Islamic Finance: Its Theory, Products and a Brief View of Islamic Finance in Europe

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Abstract

Although there are conceptual similarities in terms of financial products between conventional and Islamic finance, they are entirely different financial systems. Despite Islamic finance's small size in the conventional finance world, its promising growth makes Islamic finance a hot topic both in academia and business world. Today customers can access sophisticated Islamic financial products not only in Muslim countries but also in Europe. This study analyzes Islamic finance, its theory, source of the theory, products and includes a brief overview of Islamic finance in Europe.

Keywords: Islamic finance; Islamic banking; conventional finance; Sharia-compliant financial products; Islamic finance in Europe

Introduction

There are 1.9 billion Muslim in the world and it 25% of the world population. Only 20% of Muslims live in Middle East and the largest community in Asia with 62%. 25.8 million Muslim live in Europe and it is the 4.9% of the population. According to Pew Research Center Muslim population in Europe will be increased to 7.4% by 2050 even Europe accepts no Muslim refugee. Same research center estimates the Muslim population in USA as 8.1 million which is 2.1% of population by 2050, that is twice more than today.

Islamic Finance and banking showed a great performance and are still expanding rapidly in recent years and just in 2019 it increased by 11.4%, due to COVID it is expected a low or mild increase in 2021 (Islamic Finance Outlook, 2021). Total value of Islamic financial assets is US$2.88 trillion in 2020 and expected to be US$3.69 trillion in 2024 (Hasan, Islamic Finance Senior Proposition Manager, Refinitiv). Because of its promising future Islamic financial instruments are not only performed in Muslim countries but also being used in many non Muslim countries (Yusoff and Shamsuddin, 2003-Alharbi, 2016). More sophisticated Islamic financial instruments can also help the Muslim communities living in non Muslim countries. Islamic Finance can be a fresh way to attract money to Germany and at the same time it can help the Muslim population in Germany to integrate the country by involving them into the financial system. Unfortunately Germany has little interest to Islamic Finance when it is compared other leading countries in the world. “We all know the UK will be the Islamic finance hub in Europe.” (Adham Charanoglu, DAR). European Union acts as a single market by establishing movement of goods, services, capital and people freely. On the other hand the regulations for banking and finance are set by countries itself. Beside UK government’s pro-Islamic finance regulations helping them to achieve to be an Islamic finance center in Europe in the future, the other European countries’ governments showed little interest and they actually lead to UK in a position with respect to Islamic banking and finance that has not been achieved in nowhere else in Europe (Wilson, 2007). However, post Brexit it seems there is an uncertainty for the Islamic financial services and they are going to make a choice whether staying and operating in UK which will be more costly or moving to countries such as France or Germany to provide services. From the demographics perspective there is a pent-up demand in these markets and it is about the finding the formula to unlock that with right products, with the right education, with right messaging, etc. Furthermore politics is the very important key issue to attract the capital from Islamic world, and UK is more successful than France and Germany in terms of politics to attract and to create Islamic financial products and services.

According to PwC 50% of Islamic banking customers in Malaysia are non Muslims and Islamic finance is being more acceptable by non Muslims there (Abdullah and et al, 2012).

Mervyn Lewis asked a question related to Islamic finance in his lecture. He has works named Islamic Banking (2001), Islamic Banking (2007), Hand of Islamic Banking (2007), and Islamic Perspective on Governance (2009). Lewis asked in his lecture that would the global financial crisis have occurred if Islamic financial principles had been followed? Mirakhor and Krichene (2009), Ahmed (2010), Chapra (2011), Kayed and Hassan (2011), and Belouafi, Bourakka, and Saci (2015) studied the same or very similar question in their papers which are published in respective journals. However all these academicians are Muslim in contrast to Lewis. Before giving an answer Lewis claimed that from the religious perspective the reasons of the last financial crisis, named as 2008 Mortgage or global financial crisis, were; I) greed which is from homebuyers, mortgage brokers, banks, investment banks, credit rating agencies, and hedge funds, II) misleading contracts which are related to margin lending and home equity loans, no-doc or low-doc loans, III) speculation which can be happened in proprietary trading in derivatives, stocks, bonds, currencies, commodities, and junk bonds, IV) poor governance which can lead to shadow banking system. Islam is opposed to greed, extravagance, misleading contracts and prohibits speculation. Judaisms and Christianity are equally opposed to those practices. Islamic banks hold more capital and more profitable than conventional banks, and performed better during global financial crisis 2008 (Addawe, 2012). The difference in financial practice is that Islamic financial institutions have boards to check financial activities are whether Islamic or not. Although Islamic finance is growing rapidly, it remains still as a mystery especially in western world and it continues to be a poorly analyzed and paid attention by western communities. Since there is no Christian or Jewish finance or banking, almost all European countries are skeptical to Islamic finance and image of Islam in Europe is also feeding this skepticism although there is a high number of Muslims in European countries (Wilson, 2007).

What is the source of Islamic Finance and its Principles?

Sharia (or Shariah) that is Islamic law covers all aspect of life. Sharia has some sources. We can make these sources as two groups and show as in the following table:

Table 2: Sources of Shariah

Primary Sources	Secondary Sources
Quran	Ijma
Sunnah(Hadith)	Qiyas

The primary sources of Sharia are the Holy Quran and Sunnah of the holy Prophet. The Quran is the primary legal source of Islam since it is speech of Allah. According to Islamic belief it is necessary obeying injunctions in Holy Quran by all Muslims. Holy Quran has supplemented by Sunnah. The Sunnah which contains saying of holy Prophet Muhammad (s.a.s) and the actions done by the holy Prophet or the actions approved by holy Prophet. Sunnah can be considered as detailed explanations of Holy Quran and clarification of a matter that is not mentioned in Holy Quran directly. The other primary sources of Sharia are Ijma (principles of Islamic jurisprudence) and Qiyas (analogical deduction) which are based on Ijtihad. Ijtihad is the mental effort of scholars having juristic expertise to find solutions for emerging problems and issues.

Fikq its implementation can be considered as practices and activities of Islamic laws that is Shariah. Fikq has two branches Ibadah and Muamalat. Ibadah is man to God worship. Muamalat is the activities of a man in the community. Muamalat contains political, social and economical activities. Banking is one of the economical activities. So every financial activity such as banking is subset of Islamic laws.

