Islamic Finance in a European Union Jurisdiction

Workshops' Report

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CONTENTS

1 Introduction

The subject of Islamic Finance in a European Union Jurisdiction was discussed during five workshops organised by The Malta Institute of Management, in collaboration with the Malta Union of Bank Employees and the Malta Employers Association.

The workshops, held in Malta from the 12th to the 16th of October 2009 at Radisson Blu examined the different pillars of Islamic Finance in the European Union. The strategic position of Malta as a Centre of Islamic Finance in the EuroMed Area was also highlighted.

Various EU and other jurisdictions have different legislative and tax issues in order to facilitate Islamic Finance. To date there are just a handful of EU countries that are actually looking into Islamic Finance actively. The UK has been at the forefront in this regard, with France and Luxembourg following. Luxembourg has been very strong in attracting Islamic Funds whilst France is facing some political issues as explained in section 7.1.8 of this report.

The potential of Islamic Finance in Europe is evident amongst others from the fact that Islam is the fastest growing religion and the second largest religion in the world. Some 5% of the E.U., or nearly 20 million persons, presently identify themselves as Muslims. Should current trends continue that number will reach 10% by 2020. Moreover, by 2020, with the continued growth rate, Muslims will account for one-fifth of the entire population, that is 1.55 billion (estimate). Malta may be valuable to penetrate the Islamic community in Italy where the number of Muslims reaches approximately 1.5 million and there are 70 thousand companies set up by citizens from Arab countries. Malta may also be valuable to penetrate other countries as may be seen in this report.

It was in this context that the workshops analysed the various pillars in Islamic Finance and compared them to conventional finance. It was concluded that in actual fact many forms of Islamic Finance where present in the Mediterranean region in the past. In this respect, in order to open themselves to Islamic Finance most European countries need to look back at their origins.

General agreement also emerged that Malta has the potential to become the Bahrain in the Mediterranean and various structures were analysed in the workshops on how Malta can already assist other Mediterranean Countries in the subject area through its Funds, Financial Institutions, Stock Exchange and Special Purpose Vehicles.

The rest of this report comprises a general evaluation of the information, views, findings and suggestions shared during the workshops.

2 Islamic Banks and Basel Accord

There are major conceptual and practical differences between Islamic and Conventional Banking. The first major difference is that Islamic Financing does not deal in interest, rather it is based on a partnership agreement that shares risks as well as returns.

Islamic Banks also differ from conventional banks in that their work is not confined to financial intermediation. An Islamic Bank is an investor, trader, financial advisor, consultant and a financing house. It is a universal bank, whose objectives are much broader than profit maximisation. An Islamic Bank is expected to be a socially responsive Institution with social, cultural and other responsibilities besides making profit. The concept of not having profit maximisation as a core objective seems to create a suspicious and sceptical attitude from people in the western world. In itself this may be a barrier for people shifting from conventional finance to Islamic Finance.

In addition, there exists a variety of Islamic modes of financing which take the form of trading contracts and /or profit and loss sharing. These differences highlight the unique characteristics and peculiarities of Islamic Banks which in turn raise serious questions about the applicability of the Basel Methodology that rests on the notion of risk weighting of assets which constitutes the denominator of the capital adequacy ratio while tier capital constitutes its numerator.

Tier capital is made up mainly of share capital, reserves, retained profit and minority interest with adjustments for any goodwill, and participation in unconsolidated subsidiaries and associates.

The risk weighted assets are broken down between credit risk and market risk. The Basel Committee recommends risk weighting for each category of asset. Further, in Basel II it has been recommended that a methodology is used for computing the capital charge for market risk. In order to apply the Basel Capital Adequacy Methodology one needs to make an appropriate analysis of the liability and asset structure of the balance sheet.

One of the major differences between Islamic banks and conventional banks is the mobilisation of funds. Islamic banks mobilise funds on a profit and loss sharing whilst there is no similar concept in conventional banking. However, it has been argued that Islamic Banks' operations on certain transactions may be similar to those of the Conventional Investment Banks. Indeed, Malta had a similar bank, the Valletta Investment Bank.

On the assets' side, the recommended portfolio of Islamic banks is composed of finance contracts based on profit sharing principles such as the Musharaka and Mudaraba. On the liability side, Islamic banks arrange deposit mobilisation on a profit and loss sharing basis. Hence, the depositor is not a net creditor to the bank. These funds, which are referred to as profit sharing investment accounts are reported in the balance sheet if they are received on an unrestricted basis and off balance sheet if restrictions are placed on the modes of investment. This way, holders of investment accounts with Islamic banks are similar to capital holders in that they stand to share different kinds of risk as specified in the contracts. Ergo, Islamic Banks do not face any normal commercial risk for any loss of assets funded by the investment account holders. In fact, this peculiarity of investment deposits may result in moving them out of the denominator of the Capital Adequacy Ratio to its numerator as tier capital.

There are risks, other than normal commercial ones, which may have implications for an Islamic Bank's risk bearing capital. If the bank's management acts in breach of the investment contract, or is guilty of misconduct or negligence in the management of the investor's, then the bank may be legally liable with respect to losses sustained on those funds .The term "fiduciary risk" may be used to designate this type of risk.

An Islamic Bank is liable to find itself under commercial pressure to pay a rate of return to its profit sharing investment account holders, which is sufficient to induce such investors to maintain their funds with the bank. However, this same argument may be made towards conventional banks that may be under pressure to reduce financing interest and to increase interest in deposit accounts.

The Basel Committee did not address the different risks faced by the Islamic Banks. The Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) addressed this challenge. In March 1999, it issued a statement recommending the inclusion of 50% of the risk weighted assets of the profit sharing investment accounts in the computation of the capital adequacy ratio. Inclusion of 50% of the risk weighted assets of the profit sharing investment accounts was recommended to cover the fiduciary risk and displaced commercial risk. As Dr. Alchaar, Secretary General of AAOIFI, explained during the conference in Malta, this has been a sort of compromise. The Basel mechanism was NOT made for Islamic Banks but for conventional banks. Unless a Basel Committee is formed for Islamic Banks, than the issues cannot be fully addressed. In the absence of an appropriate mechanism, one must try and fit solutions within the existent frameworks. As things stand different Central Banks and Banking Regulators may end up attributing different risk levels to different types of contracts such as Mudaraba, Salam and Parallel Salam, Ijarah Muntiaha Bitamleek, Murabaha, Istisna and Parallel Istisna and Musharaka.

2.1 Unique risks of Islamic banking

Islamic banking presents unique risks to the financial system. This is because of the profit and loss sharing (PLS) method of financing and particular contractual features of Islamic financial products. PLS shifts the risks in the institution to investment depositors to some extent. It also makes Islamic banks vulnerable to a range of risks (including those that are normally carried by equity investors) because of the following features:

- Administration of PLS is very complex. It requires greater auditing of projects to guarantee proper governance and suitable valuation.
- PLS cannot be made dependent on collateral or guarantees to decrease credit risk.
- Product standardisation becomes more complex because of the multiplicity of potential financing methods, the increased operational risk, and the legal uncertainty in interpreting contracts.
- Because of the absence of Shari'a-compliant instruments such as treasury bills, it is difficult to manage asset and liability mismatches and hence liquidity risks are significant.

Commodity inventories on Islamic bank balance sheets increase price and operational risks. Also, for contracts with deferred delivery of products, considerable additional price risks arise.

A major challenge for the Islamic financial institutions as previously explained is to analyze the risk characteristics of Islamic financial products and to understand how to treat these products under Basel II. Islamic banking bodies are working towards clarifying these issues. Malaysian-based IFSB issued a paper called 'Capital Adequacy Standard for Institutions (other than Insurance Institutions) offering only Financial Services'. This paper offers banks and financial institutions a template for applying Basel II to Shari'a compliant products. It breaks down how Shari'a based transactions should be defined, measured and treated under Basel II. The guidelines cover capital adequacy requirements based on the standardized approach for credit risk and the basic indicator approach for operational risk, and the measurement methods for market risk.

2.2 Musharaka, Mudaraba, Istisna in Malta

Transactions similar to various Islamic Transactions have been present in Europe. The question is the definition of a bank in reality. If one takes the Musharaka and Mudaraba contracts, one is essentially talking of venture capital which is allowed under various jurisdictions. Moreover, tax incentives do exist in this aspect, particularly in Malta. In terms of the Financial Institutions Act 1994, an institution may be licensed to carry out business as a Financial Institution through the undertaking of activities which are listed in Schedule 2 of the Act, which includes venture or risk capital in Malta.

In view of the obligations that the Act poses on the Malta Financial Services Authority, the MFSA has deemed it appropriate to issue a policy document to foster understanding between financial institutions and itself in relation to what constitutes venture or risk capital, as well as

- To create awareness among financial institutions undertaking venture or risk capital activities of the requisites which the competent authority considers appropriate for such activity
- To facilitate the monitoring of the competent authority of venture or risk capital activities
- To assist financial institutions, licensed to carry out venture or risk capital services, in the assessment of whether particular business transactions involving acquisition of equity would qualify as venture or risk capital and
- To assist financial institutions licensed to carry out venture or risk capital activities, in ensuring compliance with the conditions of the license.

The definition given by the policy document published by the Malta Financial Services Authority would allow IFIs to have certain Musharaka transactions but would probably question Mudaraba transactions, although there are different views on this. The operation of Musharaka and Mudaraba transactions under the Venture Capital Fund cap would also resolve some tax issues in view of the Venture Capital Fund (Tax Credit) Regulations.

Similarly, Ijarah may occur under the same Act that is the Financial Institutions Act. The MFSA has issued another policy document in this regard, with the following objectives:

- To convey the views of the competent authority as to what distinguishes financial leasing from other activities associated with leasing in general;
- To facilitate awareness by the financial institutions as to what differs financial leasing from other leasing activities
- To create awareness of the financing options that could be availed by financial institutions to fund financial leasing operations and
- To enable financial institutions to ensure compliance with the conditions of their licence through knowledge of the implication.

If one examines the details that regulate these objectives, including the tax implications, one may find that yet another Islamic Finance Transaction is possible in Malta.

In essence, Project Financing is very much possible in Malta with respect to Islamic Finance.

2.3 Investment Account Holders in Malta

In reality even a similar concept in Malta of Investment Account Holders exists when we come to Collective Investment Schemes. Hence, there also exist laws and regulations on this aspect. The reader may refer to the MFSA regulations.

