

ISLAMIC FINANCE IN AUSTRALIA: HISTORY AND DEVELOPMENT

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ABSTRACT

Over the past four decades or so, Islamic Finance has made impressive strides. As of 2012, it was reported that USD1.6 trillion of Islamic Finance assets were managed in *Shariah*-compliant accounts around the world. An additional substantial sum is represented by *Sukuk*, or Islamic bonds. Notably too, the development of Islamic Finance is not limited to Islamic countries, Global institutions such as HSBC, JP Morgan and others, have begun to offer *Shariah*-compliant financial services through their worldwide networks. The approach of the study is not supplemented by any empirical work. The method employed in this study is a mixture of direct observation from the legal and regulatory perspectives, literature reviews and the authors' personal experience and association with this industry. Through examining the above, this paper shall discuss the history, development and current issues of Islamic Finance in Australia.

Keywords: Islamic Finance, *Shariah*, Australia

INTRODUCTION

Islamic finance is defined as a financial service principally implemented to comply with the main tenets of *Shariah* or Islamic law. Over the past four decades or so, Islamic Finance has made impressive strides. The Islamic Financial Service Board estimates the Islamic Financial services industry's assets to be worth at USD1.6 trillion as of 31 December 2012 (IFN Alerts 2013). An additional substantial sum is represented by *Sukuk*, or Islamic bonds. Notably too, the development of Islamic Finance is not limited to Islamic countries, Global institutions such as HSBC, JP Morgan and others, have begun to offer *Shariah*-compliant financial services through their worldwide networks. Australia's Muslim population is increasing at a rapid pace, and based on the requirement of *Shariah*, one would expect an increase in demand for Islamic financial products. This paper will provide some brief introduction of Islamic finance plus explanation on the theoretical framework and key principles on which it was established. The current development and issues relating to Islamic finance in Australia will also be discussed.

ISLAMIC FINANCE IN THE MODERN ERA

Looking at history, Islamic finance in the modern era began some 40 years ago. Since then, it has achieved impressive results and made inroads into the conventional financial system. Though initially concentrated in the Middle East (especially Bahrain) and South-East Asia (particularly Malaysia), Islamic finance principles are now increasingly

found elsewhere. This includes developing economies where the financial sector is almost entirely Islamic (such as Iran and Sudan) or where Islamic and ‘conventional’ financial systems coexist (including Indonesia, Malaysia, Pakistan and the United Arab Emirates) (Gait & Worthington 2007). It also includes developed economies where a small number of Islamic financial institutions have been established and where large conventional banks have opened Islamic financing windows (such as in Europe and the United States) (Archer & Karim 2007).

Before the re-emergence of the Islamic financial system, Muslims throughout the world had only the conventional financial system to fulfil their financial needs. The Islamic resurgence in the late 1960s and 1970s initiated the call for a financial system that allowed Muslims to transact in a system that is in line with their religious beliefs. The Islamic Financial system involves a social implication which is necessarily connected with the Islamic order itself and represents a special characteristic that distinguishes Islamic financial institutions from other financial institutions based on other philosophies.

In exercising all its financial or developmental activities, the Islamic Financial Institutions (“IFIs”) takes into prime consideration the social implications that may be brought by any decision or action taken by the IFIs. Profitability, despite its importance and priority, is not the sole criterion or the prime element in evaluating the performance of IFIs, since they have to match both the material and social objectives that would serve the interests of the community as a whole and help achieve their role in the sphere of social mutual guarantee (Saleem 2012). Social goals are understood to form an inseparable element of the Islamic financial system that cannot be dispensed with or neglected.

THEORETICAL FRAMEWORK OF ISLAMIC FINANCE

Figure 1 below illustrates the Islamic view of life of a Muslim and the place of his economic activities including banking and financial activities within the framework of such a view.

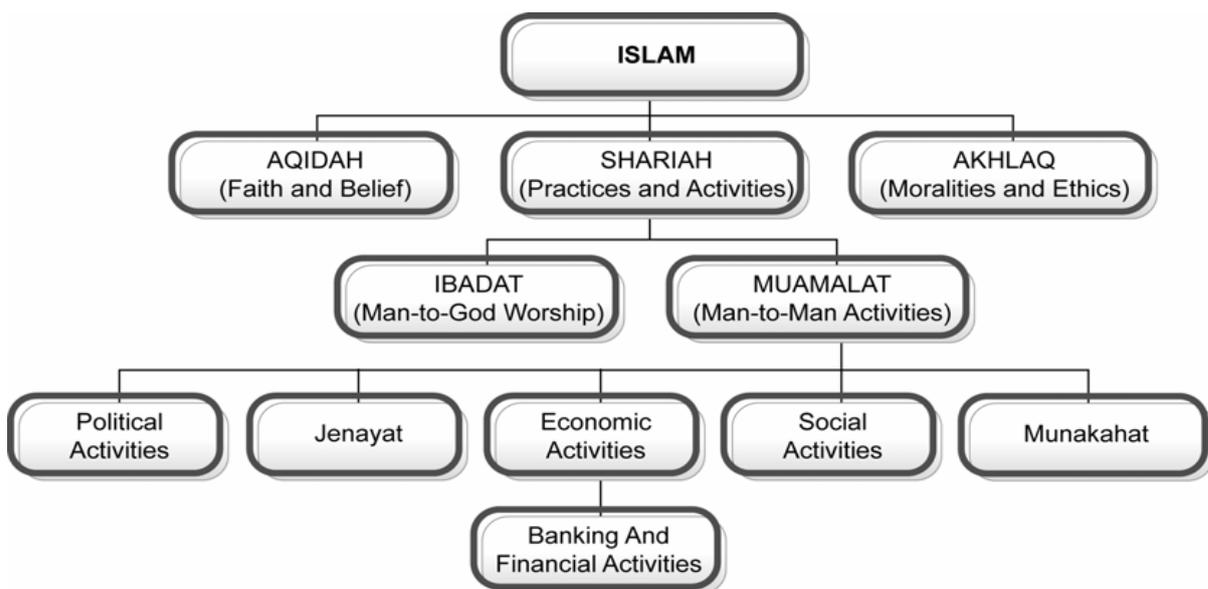


Figure 1. Theoretical Framework for Islamic finance and banking.

