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The Price of Piety in Islam

By MARLA DICKERSON

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TIMES STAFF WRITER

When the creators of IslamiCity decided to upgrade their Islamic information Web site, they knew they would need a top-notch server and other computer equipment costing \$10,000.

They also needed an equipment loan, but there was one major hitch. Islamic teaching forbids Muslims from involvement in conventional credit, the interest-based fuel that powers international finance and stokes America's consumer economy.

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Instead, the organization purchased the equipment through a lease-to-own arrangement with American Finance House, a Pasadena-based finance company specializing in transactions conforming to Islamic religious law. In the process, Aleem joined a global legion of Muslim entrepreneurs, consumers, investors and even a few non-Muslims who are reviving the ancient tradition of interest-free Islamic banking.

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With assets estimated to be nearing \$150 billion in Muslim countries, the religious-based system is gaining a toehold in the United States, where a few institutions such as American Finance House are catering to the fast-growing Muslim population.

“Muslims want cars and homes and businesses like everyone else,” said Abdullah Tug, chief financial officer and general manager of the company. “They want to do it in keeping with their religious principles.”

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Religious scholars say the ban was a response to the age-old practice of loan sharking. But in a modern society, it prevents observant Muslims from taking out mortgages, carrying balances on credit cards or investing in bonds, Treasury bills or any other instrument that smacks of a guaranteed return.

Which isn't to say that Islam frowns on making money or demands that Muslims revert to an all-cash or barter economy. What's essential is that all parties to a financial transaction share in the actual profit or loss of a venture, and that no one gets predetermined compensation--i.e., interest--going in, according to Samuel Hayes, a Harvard Business School professor and expert on Islamic finance.

In effect, the system functions much like Western equity financing while protecting borrowers from leveraging themselves into the poorhouse.

"In the Koran and the teachings of the Prophet Muhammad, it has always been understood that [investors and lenders] have the right to a decent rate of return," said Hayes, co-author of "Islamic Law and Finance: Religion, Risk and Return." "It's just the certainty of that return that's an issue. You can't put yourself in a superior position to everyone else. . . . So Muslims developed their own unique debt contracts."

Thus, "depositors" in Islamic banks are really shareholders who earn dividends when the bank turns a profit, or who lose a portion of their savings if it posts a loss. Paying rent for the use of a real asset is perfectly acceptable under Islamic law. So business owners can lease equipment through contracts called *iiara*. while would-be homeowners can acquire houses th

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Islamic finance, a touchstone of Muslim life for 14 centuries, withered under colonial rule as Muslim countries bowed to Western laws and business practices. But the system has made a dramatic comeback in the last 20 years, fueled by independence, revolution, oil wealth and Islam's emergence as the world's fastest-growing religion, with more than 1 billion followers worldwide.

Resource guides list more than 100 Islamic financial institutions operating in more than 30 countries around the globe. Islamic banks, which employ religious scholars to ensure that all procedures conform with religious law, boast combined assets approaching \$150 billion with a growth rate topping 15% a year, according to Hayes.

Most of that action is centered in the Middle East and parts of Asia, where even U.S. banks such as Citicorp have opened Islamic units. At present, only about a dozen companies serve the U.S. market, home to several million Muslims. Financial industry watchers say it's a segment poised for expansion as America's Muslim population continues to surge.

"It's going nowhere but up," said Mustafa Kamal, executive vice president of MSI Financial Services, a Houston-based Islamic finance company. "This market is too important to ignore."

With few Islamic institutions to serve them, some American Muslims have formed informal, no-interest loan pools in their communities to help members buy houses, purchase cars or start businesses. Others simply do without these essentials until they can save up enough money to pay c

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But many American Muslims are uncomfortable with this compromise, including Yahia Khairy Abdul-Rahman, an advisor to American Finance House.

An imam at Masjid Omar Ibn Al-Khattab mosque in Los Angeles, Abdul-Rahman helped found the Islamic finance company in 1987. He was still stinging from an experience more than a decade earlier when he and fellow Dallas Muslims wanted to build a mosque to accommodate that community's burgeoning Muslim population. Should they continue to worship in makeshift quarters, passing the hat for years on end to raise all the funds from private hands? Or was a mosque one of those necessities that make borrowing an imperative?

"In the end, we borrowed some money from a bank, and I took a lot of criticism for it," Abdul-Rahman said. "So I took it upon myself to learn all I could about Islamic finance."

American Finance House, started with \$200,000 in seed capital from local Muslim investors, offers home and commercial real estate loans, auto financing, equipment leases and trade financing. The walls of the small but comfortable Pasadena office are adorned with verses of the Koran, the delicate Arabic script a firm reminder that "Allah permitteth trading and forbiddeth riba," or usury. With a tiny \$5-million portfolio, the firm is still a virtual unknown outside local Muslim circles. But company officials say they won't compromise standards to place more loans or deliver higher returns to investors.

For Suvanee Ibranan, that meant s

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However, borrowers don't necessarily have to be religious--or even Muslim--to borrow money.

Pasadena accountant Fred Figueroa discovered American Finance House because his office is situated in the same building. He was in need of new computers, and he found the Islamic purchase lease to be competitively priced. He has since recommended the firm to other non-Muslims. He says he got the same tax benefits as with a conventional lease but was struck by the personal attention that came with the transaction.