2.4 Umbrella Legislation

There has been extensive discussion in Malta with respect to Islamic Banking. The focus seems to be on Article 15 of the Banking Act. The main reason is because participants in the debate kept talking of banking, and in one's frame of mind one had the conventional definition of banking as is found in the Banking Act, that is:

"bank" or "credit institution" means any person carrying on the business of banking, and unless otherwise stated, shall include an electronic money institution;

"business of banking" means the business of a person who as set out in subarticle (2) accepts deposits of money from the public withdrawable or repayable on demand or after a fixed period or after notice or who borrows or raises money from the public (including the borrowing or raising of money by the issue of debentures or debenture stock or other instruments creating or acknowledging indebtedness), in either case for the purpose of employing such money in whole or in part by lending to others or otherwise investing for the account and at the risk of the person accepting such money;

Islamic Banking cannot fall in this definition, but the legislative framework does provide other tools for such activity. In this context, various institutions have unknowingly carried out transactions in Malta similar to Islamic Finance Transactions. The most prominent are Middlesea Insurance ,Valletta Investment Bank (now merged in BOV) and the roots of APS Banks.

The debate on Article 15 of the Banking Act is, in itself, significant. Yet, rather than changing the current legislation, one may consider creating an umbrella legislation wherein a new licence is introduced that also provides for Islamic Financial Institutions and thus have one licence through which these institutions can operate. As things stand, an IFI wanting to register in Malta may comfortably do so and provide most transactions under various legislations. However, obviously this leads to an administrative burden which does not facilitate Islamic Finance.

2.5 Market Risk

The issue of market risk is equally important if not more so for Islamic banks. Both conventional banks and Islamic banks could be exposed to foreign exchange risks. Generally, an Islamic bank may not engage into the same hedging techniques available to the conventional banks. Therefore, Islamic banks should be required to apply capital charge on their foreign exchange exposures based on the market risk adopted by the Basel Committee. However, banks in Malaysia do present som hedging solutions such as the Islamic profit rate swap and Islamic cross currency swap. Furthermore, it must be noted that the bulk of profits made by Deutsche Bank, UBS in Dubai are from offering Islamic hedging solutions to small Islamic Banks. This means that while recognising that there is an issue there exist also solutions.

Islamic banks may also be involved in taking positions in equities for the purpose of trading and thus would be exposed to equity risk. The minimum capital requirement for equities would be expressed in terms of two separately calculated charges, one applying to the special risk of holding a position in an individual entity and the other applying to the general market risk.

The bank may again take the trading position through a fund manager. It might be worth considering whether the market risk should be calculated on each position taken by the Mudarib or on a portfolio basis to the account of the diversification.

2.6 Operational Risk

The third component to Pillar 1 of the Basel Accord is operational risk. An operational risk is one of those risks that has been very difficult for financial Institutions to try to put a number to. Just because a bank may have a lot of historical risk data, it does not necessarily mean that it is able to project that and/or apply the data to come up with some sort of quantitative assessment of what it's operational risk is. For Islamic banks, this is uncharted territory to a certain extent. This is one of the main issues that the Islamic Banks as much as the conventional banks will need to address .

2.7 Funding and Liquidity Risk

Liquidity is one of the most critical issues for IFIs, as only a small secondary market exits to enable them to manage their liquidity. Their assets are generally not sellable on a secondary market and they cannot invest in fixed income instruments for treasury management purposes. A key development in this area has been the formation in Bahrain, in 2002, of the International Islamic Financial Market, whose aim is to create and standardise financial instruments to meet the liquidity needs of IFIs around the world. In addition, some leading Islamic banks have set up bilateral agreements with their respective central banks in order to address this weakness. This is notably the case for Al Rajhi Bank which has an investment portfolio that can be roped with the Saudi Arabia Monetary Agency. This in itself is a potential for Malta as it promotes itself as the Bahrain in the Mediterranean. The Malta Stock Exchange could have a fundamental role in this context and could create a platform to solve such issues.

It must be noted that it appears that certain Islamic deposits in the world are being invested in US Treasury bills. This however, does not happen in all countries. For example it does not happen in Malaysia. Bank Islam was formed in 1983 and in the same year the Government launched Government Investment Issues(GII)- Islamic Securities (local currency Sukuk) so that Islamic banks can invest their money in accordance to Shariah. Essentially, they are short term Islamic treasury bills. The countries that have issued Islamic treasury bills are Malaysia, Bahrain, Indonesia, Brunei and Singapore. Consequently, this means that the bulk of Islamic banks in other jurisdictions including the UK invest their deposits in a non Shariah compliant manner. Malta should not make the same mistake as the UK and it should ensure that Islamic money keeps flowing within the Islamic Financial System.

Many Islamic Banks offer Profit Sharing Investment Accounts (PSIA) to their customers. These financial instruments are relatively similar to the time deposits in Conventional banks as previously mentioned in this paper. The terms and conditions of PSIAs provide for "depositors" being entitled to receive a share of the bank's profits but also obliged to bear potential losses pertaining to their investment in the bank. There exists however several layers of protection such as:

- Profit Equalisation Reserve – These reserves constituted by IFIs can be used to smooth returns offered to PSIA holders in the cases of reduced distributable cash flows.
- Investment Risk Reserves (IRR) – These are reserves constituted by IFIs in order to curb the risk of future unexpected losses and enable them to be in a position to support PSIA holders should such losses occur
- Liquidity – IFIs offering PSIAs are in general more liquid than conventional banks as they are aware that their reliance on PSIAs could trigger liquidity distress.

2.8 Recommendations

Islamic Banking is in essence possible in Malta and in the EU. However, their needs to be an umbrella legislation that brings together the different licences in order to provide a one stop shop. Adapting the current banking legislation is in theory not possible since the definition of banking is fundamentally different. In the light of what occurred in the UK, there are substantial difficulties that Malta should avoid. A separate legislation is therefore recommended.

The issue of transparency was also discussed in the workshops. The main issue was the fact that FSAs or Central Banks should:

- ensure that any Financial Institution claiming to be Shariah Compliant should be subject to a Shariah Audit
- Shariah Supervisory Boards should be centralised as in the case of Malaysia or transparency and independence reasons.The MFSA should regulate Islamic Finance and this includes regulating Shariah. It is imperative to have a Shariah Advisory Board at the national level to create certainty in the domestic market. Malta cannot have a situation like Bahrain in this case whereby basically their could be the perception of having shariah compliant banks more compliant than others

As reproduced hereunder, Malta is in an ideal strategic location and has the necessary agreements to act as a centre for Islamic Banking and facilitate Islamic Finance into Mediterranean Countries such as Italy and Libya.

3 Islamic Equity Funds

Unit Trusts are based on the concept that risks and rewards are shared by the investors, employing the expertise of professional managers. This is in conformity with Islamic Partnership Principles of musharakah and mudarabah and is already applied within the Islamic Financial System.

1. Investment must be made in ethical sectors. In other words, profits cannot be generated from prohibited activities such as alcohol production, gambling, pornography etc.
2. Investing in interest-based financial institutions is not allowed.
3. All wealth creation should result from a partnership between an investor and the user of capital in which rewards and risks are shared. Returns in invested capital should be earned rather than pre determined.

3.1 Islamic Unit Trusts

Islamic Unit Trust schemes are Collective Investment Funds which offer investors the opportunity to invest in a diversified portfolio of Sharia Compliant securities which are managed by professional managers in accordance with Shariah. The Islamic Unit trust schemes are required to additionally appoint a shariah committee to ensure that their operations are in accordance with Shariah.

The main objective of an Islamic Unit Trust is to invest in a portfolio of permissible stocks which comply with Shariah. Such stocks will exclude companies involved in activities, products or services related to conventional banking insurance and financial services, gambling, alcoholic beverages and non halal food products.

The returns of the Islamic Unit Trust must also avoid the incidence of riba or usury interest through the process of cleansing or purification by the removal of such amounts representing the interest element. Such proceeds are normally donated to charities. It is recommended that in the case of Malta these are donated only and exclusively to charities registered with the Commissioner for Voluntary Organisations.

The common type of contracts and products that are used by IFIs are Mudarabah, Murabaha, Musharaka, Ijaraj and Ijara wa iqtina. It has been argued, during the workshops, that many of these types of funds can occur and in fact already occur under the current Malta Legislative funds. Some tax issues with respect to holding Maltese assets have been identified.

3.2 Islamic Investment Funds

There are various investment funds such as the Mudarabah Fund, Murabaha Fund, Ijarah Fund and the mixed fund

3.2.1 Mudarabah Fund

In an equity fund the amounts are invested in the shares of joint stock companies. The profits are derived mainly through the capital gains by purchasing the shares and selling them when their price increases. Profits are also achieved by the dividends distributed by the relevant companies. If the main business of a company is not lawful in terms of Shariah, it is not allowed for an Islamic Fund to purchase, hold or sell its share, because it will entail direct involvement of the shareholder in that prohibited business. Similarly, the contemporary Shariah experts are almost unanimous on the point that if all the transactions are in full conformity the shares can be purchased, held and sold without any hindrance from the Shariah side. However, such companies are very rare.

3.2.2 Murabaha Fund

In a Murabaha fund, the amount is composed of companies whose operations are on basis of murabaha where transactions are undertaken on a cost plus basis. This kind of sale has been adopted by the contemporary Islamic Banks and Financial Institutions as a mode of financing. They purchase the commodity for the benefit of their clients, and sell it to them on the basis of deferred payment at an agreed margin of profit added to the cost. If a fund is created to undertake this kind of sale, it should be a closed end fund and its units cannot be negotiable in the secondary market. The reason is that in the case of murabaha, as undertaken by the present financial institutions, the commodities are sold to the clients immediately after their purchase from the original supplier, their price being on deferred payment becomes a debt payable by client. Therefore, the portfolio of murabaha does not own any tangible assets, rather it comprises of either cash or receivable debts, and both these are not negotiable under Shariah.

3.2.3 Ijarah Fund

The Ijarah Fund will involve companies dealing in the leasing of assets according to Shariah principles. The ownership of these assets remains with the fund and the rentals are charged from the users. These rentals are the source of income for the fund which is distributed *pro rata* to the investors.

3.2.4 Mixed Funds

Another type of Islamic fund maybe of a nature where the subscription amounts are employed in different types of investments. This may be called a Mixed Islamic Fund. In these cases, if the tangible assets of the fund are more than 51 percent while the liquidity and debts are less than 50 percent, the units of the fund may be negotiable. However, if the proportion of liquidity and debts exceeds 50 percent, its units cannot be traded in accordance to the majority of the scholars' opinion. In this case the Fund must be a closed fund.

3.3 Recommendations

It has been agreed that the current Maltese legislation can cater for many of the Islamic funds. However, there are some tax issues that need to be addressed in order to facilitate the flow of Islamic Funds to Malta.