As shown above, Islam may be perceived as comprising three basic elements. The elements are:

- a) *Aqidah* - This element is concerned with all forms of faith and belief of a Muslim in Allah (God) and His will, from the fundamental faith in His being to the ordinary belief in His individual commands.
- b) *Shariah* - This element is concerned with all forms of practical actions by a Muslim manifesting his faith and belief. *Shariah*, being the practical aspect of a Muslim's daily life, is divided into two:
 - (i) *Ibadat* - Concerned with the practicalities of a Muslim's worship of God, in the context of man-to-Allah relationship.
 - (ii) *Muamalat* - Concerned with the practicalities of various forms of man-to-man relationships.
- c) *Akhlaq* - This element is concerned with behaviour, attitude and work ethics with which a Muslim performs his practical actions.

A significant segment of *Muamalat* is the conduct of a Muslim's economic activities within the economic system. Within this economic system is the banking and financial system where he conducts his banking and financial activities. Thus, in the Islamic scheme of life and *Shariah* framework, a Muslim's banking and financial activities can be traced to his economic activities, to *Muamalat*, to *Shariah*, to Islam and finally, to God. This is the root of Islamic finance and banking.

SHARIAH COMPLIANCE

Shariah means path or way and represents the sacred laws of Islam. It is God's law according to all Muslim beliefs and cultures. *Shariah* rules and guides an individual's private and personal matters such as religion, hygiene, diet, dress code, and family life, as well as the general matters of community and society such as politics, crime, financial, and economic issues (Crawford et al. 2010; Thani et al. 2010). Within the Islamic scheme of life and *Shariah* framework, Islam imposes its '*ahkam*' (laws) or in modern terminology, sometimes referred to as norms or values, on its believers. These laws or values are not man-made, instead they are ordained by God. These laws are derived from the sources of *Shariah*. The main sources of *Shariah* are the *Al-Quran*, *Hadith*, *Sunna*, *Ijma*, *Qiyas* and *Ijtihad*.

The *Al-Quran* is the book of revelation given to the Prophet Muhammad (Peace and Blessing of Allah be upon him); *Hadith* is the narrative relating the deeds and utterances of Prophet Muhammad (pbAuh) ; *Sunna* refers to the habitual practice and behaviour of Prophet Muhammad (pbAuh) during his lifetime; *Ijma* is the consensus among religion scholars about specific issues not envisaged in either the *Holy Quran* or the *Sunna*; *Qiyas* is the use of deduction by analogy to provide an opinion on a case not referred to in the *Quran* or the *Sunna* in comparison with another case referred to in the *Quran* and the *Sunna*; and *Ijtihad* represents a jurists' independent reasoning relating to the applicability of certain *Shariah* rules on cases not mentioned in either the *Quran* or the *Sunna* (Hussain 2011). These laws as derived from the primary sources are arranged into the following scheme of five levels (refer Figure 2).

- a) *Fard* or *Wajib* (Compulsory)

Compulsory duties and acts to be performed by all Muslims. The omission of which is punishable.

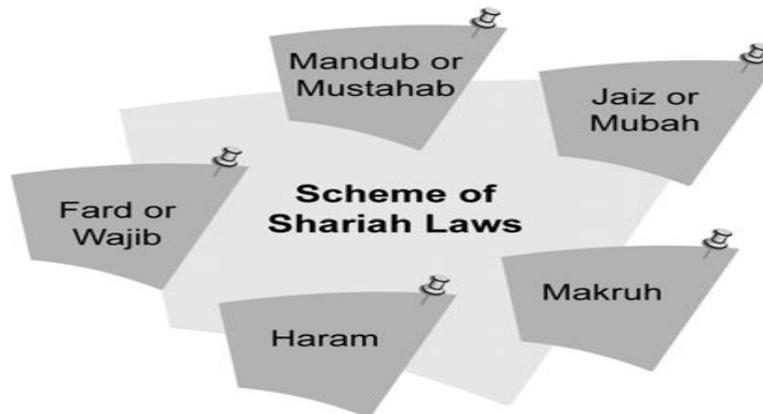


Figure 2. Scheme of shariah laws.

- b) *Mandub* or *Mustahab* (Desirable)
An action which is rewarded but the omission is not punishable.
- c) *Jaiz* or *Mubah* (Permissible)
An action if were performed or omitted is neither rewarded nor punishable.
- d) *Makruh* (Disapproved)
An action which is disliked yet not punishable, but the omission is rewarded.
- e) *Haram* (Forbidden)
An action under which is absolutely forbidden and punishable.