"It didn't matter that I wasn't Muslim. . . . They got to know me and took an interest in my business," said Figueroa, head of Figueroa & Co. tax and bookkeeping service. "It's kind of like banking used to be."

Muslim Investors Gaining Sophistication

Islamic banking isn't without its critics, most of whom are Muslims wary of financial institutions using religion as a marketing tool. Some view the "fees," "markups" and "profit-sharing" of Islamic transactions as a thinly veiled subterfuge for interest.

And religious ethics of the system notwithstanding, Muslim consumers have been hurt in the past. According to Hayes, Egyptian investors sustained huge losses in the 1970s at the hands of fraudulent "Islamic" investment companies.

The 1991 closure of the Bank of Cre

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Muslim customers.

As a result, “the Muslim market is a hard nut to crack,” said Bashir G. Ahmed, president and chief executive of Samad Group Inc., a Dayton, Ohio-based Islamic investment company. “They want to see a track record. . . . The industry also has to keep developing new products and instruments if it’s going to grow.”

Among the most promising areas is the realm of retirement savings, in which municipal bonds, T-bills, Savings Bonds and other interest-bearing stalwarts are off-limits to observant Muslims.

Equities are permissible. But how to know which stocks are halal, or lawful? Enter Bellingham, Wash.-based Amana Mutual Funds. In a religious twist on the concept of socially responsible investing, these stock mutual funds are geared toward Islamic investors who want competitive returns while adhering to religious law.

For fund manager Nicholas Kaiser, that means steering clear of the obvious, such as brewery, casino and sausage company shares. But the bank’s religious advisors also prohibit investments in companies that are highly leveraged. Nor will they allow the funds to purchase any preferred shares of stock, whose regular dividends are deemed to be too much of a sure thing and therefore a little too much like interest.

“We spend a lot of time talking about issues like that,” said Kaiser, president of Saturna Capital Corp., which manages the Amana Funds. “Our advisors are very conservative.”

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About 45 Islamic mutual funds have cropped up worldwide in recent years, reflecting the growing appetite for such investments among Muslims. Many of these investors are as discerning as they are religious. Thus, Dow Jones & Co. in February unveiled its Islamic Market Index.

It tracks 600 companies whose activities are in harmony with Islamic law, providing a benchmark to measure the performance of Islamic mutual funds. Non-Muslims might be surprised to find such well-known names as Microsoft, Intel and Gillette in the mix. But it only underscores the growing sophistication of Islamic investors, says Rushdi Siddiqui, director of the Islamic Index Group for Dow Jones.

“Muslims want compliance [with religious law] plus performance,” Siddiqui said. “They read the financial pages.”

Muslims also read the real estate section, which is why Islamic finance advocates have been trying to perfect a mortgage that meets both religious and market standards.

One of the pioneers is MSI Financial Services. Under its system, a home buyer enters into a partnership agreement with the company to buy a home. The buyer puts down at least 20% of the cost, with MSI contributing the remainder. The buyer then leases MSI’s portion of the house in a rent-to-own transaction that lets the buyer build equity in the home. Unlike a conventional mortgage, these rental payments can move up or down from year to year to reflect actual market conditions. If the buyer decides to sell before the house is paid off,

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New Choices in Home Mortgages

Now the \$3-billion United Bank of Kuwait (UBK) is set to make a push into the U.S. market. Through its U.S. operation in New York, the bank is rolling out a home-buying product called Manzil USA; manzil is Arabic for “home” or “dwelling place of the soul.”

Based on an Islamic concept called ijara wa iqtina, or “lease to purchase,” the Manzil USA program will offer features similar to conventional mortgages, including 30-year terms and 20% down payments. The product is scheduled for an April launch in California, where UBK is now organizing home-buying seminars.

UBK officials say the Internal Revenue Service is reviewing whether the “imputed interest” of such mortgages would be tax-deductible for Manzil USA borrowers. Either way, the option could prove a welcome one for would-be home buyers such as Masoud Nassimi of Redondo Beach.

The 35-year-old Caltrans engineer says he’d love to purchase a home for his wife and two young children, not to mention build some equity for retirement. But he lacks the savings to pay all cash in an area in which the price for a three-bedroom home can easily top \$400,000. As a devout Muslim, he refuses to take out a mortgage because of Islam’s stricture against interest. So he continues renting as he has done for the last 11 years.

“Who wouldn’t want to own a house?” Nassimi says. “If I find a lawful option, I’ll buy one tomorrow.”

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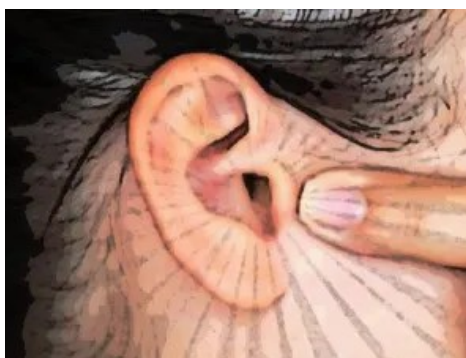
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