A potential edge for Malta would be to use its framework of, for example, Professional Investment Funds and issue specific regulations for the Islamic Funds. This would have an advantage on other jurisdictions like Luxembourg. Including specific legislation including investment restrictions that cover the main Shariah principles would give the market a certain level of comfort and Islamic Finance issues present in other jurisdictions would be covered. Hence in spite of not having a centralised Shariah Board Malta would have given the parameters in which these funds may invest and it would facilitate the screening process which is a major concern of many Islamic Investors. Malta in this circumstance would be giving an alternative model to the Malaysia Model which is one of the most acclaimed. It is the opinion of the author that this would entail minor effort from the Malta Authorities given that the main legislation is already successfully in place. Such an approach would also reduce the costs of Islamic Funds in Malta as the role of the Shariah Board would be somewhat reduced unless the fund becomes very innovative in its investments.

Furthermore, Malta could cater for funds that no other legislation is catering for, given its size. It was also agreed that Malta is in a position to tap into the Libyan Investment and assist its neighbours in having Shariah compliant investment opportunities.

4 Mediterranean Islamic Finance Index

The workshops examined the role of Islamic Indexes and Islamic Finance Stock Exchange. It was generally agreed that there need not be a separate Islamic Finance Stock Exchange, given that most of the companies on a stock exchange will be compliant. However, the Investors need guidance.

With respect to Islamic Indexes, it was felt that they are fundamental in the screening process in order to ensure that it excludes prohibited industries, it has acceptable financial ratios and that monitoring is ensured.

In this context, there was a discussion on the role of the Malta Stock Exchange and the concept of Borzamed, which was projected during previous administrations. At the time, the project had found the backing of various countries, but apparently it was abandoned for political reasons.

The participants agreed that such a concept could be a way to encourage Shariah compliant investment in the Mediterranean. There was also general agreement that this could become a massive opportunity if addressed properly by the Malta Stock Exchange (MSE). The MSE is a relatively small stock exchange which over the years failed to attract the expected listings. The Islamic Finance niche offers a massive opportunity that the MSE, with the support of the Government of Malta, should not miss. The support of the Government of Malta is required also from a marketing perspective. The Government of Malta could put Malta on the Islamic Finance world map through the issuance of a Sukuk listed on the Malta Stock Exchange.

4.1 Recommendations

Malta has the right tools, location and knowhow to present itself as the Mediterranean Islamic recognised stock exchange.

5 Sukuk

Sukuk was discussed in the workshops and explained. Sukuk is very much possible under the current legislation. As in other EU jurisdictions, there are tax issues to address. Malta is currently in a position to assist in mitigating the tax effects in other countries by the use of Special Purpose Vehicles, but is not in a position to have local Sukuk without the use of SPVs in other countries.

5.1 Recommendations

Malta is to exempt Sukuk transactions from Capital Gains Tax, Property Transfers Tax and Duty on Documents Tax if it is to encourage this investment in Malta. Sukuk is crucial and fundamental for Islamic Finance Investors.

The Government of Malta should use a Sukuk issuance to generate capital, to market Malta as an Islamic Finance Centre and also to give the political message that it is encouraging investment in Malta from the Far East and the Middle East same as it did with the Smart City project.

6 Takaful

Takaful was also discussed in the workshops. Takaful in reality did exist in Malta also in recent history, as the way some confraternities in Malta operated was very similar to this concept.

The Participants (policyholders) of Takaful each pay a Takaful Contribution (premium), based on their individual risk and the likelihood of making a claim, to create a Takaful Fund. The nature of the risk covered, and the period of cover, is specified in the Takaful Contract (insurance policy).

The Takaful Fund is invested strictly in Halal activities under non-interest bearing conditions in order to maximise the fund value. All Takaful Contracts are managed by an appointed agent, who provides all the necessary marketing, operational facilities and administration required to service the Takaful Fund and the Takaful Contracts.

The appointed agent is paid a fee called a Wakala Fee for the services provided to the Takaful Fund and its Participants. If it is ascertained that the Takaful Fund is over-funded, the amount by which the Takaful Fund is over-funded will be distributed to eligible Takaful Participants by way of a Participation Discount (in addition to any No Claim Discount) from their next year's Takaful Contribution.

In conventional insurance the risk is entirely transferred from the policyholder to the insurance company upon payment of a premium. In return for paying the premium the policyholder gets peace of mind and in the event of a valid claim, the claim settled. This brings elements of uncertainty and, in the view of Shariah, gambling, into the contract as one of the two parties will make a loss, especially the policyholder if no claim occurs.

Takaful is a structure, the first elements of which appeared in 7th Century, in which the risk is shared between all participants removing the elements of uncertainty and gambling from the contract.

Takaful means "guaranteeing each other" and is based on the principles of "Ta'awun" (mutual co-operation) and "Tabarru" (donation), where a group of Takaful Participants (policyholders) agree between themselves to share the risk of a potential loss to any of them, by making a donation of all or part of their Takaful Contribution (premium) to the Takaful Fund. The fund then will compensate the Participants for any loss.

By eliminating all of the elements prohibited by Shariah and structuring agreements in a compliant manner, Takaful provides a Shariah compliant and ethical insurance solution that makes it appealing to Muslims and non-Muslims alike.

The difficulties of re-Takaful have also been discussed.

6.1 Recommendations

Malta should lead in the introduction of Takaful in the Mediterranean but it should study the potential of becoming the World's Re Takaful Centre.

7 The Mediterranean Centre for Islamic Finance – Why Malta?

North Africa and Europe seem to be two natural immediate markets in which Islamic Finance is to expand.

In recent times, North Africa has started to embrace Islamic finance. This is happening while the banking sector develops and as governments try to channel more investment into the region. However, growth is resulting to be far slower than in the Middle East, among other things due to resistance from certain political elites.

7.1.1 Tunisia

Islamic banking in Tunisia is still very limited. Apart from Dubai's Noor Islamic Bank, which has a representative office there, there is only one other bank offering Islamic banking services. This is the Bank Et-Tamweel Al-Tunisi Al-Saudi, which is an arm of Albaraka Banking Group.

Although a growing sector, there seems to be insufficient information in Tunisia on Islamic Finance. Nonetheless, the conventional banks or representative offices present in Tunisia have in front of them the opportunity to penetrate this growing market. It may be the case that through a representative office one manages to attract better business than through an official branch or through a fully licensed bank in Tunisia.

The formula of representation offices has already worked for some conventional banks that use Malta as a base. Banks in Tunisia may use the same existent concept to open an Islamic Window. Islamic Financial Institutions may also use this proven formula to tap into the Tunisian Market. Such modus operandi of a licence in Malta and a representative office in Tunisia may be more efficient than actually having a licence in Tunisia, also from a tax perspective.

7.1.2 Morocco

Morocco now allows conventional banks to offer Ijara leasing products, Murabaha contracts to buy and re-sell an underlying good and Musharaka.

Analysts say Morocco's tax regime, especially stamp duty rules on mortgages, put Islamic Finance at a disadvantage. These disadvantages can be mitigated through the use of a Malta Licence and through Malta special purpose vehicles.

Morocco is currently assessing the state of its Islamic Finance experience and is expected to expand its Islamic banking services. The process is decidedly encouraged by the fact that a high number of foreign investors showed their willingness to open Islamic banks there. Up to 10 investors from many Arab and Islamic states have expressed interest to open Islamic banks in Morocco.

The Islamist-leaning Justice and Development Party (PJD), the main opposition group in parliament, said its members in the legislative body would press the government to ease tax on Islamic banking and authorise Islamic banks to open. PJD experts argue that developing Islamic banks and other related financial services would help Morocco adding up to 2.0 per cent growth on the top of average 4.0 per cent growth rate in the past decade.

Many Moroccans adopt a somewhat sceptical approach vis-à-vis banks and their arbitrary legislation. Quite a few people, especially those who are not on the state's payroll, prefer to keep their money at home, lend it and borrow it individually without paperwork. In so doing, they rely on trust and honour. Interest-free loan for participants in home-made schemes exist too.

Statistics indicate that the number of Moroccan wage earners, who hold a bank account, does not exceed 15 to 20 percent.

There are at least two explanations for the "under-banking" problem in Morocco. First, some people refuse to deal with financial institutions on ethical grounds, i.e. on account of the banks' nonconformity with Islamic codes. Secondly, some do not have enough understanding of the banking system and feel their money might not be secure.

In the case of the stock market, the situation is much more complex, as most people simply do not understand its mechanism or rationale.

Awareness of the importance of Islamic banking and finance, as part of a comprehensive approach to Islam, is manifestly felt among many economic and civil circles in Morocco. Intellectuals and experts in the field have drawn attention to the deficiency and inequity of conventional banking, criticising its non-Islamic character and unethical codes of practice.

Unlike the other member countries of the Arab Maghreb Union (Algeria, Libya, Mauritania, and Tunisia), Morocco does not have an Islamic bank, although conferences and *ad hoc* meetings revolving around the theme of Islamic banking and finance have taken place in the country under the auspices of various organisations, particularly the Moroccan Association for Islamic Finance. Initial projects inspired by Middle and Far-Eastern experiences in this domain have been presented to the Moroccan governments over the years, but so far they have been turned down apparently on corporate and ideological grounds.

Resistance to the establishment of Islamic banks in Morocco emanates principally from the banking corporations and interest groups, which monopolise the financial apparatus. They are wary of the sweeping success the Islamic financial system will engender, as large untapped sums will ultimately end up being pooled into Islamic banks. Studies delving on the merits of Islamic banking and finance generally converge in their emphasis on the religious and social dimensions of the system, its much needed contribution to the welfare of the mass and the fair and rational utilization of the nation's resources.

In reality, the prospects for Islamic banking in Morocco overshadow the challenges, and the terrain seems naturally conducive since there is a high demand for Islamic financial services, both amongst potential customers and investors. Undoubtedly, the distinct value of the Islamic financial system is clearly reflected in its positive traits: spiritual realisation, economic and social development and lawful investment.

In the study, Towards a Perfect Islamic Bank, it was noted that there are three feasible ways for the implementation of Islamic banking in Morocco: first, through an independent Islamic bank (nationally or regionally); second, through a branch, which is independent at the level of management but remains an offshoot of the conventional bank; and third, by designating tills devoted to Islamic banking, managed by a special department within the conventional bank.

Given the entire scenario in Morocco and taking into account the numerous spiritual and material benefits the Islamic financial system possesses, there is a great prospect that the authorities and the detractors would eventually yield to the expectations of civil society and allow new banks, based on the principles of Islam, to be established in the country.

Despite the logistical difficulties and challenges, which might appear insurmountable in the eyes of some, once authorised Islamic banking and finance will most probably entice the overwhelming majority of Moroccans and gradually replace the current system.