As a matter of fundamental principle, *shariah* law forbids any practices that are considered unfair and exploitative, and it promotes and encourages the welfare of the population (Crawford et al. 2010). *Shariah* provides sufficient tools of finance to meet all the lawful needs of man for commercial and investment transactions. These tools are based on the maxim of *al-Ghanam bil-gharm*. *Al-Ghanam*, in this context, means economic gain, profit and yield, whereas *Al-Gharm* refers to loss, risk and liability. The principle, therefore, connotes that no person is allowed to invest in a way that generates profit without exposing himself to the risk of loss rather it exposes both parties to the outcome of their deal whether it is a profit or a loss (Rosly 2005).

Islamic instruments of finance are indeed, just and fair in that they do not take-side with any of the contracting parties to the disadvantage of the other (El-Gamal 2002; Schoon 2008; Thani et al. 2010). Nevertheless, *Shariah* encourages all parties to take every precautionary measure to procure their due profit, avert and/or minimise loss. Such human effort can be done through collection of adequate and relevant data, appropriate analysis of information and use of a man's experience.

THE PRINCIPLES OF ISLAM IN CONTRACTS AND FINANCE

The Quran sets out principles of equity, justice, fairness, morality and social welfare, among others, as preferable underpinnings of any human society. It was explained in the Quran through surah *Al-Hadid* 57:30, *Al-Baqarah* 2:30, *Al-Ahzab*:72 and *Sad* 38:26,

that Allah (God) creates and owns everything and human beings therefore hold wealth on *amanah* (Trust) for God to be spent and dealt with accordingly. The beneficiary of such wealth, held by any human being, is the collective community of humans whose interest must be served in spending or dealing with money. Contractual dealings, whilst governed primarily by the principle of permissibility and recognising the freedom of the individual to contract freely (see Quran - surah *Al-Maidah* 5:1 and surah *An-Nisa* 4:29), was nonetheless to operate within the ambit of fairness as between the parties and social justice.

In general, it is accepted that in all matters (*muamalat*) other than faith (*ibadat*) the operating principle is that of permissibility (*ibaha*) unless there is a clear text in the primary sources to the contrary (Mansuri 2006b). The principle of permissibility does not operate in a vacuum but rather goes back, and is linked, to the notion of human beings as trustees or stewards of God's wealth/creation on earth. Permissibility is therefore tempered by rules enunciated in the Quran which indicate, broadly, the extent to which contracting parties are free in deciding their terms and conditions (Saleh 1992). Chief among these rules are that any given transaction should be devoid of *riba* or *gharar* (Mansuri 2006), both of which shall be discussed later in this paper.

In summary, fairness and the upholding of social justice in a contract, and permissibility are the main principles. These two principles provide a platform from which Islamic finance is to be applied in compliance with the objectives (*maqasid*) of the *Shariah*. Among the objectives of the sharia is the creation of ease (*maslaha*), both in this world and the hereafter (i.e. the material and spiritual spheres of existence), which is derived from the concept of *taysir* (making things easy) and relates closely to the concept of *raf' al haraj* (the removal of hardship) (Bakar 2008; Hunt-Ahmed 2013).

SPECIFIC RULES OF THE SHARIAH GOVERNING CONTRACT AND FINANCE IN ISLAM

The specific rules of the *Shariah* governing contracts and finance whose parameters define the scope and nature of Islamic finance are explained briefly below:

Prohibition of Riba (usury or interest)

The basic tenets of Islamic Finance are clearly set out in the following two verses from the Quran:

“Those who eat Riba will not stand (on the day of Resurrection) except like the standing of a person beaten by Shaitan (satan) leading him to insanity. That is because they say: Trading is like Riba,” whereas Allah has permitted trading and forbidden Riba. So whoever receives an admonition from his Lord and stops eating Riba, shall not be punished for the past; his case is for Allah (to judge); but whoever returns (to Riba), such are the dwellers of the fire – they will abide therein forever.” *Surah Al-Baqara 2:275 (Khan & Al-Hilali 2001).*

“Allah will destroy Riba and give increase for Sadaqat (deeds of charity, alms). And Allah likes not the disbelievers, sinners.” *Surah Al-Baqara 2:276 (Khan & Al-Hilali 2001).*

Islam prohibits *riba* as practised in conventional finance and banking operations. Prohibition of *riba*, a term literally meaning “an excess” and interpreted as “any unjustifiable increase of capital, whether in loans or sales,” is the central tenet of the Islamic financial system. More precisely, any positive, fixed, predetermined rate tied to the maturity and the amount of principal (that is, guaranteed regardless of the performance of the investment) is considered *riba* and is prohibited (Iqbal & Mirakhor 2011). The general consensus among Islamic scholars is that *riba* covers not only usury but also the charging of “interest” as widely practiced (Iqbal & Mirakhor 2011). A direct implication of the prohibition of interest is that pure debt securities with predetermined interest rates are also prohibited. This prohibition is based on arguments of social justice, equality, and property rights. Islam encourages the earning of profits but forbids the charging of interest because profits, determined ex post, symbolize successful entrepreneurship and the creation of additional wealth. By contrast, interest, determined ex ante, is a cost that is accrued irrespective of the outcome of business operations and may not create wealth if there are business losses (Askari et al. 2010).

