

Chances for Islamic Finance in Germany ?

By Rebecca Schoenenbach

In March 2010, the first Islamic Bank, Kurveyt Türk, opened a representative office in Mannheim, Germany. This fall the bank is expected to apply for a full banking license.

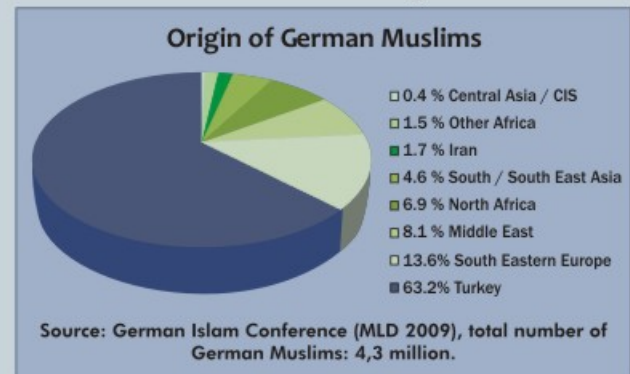
Is this the breakthrough of Islamic Finance in a country that so far had little exposure to the subject?

Historic Background

In the 1990s, several so called "Islamic Holdings" were intensively advertising "Islam-compliant" investments in mosques mainly frequented by Germany's Turkish community. They promised high returns, up to 25% on company shares without having to resort to Riba or any other non-virtuous activity. The community was pleased with the opportunity to invest their savings in accordance with their faith and at the same time support their home country - the emissaries purported to finance mainly Turkish business start-ups. A lot of families entrusted most or all of their savings to these emissaries. Suspicion was muffled by the first pay offs, apparently financed through pyramid schemes. Soon after, the "holdings" declared bankruptcy or simply disappeared. The damage caused by the fraud is estimated by experts to reach up to €25bn and left many Turkish families in a deep shock. They had not only lost their savings but also their trust was severely shaken.

As there seemed therefore no chance for a rapid pickup on the home market, German banks and institutions discovered the Islamic Finance market abroad. Deutsche Bank opened Islamic Windows in the GCC and in Malaysia. Germany's biggest insurer, Munich based Allianz successfully launched Allianz Sharia in Indonesia in 2006, with a continuing annual growth. But so far, German banks have focussed solely on Islamic countries. Only this month, Mr Ergün Akinci stated in the Financial Times Deutschland, the German-language daily of the Financial Times, that Islamic Finance is not an issue to be considered. Mr Akinci is member of the management board of Bankamiz, a branch of Deutsche Bank, which specialises on services to costumers of Turkish origin in

Germany. Asked why, he explained that there is simply no demand, his costumers are interested in conventional products only. An astonishing statement, considering that a comprehensive study by the German Federal Office for Migration and Refugees (BAMF) found that 50 % - 70 % of the Muslims do call themselves religious.



Thus one would expect a correspondingly high demand for Islamic financial products. The consultancy firm Booz & Company assumes in a 2008 study that **500.000 of German Muslims are, in fact, predisposed to execute financial transactions in accordance with Islamic principles.** Nonetheless, so far Islamic products offered on the German market have regularly failed. In 2005, the German Commerzbank closed its Al-Sukoor European Equity Fund offered in the GCC already in 2000 in cooperation with Dallah-Al-Barak Bank, stating that the demand was not meeting expectations. The fund had only managed to collect €4m instead of the envisaged €20m. Critics held that it was not properly advertised in Germany and the real demand was not even tapped. This last point at least does not hold true for the Meridio Islamic Fund issued in 2010 which was covered extensively by public media. It still had to be liquidated prematurely the following year.

Blocked by authorities or by internal obstructions?

Critics frequently claim external obstacles such as unfavourable tax and regulatory conditions as reasons why Islamic Finance has not gained a proper foothold in



Germany with its second largest Muslim population in Europe. But, as shown above, even existing products are not readily accepted by the Muslim constituency. True enough, both the UK and France especially adopted tax laws and banking regulations in favour of Islamic Finance which Germany did not. But the German Federal Financial Supervisory Authority, BaFin, already hosted two conferences on Islamic Finance and repeatedly signalled its willingness to support Islamic Banking in Germany. Asked why the BaFin has not taken further action to accommodate Islamic financial institutions, officials stated they simply had not yet received any applications for the opening of an Islamic Bank. Kurveyt Türk is to change that, now. Again, the absence of demand is seen crucial and understandably so, as it does not strike the public as reasonable to alter the rules