At this stage, as the aforementioned study indicates, Islamic Finance may penetrate in a different manner. In this context, Malta may serve as a gateway to Morocco. Representative offices in Morocco of Maltese licensed banks may be the way ahead into the country. Through the Double Taxation Treaty with Morocco a bank or an Islamic Financial Institution in Malta may mitigate the tax issues that emanate from Morocco legislation. Moroccans will be able to invest into Shariah compliant funds in Malta through such representative offices.

7.1.3 Algeria

Algeria has yet to have a fully authorised Islamic bank. However, it already permits two players.

One of these players is the Saudi-controlled Banque Al Baraka d'Algerie which has become one of the country's most successful private banks, by offering more sophisticated products and better customer service than bigger public sector lenders.

A study of the operations of this bank shows four key findings:

(1) Banque Al Baraka d'Algérie offers only few Islamic financial products to its customers;
(2) most of the instruments are geared towards short-term financing;
(3) the bank's overall performance has improved since its operations in Algeria;
(4) and credit risk remains the main obstacle facing the bank.

The second player is Al Salam Bank. This bank commenced operations in Algeria in 2008, taking its Islamic banking model to the North African region.

The bank acquired a licence from Algeria's Money and Credit Council, to operate as one of the largest banks in North Africa and to offer its banking services through its headquarters in the Kingdom with a paid up capital of 7.2 billion Algerian dinars ($100 million).

Al Salam Bank representative has reportedly said that the foray into the Algerian market comes at a time when the African nation was making rapid strides to attract investments. Algeria, he said, was poised for a new era of development. "Investment opportunities in Algeria are huge. Vast segments of Algerian society are looking for new banking services to help them achieve ambitions in various sectors of the economy. Algerian market is witnessing a real investment revolution."

7.1.4 Libya

Libya is planning to launch Islamic financing services next year, when appropriate rules are expected to be introduced following talks currently under way between the central bank and commercial banks.

Ongoing investment in Libya is pushing an expansion of banking assets: 36% year-on-year in April 2009. The banking sector is dominated by the Libyan Foreign Bank (LFB) and four state-owned or controlled commercial banks that hold 85% of assets. A Banking Law of 2005 established the Central Bank of Libya's independence and role as regulator. At present, the CBL is cautiously reforming the banking sector.

Libya's financial services industry remains highly protected, according to a recent European Union report. Shares in some of the state banks have been offered to Libyan citizens and now private banks are permitted. However, the banking sector has not yet been opened to foreign institutions and Islamic finance is largely absent from the market at this stage.

The most significant reforms in Libya's service sector over the past decade have occurred in banking and finance. Banking Law No.1 of 2005, along with the Anti-Money Laundering Law No.2 of 2005, are aimed at creating a new legal framework for the banking system in Libya.

The country's five public banks were recapitalised and its four private banks licensed. The Bank of Commerce and Development is the most substantial of the four private banks and has led the way in the modernisation of Libya's banking sector by introducing modern services such as ATMs and credit cards. Twenty-one regional banks have been merged, banking supervision reinforced and interest rates and foreign exchange partially liberalised. The year 2007 saw the start of a strategy announced by the Central Bank in 2004, to develop and modernise the banking system to meet international standards.

Minority stakes of two Libyan banks were sold to foreign investors.

The first step was to sell off a minority stake in Sahara Bank, the second largest commercial bank with total assets of around $3.6 billion. BNP Paribas SA won a bid for the privatisation of Libya's Sahara Bank with 19% of the shares, for about €145 million with the option to raise their participation up to 51% in three to five years.

Then, the Wahda Bank sale was structured in the same way as the previous deal, with the offer of an initial 19% stake.

As the EU report says, liberalisation of financial services offers potentially significant economic benefits along with high risks. Significant short term adjustment impacts are likely to be experienced as the domestic industry contracts in response to increased competition, and careful phasing will be needed to minimise these risks. Strong regulation and supervision will remain essential, to avoid a significant increase in the risk of financial instability and potential for major adverse economic and social impacts.

State-owned and private commercial banks offer a similar product range. Retail services include current and savings accounts, loans and money transfer. Corporate customers are offered trade finance and cash management services. Banks may open letters of credit and guarantees for foreign corporates operating in the country.

The CBL has been working with the IMF to create a structured capital market and the first sovereign bond issue is now expected. There has been a gradual improvement of banking supervision with centralising data and improving processes. Historically, Libya has lacked a credit culture: banks sat on liquidity and the limited lending activity that existed was to the public sector, and was poorly controlled. In response, the CBL has been working on a central Credit Bureau. The database has been in operation since April 2009 and 25% of individuals and corporates have been assessed. The Credit Bureau will improve comprehension of lending risks, but will also seek to encourage lending; stimulation of economic growth and enhancing banks' profitability. A 38% increase in lending is expected by the end of this year, 2009.

A project currently coming to fruition is the National Payment System; previously, payments were slow and unreliable, sometimes even made through another country. Order 19 of May 2009 allows local banks to form strategic partnerships. Up to 49% ownership by a foreign entity is permitted.

Foreign branches and representative offices are now allowed.

In 2008, a number of foreign commercial banks won approval to open their representative offices, including two UAE banks: Abu Dhabi's First Gulf Bank (FBG.AD) partly owned by the Economic and Social Fund of Libya and National Bank of Abu Dhabi (NBAD), one bank from Qatar Masraf al rayan, as well as Egyptian investment bank Beltone Financial, also in partnership with Economic and Social Fund of Libya.

In addition, seven other foreign banks currently operate representative offices in Libya: Bank of Valletta (Malta), UBI (France), Bawag (Austria), BACB (UK), the Housing Bank for Trade and Finance (Jordan), Suez Canal Bank (Egypt) and ABC (Bahrain).

It must be noted that some of these banks use Malta as a base given Malta's Double Taxation Treaty with

Libya and Malta's robust regulatory framework.
In March 2005 a new law allowed the opening of branches of foreign banks for the first time, with minimum capital of $50 million. Foreign banks have expressed interest, and HSBC and Qatar National Bank have opened branches. BACB has started discussions about the acquisition of a stake in the Bank of Commerce and Development. Others reported to be interested are Standard Chartered, Crédit Industriel et Commercial and Citigroup.

Overall, despite progress, the country's banking system is still felt as being highly centralised.

Libya has looked to a number of sources of foreign advice in pursuing reform. In October 2008, a cooperation agreement was signed between the Libyan Stock Exchange and London Stock Exchange, providing for training teams from the Libyan Stock Exchange in Tripoli and London to enable them to run stock market operations.

The Malta Stock Exchange may consider this an opportune moment to re-launch its regional projects and revive the so-acclaimed Borzamed, a project which provided for a platform of Mediterranean exchanges. Indeed, the Malta Stock Exchange may well present itself as the regional Islamic Finance Stock Exchange platform for Southern Europe and North Africa. The local stock exchange has the necessary expertise in order to engage into such ambitious project and I feel sure it would find the support of our neighbouring countries.

As regards the insurance sector, limited deregulation of the insurance market in Libya began in 1999 with the creation of the United Insurance Company as a joint public/private venture, and approval has been given for two private sector insurance companies. Also in this sector, Malta has a crucial role to play in Islamic Finance by acting as a gateway for Takaful in Libya. As previously stated in this paper, Takaful is not a new concept in Malta, given that the concept of mutual assistance was highly practised in the confraternities.

Given:

- The strong relations between Libya and Malta
- the fact that the Maltese identity is in itself an identity that can help to make different cultures and methods of work meet,
- The experience of the Maltese work force in financial services
- Malta's reputable Financial Services Authority

Malta has a fundamental role to play in the development of the Islamic Financial Services in Libya.

The capital market in Libya is virtually inexistent. Hence, there is every reason to believe that the funds registering in Malta and targeting Libyan investors cannot but be successful.

7.1.5 Egypt

Egypt is a country that is seen as having paved the way for Islamic banking. As a matter of fact, it was in Egypt that this idea first practically came into existence, in the form of Mit Ghamr Savings Bank, way back in 1963. The Islamic banking experience then shifted from Egypt to other parts of the Islamic world. This was through the initiatives of the early founding fathers, whose efforts were combined with those of businessmen interested in Islamic values.

Given Egypt's input as the pioneer of Islamic banking, one would expect that the number of Islamic banking institutions in Egypt would reflect this fact. However, Egypt appears to be distancing itself from this background. In fact, there are only two Islamic banks in Egypt in addition to some of the Islamic outlets of conventional banks. The two banks are: Faisal Islamic Bank of Egypt and the Egyptian Saudi Finance Bank.

In Egypt, Islamic banking is on the decline since the first merger took place between an Islamic bank (the Islamic International Bank for Investment and Development) and two conventional banks (the United Bank of Egypt and the Nile Bank). Together they constitute one financial structure working conventionally under the United Bank, of which 99.9 per cent is owned by the Central Bank of Egypt.

The Egyptian government could have acquired the bank without merging with conventional banks in order to preserve the identity of the Islamic institution in the same way that Dubai's government dealt with the Dubai Islamic Bank crisis. However, the Egyptian government gives the impression that it does not encourage this kind of investment.

Egypt's al-Azhar University has issued a fatwa, calling on the faithful not to consider all interest as usury but only excessive interest.

We have witnessed similar statements from other religions in the Western World and today we can see the results of such so-called tolerance.

With such a fatwa, existing Maghreb lenders might become Shariah-compliant, at least in the eyes of some customers. Many Maghreb Muslims do not consider interest to be a sin by definition. They have done conventional banking all their lives. However, analysts say that a large segment of the North African population is receptive to the ideas of Islamic finance.

"A conservative Islamic bank that wished to safeguard its respect for Shariah could find itself attracting only a mass clientele more sensitive to religious aspects but also less profitable and more risky," said Standard & Poor's in a research note.

Whatever the take-up of Islamic retail products, Islamic banks are already pushing into Maghreb countries by financing big real estate, industry and tourism projects. Bahraini Islamic investment bank Gulf Finance House, for example, is behind $3bn financial hub in the works in Tunisia, a $3bn economic development zone in Algiers and an 'Energy City' in Libya worth $3.8bn.

7.1.6 Lebanon

Lebanon, Egypt's neighbour, could not stand back from having a modern and progressive Islamic Finance regulatory framework. Although Lebanon's market volume could not be compared with that of its oil rich neighbouring countries, the country has achieved remarkable progress in the field of Islamic Banking since its inception some thirty years ago.

In spite of its relatively small market, Lebanon has generated a substantial amount of transactions through Jersey, which seems to be the preferred destination for Lebanon based IFIs.

In this aspect, given Malta's historical and ancient links to Lebanon, as well as its vision, most of these transactions could be channelled through Malta.