Balala (2010) argue that *riba* is not so much a matter of interest on loans (dayn) than it is a matter of distinguishing unlawful gain from legitimate gain especially because the Quran does not use *riba* in reference to loans but in reference to the unjustified (illegitimately or illicitly) taking of others’ wealth, generally. The Quran’s distinction between bay’ and *riba* implies a distinction between a legitimate and non-legitimate transactions for purposes of drawing consideration or profit making. *Riba*, generally, pertains to the prohibition against eliciting illegitimate gains in any transaction, whether they are debt, sale, lease or a combination thereof in nature (Balala 2010). *Riba* is also seen to be an unfair practise that affects borrowers and lenders alike. Iqbal and Molyneux argue that the borrower must pay interest and repay the capital, as well as bearing any losses from the use of these funds (a form of ‘double charging’: that is, charging for both the funds and the use of the funds). In addition, *Riba* is also regarded as being unjust to the lender. This is because the real rate of interest may become negative if, say, the rate of inflation is higher than rate of interest. Therefore, lenders who wish to earn a profit from lending money could make a loss. Once again the loss incurred would be unrelated to the actual use of the funds (Iqbal & Molyneux 2005). In summary, *Shariah* are all out for serving the *Maslaha* or interest of man. It does not, therefore, prohibit things such as *riba*, merely for the sake of prohibition, but rather for the injurious effect it has on the *Maslaha*, be it personal and/or public.

Prohibition of *Gharar* (Uncertainty)

Gharar is often, and insufficiently, translated as uncertainty. It is much wider than uncertainty and encompasses speculation, excessive risk, ignorant and generally hints at consumer/investor protection (Balala 2010). *Gharar* can be any contract for sale or purchase that includes uncertainty in genus, species, quantity of the object, price, time of payment in deferred sales, existence of object, and identity of object. Although there is no explicit statement known in the *Quran* forbidding *Gharar*, it is well-accepted that it is forbidden. For example, the verse of the Quran from which the prohibition of *Gharar* is derived is surah *Al-Maidah* 5:90. It states: ‘O you who believe! Intoxicants (all kind of alcoholic drinks) and gambling, *Al-Ansab* (animals that are sacrificed in the name of idols on their altars) and *Al-Azlam* (arrows for seeking luck or decision), are abominations of Satan’s handiwork. So avoid (strictly all) that (abominations) in order that you may be successful’ (Khan & Al-Hilali 2001).

There are many *Hadiths* (traditions) banning *Gharar* sales narrated by Muslims. For instance, “Ahmad and Ibn Majah narrated on the authority of Abu-said Al-khudriy: The Prophet Muhammad (pbAuh) forbade the sale of a runaway slave or animal, the sale of a bird in the air or fish in the sea, the sale of what the vendor is not able to deliver, or the unborn when the mother is not part of the transaction and milk in the udder (Yahya & Mubarakpuri 2002). This statement has been given considerable weight by *Shariah* scholars and is interpreted as having three juristic consequences: (i) a *gharar* sale is prohibited, (ii) such prohibition is total and extends to all transactions that qualify as a ‘*gharar* sale’, and (iii) the effect of the prohibition is that a *gharar* sale is void (Balala 2010; Wan Ahmad 2008).

Iqbal and Molyneux (2005), suggest that “*Gharar* refers to acts and conditions in exchange contracts, the full implications of which are not clearly known to the parties. The existence of uncertainty in a contract is prohibited because it requires the occurrence of an event which may not ultimately occur. “Full disclosure” by both parties is the norm in contractual relationships. Any type of transaction where the (i) subject matter, (ii) the price, or both are not determined and fixed in advance amounts to “uncertainty”. As a concept, it is predicated on the principles of equity and efficiency in transactions (Choudhury 2011).

Prohibition of *Maysir* (Gambling/Speculation)

Maysir is regarded by most Islamic scholars as gambling or any games of chance (including lotteries, lotto, casino-type games and betting on the outcomes of animal races). Together, these share a desire for obtaining return through deliberate risk-taking. The high risk available in these types of transactions, some people win a large amount of money, but others suffer from a loss of their money, and sometimes face bankruptcy (Iqbal & Molyneux 2005). This could lead to greater financial and societal problems. In addition, these games and gambling are unnecessary for society because they cannot add any surplus to societal wealth.

Speculation is equivalent to gambling, and therefore is prohibited. This has essentially deterred many Islamic financial institutions from participating in derivative transactions. Speculative investments on the capital market in general are viewed suspiciously by *shariah* committees and avoided by financial institutions (Balala 2010). Caution must however be taken not to confuse risk with speculation. Risk taking is inevitable in commercial and investment transactions (the basis for making a profit/increased returns) (Askari et al. 2012). Speculation may on the other hand be viewed as excessive and/or avoidable risk taking.

Risk Sharing

Social justice demands that borrowers and lenders share rewards as well as losses in an equitable fashion and that the process of wealth accumulation and distribution in the economy be fair and representative of true productivity. Because interest is prohibited, pure debt security is eliminated from the system and therefore suppliers of funds become investors, rather than creditors. The provider of financial capital and the entrepreneur share business risks in return for shares of the profits and losses (Askari et al. 2012). Moreover, it is one of the objectives of *Shariah* that wealth should benefit not only its owner, but also the other contracting party and the society as a whole (Salem 2012).

Prohibited transactions or investments

Islamic financial institutions cannot provide finance for an activity which is prohibited by *Shariah* irrespective of its profitability and economic viability. These transactions are involving prohibited elements such as pork, alcohol, armaments, activity involving speculation, gambling and any sort of immorality. By extension, Islamic institutions may have reservations about (and refrain from) investments involving businesses such as hotels and the entertainment industry (where alcohol and pork may be served and gambling may take place) (Balala 2010; Tuma 2007). The aim of *Shariah* in this regard is to promote 'ethical' investments that again do not affect people and society adversely through the violation of religious prohibitions.