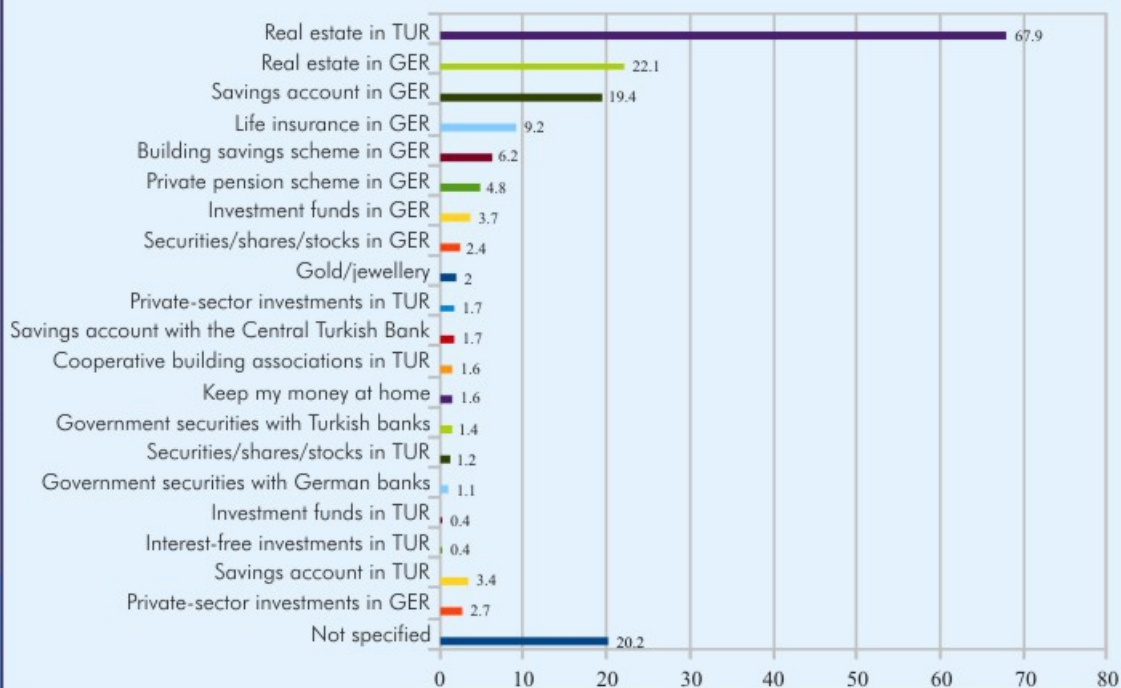
without any pressing need. The fact that BaFin recently certified the new CIMB Islamic fund that is currently being advertised in Germany proves the authorities' position is more than mere lip service. The fund's success or failure will give an indication of whether by now demand is for real. More importantly, though, **most transactions allowed by Sharia do not even fall under**

the German banking regulation but are simply regarded as trade. Most trade related transactions similar to Mudarabah, Musharaka and Murabaha can

already legally be undertaken by ordinary business enterprises without any discrimination. Thus Sharia-compliant investment meets with favourable conditions but until now this has not been explored much further.

Reasons for the reluctance to put investment possibilities in accordance with Islamic values to the test might be the fact that the Muslim community is relatively poor compared to the average German population. Education levels are well below average even in the second and third generation of Muslim immigrants. Half of the migrants of Turkish descent, the largest Muslim group, possess no or only the lowest school degree and in consequence earnings are also low. On average, disposable income in Germany is about €1.000 per month per person, whereas migrants of Turkish origin have only about half of that amount to spend—not enough for significant capital savings or investment. Anyhow, migrants of Turkish origin tend to invest mainly in real estate and much of this share is directed to assets in Turkey. Traditionally, the openness towards new forms of investment is rather low so that even Sharia-compliant transactions might face difficulties in reaching a wider audience among migrants of Turkish descent. The following table shows the allocation of investment choices by the German community of Turkish origin in 2005:

Choices of actual Investments (percentage quotation, multiple answers possible)



Another indicator for the openness of the authorities towards Islamic Finance being bigger than that of the Muslim community in Germany is the fact that a German



regional government was the first to issue a European Sukuk. Inspired by the possibility to attract new investors and hoping for an advertising effect for East Germany, the government of Saxony-Anhalt went new ways of financing besides their conventional state bonds. Some confusion among German officials and practitioners of Islamic Finance, though, did arise after the known paper on Sukuk by Mufti Taqi Usmani was issued in 2007. It would have rendered the Saxony-Anhalt Sukuk (certified in 2004) non-compliant to Sharia. This shed light, again, on the problem of missing standardisation in Islamic Finance that often induces insecurity and therefore higher risk for those who want to offer Sharia-compliant products, not only in Europe. This risk has been dubbed the “Sharia-trap” by German Islamic Finance practitioners: Differing opinions on Sharia-rulings cause uncertainty for financial transactions which again causes risk and therefore costs. Adding to the confusion, at least for European investors, is the way Sharia-Scholars mostly deliver their verdict by a simple statement of “halal” or “haram”, without giving any explanations that would make the process comprehensible for Western practitioners. Eventually, the Sukuk transaction in Saxony-Anhalt was successfully completed in 2009 but so far no successor is planned. The lack of transparency in Sharia-rulings is one of the reasons that the German public is careful to embrace Islamic Finance as a new form of banking. Alternative banking is otherwise very successful, eco-social and sustainable investment enjoyed high growth rates up to 30 % during the past few years in Germany.

Conclusion

So, is Deutsche Bank right and Islamic Finance is not an issue worth considering in Germany? The UK is the European country most advanced in the Islamic Banking field. Even though the way for Islamic Finance has been

actively cleared there, convincing achievements are yet to be shown for. The Islamic Bank of Britain, the only one offering retail services in Europe so far, failed to be successful over the past few years and had to be saved by capital injection from the GCC. Thus external factors cannot be blamed to be the main hindrance of Islamic Finance, neither in the UK nor in Germany. Changes to the tax and banking regulations might not be the crucial key to success many players portray it to be.

Relatively low incomes, diverse and sometimes contradictory Sharia-rulings, reluctance towards investments other than real estate and a lack of transparency are all internal factors for Islamic Finance in the West. The way for improvement is adjustments to these internal factors. Thus it will depend more on the development of the Muslim communities themselves to decide whether Islamic Finance in the West will be a success story or constantly hinged on capital injections from the GCC. **A great leap forward would be to prove real demand by simply starting to take advantage of the given legal opportunities instead of lamenting about discrimination.** The road for the establishment of Islamic investments is already well paved. Only if this road is taken more forcefully, Islamic Finance will become an issue in

Germany, soon...