7.1.7 Turkey

The first Islamic bank in Turkey was established in 1985. At that time, the bank was given the status of a "Special Finance House".

In 2006, the status was enhanced for participation banks which were still not recognised as full banks. This began to attract hidden capital to the Turkey capital markets.
Over the last 20 years, the growth and development of Islamic finance in Turkey has however been slow.

Turkey has four participation banks and the comparative growth has been remarkable. Yet, Islamic finance still remains a long way from reaching its potential in Turkey.

It would appear that the political environment in Turkey should adopt a financial approach towards Islamic finance, rather than a political perception. Having a specialist in the new cabinet who is in charge of the coordination of the economy, along with the fact that some of the state owned banks are now run by CEOs transferred from participation banks, there are now better prospects of seeing a more positive environment shaping up. This is expected to once again attract more hidden cash, considering that there seems to be a high amount of non-banked cash.

The potential for Islamic Finance in Turkey is immense. With the right strategies, not only will more people move towards Islamic Finance, but also more investors will utilise the services.

Malta and Turkish banks have a long historical relationship. Most Turkish banks have a branch in Malta, or rather a substantial amount of banks that operate in Turkey register in Malta as well. The main reason for this is purely a tax reason given Turkey Tax on every banking transaction.

7.1.8 Southern Europe

With respect to Southern Europe, the main interest of Malta would be Italy.

The Arab world has always considered investment opportunities in Italy. Such interest is confirmed by a number of relevant investments already made in the country. The perception of attractiveness by Arabic Investors, however, has not been stable because of Italy's economy as well as known structural rigidity in terms of excessive bureaucracy, low quality infrastructures, intrusive tax system and the powerful trade unions that lead to low productivity. Strong limitations are also related to the financial credit support due to the scarce international dimension of the Italian system. In future this might worsen given the increasing request of Arab investors for technical peculiarity complying with Islam

At the moment the Italian Banking Association (ABI) and the Union of Arab Banks are devising the project of an Italian Arab banking federation to favour the entry of Islamic Financial contracts into the Italian credit and banking system. However, indications are that the introduction of Islamic Finance in Italy is far from becoming a concrete reality unless an alternative route is found

It is in the author's opinion that in Italy's case, the alternative route that could be considered in the light of the kind of Tax Legislation that is to be found in Italy is Malta particularly with respect to certain areas of Islamic Finance.

The other two EU Mediterranean countries that have been discussing Islamic Finance are France and Spain.

The French Parliament in October 2009 approved changes to legislation to allow Islamic "sukuk" bonds to be issued and the Qatar Islamic Bank has applied to be the first such bank to open in France.

France is home to Europe's biggest Muslim community. The country is aspiring to unseat London as the European hub for Islamic banking, offering products that comply with Shariah law and meet the needs of big investors mostly from Gulf countries.

But the drive is raising hackles, with some conflicting political views. After failing to garner enough votes to derail the bill, the Socialist opposition is challenging the legality of the new legislation on Islamic finance before the Constitutional Council.

Economists argue that money raised through Islamic finance could help spur France's nascent recovery with tools that are seen as financially sounder than the high-risk derivatives that led to the 2008 global meltdown.

Whatever the developments in France, it will not effect the development of strategically located Malta in the Mediterranean Centre of Islamic Finance. The Islamic Community can look at Malta as the natural home of Islamic Finance in an EU jurisdiction.

As regards Spain, in May 2009 the financial newspaper Negocios announced that the Halal Institute - the centre of Islamic quality certification in Cordoba operating under the Spanish Islamic Commission - was shortly to sign an agreement with the Sa Nostra building society in the Balearic Islands, for the creation of an Islamic current account.

Thanks to the agreement soon to be sealed by the Halal Institute and Sa Nostra, Muslim residents of the Spanish archipelago will also be able to open special current accounts to save the funds needed to be buried in the first Islamic cemetery in the Balearics, without the bank taking any commission or adding any interest to the holder's deposits.

The Halal Institute has gone a long way, as it was in 2006 that it started its talks with various Islamic Banks.

This was a major milestone for Islamic Finance in Spain.

Spain and Malta have only recently started to re-activate commercial relations. However, to date commercial activity has been growing slower than expected. Islamic Finance could be the area that reinforces relations between the two countries and whereby fresh strategic alliances could be established to compete with larger jurisdictions in Islamic Finance.

7.1.9 Offshore Centres

Offshore centres have been the unexpected beneficiaries through the growth of Islamic Finance. These centres, such as Cayman Islands, Guernsey and Jersey now provide a convenient domicile for popular Islamic finance structures.

Malta is once again finding itself competing with these centres with the added advantage that although tax convenient, Malta is not considered as an Offshore centre apart from the fact that the country is an EU member.

On this front however, Malta competes as well with centres such as Bahrain, Labuan which is usually preferred by Malaysians, and the Caribbean.

Malta is ideal to service Sukuk structures, if Malta continues to follow the right direction.

The Cayman Islands, for instance, have marketed themselves very well for these types of structures. They have also been very strong in attracting Shariah compliant funds. However, on its part, to date Malta failed to embark on a solid marketing exercise on this front.

When one analysis Malta's legislation including the country's fund registration regulations, its tax exemptions, as well as its trust and trustees act, one can immediately realise that Malta has a lot to offer to Sukuk structures and Islamic Funds.

The Maltese Ministry of Foreign Affairs continues to accelerate its efforts towards ensuring that the right agreements with various countries are in place. The wide network of agreements with EU countries, as well as North African Countries is an indication in itself where Malta is heading to. Combined with other agreements with the Gulf Countries and other Islamic Finance Centres, such as Malaysia, such an approach is a further endorsement of Malta's vision. Malta's negotiators have successfully concluded DTTs with Qatar, Saudi Arabia, United Arab Emirates, and Oman. With regard to Bahrain, we expect to start bilateral negotiations in the very near future.

The recent agreements with Qatar and the statement made by the President of the Republic of Malta, His Excellency Dr George Abela in his speech at the Chamber of Commerce in Qatar, whereby he encouraged Islamic Finance Institutions to look at Malta as a Centre for Islamic Finance, are yet further steps in line with the same vision.

7.1.10 The ideal centre – Bahrain in The Mediterranean

It has been generally agreed that Malta is the ideal centre for Islamic Finance, taking into account:

- It is Geographically Well-Positioned to serve various Mediterranean countries
- It has an Extensive Network of DTTs that mitigate the tax effects of certain legislations on Islamic finance transactions
- It provides Unique Opportunities such as the Double Taxation agreement with Libya
- It is the First Jurisdiction that is thinking of a centre for Islamic Finance in the Mediterranean
- It is a Reputable Financial Services Location
- It has a Reputable Regime in terms of banking, funds and insurance
- It has a Huge Potential for Special Purpose vehicles
- It has a Trust and Trustees Legislation
- It is considered by the World Economic forum as the 10th Safest Country to invest in.
- It has Excellent Relations with all EU countries and North African countries

In its evaluation of the benefits that could be generated through the opportunities offered by Islamic Finance, Malta has the big forward-looking challenge of developing and projecting itself as the Bahrain in the Mediterranean. This is in view of the similarities between the two countries.

In recent years, Bahrain claims to be a global leader in Islamic finance, playing host to the largest concentration of Islamic financial institutions in the Middle East. Presently, there are 24 Islamic banks and 11 Islamic insurance companies (Takaful) operating in the Kingdom. In addition, Bahrain is at the forefront in the market for Islamic securities (Sukuk), including short-term government Sukuk as well as leasing securities. Its Central Bank has played a leading role in the introduction of these innovative products. [1]

Like many of the Middle East states, the Bahraini Government receives most of its revenues from the oil industry which obviously puts the country at an advantage. However, Malta should not be disheartened because in the Euro Med area it is the ideal location to become the only centre that has a full Islamic capital market.

In consideration of the advantages offered by its tax system, Malta may well aim to comfortably become the Mediterranean Centre for Islamic Finance. If one focuses exclusively on the situation in the Mediterranean EU member states, one can immediately recognise that there is currently no other EU country that may offer to the Shariah investors a competitive market, from a cost efficiency to a tax perspective, better than Malta. Indeed, the Government of Malta is being very wise in instructing the authorities concerned to take all necessary steps to ensure facilitation of Islamic Finance investment in Malta. Furthermore, the Prime Minister, Hon Dr Lawrence Gonzi has on various occasions recognised that regulatory frameworks and policies should be an important driver towards ensuring that Malta succeeds in penetrating this market. Following the workshops the Prime Minister reinforced Malta's position vis-a-vis Islamic Finance.

1: www.cbb.gov.bh

The Malta Regulator needs to work hand in hand with International Islamic Financial Services Centre in order to strike the necessary alliances to ensure that the industry is well served in the Mediterranean through Malta.

In addition to the numerous Islamic financial institutions active in its financial sector, Bahrain also plays host to a number of organisations central to the development of Islamic finance, including:

i) the Accounting and Auditing Organisation for Islamic Financial Institutions ('AAOIFI');
ii) Liquidity Management Centre ('LMC');
iii) the International Islamic Financial Market ('IIFM'),
iv) the Islamic International Rating Agency ('IIRA')

Malta can benefit in attracting investment in the Mediterranean by also establishing a good relations with the Liquidity Management Centre (LMC).

The Liquidity Management Centre was established with the primary purpose of addressing the global liquidity management needs of Islamic Financial Institutions. LMC facilitates the investment of surplus funds of Islamic Banks and Financial Institutions.

The Government of Malta may consider creating the necessary instruments, with its upcoming capital projects, to attract such funds into Malta whilst enhancing Malta's potential as an Islamic Finance Centre.

The Central Bank of Bahrain has recently established a special fund to finance research, education and training in Islamic finance (the Waqf Fund). It is also active in working with the industry and stakeholders towards developing industry standards and the standardisation of market practices.

At this stage, a similar move may be premature for Malta. Nonetheless, together with the neighbouring countries and/or in collaboration with the Central Bank of Bahrain, Malta may start aiming at having a comparable instrument in order to fuel even further its potential.

Considering Malta's vision, its political commitment, the 'can do' promptness of its people, its cost effectiveness, its international relations and its tax regime, Islamic Finance Institutions have every good reason to consider Malta as their base in the Mediterranean.

No organisation should be sceptical in taking the lead in this.

The financial services industry in Malta continues to grow. In actual fact, the international financial crisis was in a way beneficial to Malta, as the number of funds and companies re-domiciling to Malta developed into a phenomenon that is still going on.