Financial assets

Money and financial assets in general are deemed merely media of exchange, not commodities that can be traded in (i.e. they are not deemed property). The sale of currency is therefore prohibited (both as a medium of exchange and/or a highly speculative investment) while the sale (through securitisation, restructuring or otherwise) of any debt remains largely doubtful in legality due to the scholastic consideration of debt as money (Balala 2010; Schoon 2008). Money is treated as "potential" capital – that is, it becomes actual capital only when it is joined with other resources in undertaking a productive activity. Islam recognized the time value of money but only when it acts as capital, not when it is "potential" capital (Askari et al. 2010).

Sanctity of contracts

Islam upholds contractual obligations and the disclosure of information as a sacred duty. This feature is intended to reduce the risk of asymmetric information and moral hazard (Askari et al. 2010).

Social justice

In principle, any transaction leading to injustice and exploitation is prohibited. A financial transaction should not lead to the exploitation of any party to the transaction. Exploitation entails the absence of information symmetry between parties to a contract (Askari et al. 2012). Based on the above backdrop, Islamic finance emphasises a close link between financial transaction and real economic activities. Islamic Finance, thus, is not only considered as a feasible and viable alternative for the conventional financial system but also a more efficient, productive and equitable way of financial intermediation (Khan 2010; Obaidullah & Latiff 2008).

INTRODUCTION TO ISLAMIC FINANCE METHODS

Islamic finance institutions (IFI) have developed a wide range of methods and/or techniques which allow them to uphold the religious and legal principles while enabling them, at the same time, to offer viable financial products. The search is actually still going on to find newer, and for variations based upon the existing ones to offer more attractive and useful instruments for the investors. The following list covers many of

them, but it is not considered as exhaustive (Ahmad et al. 2010; Hussain 2010; Karim 2010; Yahya et al. 2012):

- **Murabaha:** A form of asset financing where an IFI purchases an asset and then sells it to its client at a higher price (mark-up sale) with deferred payment terms. The interest that would ordinarily be paid by the client in a conventional loan – and which would constitute the bank’s profit - is replaced by the difference between the purchase price and the sale price;
- **Mudaraba:** A form of limited partnership where an investor (the silent partner) gives money to an entrepreneur for investing in a commercial enterprise. The profits generated by the investment are shared between the partners in a predetermined ratio. The losses are borne only by the investor;
- **Musharaka:** Unlike a Mudaraba transaction, both partners in Musharaka must contribute capital to the partnership. Both partners and/ or one of them may manage the venture or alternatively both may appoint a third party manager to manage the investment. While profits may be shared in a pre-determined ratio, losses are shared in proportion to the capital contributed;
- **Ijara:** Similar to a hire-purchase, IFI purchases the asset and allows the customer to use it for an agreed period and for an agreed rent;
- **Sukuk:** Shariah-compliant financial certificates of investment that are similar to asset-backed bonds; and
- **Takaful:** Similar to a mutual insurance arrangement, a group of individuals pay money into a Takaful fund, which is then used to cover payouts to members of the group when a claim is made.

HISTORY AND DEVELOPMENT OF ISLAMIC FINANCE IN AUSTRALIA

In Australia, there are 20 locally owned Banks, 8 foreign subsidiary Banks and 40 branches of foreign Banks (APRA 2013). However, none of these Banks or any of the high street banks offered Islamic finance even though some of the foreign banks do provide Islamic finance facilities elsewhere. Australia’s experience with Islamic financing has been relatively recent. The first attempt to introduce Islamic financing products in Australia was made by the Muslim Community Co-operative Australia (MCCA) (Ahmad et al. 2010). The organization began in 1989 with AU\$22,300 worth of seeding capital and by 2003, MCCA had 5,600 members and deposits worth AU\$24 million (Faruq & Rafique 2009). Majority of the MCCA members are from Melbourne and Sydney where the organization has a physical presence. Apart from MCCA, there is another two organisations that offers Islamic finance facilities: Islamic Co-operative Finance Australia Limited (‘ICFAL’) and Iskan Finance. In terms of Islamic fund management, there exists Crescent Investments and LM Investment Ltd (Farrar 2011). However, the expansion and growth of Islamic finance in Australia has been slow due to various reasons, for example lack of regulatory support and policy framework.

In July 2003 the *Weekend Australian* reported that the then Prime Minister John Howard had endorsed a shared partnership scheme between home buyers and banks which was very similar to schemes already being used by Islamic financial institutions (Faruq & Rafique 2009). In addition, a report published in *The Australian* on October 20, 2006 disclosed that National Australia Bank (NAB) will look at introducing Islamic financing into its product range to capture an “untapped” market that could be worth millions of dollars. It also declared offering a \$25,000 post-graduate scholarship to a

member of the Muslim community for the year 2007 to further NAB's understanding of Islamic banking (Kerbaj 2006).

The Australian Government also committed to support the introduction of Islamic finance. In the opening speech by the then Assistant Treasurer of Australia while launching a book entitled "*Demystifying Islamic Finance – Correcting Misconceptions, Advancing Value Propositions*" in May 2010:

'We are taking a keen interest in ensuring there are no impediments to the development of Islamic finance in this country, to allow market forces to operate freely. This is in line with our commitment to foster an open and competitive financial system and a socially inclusive environment for all Australians. We also recognise that Islamic Finance has great potential for creating jobs and wealth' (Hussain 2010).

Recent developments in the field of Islamic finance have led to renewed interest in Australia as suggested by the sequence of events elaborated above.

