CHAPTER 24

Regulating Islamic finance in the USA

24.1 Introduction

As the Shari'a broadly addresses human activity, so does Islamic finance – in principle particularly – urging a concern for all of creation as service to the Divine. Among other things, Islamic tenets promote honesty, transparency and fairness, express concern for the well being of employees, partners and counterparties, and place certain limits to monopoly and wealth concentration. These more general principles, along with detailed technicalities and legalities, fall under the purpose of Islamic law: securing benefit and preventing harm. Readers may already be well aware of this or may wonder what exactly its relevance is to a discussion of law and regulation. This is mentioned, because it is important to first understand the subject under consideration for regulation before tackling the questions of whether regulation is appropriate and then finally how best to regulate.

The United States is not normally considered among the most significant markets for Islamic finance. Any discussion of the Islamic finance industry in the U.S. must thoughtfully consider its prevailing social and political climate. What some term "Islamophobia", which persists in certain, sometimes influential, quarters of American society would certainly vigorously challenge any perceived attempt at establishing or integrating the Shari'a, Islamic law or Islamic finance (whether in theory or in practice) within the U.S. framework. Indeed, a few already challenge whether Islamic transactions and financial products should even be permitted in the country. Consider for example the proposed ban on Oklahoma state courts from considering Shari'a law (or international law for that matter) when making decisions. This proposal was approved by more than 70% of Oklahoma voters. But note that the proposed law was struck down by a U.S. federal judge.[1]

In fact, there has been tremendous innovation and success for contemporary Islamic finance in the U.S. There have also been, and will probably continue to be, important governmental and regulatory efforts to welcome and integrate Islamic finance into the prevailing in the U.S. legal framework. Admittedly, these efforts have not been as conspicuous as those made by certain other Western nations, such as the United Kingdom or even France. But this is not in itself a problem, especially when regulatory efforts in the U.S. have enabled Islamic finance to innovate and succeed globally. In fact, such an approach may be wiser given some of the vocal opposition.

This chapter explores the question of whether and how to regulate the Islamic finance market in the United States. We begin by discussing the American Islamic finance market, compare and contrast U.S. and Islamic commercial laws generally, and discuss both the ease and the challenge of implementing Islamic principles within the U.S. regulatory framework. Lastly, this chapter presents the innovation that has taken place overcoming some of these challenges and asks: Given such innovation and success, is specific regulation appropriate? Does the answer to this question depend on whether such regulation speaks to transactions (e.g., an investment) or actors (e.g., a bank)?

24.2 The U.S. Islamic finance and investment market

As an industry in the U.S., Islamic finance has a straightforward and practical objective: conducting business transactions profitably and responsibly, as the notion of both profit and responsibility are defined and controlled by Islamic norms. The concern is not creating legal or

[1] *Muneer Avad vs. Paul Ziriax, Agency Head, Oklahoma State Board of Elections, et al.*, Case No. CIV-10-1186-M, November 29, 2010.

See also M.Scott Carter, The Journal Record, November 29, 2010.

regulatory policy shifts through application or integration of Islamic values into existing law. Of course, the expectation would be, and the norm is, that Islamic parties carefully and diligently seek to comply with all applicable U.S. laws and have those existing laws applied to them.

The U.S. Islamic finance market may be subdivided into two segments: One segment we might term the "wholesale" or "foreign-institutional market." Here, we mostly see foreign Islamic investors – in the form of investment banks, private and some public investment companies, and family offices – targeting the U.S. on a one-off basis sometimes and in other instances through a private investment fund or other collective investment mechanism. In the early years (the mid to late 1990s), the wholesale Islamic market focused on the residential and single tenant real property markets – probably in large part because Islamically prohibited issues could be more easily avoided (than with other property types, such as shopping centres, in which a myriad of prohibited matters generally arise). Early in this decade, Islamic investors added to this wholesale market commercial office property investments as the applied Islamic legal method became more tolerant of some of the otherwise prohibited, as detailed below.

Wholesale Islamic finance practice in the U.S. would subsequently add to its transactional portfolio private equity transactions in the form of leveraged buy-outs and, less frequently, growth equity type investments.[2] Most importantly, for our purposes, the developments that led to such private transactions took place in the United States and then produced global consequences.[3] It may very well be that this was spurred on by developments in the public securities market – namely, the landmark establishment of the Dow Jones Islamic Market Indexes in 1999. The fatwa which was issued in connection with these indexes enabled public securities investment on an Islamic basis. Previously, Islamic investors (thought they) could invest only in businesses that were entirely and in all aspects in line with Islamic tenets and lacking any conventional debt (whether by borrowing or as income). This fatwa, as has been previously discussed in detail by others,[4] (i) begins the analysis of whether an investment is permissible with an assessment of the security to be acquired, (ii) evaluates the nature of the primary business (and not all business lines) of the target, and (iii) permits and tolerates conventional debt (owed or earned) if certain specified ratios (limiting its presence) are adhered to. This result is demonstrative of a recognition by at least some Muslim jurists that absolute compliance is not currently obtainable, and, accordingly, in some very limited instances (i.e., not all prohibited matters), de minimus variations are permitted. Income resulting from such variances are subject to some kind of removal process, such as through charitable donation and or a subsequent effort to further minimize the variance.

