" unless it does a better job of realizing its vision); EL-GAMAL, *supra* note 22, at 175–76 (indicating that while there are "moderate" opportunities for growth for Islamic finance using current methodologies, "sustained, long term growth" requires a different approach); Haider Ala Hamoudi, *You Say You Want A Revolution: Interpretive Communities and the Origins of Islamic Finance*, 48 VA. J. INT'L L. 249, 294 (2008) (suggesting that "it is hard to see how Islamic finance could retain its legitimacy if it were to abandon" its functional objectives).

258 Chapra, *supra* note 52, at 12; Hamoudi, *supra* note 257, at 294; EL-GAMAL, *supra* note 22, at 176.

259 Asutay, *supra* note 256, at 173.

260 IBRAHIM WARDE, ISLAMIC FINANCE IN THE GLOBAL ECONOMY 1 (2d ed. 2000).

261 *Id.*

262 Salah, *supra* note 37, at 138.

263 *Future Growth*, *supra* note 38 (citing Ernst & Young projection).

264 Some have challenged the idea that the Muslim public actually expects something substantive out of Islamic finance, as opposed to narrow and formal adherence to doctrine on its terms alone. *See, e.g.*, VOGEL & HAYES, *supra* note 3, at 26 n.2. If this were true, then the mimicking of conventional finance would be no more relevant than the fact that turkey bacon "mimics" pork, and yet the former is permitted while the latter is not. I summarily dismiss such claims here as wholly implausible. As has been explored in *supra* note 252, the rhetoric in favor of the substantive benefits and social justice that Islamic finance provides is so persistent and so widespread that it is difficult to compare to dietary rules or other formal strictures, compliance with which represents little more than discharge of an divine obligation.

265 Global Islamic finance is potentially different from the American Islamic bank in one important respect: whereas the latter is clearly impossible under the current U.S. regulatory

Political considerations well beyond the narrow confines of legal and religious doctrine again provide the answer. These considerations have become particularly salient in the Muslim world over the past several decades, which has seen a rise in the political movements referred to as "Islamist," meaning for these purposes that they seek a more robust role for the *shari'a* in public life.[266] In many cases, governments that are not themselves Islamist will seek to invoke *shari'a* as a means to blunt the popularity of Islamist groups.[267] For any such government, Islamic finance proves particularly useful as a means to demonstrate Islamic credentials without disrupting the existing political, economic, and social order.

One of the premier states in which a secular government endorsed Islamic causes because of Islamist competition is Malaysia.[268] Specifically, beginning in the 1970s, Malaysia's premier party, the UMNO, "co-opted prominent Muslim leaders, created its own channels (and curtailed others) for Islamic renewal and proselytization ..., strengthened state-provided Islamic education, mandated Islamic rituals and discourse in public life, and bolstered Islamic institutions of all sorts, from banks to universities."[269] The UMNO took these steps at least in part because of the rise in popularity of an Islamist competitor known as PAS.[270]

The public support that has been devoted to Islamic finance as part of the broader Islamization effort is hard to overstate.[271] It included measures such

banking system for the reasons discussed in Part II, one could not demonstrate in any sort of conclusive fashion that it is "impossible" for a financial system to be built in a manner that was truly centered on the principle of profit and loss sharing. Indeed, the disappointment felt by both outsiders and insiders respecting the current practice of Islamic finance discussed in this section seems premised on the notion that Islamic finance is somehow redeemable. In any event, I will not burden this paper with the far more elaborate question of whether expecting something different from Islamic finance is indeed possible, or rather is unrealistically utopian. *Compare* Asutay, *supra* note 256, at 169–72 (arguing in favor of a utopian vision) *with* Mahmoud El-Gamal, *Rising Islamism and (Bad) Islamic Economics*, ISLAM AND ECONOMICS: RANDOM THOUGHTS ABOUT ISLAM, MUSLIMS AND ISSUES RELATED TO ECON. AND FIN. (July 4, 2007, 9:16 AM), http://elgamal.blogspot.com/2007/07/rising-islamism-and-bad-islamic.html (suggesting that Islamic finance cannot be reformed unless it abandons "historical" and "pietist" utopianism). Rather, the fact that Islamic finance has seen exponential growth *despite claiming to want to abandon its formalist approach while failing to do so* is paradox enough.