Muslims in Australia

Muslim in Australia is a minority religious group. According to Census 2011, 476,300 people or 2.25% of the total Australian population were Muslims. This made Islam the fourth largest religious grouping, after all forms of Christianity (64%), no religion (22.9%) and Buddhism (2.5%) (ABS 2011). The Australian Muslim community is drawn from more than 70 different countries, is ethnically and linguistically diverse, and geographically scattered (DFAT 2008). There are indications that even earlier Muslim Arab explorations took place off northern Australia. The map of the Sea of Java of Muhammad ibn Musa al-Khwarizmi 820 CE shows, Cape York Peninsular, a "V" shaped Gulf of Carpentaria and a curved Arnhem Land. A later map by Abu Isak Al-Farisi Istakhari 934 CE, also includes an outline of the northern coast of Australia (Tames 1999).

The first regular Muslim contacts with Australia were made by the people of Makassar from Indonesia who had converted to Islam in the early 1600s. They traded with the Aboriginal people living along the northern coast from about 1650 until the early 1900s and influenced their language and culture. A few Muslim free settlers and some Muslim sailors arrived in the early years of settlement but little is known of them. The most significant early arrivals were the 'Afghan' cameleers who from 1860 to 1939 took part in expeditions to explore the interior. They were also involved in survey, construction and carrier work for the Overland Telegraph Line from 1870 to 1872, supplied the goldfields and provided an essential transport and communications network throughout Australia until they were superseded by rail, road and air services (Tames 1999).

Awareness of Islamic Finance in Australia

Empirical research on attitudes towards Islamic finance and banking has been limited globally. In Australia, only two known studies have been carried out to date (Farrar 2011) and only one on individual customers' attitudes, by Rammal and Zurbruegg. Their research was carried out in Adelaide in June 2004 and showed genuine interest amongst practising Muslims in the idea of Islamic banking products – but a lack of familiarity with Islamic brands and understanding of Islamic principles of financing

(Rammal & Zurbruegg 2007). The other study by Jalaluddin in 1999 surveyed the attitudes towards profit and loss finance methods of 385 small businesses and 80 financial Institutions in Sydney. He noted that 60 per cent of his small business respondents (the majority of whom were non-Muslim) expressed an interest in profit and loss (ie, *mudārabah*) financial arrangements and more than 40 per cent of the financial institutions were prepared to lend on that basis (Jalaluddin 1999) .

The latter study suggests policy makers should look beyond the actual numbers of the Muslim population when determining the potential market; Islamic finance is not just for Muslims. Evidence from Malaysia indicates a substantial take-up from non-Muslims attracted by the fair terms and quality of Islamic finance products (Venardos 2006). As such, it is imperative that additional steps to introduce Islamic finance in Australia to be taken so as to increase awareness and disseminate the correct information to the public.

Legal and Regulatory Framework

An appropriate legal and regulatory framework is a basic requirement for establishing and operating a sound financial institutions and markets. Similar to the Common law and Civil law systems the *Shariah* offers its own framework for the implementation of commercial and financial contracts and transactions (Ahmad 2008). However, not many countries have the appropriate financial, commercial and company laws to facilitate the implementation of Islamic finance and financial contracts. For example, in most countries, many Islamic banking and financial contracts are treated as buying and selling properties and hence are taxed twice. In some countries like the UK and Singapore, double stamp duty on some Islamic home finance schemes has been abolished so as to provide tax neutrality (Ahmad et al. 2010).

In Malaysia, the Stamp Act 1949 has been amended to cater for the Islamic finance in line with the government's policy to ensure tax neutrality between Islamic and conventional financing products (Thani et al. 2010). The additional instruments that are required to be executed in accordance with the Islamic principles have been given stamp duty exemption so that the stamp duty on the Islamic financing product is similar to that of the conventional product.

Section 35 of the Stamp Act 1949 provides the following:

The instruments appearing under the heading of "General Exemptions" in the First schedule shall not be chargeable with duty.

"General Exemptions" in the First Schedule include:

6. An instrument executed pursuant to a scheme of financing approved by the Central Bank, the Labuan Offshore Financial Services Authority or the Securities Commission as a scheme which is in accordance with the principles of *Shariah*, where such instrument is an additional instrument strictly required for the purpose of compliance with those principles but which will not be required for any other scheme of financing.

Conventional financial laws also narrow the scope of activities of Islamic financial institutions within conventional limits. In the absence of Islamic finance and banking laws, the enforcement of agreements in courts may require extra efforts and costs. Therefore, banking and company laws in several countries require suitable

modifications to provide a level playing field for Islamic financial institutions (Ahmad 2004). Furthermore, international acceptance of Islamic financial contracts requires them to be *Shariah*-compatible as well as acceptable under the major legal regimes such as the Common law and Civil law systems.

Like many Western economies, Australia utilises a combination of market and government mechanisms to regulate the banking and finance industries. Government involvement operates to prevent market failure and also to facilitate efficient running of the markets. Australia uses three government regulatory agencies at the federal level:

1. Australian Prudential Regulation Authority ('APRA');
APRA enforces prudential legislation and is in charged specifically with protecting the interests of depositors, insurance policy holders and superannuation fund members (APRA 2003). Islamic deposit-taking institutions, such as banks and cooperatives, and those running *Takaful* (Islamic insurance) operations, therefore, would have to deal with APRA. Under the *Banking Act 1959* (Government 2003), APRA can exert a significant degree of supervisory control through insertion of conditions requiring the holder of a licence to comply with any of its inquiries or directives.
2. Australian Securities and Investment Commission ('ASIC')
ASIC supervise matters that fall outside the jurisdiction of APRA, for example supervision in the area of financial securities, financial instruments and stock exchanges. Like APRA, it has considerable scope to supervise Islamic financial institution through the conditions it imposes on its licensees and the need for self-reporting of breaches. ASIC's responsibilities fall under the *Corporations Act 2001* and are concerned more with market integrity in general and consumer protection. It has civil and criminal jurisdiction, has powers to investigate corporations, inspect books, call witnesses, require disclosure on the detail of financial products, and hold public hearings (Government 2001).
3. Reserve Bank of Australia ('RBA')
The RBA, formally independent of the Federal Government, decides on monetary policy (similar as the Bank of England) and works to ensure stability of the financial system as a whole. Its responsibilities are covered by the *Reserve Bank Act 1959*. Since 1998, it has not been involved with prudential regulation of banks or other deposit-taking institutions. In addition to supervision from government regulators, Islamic finance service providers have to comply with directives from their market regulators, who are themselves subject to directives from ASIC and the overall supervision of the Minister (Farrar 2011).