The extension of these principles from the public market to real estate investing and even to private equity did not happen immediately. This seems rather to have taken some years. Ultimately, such an extension has advanced Islamic transactional activity and broadened the target asset profile. From time to time though we still see a hesitation by some, or an outright unwillingness by others, to extend these principles to private equity though to some they make more sense there than in the public markets.[5]

The wholesale American Islamic finance market has also seen significant developments in financing structures of global consequence. These accomplishments include a handful of sukuk issuances in recent years using Rule 144A adopted in the U.S. in 1990 as well as the recent Islamic derivatives contract launched by the International Swaps and Derivatives Association (ISDA) with Bahrain-based International Islamic Financial Market (focusing on profit ratio and currency swaps).

The second segment of the American Islamic finance market consists of the "retail" where American needs are identified and addressed (often self-addressed) to enable the acquisition of homes, retirement savings and investment, and general consumer banking in accordance with Islamic tenets. American Muslims have been keen to develop financing structures to enable home purchases. These efforts began more simply, and with time, demand, expertise, and savvy grew. Financing mechanisms and related documentation became more sophisticated with the simultaneous presence of murabaha, ijara and musharaka structures in the marketplace, became arguably more compliant with Islamic principles, and created competition and success. Strong demand also saw the creation of an Islamic secondary market structure to provide for much needed liquidity in at least one instance of a residential mortgage product. Shortly thereafter, a nationalized and standardized U.S. commercial mortgage product was developed in the U.S., which it seems but for the credit crisis, might have produced one of the world's first CMBS sukuk. The American Islamic retail market is also witness to a variety of U.S. asset managers, offering investment vehicles and opportunities, but mostly to offshore persons. The market seems to have self-addressed the need for Islamic mutual funds for U.S. persons.

Overlap between these "wholesale" and "retail" market segments is rare unfortunately, and has taken place, for example, in the form of multinational financial institutions offering Islamic products to U.S. persons and the recent sukuk issuance by General Electric Co. We do expect to see an increase in the overlap with time, particularly as the retail market matures and the opportunities therein are better appreciated.[6]

24.3 The two legal systems

It may surprise some to learn that Islamic financial laws and U.S. regulations are not (in our experience and knowledge) wholly inconsistent. In fact, in the financial realm, we find a number of similarities and parallels between the two systems of law.[7] There is even research evidencing the origin of many aspects of Anglo-American contract law and trust law in Islamic law.[8] This is not to say that the two legal systems are premised similarly and that premises are unimportant. On the contrary, they are quite important, but the question we focus upon in this chapter is what practical challenges

[2] Growth equity investments are typically minority positions. They take place infrequently because control makes compliance with Islamic law difficult and because of Islam's limitations on preferred returns. For a case study in Islamic growth equity investments in the U.S. see Umar F. Moghul, No Pain, No Gain, The State of an Industry in Light of an American Islamic Private Equity Transaction, Univ. of Chicago J. Int'l L. 469 (Winter 2007) [hereafter No Pain, No Gain]

[3] Namely, knowledge and experience with such transactions, helping them to take place elsewhere.

[4] See e.g., Rushdi Siddiqui, Shari'a-compliance, Performance and Conversation: The Case of the Dow Jones Islamic Market Index, Univ. of Chicago J. Int'l L. 427 (Winter 2007).

[5] For instance, we are aware of a well-established GCC-based Islamic investment bank the Shari'a supervisory board of which does not permit private equity investments in privately-held U.S. companies with any conventional borrowings.

[6] *See* e.g., Faisal Mahfooz, *Islamic Banking: The Untold Billion-dollar Story*, available at http://www.nowpublic.com/world/islamic-banking-untold-billion-dollar-story (last visited December 2, 2010).

[7] *See* e.g., Ayman H. Abdel-Khaleq, *East Cameron Gas sukuk: The Dawn of a New Frontier*, Islamic Finance News, Deals of the Year 2006 Handbook, p. 32 (stating, "The successful closing of the ECP sukuk transaction, which constitutes the first ever sukuk backed by oil and gas assets in America (as described in more detail below), supports the foregoing conclusion. In fact, one can argue that American oil an gas law, under which oil and gas rights are characterized as severable and alienable real property with well recognized legal attributes, satisfies a number of Shari'a requirements.")