In theory what are permissible and what are forbidden are defined and stated clearly. However, there are differences in practice. There is different implementation of the theory. This is another huge area to go deeply and explain in this study. Therefore, we only state as a fact that there is different implementation of Shariah. That is why many Islamic Banks or Institutions have their own boards to check whether financial operations are Islamic or not. Transparency and documentation are the key issues to convince the clients that performing operations are Sharia-compliant operations. Scholars in those boards are deciding whether an instrument is a Sharia-compliant instrument or not. However, those scholars have mostly religious knowledge rather than finance. Educating scholars in terms of conventional finance will give the chance to create innovations in Islamic finance. Islamic finance is growing rapidly, on the other hand it is still relatively very small when it is compared to conventional finance. Total value of Islamic finance is 1 percent of the conventional finance. Islamic finance still needs to improved and Islamic finance world need to learn more from conventional finance which its history goes back to hundred years ago and has lots of complicated financial instruments.

Islamic Finance's approach to interest is the well-known principle. Islamic Finance prohibits the interest. Earning money from money is strictly forbidden, instead of this Islamic Finance encourage trading and running the money. Maybe ten years ago a financial system without interest could not be imagined. However while we are now experiencing negative interest rates, conventional finance can be more open the idea a financial system without interest.

Although prohibition of interest is the well-known principle in Islamic Finance, the following principles are also equally important as prohibition of interest.

Prohibition of Uncertainty: The terms and the conditions which of the risk are not clearly understood by all parties to a financial transaction are not allowed.

Profit-Loss Sharing: Sharing profit or returns from assets are permitted if parties involved in a financial transaction share both the risks. So the business risks must be shared by the lender (seller) and borrower (buyer).

Ethical Investments: Investments such as alcohol, pornography, gambling, and pork based products are not allowed.

Money: Money in Islamic Finance is just a medium of exchange. It just measures a value. Money can be borrowed but for equal re-payment. Therefore, money itself can not be used to make profit.

Islamic Finance shortly can be defined as sum of financial activities which are not against Islamic laws and rules, having no interest, uncertainty and speculation. Investments for alcoholic beverages, gambling, pork, pornography are not allowed too.

Who decides what is and is not *sharia*-compliant?

There are lots of different types financial activities but at the end who decides that those activities are Islamic or not. There are different standards in different countries. There is no unique set of rules that can be used to check a financial activity whether it it Islamic or not. This can be surprising for non-Muslim but it is a fact that there are more than 1.5 billion Muslim and there is no single Sharia rules in Muslim world. Therefore, it is quite normal absence of the unique standards in Islamic financial world.

However, there are two important organization which are recognized by many countries, investment banks, banks, institutions, etc. They are Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and Islamic Financial Services Board (IFSB).

'AAOIFI, established in 1991 and based in Bahrain, is the leading international not-for-profit organization primarily responsible for development and issuance of standards for the global Islamic finance industry. It has issued a total of 100 standards in the areas of Shari'ah, accounting, auditing, ethics and governance for international Islamic finance. It is supported by a number of institutional members, including central banks and regulatory authorities, financial institutions, accounting and auditing firms, and legal firms, from over 45 countries. Its standards are currently followed by all the leading Islamic financial institutions across the world and have introduced a progressive degree of harmonization of international Islamic finance practices (aaoifi.com)'.

'The Islamic Financial Services Board (IFSB) is an international standard-setting organisation that promotes and enhances the soundness and stability of the Islamic financial services industry by issuing global prudential standards and guiding principles for the industry, broadly defined to include banking, capital markets and insurance sectors. The IFSB also conducts research and coordinates initiatives on industry related issues, as well as organises roundtables, seminars and conferences for regulators and industry stakeholders.' (ifsb.org)

Standardization is very important in our global world. Islamic finance is not operating in a few Muslim countries, it is expanding not only in Muslim countries but also in non Muslim ones. IFSB and AAOIFI are different organizations and set up different rules. IFSB is established almost one decade later than AAOIFI. IFSB is Malaysian-based Islamic board. After seeing the difficulty to apply conventional banking standards to Islamic ones, Malaysia established a national Islamic Sharia board to set up rules for Islamic banks. There are some discussions around Islamic finance, in other words criticism. Although Islamic finance is growing exponentially, it is still a small proportion in conventional finance world. Transparency is one of the biggest criticism for Islamic finance. The lack of transparency brings another criticism which tells that Islamic finance mimics conventional finance. The same criticism is made for IFSB. Someone finds also it too liberal. Differences in terms of referencing standards, capitalisation, risk management, capital gains tax, value added tax, Sukuk issuance, Sharia-compliant home mortgages, tax on Murabaha contracts, tax-deductible Sukuk payments, Ijara or Murabaha contracts for mortgage products is seen in Australia, Bahrain, France, Indonesia, India, Luxembourg, UK and USA. Differences are not only about Islamic financial standards, they are also about how Islamic products take place in conventional finance system.

These two international Sharia supervisory bodies' standards are becoming more similar in the last years and standards in AAOIFI and IFSB are slightly overlapping. The collaboration of AAOIFI and IFSB with IMF and World Bank helps also establishing unity in terms of standards. Nevertheless it muss be known that both supervisory boards have no power to impose sanctions when any Islamic institution does not follow those standards. There are many both national and institutional level boards to decide whether a financial product is Islamic or not. Transparency plays a crucial role in this case. Transparency attracts not only more capital from Islamic world but also helps to eliminate the criticism that Islamic finance mimics conventional finance.