Malta's leaders and planners should leave no stone unturned towards seeing this unprecedented phenomenon also translating into Islamic Finance. With such a potential achievement, which would reflect the distinctive type of socialconscience that exists in Islamic Finance, Malta will additionally be able to further participate in the development of its neighbouring countries.

Reuben Buttigieg
Chairperson of
Islamic Finance in a European
Union Jurisdiction Workshops

Joe Zammit
President
Malta Institute of Management

William Portelli
President
Malta Union of Bank Employees

Pierre Fava
President
Malta Employers Association

8 Appendix One – Workshops Programme and Speakers

Monday, 12th October 2009

8.30 - Welcome Coffee and Registration

8.45 - Introduction – **Mr. Reuben Buttigieg**

9.00 - Opening Speech – **Mr. Mohammed El Sadi** (IMAM) – Malta

9.20 - **Dr. Mohamad Nedal Alchaar**
General Secretary of AAOIFI – Syria
"Standardization and Characteristics of Islamic Banking in an Evolving World."

10.10 - Coffee Break

10.40 - **Mr. Oliver Agha**
Managing Partner Agha&Shamsi (Shariah compliant law firm) – Emirat Dubai
"Opportunities and Challenges: Basics, infrastructure and current developments"

11.30 - **Dr. Hussein Hamid Hassan**
Prof. of Shariah, Chairperson of the Shariah Supervisory Committee of many Islamic Banks in the Middle East and has advised several governments – Emirat Dubai
"The Role of Shariah Boards in New Islamic Finance Jurisdictions"

12.00 - **Mr. Ahmad Nazmi Camalxaman**
Manager, Global Markets CIMB Islamic, CIMB Bank Berhad, London – UK
"Why Malaysia is the most comprehensive and sophisticated Islamic financial market in the world"

12.30 - **Mr. Germain Birgen**
Managing Director - Global Head of Fund Solutions, HSBC Securities Service – Luxembourg
"The position of Luxembourg in the Islamic Finance sector how is Luxembourg already positi oned in the Islamic financial sector and what are the recent initiatives"

12.45 - Lunch and Prayer time (12.50)

14.15 - **Mr. Reuben Buttigieg**
FCCA, MBA (WARWICK), Chairperson of the Management School of the Malta Institute of Management, Manager Director of Erremme Business Advisors – Malta
"The Mediterranean Centre for Islamic Finance" – Why Malta?"

14.45 - **Dr. Alberto Brugnoni**
President of ASSAIF – Italy
"Pilot Project Genoardo – Islamic finance and the Mediterranean sea: a long story"

15.15 - **Prof. Dr. Abdullah Al-Shami**
Prof. of Comparative Islamic Jurisprudence & Islamic Studies, lecturer at the Petroleum Institute in Abu Dhabi
"Islamic Finance – did it resist the Global crisis?"

15.55 - Coffee Break and Prayer time (16.03)

16.30 - Panel discussion: **"Did Islamic Finance weather the crisis?"**

Chairperson: **Mr. Oliver Agha**
Podium: **Dr. Mohamad Nedal Alchaar, Prof. Dr. Abdullah Al-Shami, Mr. Reuben Buttigieg, Mr. Ahmad Nazmi Camalxaman, Mr. Francis J. Vassallo.**

17.30 - Closing Remarks:
Mr. Reuben Buttigieg, Mr. Joe Farrugia, Mr. William Portelli.

18.33 - Prayer time – End of first day

Tuesday, 13th October 2009 – Workshop-Day I

8.30	-	Opening – **Mr. Reuben Buttigieg**
		Agenda/Topics: **Takaful vs Conventional Insurance**
		Chairperson: **Mr. Peter Grima** – First United Rapporteur: **Mr. Stuart Fairbairn** – Middlesea Insurance p.l.c
9.00	-	Speech: **Mr. Oliver Agha**
9.15	-	Panel Discussion: **Mr. Reuben Buttigieg, Mr. Oliver Agha, Dr. Mohamad Nedal Alchaar, Prof. Dr. Abdullah Al-Shami, Mr. Ahmad Nazmi Camalxaman.**
9.45	-	Workshop part I
10.30	-	Coffee Break
11.00	-	Workshop part II
12.00	-	Workshop Report: **Mr. Peter Grima, Mr. Stuart Fairburn.** Closing Remarks: **Mr. Reuben Buttigieg**
12.49	-	Prayer time – End of Workshop-Day I

Wednesday, 14th October 2009 – Workshop-Day II

8.30	-	Opening – **Mr. Reuben Buttigieg**
		Agenda/Topics: **Islamic Funds and Sukuk**
		Chairperson: **Mr. Francis J. Vassallo** – Francis J. Vassallo&Associates Rapporteur: **Dr. Louise Chircop** – Francis J. Vassallo&Associates
9.00	-	Panel Discussion: **Mr. Reuben Buttigieg, Mr. Yahya Pallavicini, Mr. Ahmad Nazmi Camalxaman, Prof. Dr. Abdullah Al-Shami, Mr. Mansour Baudo, Mr. Haider Ali.**
9.30	-	Workshop part I
10.30	-	Coffee Break
11.00	-	Workshop part II
12.00	-	Workshop Report: **Mr. Francis J. Vassallo, Dr. Louise Chirchop.** Closing Remarks: **Mr. Reuben Buttigieg**
12.49	-	Prayer time – End of Workshop-Day II

Thursday, 15th October 2009 – Workshop Day III

III

8.30 - Opening – **Mr. Reuben Buttigieg, Mag. Nassif Chebab, Dr. James Muscat Azzopardi.**

Agenda/Topics:
Islamic Banking vs Conventional Banking
Analysis of BASEL 11 and other implications
Individual country issues

Chairperson: **Mag. Nassif Chebab**
Rapporteur: **Dr. James Muscat Azzopardi** – Muscat Azzopardi & Associates

9.00 - Round Table Discussion:
Mr. Reuben Buttigieg, Mr. Ahmad Nazmi Camalxaman, Dr. Hussein Hamid Hassan, Prof. Dr. Abdullah Al-Shami, Dr. James Muscat Azzopardi, Mr. Haider Ali.

10.00 - Workshop part I

11.00 - Coffee Break

11.30 - Workshop part II

12.40 - Lunch and Prayer time (12.49)

14.15 - Workshop Report: **Mag. Nassif Chebab, Dr. J. Muscat Azzopardi.**
Closing Remarks: **Mr. Reuben Buttigieg**

15.00 - End of Workshop-Day III

Friday, 16th October 2009 – Workshop-Day IV at the Islamic Center in Paola

IV

8.30 - Opening – **Mr. Reuben Buttigieg**
Visiting of Mosque

Agenda/Topics:
Islamic Capital Markets

Chairperson: **Dr. Max Ganado** – Ganado&Associates
Rapporteur: **Mr. George Bugeja**

9.00 - Round Table Discussion:
Mr. Reuben Buttigieg, Mr. Ahmad Nazmi Camalxaman, Dr. Hussein Hamid Hassan, Prof. Abdullah Al Shami, Dr. James Muscat Azzopardi, Mr. Haider Ali, Mr. Mansour Baudo.

10.30 - Coffee Break

11.00 - Conclusion and wrap up

12.00 - Workshop Report: **Mr. George Bugeja, Dr. Max Ganado.**
Closing Remarks: **Mr. Reuben Buttigieg**

12.49 - Prayer time in Mosque

14.00 - End of Event

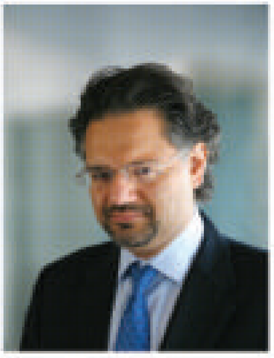
Dr. Mohamad Nedal Alchaar

Secretary – General AAOIFI

Dr. Mohamad Nedal Alchaar is the Secretary – General of the Accounting and Auditing Organization for Islamic Financial Institutions which is an international organization consisting of over 200 members from over 40 countries.. Dr. Alchaar has a vast working experience in financial markets and institutions in addition to his central banking experience in developing countries. He was Director of Market Performance Analysis at Fannie Mae, and previously Vice President at Johnson & Higgins in Washington D.C. Dr. Alchaar also taught for several years at The George Washington University, where he received his Ph.D. Degree in Monetary Economics. He has also published several well-recognized books in the field of banking and financial markets, such as "Financial Markets", "Economic Inquiries" and "Fundamentals of Banking Operations", in addition to other scientific articles in the field of monetary policy and exchange rates analysis.

Mr. Oliver Agha

Managing Partner Agha&Shamsi



Oliver Ali Agha is a founding partner of Agha & Shamsi, L.L.C., a UAE based legal consultancy and the first Shari'ah compliant law firm.

The firm has been established, pursuant to Mr. Agha's vision, to develop the cause of 'genuine' Islamic finance by:

- Conducting its affairs in compliance with Shari'ah.
- Enabling its lawyers to pursue and develop Islamic scholarship.
- Providing authentic and considered Islamic law advice for application in today's modern day complex transactions.

Prior to establishing Agha & Shamsi, Mr. Agha was the global head of Islamic Finance at the largest law firm in the World and prior to that was the head of projects and co-head of Islamic finance at Clifford Chance's Saudi affiliate. Mr. Agha is a New York lawyer and spent the majority of his career prior to the Middle East at Fulbright & Jaworski in the U.S., New Delhi, Hong Kong and Beijing.

Mr. Agha is recognized as a leading Islamic finance authority; he is on the board of the Accounting and Auditing Organization of Islamic Finance Institutions ("AAOIFI"), the team leader recipient of a Sheikh Maktoum endorsed Islamic finance award and is recognized as a top Islamic finance lawyer by numerous publications including Chambers Global 2009, Islamic Finance News: Leading Lawyers 2009 survey, Legal 500, Who's Who Legal, IFLR Best of the Best Islamic Finance Lawyers and as one of the top 20 lawyers that helped the Gulf's economic boom by the Brief Magazine. Islamic Finance News: Leading Lawyers 2009 survey recognized Mr. Agha as a leading lawyer in seven our of twelve Islamic finance practice areas.

In addition, Mr. Agha is author of published papers, articles and presentations regarding salient Islamic finance topics, is frequently quoted in leading publications on salient issues in Islamic finance and has been invited to speak at numerous Islamic conferences and on television (including CNBC) and radio. Mr. Agha's team won the Sheikh Maktoum endorsed IIFF Global Recognition in Islamic Finance for a Law Firm Award in 2008.

Dr. Hussein Hamid Hassan

Chairmain of Fatwa & Shariah supervisory board Dubai Islamic Bank – UAE

Dr. Hussein Hamid Hassan does not need any introduction in the field of Islamic finance. He did his PhD. in the Faculty of Sharia from Al Azhar University, Egypt, and Master of Comparative Jurisprudence from University of New York, USA. He graduated in Law and Economics from University of Cairo, Egypt.