[266] Haider Ala Hamoudi, *The Death of Islamic Law*, 38 GA. J. INT'L & COMP. L. 293, 295 (2010).

[267] Malaysia is an excellent example of this phenomenon. Donald L. Horowitz, *The Qur'an and the Common Law: Islamic Law Reform and the Theory of Legal Change*, 42 AM. J. COMP. L. 233, 243 (1994).

[268] Meredith L. Weiss, *The Malaysian State Turns 50—And the Nation?*, 31 FLETCHER FORUM OF WORLD AFFAIRS 119, 120–21 (Winter 2007).

[269] *Id.* at 121.

[270] *Id.*; *See also* Horowitz, *supra* note 267, at 243.

[271] Horowitz, *supra* note 267, at 243.

as encouraging local religious leaders to develop Islamic financial products that resembled those of conventional finance, along with disapproval of and distaste for obsession with finer points of religious doctrine in a way that would inhibit the cause of Islamic finance.[272] Government support also took the form of direct financial and administrative aid, including the subsidizing of research centers and universities to legitimize Islamic finance and Islamic capital markets and the creation of a national *shari'a* board that would determine which Islamic financial practices were permissible and which were not throughout the nation.[273] The ultimate result of this broad and extensive support was the establishment and fostering of a parallel banking system in Malaysia that ran alongside the conventional financial sector,[274] one that became a premier center for Islamic finance in the world.[275]

The other major area in which Islamic finance tends to operate within the Muslim world is in the Arab Gulf, and specifically those nations that comprise the Gulf Cooperation Council (GCC).[276] Here, again, the support offered to Islamic finance, derived ultimately from the extensive oil wealth in the region, began in the 1970s, precisely when criticism was on the rise respecting the perceived decadent and squandering ways of the Arab oil sheikhs.[277] Saudi Arabia, a state that is "notoriously sensitive" to any accusations respecting its Islamic legitimacy, led the effort.[278] Such accusations, after all, undermine the very political legitimacy of the Saudi monarchy, which relies on the support given to it by a deeply conservative religious establishment.[279]

The other GCC states have Islamist movements of their own to contend with, making their support for Islamic finance as a means to blunt Islamist power equally sensible. The major political opposition force in Kuwait, for example, is Islamist in its orientation.[280] The United Arab Emirates is concerned enough about Islamist opposition as to hold show trials in order to send dozens of Islamists to prison, notwithstanding the predictable criticism this generates from prominent human rights groups.[281] Qatar's emir is notoriously adept

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[272] WARDE, *supra* note 260, at 125.

[273] *Id.* at 125; *see also* Weiss, *supra* note 268, at 121 (describing support for universities).

[274] WARDE, *supra* note 260, at 123.

[275] EL-GAMAL, *supra* note 22, at 112.

[276] *Id.* at 112. The Gulf Cooperation Council consists of six Arab states: Saudi Arabia, Bahrain, Oman, Kuwait, Qatar, and the United Arab Emirates. *Member States*, THE COOPERATION COUNCIL FOR THE ARAB STATES OF THE GULF (2012), http://www.gcc-sg.org/eng/indexc64c.html?a ction=GCC (last visited Jan. 12, 2014).

[277] KURAN, *supra* note 219, at xiii.

[278] *Id.*

[279] Ann Elizabeth Mayer, *Conundrums in Constitutionalism: Islamic Monarchies in an Era of Transition*, 1 UCLA J. ISLAMIC & NEAR E. L. 183, 185–86 (2002).

[280] Goldenziel, *supra* note 3, at 27.

[281] *UAE Islamists Convicted for Plotting Government Coup*, BBC NEWS (July 2, 2013), http://www.bbc.co.uk/news/world-middle-east-23142248 (describing trial of Islamists for a coup plot and criticism of the trial by human rights groups).

at using Islamism to bolster his own political legitimacy.[282] Finally there is Bahrain, with its explosive combination of a Sunni monarchy and a Shi'a majority population,[283] where a need by the leadership to legitimize itself given the circumstances is both patently urgent and blatantly obvious.