[8] See John Makdisi, The Islamic Origins of the Common Law, 77 N. CAR. L. REV. 1635 (1999).

do these more theoretical or jurisprudential differences create for the practitioner of Islamic finance to address. We do not find many challenges in number.

The introduction of this chapter spoke of the broad purposes of Islamic law as well as the limited practical aim of Islamic finance in the U.S. Comparing Islamic financial law with U.S. law, we find a number of parallels between the two at their respective theoretical or "policy" levels. Both legal systems, for instance, share concerns against exploitation and unjust enrichment, seek to preserve and protect property rights, and enact laws to fulfill such purposes. The importance of honesty, transparency, and fair dealing within Islamic law, for example, may be analogized to the stated rationale and purposes of U.S. securities laws and consumer protection regulations. At a more particular level, we find the detailed requirements of each legal system having parallels in the higher purposes of the other system though they differ in some cases in the "minutae" of how they go about achieving the same purposes.

The Shari'a has a broad freedom to contract, and some interpretations have it broader than others. This is particularly so in the realm of finance and transactional law where the majority of Muslim jurists presume legal permissibility without a textual indication to the contrary. In addition, Islamic law emphasizes the importance of consent and the rights of contracting parties. Similarly, U.S. contract law affords a broad freedom to contract, and, as under Islamic law, the subject matter of the contract must not be prohibited. While one can certainly argue that what is prohibited under U.S. law is of a different nature than that under Islamic law and that these differences represent a significant "philosophical" difference, practically speaking, there is generally little difference when effectuating transactions. Moreover, what is prohibited under Islamic law is not generally, if ever, required by U.S. contract law. Thus, the parallels between the legal systems and their respective contractual freedoms allow Islamic parties to freely engage in Islamic transactions in the U.S. upon the terms and conditions to which they and their counterparties agree. Further, though proper and sufficient specificity, it should generally be possible to utilize Islamic law by incorporating it, or aspects of it, as contractual terms rather than as a governing law per se.

Finance in the Anglo-American model is premised on a debtor-creditor model central to which is interest-based lending and the idea that money can itself earn money. The Islamic finance theory, on the other hand, is said to envisage a model where risks and rewards are allocated differently. The most conspicuous features of Islamic finance are its prohibitions of gharar and, moreso, riba. It is usually because of these foundational divergences that many view Islamic financial laws and U.S. financial laws as incompatible and even diametrically opposed. But, as has been shown by various others, these prohibitions are indeed not unique to Islam, and, at the very least, many of the purposes for which such prohibitions are believed to have been legislated are not unimportant to U.S. law. Much of the challenge in conducting Islamic finance transactions in the U.S. does not come from conflicts of law per se, but from varying business practices and expectations, namely the debtor-creditor model on which the U.S. economy is so heavily dependent.

Very often, gharar can be alleviated by proper specification of material terms and conditions (such as subject matter, price and time of delivery) at the time of contracting. Such specificity is a common practice in the U.S. It also has other, sometimes unexpected, implications, resulting, for example, in certain contract provisions, such as post-closing purchase price adjustments, being deemed impermissible. But gharar has its deepest implications upon conventional insurance and derivatives, generally prohibiting both.

Certainly, Islam's prohibition of riba creates some interesting tensions and challenges in the U.S. (and elsewhere). It would be rather difficult to assert that any party is obligated by U.S. law to borrow at interest or to otherwise engage in a ribawi transaction (except in very limited, narrow instances perhaps). However, one could assert that certain laws, namely tax laws and those regulations governing banks, as well as prevalent business practice or custom (sometimes adhered to by some Islamic finance professionals themselves), have created challenges if not outright contradictions with the rules of riba and Islam's requirements for market or asset risk sharing.

U.S. tax laws give preferential treatment to debt-based instruments and to interest earned on debt, which it does not afford to equity-based structures. Islam's preference, particularly in the consumption context, to not incur debt and to take on a market or asset risk instead, seems to stand in tension with these tax laws. Perhaps more significantly, U.S. laws governing banks and banking stand in direct conflict with the notion under Islamic law, that to legitimately profit, a financier must bear a market or asset risk and not merely a credit risk. For example, U.S. banks are not permitted to own real estate unless held for their own use or as collateral in connection with an enforcement action. Moreover, as a matter of custom and not law, banks strongly prefer to utilize (their own standard) conventional loan documentation. This customary preference, coupled with the aforementioned regulations, prohibit banks from bearing the risks required by Islamic law and thus from directly (or to some correctly) participating in an Islamic financing.