As of this paper was written, there is no mechanism in Australia that would compel Islamic finance service providers to comply with regulations and directions of the international Islamic regulatory bodies, whether directly or indirectly. There are two international standards-setting bodies: the Islamic Financial Services Board ('IFSB') and the Accounting and Auditing Organisation for Islamic Financial Institutions ('AAOIFI'). The former is an association of central banks, monetary authorities and other institutions responsible for regulation and supervision of Islamic financial services. Its primary purpose is to set and harmonise standards for supervision and regulation internationally that are consistent with *Shariah* principles (Farrar 2011; Saleem 2012). IFSB also liaises and coordinates with standards-setting bodies from the conventional sector to promote stability and disseminate best practices. One of its most

important functions to date has been the adaptation of Basel II on capital adequacy requirements to Islamic finance service providers.

The AAOIFI is an autonomous international Islamic organisation which prepares accounting, auditing, governance, ethics and *Shariah* standards for Islamic finance service providers. Its members are drawn from certain Islamic financial institutions and *Fiqh* academies, including the Fiqh Academy of the Organisation of the Islamic Conference (OIC). The AAOIFI complements the IFSB through the setting and harmonising of *Shariah* standards. The rulings, standards and guidelines of both organisations are voluntary in nature but have been incorporated (directly and indirectly) into the domestic laws of some jurisdictions. In both Dubai and Bahrain, for example, the rulings of the AAOIFI are incorporated into local law (Krichene 2012). In Malaysia, on the other hand, they serve as benchmarks for general *Shariah* compliance, though ultimately decisions are left to the *Shariah* Advisory Councils of the Malaysian Central Bank and the Malaysian Securities Commission, respectively (Venardos 2011). The Malaysian Central Bank, as Malaysia's prudential authority, also takes into account the guidelines issued by the IFSB when issuing its own guidelines on appropriate governance and supervisory frameworks for Islamic finance service providers (though is not technically bound) (Thani et al. 2010; Venardos 2011).

Amending the current Australian legislation to require the Australian regulators to refer to the standards of AAOIFI, and the IFSB in particular, would fill an important gap in the Australian context and facilitate further development of Islamic finance in Australia (Thani et al. 2010).

Impediment issues related to Islamic Finance in Australia

According to Thani, Abdullah and Hassan, the Islamic Finance sector requires more than a receptive market; it also needs an enabling legal environment for both the retail and wholesale markets to prosper. In their analysis of the experiences of several countries, key factors in the successful development of Islamic finance have been: clear policy decisions and directions coordinated by local financial regulations; legislation establishing, licensing and supervising institutions offering Islamic finance services and clarifying the difference with conventional services; comprehensive and precise mechanisms that ensure systemic *Shariah* compliance, supervised by qualified Sharia scholars as part of a *Shariah* Advisory Board (SAB); taxation friendly frameworks which enable Islamic finance providers to compete effectively with providers of conventional finance; supporting infrastructures, including accounting standards and human resource development; and participation in global initiatives, such as the Islamic Financial Services Board (Thani et al. 2010).

Research conducted indicates that due to the unfamiliarity of the relatively new Islamic finance system, Islamic financial institutions in Australia have not been able to play the expected role in the development of Australian economy through mobilising funds and attracting more customers (Ahmad 2008). Other major obstacle in Australian regulatory system is its federal structure. All institutions, be they financial or otherwise, are required to follow both State and Federal regulations. These regulations may vary from State to State. The States and Territories may have different regulations. Thus lack of uniform regulations across all the six States and two Territories are also not conducive for growth of Islamic finance in Australia (Ahmad & Hassan 2006).

In September 2008, the Australian government commissioned a report into how to position Australia as a leading financial services hub in the Asia-Pacific region and as a result, the Johnson Report was introduced. The Johnson report made two specific recommendations on Islamic finance; the removal of regulatory barriers to the development of Islamic finance products in Australia, and a call for an inquiry by the Board of Taxation into whether Australian Tax law needs to be amended to ensure that Islamic financial products have parity of treatment with conventional banking products (Khan 2012). The focus of this report was not to give any special treatment to Islamic finance, but to make sure there is a level playing field for the development of Islamic finance in Australia. This wouldn't require large scale re-writing of the Australian law and merely targeting neutrality in treatment. For example, purchasing a home through an Islamic mortgage would result in double payment of stamp duty. This is because *Shariah*-compliance requires the asset to change hands twice. A neutral treatment would require amending the law such that the stamp duty is paid once or an equivalent amount in two instalments. The Victorian government already introduced such changes after working together with the Muslim Community Cooperative Australia Limited ('MCCA') (Khan 2012).