In his Professional career, spanning over half a century, he has been a prominent scholar and teacher of universal dimensions, having established Islamic universities and Islamic faculties in various parts of the world including, Makkah, Islamabad, Kazakhstan and Libya. He has been Advisor to the President of the Republic of Kazakhstan (at whose request he prepared Civil Codes framework for Kazakhstan in the early 90s and most recently prepared the Islamic banking law for the country), various Presidents of the Islamic Republic of Pakistan, Prime Minister of the Republic of Kyrgyzstan, President of the Islamic Conference of the Muslim World and General Secretary of the Muslim World League, Saudi Arabia.

Dr. Hussein is also the President of the US Muslim Jurists Association. He is Chairman, Sharia Supervision Board, of several Islamic financial Institutions including Dubai Islamic Bank, Emirates Islamic Bank, Sharjah Islamic Bank, Amlak, Tamweel, National Bonds, Liquidity Management Centre, AMAN Takaful Company, and others besides beingcore member of the Sharia Board of Islamic Development Bank. He has converted conventional banks into Islamic ones and was instrumental in the creation of the DFM as the world's first Islamic stock exchange. Dr. Hussein has given many landmark innovative products to the Islamic finance industry, including the World's First: Convertible Sukuk, Multiclass Sukuk, Currency and Rate Swaps, Personal Finance, and others.

Prof. Dr. Abdullah Al-Shami, Ph.D.

Professor of Comparative Islamic Jurisprudence and Islamic Studies
Lecturer at the Petroleum Institute, Abu Dhabi – UAE

Abdullah Al-Shami is a Professor of Comparative Jurisprudence and Islamic Studies at the Petroleum Institute (PI). He came to the PI from Saba University in the Republic of Yemen where he was the Chancellor as well as an Islamic Law Professor. His previous appointments include Fulbright Visiting Professor of Islamic Law at the Law School of the University of California Los Angeles; Full Professor and acting Vice-Chancellor for Academic Affairs and, Dean of the Faculty of Education and Professor of Islamic Studies at Hodeidah University in Yemen; and Professor of Islamic Law at the University of Brunei Darussala. Professor Al-Shami obtained his B.A. in Islamic Law (Shari'ah), Master Degree in Comparative Islamic Jurisprudence from Saudi Arabia and PhD in Comparative Islamic Jurisprudence from the University of Manchester, UK. He has written and edited a total of six books and over 40 research articles on Islamic Law and Islamic Studies. His research focuses on Comparative Islamic Jurisprudence and Islamic Studies including the Judicial Authority System in Islamic Law; Islamic Family Law; Islamic Law of Transactions and Finance; Contemporary Islamic Thought and Culture; Professional ethics, Islamic Philosophy and Faith; Islamic Ethics and Values; Islam and the Environment; and Islamic Law and Human Rights.

Mr. Ahmad Nazmi Camalxaman

Manager, Global Markets CIMB Islamic,
CIMB Bank Berhad, London – UK

Nazmi Camalxaman began his career with one of the big four accounting firms where he was involved in the fields of tax and corporate finance. In 2005, he joined the Islamic financing arm of Malaysia's leading investment bank called CIMB Group. He has participated in numerous groundbreaking Islamic debt capital market transactions including:

- the world's first Islamic residential mortgage backed securitisation by Cagamas MBS Berhad in 2005;
- the first Sukuk arranged by a Malaysian bank for a Middle Eastern company called National Central Cooling Company otherwise known as Tabreed in 2006;
- the RM10 billion Sukuk for Khazanah Nasional Berhad - the Government of Malaysia's investment arm in 2006.

Currently, Nazmi Camalxaman is based in London where he oversees the Islamic investment banking business of CIMB Islamic in Europe and Africa. He was awarded ,Young Islamic Banker of the Year' at the 2009 London Sukuk Summit. He holds a Bachelor of Science degree in Economics from the University of Kent UK.

Mr. Germain Birgen

Managing Director - Global Head of Fund Solutions,
HSBC SecuritiesService – Luxemburg

Germain Birgen, a Luxembourg national, is a Managing Director of HSBC Securities Services (Luxembourg) S.A. and Global Head of Fund solutions HSS. He has been active in the Investment fund sector in Luxembourg for more than 25 years. In the local industry, he was a member of the Luxembourg Stock Exchange Commission for more than 10 years. Within the Association of the Luxembourg Fund Industry (ALFI), he created in 2008 a dedicated Committee with a focus on Islamic Funds and he is presently chairing such Committee. Furthermore, he is coordinating a task force on the same subject implemented by the governmental agency for the development of financial services .

Mr. Reuben Buttigieg

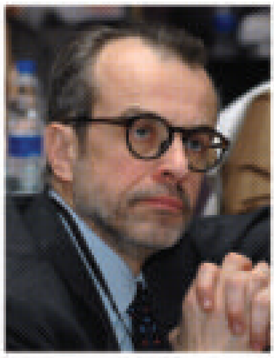
FCCA, MBA (WARWICK),
Chairperson of the Management School of the Malta Institute of Management, Manager Director of Erremme Business Advisors – Malta

Mr. Reuben Buttigieg is Chairman of MIM Training and Development Limited, the training arm of the Malta Institute of Management. The company represents amongst others Edinburgh Business School and the University of Birmingham. Until recently Mr.Buttigieg was Hon Treasurer of the Malta Institute of Management and acted as a Membership Services Committee Chairman. He currently chairs the Investments Committee of the Institute. He has been a council members for the last 6 years.

Besides also being the Manager & Founder of ERREMME, Mr.Buttigieg has been the pioneer in the discussions on Islamic Finance in Malta and has prepared various papers and articles on the subject. He is a regular speaker in International Islamic Finance conferences. Acts as consultant on various Islamic Finance transactions in Malta and abroad and is also the first Islamic Finance Advisor in Malta.

Dr. Alberto G. Brugnoni

President and Founding member ASSAIF (www.assaif.org)



Arabist, he is a former director of Merrill Lynch Private Bank (Suisse). He runs from Milan and London ASSAIF (www.assaif.org) a consultancy on Islamic finance that advises governments, international organizations, public agencies, companies, international law firms, banks, management companies, universities and stakeholders associations.

He has personally been involved with Islamic finance since the late '80s and has authored ‚Pilot Project Genoardo', a multi-disciplinary study for the establishment of a Mediterranean Development Bank based on Islamic principles. He regularly chairs the major Islamic finance events around the globe.

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9 Appendix Two - Glossary of Islamic Finance Terms

Al-kharaj bi al-daman:	The concept that reward should correspond to risk involved.
Al-Wadi'ah:	In contemporary Islamic Finance, a deposit held by a deposit-taking financial institution for the depositor.
Amanah:	Trust. The contract of *amanah* gives rise to a fiduciary relationship and duties.
Ameen:	Also spelled *Amin*: custodian or guardian.
Amwal:	Wealth. In a business context, *amwal* means wealth that is contributed as capital in a partnership. Plural: maal.
'Aqd:	A contract.
'Aqd sahih:	A legal contract.
Arbun (urboon or arboon):	Down payment paid in advance; a non-refundable deposit paid by a buyer retaining a right to complete a sale.
Arkan :	The elements or essential ingredients of an act, without which the act is not legally valid.
Ashum:	Shares.
Awad:	Compensation on counter-value.
'Ayn:	A tangible (physical) asset.
Bai' (also Bay'):	Sale.
Bay'al-dayn:	The sale of debt.
Bay' al-murabahah:	Sale of a commodity at cost price plus a known profit.
Bay' al-tawliyah:	Sale at cost without profit or loss.
Bay' al-wadiah:	Sale below the cost price or at a discounted price.
Bay' mu'ajjal:	Deferred payment sale.
Bayt al-mal:	Government treasury.
Bulugh:	Physical puberty.
Dain:	Loan or debt.
Dayn:	A debt or obligation to deliver an asset.
Dhaman:	Liability
Dharar:	Harm, damage.
Diminishing musharaka:	A form of *musharaka* financing developed in recent years where the share of the financier in the *musharaka*is purchased by the customer periodically and in scheduled amounts.
Faqih:	Jurist specialising in *fiqh*.
Fard:	Obligatory.
Fatwa:	A legal verdict or pronouncement based on *fiqh*, given by *Shariah* scholar or a *Shariah* board.
Fiqh:	Islamic substantive law.
Fiqh al-muamalah:	Islamic commercial law.

Gharar:	Uncertainty.
Gharar fahish:	Major uncertainty.
Gharar yasir:	Minor uncertainty.
Hadith:	Sayings and practices of the Prophet Mohammed (peace be upon him). Plural: *ahadith.*
Halal:	Acceptable and lawful.
Hanafi:	Particular school of law.
Hanbali	Particular school of law.
Haq:	Legal right.
Haram:	Unacceptable or prohibited.
Hasuna:	Pleasing, appealing or nice.
Hawala:	Transfer of liability.
Hiba:	Gift.
Hiwalah:	Transfer of debt/right to claim.
Hukm:	A ruling in the Qur' an or the Traditions of the Prophet Mohammed, or derived thorough reasoning of jurists.
Ibra':	Can be defined as a discount or rebate.
Ijarah:	A lease contract.
Ijarah 'ala al-ashkash:	Hire of people.
Ijarah al-a'yan:	Lease of the asset.
Ijarah mausufah fi al-dhimmah:	Forward lease.
Ijarah muntahia bi tamleek:	Where an option to transfer the title of the asset to the customer is provided for in the lease, the lease agreement is *Ijarah muntahia bi tamleek*
Ijarah tasqhilliyyah:	Refers to an operating lease, where the financial institution transfers the usufruct (right of beneficial use) of a particular property to another person in exchange for a rent claimed from the lessee.
Ijarah thumma al bay':	See Ijarah muntahia bi tamleek.
Ijarah wa al-iqtina:	See Ijarah muntahia bi tamleek.
Ijma':	Consensus or agreement of all Muslim scholars over interpretation.
Ijtihad:	Interpretation.
'Illah:	Effective cause or ratio legis.
In rem:	Action relating to property rather than the person.
Inter absentes:	Not physically present.
Inter praesentes:	Contract physically present.
Istihsan:	Equity consideration.
Istishab:	Presumption of permissibility.