Table 1: Timeline of The Complexity of the Products in Islamic Finance

1970's	1980's	1990's	2000's	2005+
Commercial Banking	Commercial Banking Project finance and syndication	Commercial Banking Project finance and syndication Equity Ijarah (Leasing)	Commercial Banking Project finance and syndications Equity & Funds Ijarah (Leasing) Sukuk (Bonds) Structured alternative assets	Commercial Banking Project finance and syndications Equity and Funds Ijarah (Leasing) Sukuk (Bonds) Structured alternative assets Liquidity management tools

Source: Kuala Lumpur Islamic Finance Forum, 2007

The emergence of modern Islamic Finance starts in early 1970s. Two important factors were involved in the development of modern Islamic Banking in these years. First is the rise of oil prices. They facilitated the development modern Islamic finance and increased vastly the financial resources. Many Islamic banks were established in these years such as Islamic Development Bank (1973), Dubai Islamic Bank (1975), Kuwait Finance House (1977), Bahrain Islamic Bank (1981), Qatar Islamic Bank (1983), Faisal Islamic Bank of Egypt (1977), Faisal Islamic Bank-Sudan (1978), Albaraka Investment and Development Company (1982). Later Albaraka established an investment company in London and banks in Jordan, Egypt, Tunis, Bahrain, Sudan, Turkey, South Africa, Algeria, Pakistan, Lebanon, Saudi Arabia, Syria, Morocco and Germany. The second important factor involving in the development of modern Islamic Finance is the effort of Islamic finance scholars. Their efforts eliminated the prohibited elements according to Shariah and enforced to establish of Shariah-compliant instruments and standards for Islamic finance. One interesting anecdote relating to the emergence of modern Islamic banks is about the movement of funds during 1980s and 1990s. These banks invested mostly in the West since investment decisions were influenced largely by risk assessment.

Islamic Financial Products

Musharaka

Musharaka in Arabic means sharing. In Islamic finance partnerships are formed by the methods which are based on profit and loss sharing (PLS). Since interest or fixed rate of returns is forbidden in Islamic finance, there is no fixed rate of return in Musharaka (or Musharakah). In conventional finance, the financier does not suffer in the case of loss, however in Musharaka, all the partners share profit or loss. It is basically an alternative for interest-based financing. There are different types of Musharaka. Most of them are used rarely in Islamic financial world. However one type of Musharakah which is called diminishing Musharaka, is very commonly used by Islamic banks. It is basically home financing. In conventional finance, when you want to buy a house and need money, you can borrow money from a bank. The relationship between bank and client is debtor and creditor. On the other hand, since Islam prohibits interest and encourages trade, the relation between bank and client is also different. In Islamic finance home financing works as follow:

I. You want to buy a house and need money. You approach to an Islamic bank to find out if there any possibility to buy a house through installments.

II. Islamic bank offer a deal which is based on the partnership.

III. The bank and customer will jointly buy the house. The customer contributes a certain share of the house and bank owns the rest of the share of the house. Therefore the house is owned by both customer and bank. Then the bank rents its share to customer and since customer wants to have the house, bank sells also its shares gradually to the customer until the customer becomes the owner the house completely.

Instead of debtor and creditor, bank and customer in Islamic finance create a relationship which is based on the partnership. It can be said that it is basically Islamic mortgage. However diminishing

Musharaka has a wide range of usage. 27% of the Islamic banks in Qatar and Bahrain use Musharaka as an Islamic financial product (Al-Sulaiti, Ousama, & Hamammi, 2018).

Table 3: Musharakah Practices across the World

Country	Practices	Bank Name
Ireland	Diminishing Musharakah/Hire Purchase Musharakah Deposit	Regulation only
Luxembourg	Sukuk al-Musharakah Undertakings for Collective Investments in Transferable Securities (UCITS) Specialised Investment Funds (SIF)	KBL European Private Bankers (KBL epb)/Islamic Liquidity Management Blackrock Alliance for Luxembourg Islamic Finance (ALIF) Sedco Capital
Turkey	Sukuk al-Musharakah	Regulation only
United Kingdom	Sukuk al-Musharakah Diminishing Musharakah	Sanctuary Building/ Lloyds TSB Al Rayan Bank
USA	Sukuk al-Musharakah Diminishing Musharakah	East Cameron Gas Devon Bank Zayan Finance Guidance Residential Lariba – American Finance House/Bank of Whittier
Saudi Arabia	Equity Financing Musharakah Letter of Credit (L/C) Musharakah for Corporate Finance	Islamic Development Bank (IDB) Al-Rajhi Bank
Oman	Musharakah in Agricultural Sector Diminishing Musharakah: Business Diminishing Musharakah: Property Diminishing Musharakah : Home Financing	Government Policy MUZN Islamic Banking MEETHAQ Islamic Banking
Kuwait	Diminishing Musharakah: Home Financing	Kuwait Finance House
Bahrain	Musharakah Financing	Islamic Bank of Bahrain
UAE	Musharakah Financing Cooperate sukuk: Al Musharakah	Abu Dhabi National Bank Dubai Islamic Bank Emirates Islamic Bank

Egypt	Musharakah Business Financing (Agriculture, Industry)	Al Baraka Bank Egypt AT. Asset Management A.T Brokerage Faisal Islamic Bank Ridge Islamic Capital
South Africa	Musharakah Business Property Financing	Absa Islamic Banking (Islamic window) Al-Baraka Bank
Morocco	Diminishing Musharakah Musharakah Business Financing	Attijari Wafa Bank Banque Populaire BMCE BMCI
Sudan	Musharakah Business Financing (Agriculture, Industry, Trading) Sukuk Al Musharakah	African Bank for Trade and Development Agricultural Bank Animal Resources' Bank
Malaysia	Sukuk Musharakah Diminishing Musharakah Outward Letter of Credit-i	Bank Islam Malaysia Berhad Maybank Islamic Affin Islamic Bank AmIslamic Bank CIMB Islamic Bank Public Islamic Bank RHB Islamic Bank Bank Muamalat Malaysia
Indonesia	Diminishing Musharakah Sukuk Diminishing Musharakah	PT Bank Muamalat Indonesia PT Bank syariah mandiri PT Mega Bank Syariah PT Bank syariah BRI PT Bank Syariah Bukopin PT panin bank syariah PT bank victoria syariah PT BCA syariah PT Bank Jabar dan Banten PT Bank syariah BNI PT Maybank Indonesia syariah PT Bank Tabungan Pensiunan Nasional Syariah
Singapore	Sukuk Musharakah Diminishing Musharakah	UOB Majlis Ugama Islam Singapura (MUIS) Monetary Authority of Singapore (MAS)

		(Diminishing Musharakah –only regulation in place)
Brunei	Diminishing Musharakah (Home financing) Musharakah Corporate Financing BIBD Musharakah Musahamah Al-Bai Tradable Musharakah Certificate.	Bank Islam Brunei Darussalam (BIDB)

Source: Moriguchi and et al, 2016.