Quite notably, however, Islamic finance and Islamic economics served, and continue to serve, the uses of the GCC states and Malaysia as a means to bolster Islamic credibility only if they are not truly revolutionary. In other words, where the founders of Islamic economics in the middle of the previous century advocated and agitated for political and economic revolution,[284] the state benefactors of Islamic economics two decades later in the 1970s very much sought to transform that revolution into something altogether more compliant. Hence, they were as responsible for *directing* Islamic economics and Islamic finance as they were in *supporting* it. Saudi Arabia helped narrow the focus of Islamic economics,[285] and Malaysia's premier Mahathir Mohammad directed support to clerics and proponents who supported his own modernist ideas while curtailing dissenting voices.[286] This trend did not alter the revolutionary *rhetoric* of Islamic finance as being a source of social justice and wealth redistribution,[287] nor was it intended to. But quite plainly it altered the *practice* of Islamic finance, from one advocated by forces of revolution to what is now practiced by international financial giants such as Citibank[288] and HSBC,[289] both of which have Islamic finance desks.

Having been so thoroughly compromised, it is hard to imagine Islamic finance poses any sort of threat to the prevailing political, social, and economic order that the GCC states and Malaysia seek to preserve. Of course, it also will not do much to help Muslim societies deal with their severe economic problems,[290] but this was never the point of the support offered to it anyway.

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[282] Barnard Haykel, *Qatar and Islamism*, NORWEGIAN PEACEBUILDING RESOURCE CENTRE (Feb. 2013), http://www.peacebuilding.no/var/ezflow_site/storage/original/application/ac81941df1be874ccbda35e747218abf.pdf.

[283] Marina Ottoway, *Bahrain: Between the United States and Saudi Arabia*, CARNEGIE ENDOWMENT FOR INT'L PEACE (Apr. 4, 2011), http://carnegieendowment.org/2011/04/04/bahrain-between-united-states-and-saudi-arabia/2tzk (indicating Bahraini population is 65 percent Shi'i currently).

[284] Hamoudi, *supra* note 257, at 250. ("Despite its currently conservative character, the modern practice of Islamic finance lies on a bedrock of social, cultural, and economic revolution.").

[285] KURAN, *supra* note 219, at xiii–xiv.

[286] Weiss, *supra* note 268, at 120–21.

[287] *See* VOGEL & HAYES, *supra* note 3; *supra* note 252 and accompanying text (noting continuing influence of social justice rhetoric within Islamic finance industry).

[288] CITI ISLAMIC INVESTMENT BANK, http://www.citibank.com/ciib/homepage/index.htm (last visited Jan. 12, 2014).

[289] HSBC AMANAH, http://www.hsbcamanah.com (last visited Jan. 12, 2014).

[290] *See, e.g.*, Asutay, *supra* note 256, at 172–75 (noting "social failure" of Islamic finance in achieving broader economic objectives); EL-GAMAL, *supra* note 22, at 190 (arguing

The point was to demonstrate Islamicity while not forcing major economic or political disruption, and in this, Islamic finance has succeeded magnificently.

Interestingly, the same factors will likely lead to broader support and expansion of Islamic finance in years to come. This is because, ironically, many political movements grounded in principles of religious conservatism find themselves in something of the same predicament as the ruling governments that have long sought to suppress them. Recently, for example, Islamist parties have been able to lead governments following electoral victories, and in particular following the Arab Spring .[291] The movements that have come to power in this way are hardly radical or revolutionary.[292] In fact, they generally seek to downplay or ignore more radical manifestations of contemporary *shari'a* implementation for fear that to advocate for such things would be electorally damaging.[293] The movements thus insist they adhere to values of human rights, freedom of speech, democratic politics, the separation of powers, and equality under the law, irrespective of race, origin, gender, or

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that Islamic finance is inefficient and fails to provide substantive economic value to its consumers).