Istisna:	Sale of an asset to be produced.
ju'alah:	Commission-based.
Kafalah:	Guarantee.
Kafil:	Guarantor.
Litera legis	Literal rule.
Madhhab:	Schools of Islamic law.
Madhahib:	Plural of *Madhhab.*
Mafsadah:	Evil and harm.
Maisir:	Gambling.
Majallah al-ahkam al-adliyyah:	The Islamic Civil Code of the Ottoman Empire.
Makrooh:	Disapproved of, but not prohibited.
Maliki:	Particular school of law.
Manfa'ah:	Usufruct.
Maqasid:	Objectives and ultimate purposes of Islamic law.
Maslahah:	What is good or beneficial.
Maslahah mursalah:	Benefit or interest/unrestricted public interest.
Mudaraba:	Akin to a silent partnership or investment trust management, with the *rub ul-maal* providing capital of the *mudaraba* and the *mudarib* using its skill and enterprise in investing that capital.

Mudarabah:

A *Mudarabah* contract is a profit sharing contract. Under a *Mudarabah* contract, the capital provider agrees to share the profits between themselves and the entrepreneur at an agreed ratio or percentage.

1. As a source of capital for a business venture, a businessman might consider undertaking a commercial project financed by funds from a bank under a *Mudarabah* contract. If agreeable, the bank supplies the finance to the businessman on the understanding that both parties will share profits of the venture.

As a deposit taking activity, money deposited in a bank by an individual or institution under a *Mudarabah* contract is treated as an investment in the bank by the individual or institution. The bank will use this investment to help make profits from its trading activities, i.e financing of individuals and businessmen. Under the *Mudarabah* contract, the bank will have agreed to give the depositor a share of its profits in return for the investment, based on a pre-agreed ratio.

Investment financing through *Mudarabah* is a commitment to participate in the risk associated with business ventures, with the aim of sharing profit generated from a given business venture. Parties to the *Mudarabah* contract will only benefit if the venture is successful. Should the project fail, the financier will lose his investment, whereas the businessman will only lose the time and effort expended on the project.

In general, conditions imposed and agreed on by both parties limit the mobilisation of the funds raised under a *Mudarabah* contract, such as pooling with other funds, types of business venture or investment, as well as profit and loss sharing among the funds. In the case of a savings account, a *Mudarabah* contract without conditions and restrictions is usually adopted, which is intended for public and retail investors. *Mudarabah* unlike *Musharakah*, does not entitle the capital provider to an executive function in the management of the business venture.

Key principles of *Mudarabah*:

- Profit sharing contract.
- Returns depend on a profit being earned.
- Conditions could apply to what the investment can be used for.
- Requires a commitment to participate in the risk associated with the business venture.
- The businessman only loses the time and effort expended on the project, where the financier assumes the financial loss.
- Does not entitle the financier to any say in the running of the venture.

Mudarabah muqayyadah:

This type of contract is specific in bank accounts know as restricted investment accounts (RIAs), where the bank acts as an agent for the investor(s) simply by acting upon their instructions. Here, the funds deposited based on the *Mudarabah* contract are never really under the control of the bank because the depositor(s) determine the manner as to where, how and for what purpose the funds are to be invested. Commingling of the funds raised under this type of contract with the bank's shareholder and other deposit funds is usually restricted or prohibited. The returns distributed to restricted investment account holders (RIAHs) is based on an agreed profit sharing ratio confined top the returns eared on a designated specific investment portfolio involving the funds agreed upon by RIAHs.

Any distribution between the bank and the depositor will be in accordance with an agreed profit sharing ratio, or agency fee if the contract is based on wakalah or agency for investment. Mudarabah profits or income distributable to RIAHs are derived from the performance of designated financing assets or investments managed by the bank.

Key Principles of *Mudarabah muqayyadah*

- Financial institutions act as entrepreneurs or agents for investors.
- Investors decide where funds will be invested.
- Commingling of funds is either restricted or prohibited.
- Returns paid to investors come only from returns earned on the specified investments.

Mudarabah mutlaqah: Unlike *Mudarabah muqayyadah*, this contract related to investment accounts where the account holder fully authorise the bank to invest the funds without restrictions imposed by the account holder and is in accordance to the *Shariah* principles and rules. The funds are pooled with the bank's shareholder funds and other deposits facilitate financing investments by the bank. The returns depend of the level of profits earned, and are shared and distributed across the varying classes of investment account holders based on different investment horizons from one to 60 months or more. Usually, returns to investment account holders are computed and accrued on a month-to-month basis. The investment account holder must submit written notice to Islamic banks prior to the withdrawal of funds and a minimum notification period is required. Mudarabah profits or income distributable to unrestricted investment account holders are derived from the performance of the bank's financing assets and investments.

Key principles of *Mudarabah mutlaqah*

- Financial institutions fully authorised to invest deposited funds without restrictions.
- Commingling of funds can take place.
- Returns paid to investors come only from returns earned across all investments of the financial institution.
- Returns paid to investors depend on class and time horizon of investment.

Mudarib: The person who provides entrepreneurship and management of a mudaraba. *Rub ul-maal* are the investors or providers of capital of the *mudaraba*.

Mufti: One who passes verdicts.

Muhammad: The last prophet of Islam.

Mujtahid: The person who performs *Ijtihad*.

Muqasah: Set-off.

Murabaha: Sale at cost plus agreed and stated profit.

Murabahah li al-amir bi al-shira: *Murabahah* to the purchase orderer.

Murabahah-tawarruq: Contract to realise cash.

Musawamah: Negotiated sale.

Musawamah, Tawliyah: Negotiated sale at agreed price.

Musharaka: Partnership or join venture.

Musharakah mutanaqisah: A variety of *Musharakah* contract, where the term *Mutanaqisah* means 'to diminsh'. A form of partnership which creates an avenue for the capital provider to reduce or be free of the joint ownership after the initial investment period has been satisfied. This specifically relates to a reducing investment.

Parallel Istisna': See *Istisna'* – two contracts operated in parallel.

Parallel Salam :	See *salam* – two contracts operated in parallel.
Praesentes :	Where the parties to the contract are present at time of agreement.
Qabd:	Possession.
Qard:	A non-interest bearing loan.
Qard al-Hassan:	A loan given for a good cause.
Qard/Hassan:	Interest free loan.
Qiyas:	Analogy.
Qiyas al-tard:	Extension of a legal rule from one case to another due to a material similarity.
Qur 'an:	The Holy Book revealed to the Prophet Mohammed.
Rahn:	Pledge.
Ratio decidendi:	Legal basis.
Ra'y:	Personal opinion.
Rem:	See in rem.
Riba:	Interest/usury.
Riba al-fadl:	Interest by an excess of counter values.
Riba al-nasiah:	Interest by deferment in the delivery.
Ribawi:	Usurious or interest based.
Rub ul-maal:	A person who invests in *Mudaraba.*
Rushd:	Prudence.
Sadd al-dharai':	Blocking the means.
Sahm:	A share.
Salam:	*Shariah*- complaint forward contract.
Sanadat al-dayn:	Certificates of debt.
Shafi'i:	Particular school of law.
Shari 'ah:	Sacred law revealed by God almighty.
Shariah:	The principle from the Koran and Sunnah to guide Muslims in the good conduct of their lives and for the good of the community as a whole.
Sharikat al-'aqd:	A partnership created through contract as opposed to co-ownership that may be the result of, for instance, a joint purchase.
Sharikat al-jabr:	Mandatory co-ownership arising by operation of law, like inheritance.
Sharikat al-melk:	Co-ownership that may be the result, for instance, of a joint purchase.
Shirkah:	Partnership.
Sukuk:	Certificate of investment.
Sukuk al-ijarah:	Certificates of investments of leased assets.
Sunna:	The traditions of the prophet Mohammed.
Ta' awun:	Cooperation.
Tabarru:	Donation contracts.
Takaful:	Islamic insurance.

Takharuj:	Exit from partnership by selling the shares to another party.
Tanazul:	An act to waive certain rights of claim in favour of another party in a contract. In Islamic finance, it is applied where the right to share some portion of profits is given to another.
Tawarruq:	Buy spot and sell deferred payment or vice versa to facilitate cash liquidity.
Taskeek:	Securitisation.
Thimma:	The capacity to accept obligations and duties.
Tijaarah:	Trade. Act of buying and selling.
Tijarah:	Private commercial transactions.
Ujrah:	Fee.
Ulama:	*Shariah* scholars.
Ummah:	The Islamic nation.
Umum balwa:	Common plight and difficult to avoid.
'Urbun:	Is essentially a down payment made by a buyer to a seller after both parties have entered into a valid contract. The down payment represents the commitment to purchase the goods. If the buyer is able or decides to pay the remaining outstanding payment during a prescribed period, the amount paid as down payment will be counted as part of the purchase price. Otherwise, the down payment will be forfeited by the seller.
'Urf:	Customary practice.
Usufruct:	The right of use.
Usul al-fiqh:	Islamic legal theory providing principles and guidelines on interpretation.
Wa'd:	Promise; used in the context of purchase undertakings and sale undertakings.
Wadiah:	Sales custody.
Wadiah yed dhamanah:	Guaranteed safe-custody deposit contracts.
Wajib:	Compulsory.
Wakala:	Agency.
Wakalah:	Is a contract between an agent and principal. This contract enables the agent to render services and be paid a fee *(ujrah)*.
Wakil:	Agent.
Waqf:	Permanent endowment.
Wasiyyah:	Will contract.
Zahiris:	Literalists.







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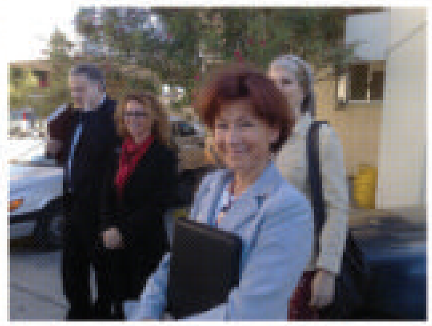

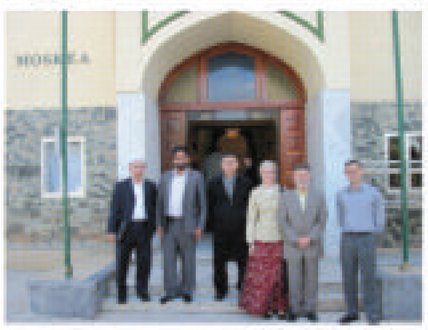
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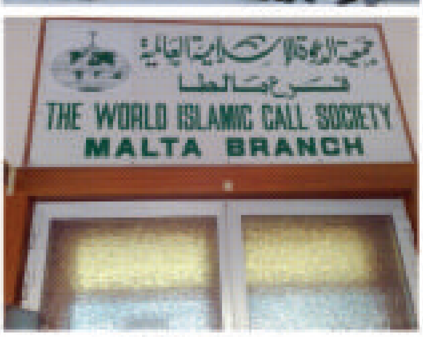
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