Mudarabah

Mudarabah (or Mudaraba) is actually a special kind of partnership. One partner which can be an Islamic bank or any other Islamic financial institution or any individual acts as a money provider. This partner-is called in Arabic ‘Rabbul mal’ supplies the capital needed for financing a project. The other partner manages the business-and it is called in Arabic ‘mudarib’. These partners agree in advance on the proportion of the profit. As a rule Rabbul mal cannot interfere the management however Rabbul mal can restrict the business, for example where to invest or what to invest. We call this type Mudarabah as restricted Mudarabah. If there is no restriction then it is unrestricted Mudarabah. In Musharakah both parties invest money and provide financing, on the other hand Musharakah only one partner is supplying capital and the other partner is running the parties.

Uses Of Musharakah / Mudarabah :

These modes can be used in the following areas (or can replace them according to Shariah rules).

• Asset Side Financing

• Short/medium/long - term financing

• Project financing • Small & medium enterprises setup financing

• Large enterprise financing

• Import financing

• Import bills drawn under import letters of credit

• Inland bills drawn under inland letters of credit

• Bridge financing • LC without margin (for Mudarba)

• LC with margin (for Musharakah)

• Export financing (Pre-shipment financing)

• Working capital Financing

• Running accounts financing / short term advances Liability Side Financing

• For current/ saving/mahana amdani/ investment ccounts (deposit giving Profit based on Musharkah/Mudarbah – with predetermined ratio)

• Inter- Bank lending / borrowing

• Term Finance Certificates & Certificate of Investment

• T-Bill and Federal Investment Bonds / Debenture.

• Securitization for large projects (based on Musharkah)

• Certificate of Investment based on Murabahah (Eg: Al Meezan Riba Free)

• Islamic Musharakah bonds (based on projects requiring large amounts – profit based on the return from the project)

source: *Dr. Muhammad Imran Ashraf Usmani, Meezan Bank's Guide to Islamic Banking.*

Istisna and Salam

Istisna (Istisna'a or Istisna') is sale contract of a specified item to be manufactured or contstructed to be delivered at future date between a customer and manufacturer or constructor. The terms and conditions in the contract must be stated clearly and it has to include all information about price, quality and quantity of material, the period and place of delivery.

Istisna is used mostly to finance the construction of buildings, roads, bridges, schools, hospitals and manufacturing ships, machines, airplanes, etc. Indeed Istisna derived from the Sanaa which means 'manufacturing'. Salam is very similar to Istisna but the subject of the agreement in Salam can be any item. Salam is used frequently to finance small and medium enterprises. Differences between Istisna are the followings (Usmani, 2005):

i. The subject of Istisna' is always a thing which needs manufacturing, while Salam can be affected on any thing, no matter whether it needs manufacturing or not.

ii. It is necessary for Salam that the price is paid in full in advance, while it is not necessary in istisna'.

iii. The contract of Salam, once affected, cannot be cancelled unilaterally, while the contract of Istisna' can be cancelled before the manufacturer starts the work.

iv. The time of delivery is an essential part of the sale in salam while it is not necessary in Istisna' that the time of delivery is fixed.

If the customer and manufacturer, constructor or seller make the contract or agreement directly then it is called simple Istisna or Salam. However when customer does not have financing then an Islamic bank plays an intermediary role between those parties, therefore it would be consist of two separate contracts, one of the between bank and manufacturer and the other one between bank and customer. These types of Istisna or Salam are called parallel Istisna or Salam. Parallel Istisna or Salam work as follow:

I. Customer contacts to an Islamic bank to enter a contract. Customer gets required financing from the Islamic bank.

II. Islamic bank contacts to a seller or manufacturer to enter an Istisna or Salam contract.

III. Seller or manufacturer delivers the asset to the Islamic bank.

IV. Islamic bank delivers the asset to the customer.

Ijarah

Ijarah (or Ijara) can be basically defined as an Islamic leasing. And actually there are small differences between Ijarah and conventional leasing. Lessor in conventional leasing does not bear any responsibilities of an asset which is not permissible in Islamic finance (Abdullah, 2008).

Takaful

Takaful is an Arabic word and it comes from the Arabic root-word ‘kafala’ which can be translated as guarantee. At the second century of the Islamic era, Arab Muslims had started long journeys for trading to India, South Asia and many other countries and some continents. During these long trading journeys, they faced many risks such as natural disasters, losses, piracy, and other problems. After these kinds of problems, Arab Muslim traders agreed to set up and contribute into a fund that can be used to compensate anyone who suffered from handicaps of these long trading journeys. So the origin of ‘Islamic insurance’ which is Takaful has a very long history which is from the period of Abbasid and the Ottoman Empire.

When we come to nowadays, in 1970s that come up with an Islamic way of insurance instead of conventional insurance serious efforts were made in our modern times’ world. The first Takaful Company was set up in Sudan in 1979 and almost at the same time another one was set up in Bahrain. According to a research total value of Takaful market in the world in 2019 is almost 24 billion USD (IMARC Research Company).

Takaful is not just a way of insurance, it has an ideology. It supports solidarity and joint guarantee; it promotes sustainability and helps to those that need it. In Takaful insurance, members contribute financing to a fund to cover loss or damage when any member of that fund face to loss or damage. It can be considered as an insurance system where individuals or companies are responsible to each other and protect one who has loss or damage. In conventional finance risk is not shared, it is simply transferred, however in Islamic finance any risk must be shared and there cannot be any return without risk. This is the main difference between Takaful and conventional insurance.

Sukuk

Sukuk is translated mostly into English as Islamic bond. Sukuk represents ownership of an asset or its usufruct and it is an investment certificate consisting of ownership claim in a pool of assets.

Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) defines Sukuk as being:

"Certificates of equal value representing after closing subscription, receipt of the value of the certificates and putting it to use as planned, common title to shares and rights in tangible assets, usufructs and services, or equity of a given project or equity of a special investment activity".

