



Credit Crunch: A Chance to Develop the Islamic Finance Market in Germany?

*Nicole Guski, Partner
Norton Rose*

Nearly five years have passed since the federal state of Saxony-Anhalt in Germany issued Europe's first Islamic bond in July 2004. This prompted market players to be quite enthusiastic about the potential of Islamic finance in the German market. Although more than three million Muslims live in Germany and corporate Germany has a good reputation in many Muslim countries, the expected boom for Islamic finance does not seem to have emerged.

The reasons for this are manifold, but unlikely due to a lack of potential. Although the majority of Muslims living in Germany have a background of migration and have a lower income compared to the Germans, their savings are usually higher. According to Booz & Company, there is a potential of €1.2 billion (US\$1.5 billion) a year for Shariah-compliant finance products, which would mean an annual growth rate of 15-20%. There is definitely growing interest in such products as the increasing number of participants from Germany at Islamic finance conferences shows.

Due to globalisation, an increasing number of German banks are already involved in the Islamic finance markets outside Germany. They include Deutsche Bank, Commerzbank and Dresdner Bank. Deutsche Bank has been issuing Sukuk in cooperation with banks in Saudi Arabia since 2005. These are, however, not the only banks that are active in Islamic finance.

In 2005, for example, it was announced that Arcapita Bank mandated Bayerische Hypo-und Vereinsbank, Standard Bank and WestLB's London branch to arrange a US\$200 million five-year multi-currency Murabahah Sukuk. Similarly, CCH Europe, the German subsidiary of CCH International, arranged a US\$20 million Murabahah for Globexbank in Moscow in 2006. Islamic trade and export finance structures are also regularly used by German banks.

In order to service their Muslim customers, German banks often establish a Shariah-compliant window. HSH Nordbank, a German financial institution and key market player in shipping and renewable energy finance, signed an agreement with Dubai's Al Salam Investment to set up a Shariah-compliant joint venture in 2009.

Islamic finance has never been a one-way street. Since 2006, Islamic investors have shown increasing interest in investment opportunities in Germany, in particular the German real estate market. Abu Dhabi Investment House launched a €600 million (US\$767 million) Gulf German residences fund in 2006, while Arab Investment set up its German AIL Fund 1 for investments in German shopping centres and commercial properties in 2007. Deutsche Bank even launched a special banking brand called Bankamiz for its Turkish customers who represent the largest Muslim community in Germany.

Still, the German Islamic finance market is not as developed as that in the UK, and in all likelihood now, also ranks behind the French Islamic finance market, given the significant tax and regulatory changes announced by the authorities there last year. What are the obstacles which prevent the German Islamic finance market from developing at a faster rate? Why isn't there greater demand for Islamic finance products in Germany, given the size of the Muslim community?

Lobby for Islamic finance in Germany

One possibility is that German Islamic finance products are not widely known within the Muslim community in Germany as such products are rarely advertised. Even bankers are often not aware of the existence and availability of such products within their banks.

Accordingly, such products are not offered to their customers and there is also probably an element of reluctance by such customers to enquire about these products. This is in light of the unjustified, but nevertheless stereotypical association that is often made with persons of a Muslim background being linked to terrorists.

In addition, the Muslim community in Germany is not a homogeneous group as most of them have a background of migration, with families originating from different countries. Even if they are second or third



generation Muslims living in Germany, their cultural differences are still quite apparent. Accordingly, it is more difficult for them to create their own lobby in Germany.

A good example of such difficulties is the Central Council of Muslims in Germany (Zentralrat der Muslime in Deutschland or ZMD). Although ZMD was established in 1995, there is still ongoing discussion among Muslims in Germany as to whether it has the authority to represent the German Muslim community.

To alleviate such concerns it would assist if, similar to the UK or France, the German government acknowledges Islamic finance by implementing the appropriate legal framework. A possible platform is the Federal Financial Supervisory Authority (BaFin) in Germany, which has signed memoranda of understanding (MOUs) with various regulatory authorities in the Middle East.

Following this, BaFin agreed to cooperate with these authorities, including establishing training programmes for better mutual understanding. Although such cooperation will not immediately change the legal framework for Islamic finance in Germany, better mutual understanding will increase awareness of Islamic finance products in the country. This may, in turn, build greater confidence in Islamic products, which will ultimately lead to a stronger lobby for such structures.

Certification of Islamic finance products

In addition to the lack of a unified lobby, not every product which is called an Islamic finance product may be recognised as such by every Muslim living in Germany. To overcome such obstacles and to support German financial institutions in improving the Shariah compliance of their products, ZMD commenced an initiative to establish a programme to certify their Shariah compliance.

Although such a programme will improve the reliability of Islamic finance products, it is unlikely that it can allay all doubts surrounding Shariah-compliant products, as ZMD is not recognised by all Muslims in Germany as their authorised representative. In most Muslim countries, Shariah compliance of a product is supervised by a competent Shariah board of the relevant financial institution.

Although the Shariah board is independent of the financial institution and not bound by any instructions from it, experience shows that the degree of supervision often depends on the individual members on such a board. For example, a product approved by one Shariah board may be criticised by another Shariah board. It is therefore regularly discussed at conferences and meetings whether a central Shariah board should be established to avoid any discrepancies. Apart from Malaysia, the concept of a central Shariah board is, however, not accepted in Muslim countries since Islam does not recognise the concept of a centralised representative.

Highly engineered products

Furthermore, it has to be acknowledged that Islamic finance products compete with conventional banking products. The German Muslim community is not prepared to accept Islamic finance products which do not provide them with a similar return as conventional products.

Although a number of Shariah-compliant structures have been developed to address issues such as double real estate transfer tax, it is desirable that the legal framework in Germany be adjusted to reflect the particular aspects of Shariah-compliant products and thus provide for a simplification of the relevant structures. This would support broader use and acceptance of such structures in Germany.

Credit crunch – an opportunity for Islamic finance?

Due to globalisation, Islamic finance markets have also not been immune to the financial crisis, but as a result of adherence to Shariah principles, Islamic banks are not as highly leveraged as conventional banks and tended to stay away from the main triggers of the financial crisis, such as risky derivative products.

Due to the global financial crisis, the financial sector faces an unprecedented situation which requires a new way of thinking to overcome the difficulties. Therefore, the market is probably more prepared to look at the financial sector from a different angle and, in particular, take a more ethical approach.



Accordingly, there is a good chance that the principles of Shariah-compliant financing, like the ban on uncertainty (gharar), the promotion of risk and profit sharing as well as the promotion of asset-backed transactions, may be of greater interest to non-Muslims. On the other hand, Shariah-compliant products have other inherent risks which have to be taken into account. For example, they usually have greater liquidity risk due to greater mismatch in maturity.

Conclusion

The German market still holds some interesting potential for Islamic finance products. Regardless of the fact that it is already possible to use Islamic finance products in Germany, it is desirable to increase their awareness and lobby for Islamic finance in Germany by a clear statement from the German government in the form of establishing a legal framework as has been done in the UK and France which recognise the particular aspects of Islamic finance products.

Certification of the Shariah compliance of a product is likely to support the development of the German Islamic finance market, even if such certification is not recognised by all Muslims living in Germany.

Despite the fact that the Islamic finance market is not large enough to resolve the credit crisis on its own, it can add an interesting dimension as a solution even for the non-Muslim community, but without forgetting to mitigate the risks which are inherent in Islamic finance structures.

This article first appeared in Islamic Finance news (Volume 6, Issue 10).