[291] For example, in Tunisia, the Islamist Ennahda has formed a ruling coalition with smaller secular parties. Carlotta Gall, *Tunisia Faces More Anger as an Ambush Kills Soldiers*, N.Y. TIMES (July 29, 2013), http://www.nytimes.com/2013/07/30/world/africa/tunisia-faces-more-anger-after-soldiers-die-in-attack.html. Iraq's current government is also Shi'a Islamist in orientation. Reidar Visser, *The Iraq We Are Leaving Behind: An Unstable, Divided Land,* N.Y. TIMES, Dec. 16, 2011, at A43. Finally there is Egypt, where the Muslim Brotherhood took power for a brief period of months after decades of effort, only to be deposed in a military coup that took place at the end of June of 2013. Nathan J. Brown, *Where Does the Muslim Brotherhood Go From Here?: Reckoning With Morsi's Failure*, NEW REPUBLIC (July 3, 2013), http://www.newrepublic.com/article/113762/egypt-coup-mohamed-morsi-out-muslim-brotherhood-disarray.

[292] This is not to deny the existence or importance of radical Islamist movements that have come to power through coup, insurrection, or revolution and incorporated the harsh criminal penalties developed in medieval times and referred to as the *hudud*. Some particularly notable examples include the radical Islamist takeover in Mali, the rule of the Taliban in Afghanistan, post-revolution Iran, and the *hudud* ordinances of Pakistan. *See supra* PETERS, note 203, at 158–64 (Pakistan and Iran); AHMED RASHID, TALIBAN 93 (2000) (Afghanistan); Sudarsan Raghavan, *Malians Vote in First Presidential Election Since Coup*, WASH. POST (July 28, 2013), http://www.washingtonpost.com/world/malians-vote-today-in-crucial-elections/2013/07/28/c4c49458-f78f-11e2-a954-358d90d5d72d_story.html. The point here, however, is that the movements grounded in some notion of Islamic conservatism that have taken power in states as varied as Turkey and Egypt, and that challenge ruling parties in a state such as Malaysia, do not espouse such notions. Hamoudi, *supra* note 45, at 445–46; Christopher Fernandez, *Impossible to Have Hudud*, FMT NEWS (May 5, 2013), http://www.freemalaysiatoday.com/category/opinion/2013/05/05/impossible-to-have-hudud/ (describing the intent of the primary Islamist party in Malaysia to implement *hudud* as "non-existent").

[293] Hamoudi, *supra* note 45, at 445–46.

even creed.[294] At the same time, of course, such parties are Islamist and need to demonstrate some deference to traditional understandings of the *shari'a* to appeal to their more conservative base supporters if nothing else.[295] If they did nothing but speak of peaceful transfer of power through elections, supremacy of the law, and equality of all citizens under law, then there would be little to distinguish them from secular and liberal parties.

As it did with the states of the GCC and Malaysia, a commitment to Islamic finance fits the needs of Islamist parties perfectly. In its compliant and compromised form, support for Islamic finance is unlikely to alienate even the most hardened secularist, so long as the state does not go so far as to mandate it—an exceedingly unlikely and radical step for a moderate Islamist movement to take.[296] And, to satisfy religious conservatives, Islamic finance shows commitment to something that is at least rhetorically Islamic and sounds in the forms of classical Islamic jurisprudence.[297]

Hence, Iraq's highly divided legislature recently enacted a law forming its own state-chartered Islamic bank, the Islamic Bank of Mesopotamia, because Islamists wanted to demonstrate a commitment to *shari'a*.[298] For their part, secular groups thought it was pointless to object to the establishment of

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[294] A particularly salient example is Egypt's Muslim Brotherhood, whose 2011 party platform emphasized values from freedom of religion to separation of powers to peaceful democratic transition. Where the platform mentions *shari'a,* it generally does so at such a high level of abstraction it is very difficult to know what it meant by the reference. *See FJP 2011 Program on Freedoms and Political Reform*, FREEDOM & JUST. PARTY, http://www.fjponline.com/article.php?id=197 (last visited Jan. 12, 2014).

[295] *See* Nathan J. Brown & Amr Hamzawy, *The Draft Party Platform of the Egyptian Muslim Brotherhood: Foray Into Political Integration or Retreat Into Old Positions?* (Carnegie Papers, Middle E. Series, No. 89 (2008), *available at* http://carnegieendowment.org /2008/01/14/draft-party-platform-of-egyptian-muslim-brotherhood-foray-into-political-integration-or-retreat-into-old-positions/3gej (describing tensions for Brotherhood in seeking to navigate between satisfying more stalwart members and appealing to a broader, more moderate public). This is by no means limited to Egypt. Iraq, for example, has a number of Shi'i Islamist parties that compete with one another, thereby making a complete abandonment of any *shari'a* claims a significant political liability as more devoted and religious members can easily transfer their loyalties to a competing political party. *See* Haider Ala Hamoudi, *The Real Electoral Crisis in Iraq*, ISLAMIC L. IN OUR TIMES, (Jan. 23, 2010, 5:11 PM), http://muslimlawprof.org/2010/01/23/the-real-electoral-crisis-in-iraq.aspx.