Sukuk has been spreading all over the world in recent years. It is also attracting both Muslim and non Muslim people. From this aspect, we can say that Sukuk has been developing as one of the most important Islamic financial instrument in the capital markets which are acceptable according to Islamic laws. There were three Sukuk worth $336 million in 2000 and by the end of 2006, just after six years it reached to 77 Sukuk with over $27 billion funds under management. (Shariq Nisar, Islamic Bonds (Sukuk): Its Introduction and Application). In 2019 total value of global Sukuk is almost $146 billion (IIFM Sukuk Database). According to IIFM Sukuk Database, Germany had three Sukuk issues between 2001 and 2019 with the value of $206 million which is less than Luxembourg. Luxembourg had also three Sukuk issues in the same time period however their total value is $280 million. On the other hand UK has 10 Sukuk issues and their value is more than $1.7 billion.

Sukuk has a special place in Islamic financial products since it is a promising product in non-Muslim countries. In 2019 it has increased by more than 18% and reached the value almost USD 146 billion globally (IIFM). Sukuk has continued to attract attention in 2020 despite the Corona Pandemic. Sukuk has performed the same year well in not only in Muslim countries like Egypt but also in non-Muslim countries like Taiwan and gained new issuers. However for many years Malaysia, Indonesia and Saudi

Arabia are major Sukuk issuers and they are dominating Sukuk market. Moreover Turkey, Bahrain and Pakistan tend to increase their Sukuk issuance in the following years. Sukuk has grown more than 20% during the period of 2008 and 2013. Sukuk is the fastest growing Islamic financial product and it has second largest total asset value in Islamic finance after Islamic banking. After 2010s non-Muslim countries like UK, Hong Kong and Luxembourg started to issue Sukuk and in the near future some Asian and African countries will be added to the list.

Sukuk has a wide range of usability like for a new source for renewable energy, ethical investments, infrastructure projects, financing for small&medium enterprises and so on. Safari, Ariff and Mohamad (2014) define the types of Sukuk as follow:

Musharakah Sukuk: A Musharakah contract is a partnership arrangement between two (or more) parties, whereby each partner contributes to the capital of the partnership in the form of either cash contributions or contributions in kind. The musharakah partners share the profits of the musharaka in pre-agreed proportions and share the losses of the musharaka in proportion to their initial capital investment. Musharakah Sukuk are equity based securities issued for the purpose of financing business activities or establishing a new project. The Sukuk holders assume ownership in the project based on their respective share ownership. Hence the buyers are essentially partners in the project. The profits and losses are then shared as in a Musharakah contract.

Murabahah Sukuk: This is also referred to as “discount” Sukuk. Murabahah is a type of sale transaction where cost of goods as well as the profit on the sale is declared in advance to both parties. The purchase price, selling price and the profit margin are clearly stated at the time of the agreement. In this contract, the holders receive a payoff only at the maturity. In Murabahah Sukuk, the amount returned at the time of expiration is expected to be higher than the principal amount, but is not explicitly specified early on.

Ijarah Sukuk: These are based on “Ijarah” contracts, which refer to Islamic leasing. Lease contracts based on Ijarah financing require transfer of ownership from the lessor to 6 the lessee. The former is supposed to have the ownership of the underlying asset throughout the lease period. The lessee is only liable for loss to the leased asset due to negligence but not for any other losses, particularly the ones related to the ownership of the asset. Ijarah Sukuk are based on the principle of Islamic leasing contracts. They can also be termed as “fixed payoff” securities. Here, the payoff share and the growth rate are agreed upon from the inception. The general concept is that the holders receive periodic rental payments for the ownership of the underlying assets, as is the case with the lessor receiving Ijarah payments.

Mudarabah Sukuk: Mudarabah is a contractual relationship between two parties, with one supplying the capital and the other supplying the labor and skill. The latter invests the capital over a pre-determined activity, which grants each party a share of the earnings as determined at the time of the investment. Since the capital is supplied by only one party here, the risk of loss is also borne entirely by it. Mudarabah Sukuk, based on Mudarabah contracts, can be considered as variable payoff instruments. The contract specifies a profit sharing ratio instead of a certain amount. Hence, the returns to the holders are subject to the returns achieved by the issuer. Usually, the payoff ratio is associated with a known benchmark, such as LIBOR.

Istisna Sukuk: In an Istisna sale agreement, a manufacturer is ordered to manufacture a specific good for the purchaser. Like other Islamic finance contracts, the price and the specification of the goods are specified in advance. In case of Istisna Sukuk, the funds are utilized for manufacturing purposes, such as commodities or buildings etc. The payments to the holder are made through installments of a pre-agreed amount. The last payment includes an extra amount based on the market value of the manufactured item.

Salam Sukuk: Salam contracts are meant to provide funding for projects where payments are made in advance of the transaction. These contracts are widely applicable in the agriculture and mining industries. In these contracts, the financial institution makes an advance payment to purchase assets, which the seller is supposed to supply on a pre-agreed date. For the payment in advance, the contracting parties stipulate a future date for the supply of goods of specified quantity and quality. Salam Sukuk operate with the underlying assets to be purchased based on a Salam agreement. The Sukuk certificates entitle the holders to an ownership interest in the asset and a right to a return in proportion to their investment in the underlying Salam contract.