In April 2010, the Australian Government announced that the Board of Taxation would conduct a comprehensive analysis of Australia's tax laws as recommended by the Johnson Report and identified areas which might need fine-tuning. In further development, on 18 May 2010 the then Assistant Treasury Mr Nick Sherry announced the Terms of Reference for the Review (Government 2012). Among others the issue under review are as follows:

Review of the Tax Treatment of Islamic Finance

1. The Board of Taxation was asked to undertake a comprehensive review of Australia's tax laws to ensure that, wherever possible, they do not inhibit the expansion of Islamic finance, banking and insurance products.
2. The Board was asked to:
 - i. identify impediments in current Australian tax laws (at the Commonwealth, State and Territory level) to the development and provision of Islamic financial products in Australia;
 - ii. examine the tax policy response to the development of Islamic financial products in other jurisdictions (including the United Kingdom, France, South Korea and relevant Asian jurisdictions); and
 - iii. make recommendations (for Commonwealth tax laws) and findings (for State and Territory tax laws) that will ensure, wherever possible, that Islamic financial products have parity of tax treatment with conventional products.
3. In conducting the review, the Board should have regard to the following principles as far as possible:
 - i. The tax treatment of Islamic financial products should be based on their economic substance rather than their form.

- ii. Where an Islamic financial product is economically equivalent to a conventional product, the tax treatment of the two products should be the same.
4. If the Board concludes that amendments to the tax law are required, the Board should consider whether adjustments can be made to existing tax frameworks rather than the development of specific provisions directed solely at Islamic financial products.
5. The Board was asked to report to the Assistant Treasurer by June 2011 (Sherry 2010).

In respond to the April 2010 announcement, the Chairman of the Board of Taxation, Mr Dick Warburton AO, announced the release of a discussion paper on the Board's review of the taxation treatment of Islamic finance, banking and insurance products in a statement dated 13 October 2010. To facilitate public consultation, the Board has developed a discussion paper as a basis for further discussion. The Board welcomes submissions on issues raised in the 84 pages discussion paper and sets the closing date for submissions on 17 December 2010. To assist in the Review process, the Board conducted consultation meetings on 8 November 2010 in Melbourne and 11 November 2010 in Sydney. The consultation meetings were attended by representatives from taxation professional bodies, major law and accounting firms, various major corporations and business associations. The Board was expected to provide a final report to the Assistant Treasurer by June 2011 after considering the views of all stakeholders (Government 2010).

The Board of Taxation has finally submitted its final report to the Government recently. The submission was informed to the general public by the Parliamentary Secretary to the Treasurer, The Hon Bernie Ripoll MP at the “Amanie Australia Islamic Finance Forum” in Melbourne on 16 April 2013 (Moore 2013). In his speech, Mr Ripoll said that Australia is making progress on implementing the recommendations of the 2010 Johnson Report. The Report made two specific recommendations relating to Islamic Finance (Ripoll 2013):

1. The first recommendation was to review Australia’s tax laws to ensure that wherever possible they do not inhibit the provision of Islamic finance, banking and insurance products and that it has parity of tax treatment with conventional products - Mr Ripoll confirmed that the Board of Taxation has submitted the final report to the Government, which is considering the issues raised in the report.
2. The second recommendation was to review whether any regulatory barriers to the development of Islamic financial products in Australia – Mr Ripoll informed that currently there is no substantive regulatory barriers at the Commonwealth level.

However, to the best knowledge of the authors, the Australian Government has not release any decision with regards to the Board of Taxation’s recommendations. Whatever decision of the Australian Government going to make, it will decide the future of Islamic finance in Australia. It is the much awaited decision by the local and foreign banks who has taken the wait and sees approach.

Other related Development

The Australian Islamic finance industry also recently welcomed the latest investment fund manager specializing in wholesale property that is *Shariah* compliant (Omran 2013). Piety Investments a Sydney based company, specialises in structuring and managing *Shariah* compliant investment funds across both residential development and commercial real estate within Australia. Piety offers property trusts aimed at offshore investors seeking to tap into the under-supply of Australian bricks and mortar. With the population continuing to grow rapidly from significant immigration and natural growth, the demand for quality commercial and residential housing continues to flourish. Piety Investments managed numerous large-scale residential and commercial developments for many years prior to attaining their wholesale Australia Financial Services License (PietyInvestment 2013). In another development, Crescent Wealth was given approval for its *Shariah* compliant “Crescent Wealth Superannuation Fund” (CWSF) in February 2013 (Omran 2013). Crescent Wealth is Australia’s first dedicated Islamic wealth Manager offering superannuation that is based on Islamic investment principles. The trustee of the CWSF holds both an Australian Financial Services License (issued by ASIC) and a registrable Superannuation Entity License (issued by APRA) (CrescentWealth 2013). Both Piety Investment and Crescent Wealth brought an interesting development into the Australian Islamic finance industry. It is hope that such development will continue in the near future with the participation of more companies.

CONCLUSION

The combination of ethical, social and financial considerations makes Islamic finance an increasingly attractive proposition. Financial products that comply with *Shariah* principles offer a genuine alternative for both Australia’s Muslim and non-Muslim population. It is natural that the Muslims in Australia like Muslims in any other countries wish to conduct their financial activities in accordance with the tenets of their Islamic belief. The Australian government has shown strong support towards the development of Islamic finance by making several initial steps to facilitate the establishment of a full fledge Islamic financial institutions that would cater for the needs of the people. The establishment of these institutions would enhance competition in the financial market by offering an alternative to the traditional interest based banking which ultimately would benefit the consumers including the Non-Muslims. Consequently, this would help the Australian economy by creating an opportunity to bring in foreign investments into Australia and also help expand its existing trade and economic ties with other Muslim countries.

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