[296] Hamoudi, *supra* note 45, at 445.

[297] *See* EL-GAMAL, *supra* note 32, at 2 ("Islamic financial forms are derived, albeit loosely, from classical sources of Islamic jurisprudence, which process of derivation gives the industry its 'Islamic' label.").

[298] The Law of the Islamic Bank of Mesopotamia, No. 95 of 2012; Caleb Pittman, *Iraq's Islamic Bank and the Islamicity of Interest—Forum*, JURIST (Jan. 14, 2013), http://jurist.org/forum/2013/01/haider-hamoudi-islam-banking.php.

a bank with a paid up capital of U.S. $43 million,[299] a fraction of the size of Iraq's two largest conventional banks.[300]

Another salient example is Tunisia, where the ruling Islamist Ennahda party has repeatedly insisted that the imposition of *shari'a* is not part of its political program.[301] Yet of course, Ennahda is an Islamist party, and it relies on support from a base that wishes to see a broader role for *shari'a* in public life. It could lose that base to more conservative elements if it disavowed *shari'a* entirely.[302] Again, Islamic finance fits Ennahda's purposes perfectly, a fact that became obvious when its Prime Minister announced in June of 2012 an intention to make Tunisia a hub for Islamic finance.[303] This broad effort has led most recently to a parliamentary vote to authorize a sovereign issuance of a form of Islamic bond known as the *sukuk*, thereby both enabling the state to encumber itself with potentially unpopular foreign debt while simultaneously advancing the cause of mild Islamic revivalism.[304]

None of this demonstrates a lack of sincerity on the part of the many participants in global Islamic finance any more than the American Muslim, or the American federal regulator for that matter, is being insincere in expressing a desire to see more Islamic retail banking take place in the United States. For the most part, it is fair to assume that the participants *want* what they have expressed an interest in promoting, and are not cynically hiding ulterior motives.

The point, rather, is that in examining what they want by way of Islamic finance globally, and American Islamic retail banking particularly, there lies exposed a fundamental doctrinal incoherence. No purely formal legal analysis can explain away that incoherence. To understand Islamic banking, we must look beyond the law. When we do that, and only when we do that, can we make any sense of the industry.

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[299] *Id.*

[300] Cabinet Decides to Support the National Product and Increasing the Capital of the Rifadain and Rasheed, AL-BAGHDADIAN NEWS (May 15, 2012, 6:26 PM), http://albaghdianews.com/economy/item/9442-LvkYO-AkNeEAs-njEE-DIL-AkLlbv-AkNZln-NenAD%D8%A9-EaYOLAk-LZHEJn-AkEAJDnl-NAkEyonD.html (describing capital of Rafidain and Rashid banks as being between $250–$350 million each).

[301] *See, e.g.*, David D. Kirkpatrick, *Islamists Head Toward Victory in Tunisia Vote*, N.Y. TIMES, Oct. 25, 2011, at A1 (describing Ennahda and its candidates as focusing on economic issues and security rather than moral concerns). Scott Sayare, *Tunisia is Uneasy over Party of Islamists*, N.Y. TIMES, May 16, 2011, at A9.

[302] *See* Tarek Amara, *Tunisia's Islamic Finance Push Has Political Echoes*, REUTERS (Oct. 10, 2012, 10:00 AM), http://www.reuters.com/article/2012/10/10/tunisia-islamic-finance-idU SL6E8L2ESJ20121010.

[303] *Id.*

[304] *See* Tarek Amara, *Tunisian Parliament Approves* Sukuk *Bond Issues*, REUTERS (July 18, 2013, 5:21 AM), http://www.reuters.com/article/2013/07/18/tunisia-sukuk-idUSL6N0FO1GI20130718.