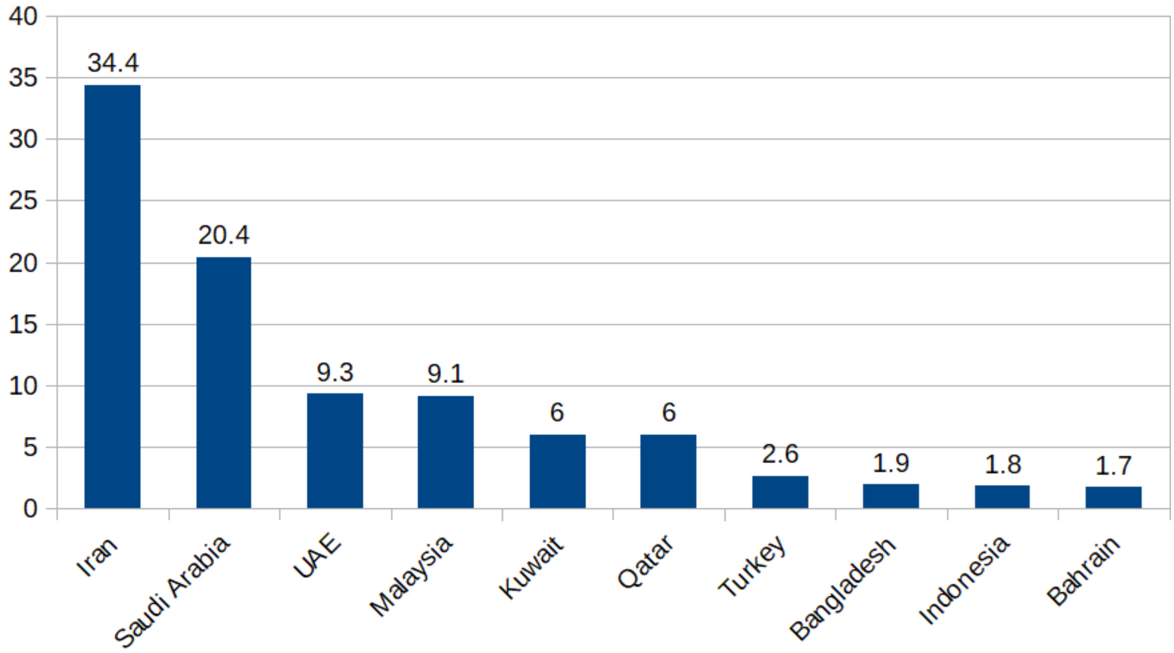
There is another type of Sukuk which is attracting attention in a few years and it is called Green Sukuk. The idea is same as green bonds, Green Sukuk is a financial instrument used for environmental investments and it is at the same time Sharia-compliant financial instrument. In 2019 just World Bank issued green bonds with total of US$ 13 billion. First Green Sukuk issued in 2017 to finance an environmental project which has a total of US$ 58 million. In 2018 the total value of Green Sukuk in global was US$ 182 billion and the next year increased by 67% and reached to US$ 271 billion (World Bank). Despite of its promising future, there are discussions about Green Sukuk's 'green' part and its sharia-compliant part (Ramadhan, 2020). The regulations and standards should be stated clearly, here once again transparency plays a crucial role.

Islamic Banking

Islamic finance has been using several instruments that fit by Sharia rules. Main player in Islamic finance is the Islamic banks like conventional banks in conventional finance. Islamic banking system is different than the conventional ones in terms of several aspects. The most well-known difference between Islamic banking and conventional banking is that charging interest is forbidden by Islamic finance. The money has no value in itself according to Islamic rules known as Sharia law. Money is just a way of defining the value in Sharia's law. It is forbidden to generate money by money. Money can be generated by taking risk in Islamic finance. However the risk must be shared by the participant of the business activities. Islamic banks accept deposits in as a two types of accounts that can be named as current account and call accounts. Current accounts let the people save their money in the bank and have banking services. The money in those accounts can be withdrawn at any time by depositors. In the other option depositors deposit their money for a specified time period. The depositor and the bank make an agreement to sign a contract to assign the bank to invest the money and share the loss or profit by a pre-determined rates.

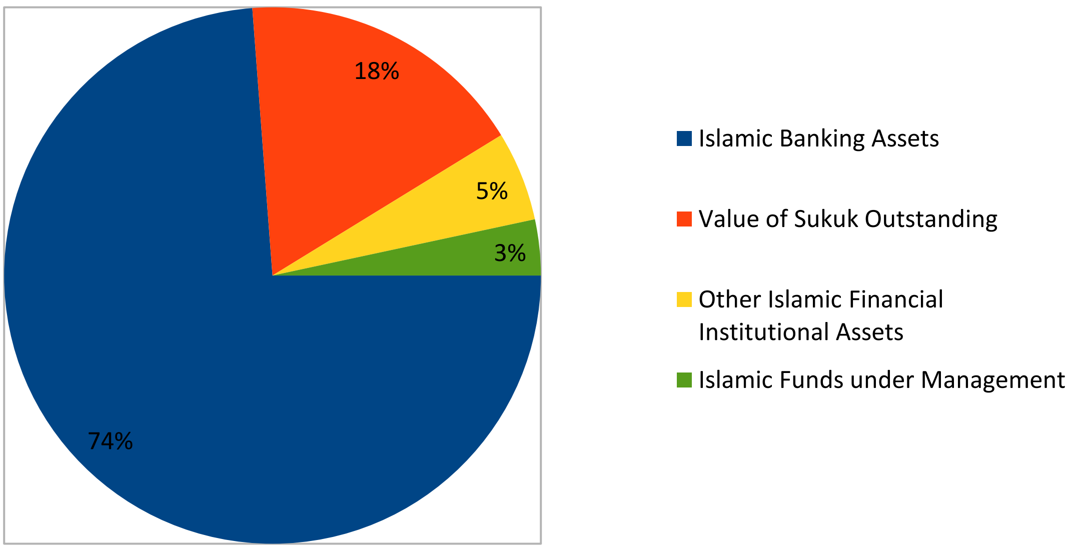
Haron (1996) stated that both Islamic banks and depositors have benefits by profit-loss sharing system in Islamic banking based on evidences that he got in his paper. Furthermore Olson and Zoubi (2016) stated by using data between the years 1999-2014 that Islamic banks outperformed than conventional banks. These facts stimulate the sector to grow during the two decades. Islamic finance has been using several instruments approved by the Sharia. The biggest portion among these instruments is Murabahah. Murabahah (or Murabaha) is a loan but not based on interest. It can be considered as a credit sale according to Sharia law. Islamic bank buys the property and sells to the customer according to an agreed price and bank retains ownership of the property until customer finishes the all payments.

Table: Top Islamic Banking Market, by Country in USD billion (year 2017)



Source: Mordor Intelligence

Table: Composition of Global Islamic Financial Assets 2016



Source: Ahmed, 2017

Islamic Finance in Europe

Although there are many Islamic financial instruments, Islamic banks and Islamic funds mostly exist in Europe including Turkey. There are Islamic banks in France, Germany, Italy, Ireland, Luxembourg, United Kingdom and Turkey. Additional to Islamic banks there are some conventional banks in Europe offer 'Islamic Window' for the customers who are interested Islamic financial products, such as Bank of Ireland, Barclays, Citigroup, Deutsche Bank and HSBC Amanah. On the hand there is still low interest to Islamic finance in Europe, on the other hand there is a potential for the future in terms Islamic finance in Europe because of several reasons. First of all, there is a significant amount of Muslims in Europe and their proportion in the population tends to increase.

Second is the growing interest to Islamic financial products in some countries by non Muslims like in Malaysia.

France

There are about 4 million Muslims in France(largest Muslim population in Europe) and it is approximately 5.6% of the population. There are 8 Islamic banks in France (thebanks.eu). Islamic banks are the major players in Islamic finance, therefore Islamic banks are a good sign to analyze the scale of Islamic finance in a specific country. When we compare France with Germany, where there is only one Islamic bank, the existence of 8 Islamic banks in France can cause a bias, since majority of these banks are only corporate banks and not offering retail banking products. Political environment, insufficient legal framework and struggling to develop Sharia-compliant products discourage Islamic financial institutions to extend and to offer retail banking products in France (Grassa and Hassan, 2015). France took some steps to encourage funds to attract the country from Islamic world especially after 2008 global financial crisis. However these regulatory changes were limited to some tax regulations for Murabaha and Sukuk which had no significant impact to attract funds from Islamic world. In 2009 French authorities announced that they will make their country more attractive and open for Islamic finance but total value of Islamic financial assets were only about US $147 million in France and on the hand UK was holding US $19 billion Islamic financial assets. Although its highest Muslim population in Europe, France has a long way to go in terms of Islamic finance.

Germany

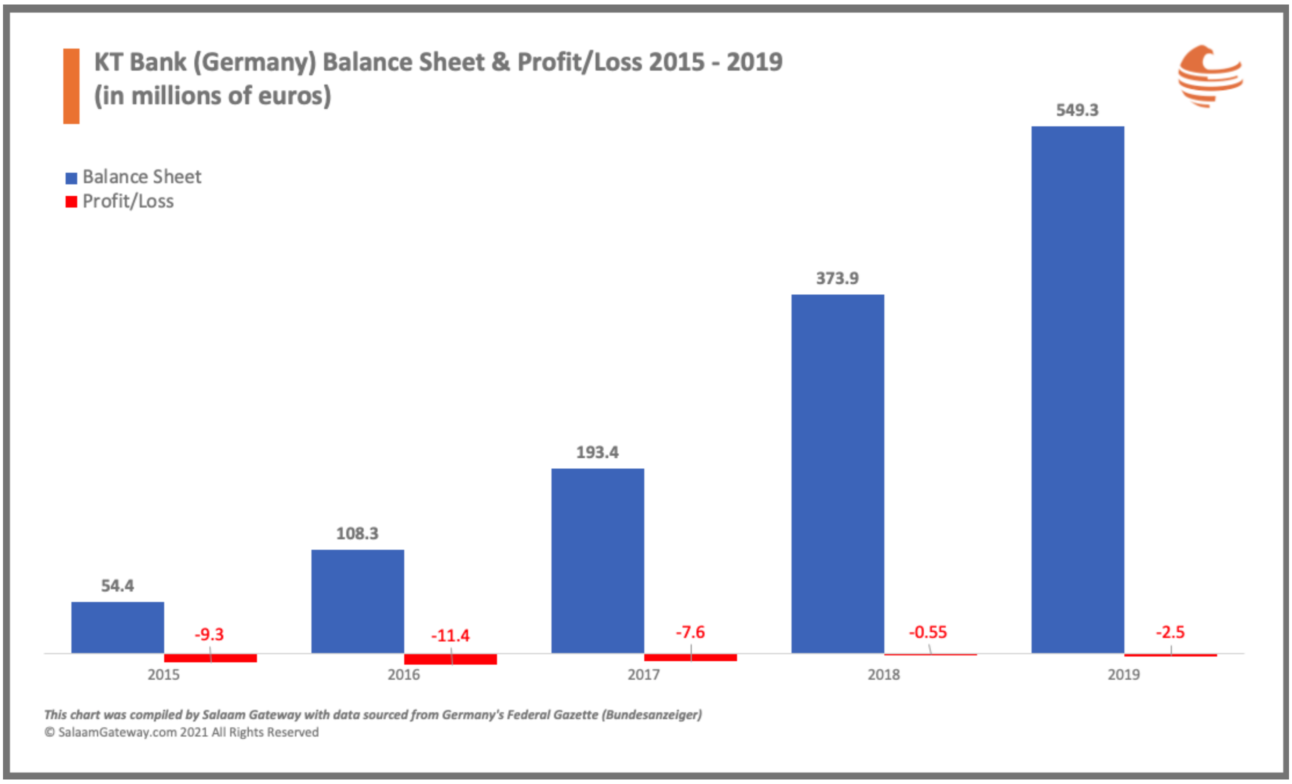
There are successes and failures in Germany in terms of Islamic finance. Germany has a biggest economy in Europe. However its Islamic finance market is less developed than France much more less developed than UK. We witnessed also failures of some Sharia-compliant funds in 2013 and 2016 and these financial institutions are not running anymore. Here is the list of Islamic banks or Islamic windows of conventional banks which offer several Islamic financial products(wdibf.com):

- Kuveyt Türk Beteiligungsbank
- ZinsFrei
- INAIA GmbH
- MUFG Bank
- ABC International Bank PLC
- HSBC Trinkaus & Burkhardt AG
- Bank Melli Iran
- Macquarie Group
- Bank Saderat Iran Zweigniederlassung
- Credit Agricole Indosuez (Deutschland) AG
- HSBC Deutschland

The first Islamic bank in Germany is Kuwaiti-Turkish bank and this bank could get its fully-fledged license in 2015. Kuwaiti-Turkish (KT) bank had to wait three years after application to get fully-fledged license although its existence in Germany started from 2004. After 2015 KT bank announced loss each year between 2015 and 2019. German financial environment and demographics of Muslim population play a major role regarding to negative balance sheet of KT bank. Unlike UK, German financial environment and legislation do not provide a desired financial ecosystem for Islamic financial institutions to develop. There are 1.7 million Turkish citizen living in Germany however there are about 2.8 million people with Turkish roots. These make the Turkish population biggest community in Muslim population in Germany. Islamic finance and Islamic banking are also relatively young for Turkey and Turkish people. Therefore beside the financial environment in Germany demographic of Muslim population is another issue that must be taken into consideration. The lack of advertisement and awareness of Islamic banking in Germany are other issues that affecting performance of the Islamic banks or windows.

There are around 4.7 million Muslims in Germany and it is almost equal to 4.7% of the population. Compare its economic scale and its Muslim population, it is fair to say that Islamic finance in Germany developed slower than in other major European countries.

Table: KT bank balance sheet, 2015-2019



Despite all these negative facts, Europe's first Sukuk was issued in 2004 by Germany. The issuer was actually not the German federal government, the issuer was the state of Saxony-Anhalt (this Sukuk issuance was called as Saxony-Anhalt Sukuk). The face value of Islamic bond (another name for Sukuk) was 100 million Euro. The state of Saxony-Anhalt was part of the East German before reunification of Germany and this state can be considered as underdeveloped state in Germany (there are 16 states in Germany and Saxony-Anhalt is the 13th richest state in Germany). Raised debt in Islamic rule was never done before in Europe, therefore what the state Saxony-Anhalt did was certainly a success for Germany in terms of Islamic finance. Although the high debt of the state of Saxony-Anhalt (at that time this state had more debt than any other state in Germany) was a big motivation to find a new way to fund debts, it was nevertheless a promising step for the future of Islamic finance in Germany. The state wanted also a new place for not only for funds from Islamic world but also all investors and entrepreneurs. Actually the demand for Saxony-Anhalt Sukuk was strong at that time, more than 50% was bought by investors in Bahrain and UAE and the rest was bought by European investors-the majority was from France and Germany. Total global Sukuk issuance in 2018 was about US $120 billion and total international Sukuk issuance in Germany from 2004 to 2018 (in 14 years) was around US $200 million on the other hand in UK in the same time interval it was more than US $1.7 billion. Sukuk issuance started in UK in 2007 and UK government became the first Western government in Europe as sovereign Sukuk issuer. This Sukuk issuance was in 2014 and it received a strong a demand. Total value of first UK government's Sukuk issuance was 2.87 billion Euro (almost 29 times more than Germany's first Sukuk issuance). Muslim population in UK is less than both in France and Germany however UK is the leading country in Europe in terms of Islamic finance. There is a little interest to Islamic finance in Germany due to the lack of awareness and advertisement and for those who have interest to Islamic finance, the religion is the main factor to intervene in Islamic market (Catak and Yilmaz Arslan, 2020). The survey in the study (Catak and Yilmaz Arslan, 2020) shows that 96% of the Muslim participants have no knowledge that Islamic banks offer various financial products like many other conventional banks. Another survey which is done 10 years earlier shows that 72% of the Muslim participants are interested in Islamic finance (Desai, 2016). These two surveys together show that there is an obvious situation for the lack of awareness and advertisement of Islamic finance in Germany. The Muslim population is almost twice larger than the Muslim population in UK. However there are much more Islamic banks, financial institution, variety of Islamic financial products, customers of Islamic banks whether Muslim or non Muslim than in Germany. There are more universities or business schools which are offering education in Islamic finance in UK than in Germany. Integration is for many years widely discussed in Germany at different levels however even recent studies show that despite many changes in regulations, expressions and funds for integration Muslims think that Germans are not willing to accept people with different races or religion and German think that the lack of German language knowledge is the main problemin the regard of integration (Mohiuddin, 2017). Although both parties do not agree with the source of the problems, both accept that the integration has failed in Germany. Not only German society suffers from this failure but also Muslims seriously suffer from the unsuccessful integration (Schnittker, 2017). integrating Muslims into financial ecosystem will certainly help them to integrate to the society.

United Kingdom

Islamic finance in UK has almost 40-year history. First Islamic financial product in UK was commodity Murabaha. This financial product aimed to reach Muslim retail customer but because of the lack of structure this product was actually not a complicated product and did not cover the fully regulations (Ainley and et al, 2007). Nevertheless after one decade Islamic finance in retail-base could start in UK. The lack of the regulation in UK prevented the development of Islamic finance in next 10 years. During 2000s some Muslim countries-basically the countries of Gulf region- started to have excess liquidity due to rapid increase in oil prices. Beside the excess liquidity of the countries of Gulf region, UK government made some chances in policies and tax regulations which affected Islamic finance in UK in a positive way.

Table: Islamic banks and the conventional banks in UK which offer Islamic financial products

Fully-fledged Islamic Banks	Conventional banks offering Islamic financial services
Abu Dhabi Islamic Bank	ABC International Bank
Al Rayan Bank	Ahli United Bank
Bank of London and The Middle East	Bank of Ireland
Gatehouse Bank	Barclays
QIB UK	BNP Paribas
	Bristol & West Citi Group
	Deutsche Bank
	IBJ International London
	J Aron & Co
	Lloyd’s Banking Group
	Royal Bank of Scotland
	Standard Chartered
	UBS
	United National Bank

Source: TheCityUK

More than 65 Sukuk with more than value of US $50 billion were issued in London Stock Exchange to date. UK is the bigger sovereign Sukuk issuer among the western countries. Regularity developments which started in the mid-90s and were get into practice at the beginning of 2000s played a crucial role in the success of UK in terms of Islamic finance. UK is also very strong in Islamic financial education. The total number of universities or business schools which gives Islamic financial education is 68 which is more than any other country in the world including Malaysia where hosting almost 90% of Islamic banks in global. UK's clear objectives, concrete steps by changing regulations to achieve the objectives and to create suitable financial ecosystem for Islamic finance and strong education made itself leading country in Europe in terms of Islamic finance. Today Islamic finance plays a crucial role in infrastructural investments in UK and UK funded many important projects through Sharia-compliant financial products.

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