As such, when transacting in the U.S., Islamic parties must decide whether to utilize equity or debt structures. It seems though that to date, the attraction of leverage prevails in most Islamic transactions in the U.S., whether we speak of the wholesale or the retail markets. Given the regulatory as well as the "cultural" barriers to engaging in an Islamic financing structure where the financier is given an asset risk, the probability of convincing the usual sources of lending to participate in an Islamic financing in both form and substance are slim at best. This is probably why structures in contemporary Islamic finance have focused on form. And perhaps thus, conventional finance came to be a part of nearly all of the American Islamic financing structures, particularly in the wholesale market segment.[9]

Further, Islamic parties typically describe their leverage structure as a single interest-bearing transaction for tax purposes so as to avail themselves of the preferential tax treatment not otherwise available.[10] This tax-driven

[9] Acceptance of a conventional component in retail Islamic financing structures appears quite low. In our experience, many American Muslims, rightly or wrongly, tend to be sceptical of the Islamic finance industry and any products offered to them generally seem to fare best when they are end-to-end compliant with Islamic tenets. Even then, as was the case with a prior murabaha mortgage product, many American Muslims were generally unwilling to deem it Islamic. While the lay Muslim individual is not the legal arbiter of whether something is permissible, such individuals can and do play a significant role in the success and failure of retail products.

[10] It is worth noting that we understand some users of Islamic home finance in the U.S. have elected not to avail themselves of the interest deduction under U.S. tax laws.

characterization, together with the form of the underlying leverage,[11] continues to spur many discussions in the industry regarding form and substance – a summary and analysis of which is beyond the scope of this Chapter. Were they not to agree to such a recharacterization[12], Islamic investors would forego the aforementioned preferential treatment and perhaps be unable to convince some of their conventional counterparties to do business together.

It is important to note that Shari'a advisors (generally but with reluctance from some) permit the aforementioned tax-driven recharacterization. It may also be worth noting that these advisors often permit the use of conventional insurance (in the absence of Islamic insurance options in the U.S.), even when insurance is not a U.S. legal requirement per se but sometimes of the financier as a contractual requirement. While Shari'a scholars have no choice but to work within the existing U.S. regulatory framework, they very well could simply not issue the relevant fatwas, more strongly advocate for the use of equity, and object to the tax-driven recharacterization. That they tend to be permissive (though sometimes while noting an objection) is not only a reflection of scholarly deference to applicable U.S. law in the U.S. market, but the flexibility of their jurisprudence when interacting with long-established, nearly standardized business practices and norms. For our purposes, this flexibility is demonstrative of how Islamic financial law and U.S. laws are interacting productively.

In our experience, Shari'a advisors typically create legal dispensations in those very rare cases in which Islamic law and U.S. laws conflict. For instance, when the murabaha-based home finance product was structured, the absence of a reduction in the total purchase price (which would typically result from a total prepayment in conventional finance) potentially ran afoul of U.S. state usury laws because the net effect of the absence of such a reduction could have been a rather high interest rate. Accordingly, the Shari'a advisor permitted the purchase price reduction. This is again demonstrative of the Shari'a advisors method for effectuating Islamic transactions in the U.S.

To the foregoing, we add that Islamic law is not wholly or generally applicable to non-Muslims. While this is perhaps an obvious descriptive point, it is also one that holds true prescriptively as a matter of Islamic jurisprudence. This is another factor easing transacting in the United States on an Islamic basis and questioning whether regulation specific to Islamic finance, at least on a transactional level, is necessary or appropriate. Of course, as an Islamic transaction or agreement, conventional parties will be concerned about the extent to which their rights and/or responsibilities are different to what they are accustomed to.

24.4 Legal and regulatory successes

In addition to the various transactional innovations that have taken place in the United States with far reaching implications for Islamic finance worldwide, the U.S. has also seen its share of regulatory successes.

The Office of the Comptroller of the Currency (OCC), which regulates national banks, addressed the tension, if not outright conflict, between bank regulations and Islamic law several years ago in the form of two letters of guidance. Enabling U.S. banks to participate in Islamic transactions on certain specified terms and resulting in some of the first Islamic leveraged acquisitions and revolving facilities, these advisory letters stand among the first attempts at "regulating" Islamic finance in the United States.

Other regulatory successes include the New York State Banking Department approving Islamic home financing structures, the Board of Governors of the Federal Reserve allowing U.S. financial institutions to engage in Islamic transactions in countries where required to do so or where it may be a competitive necessity, and New York tax authorities issuing rulings eliminating the additional tax which might otherwise result from a murabaha-based home financing structure. Some of these regulatory approvals might be said to utilize a substance over form approach – which is the subject of an important ongoing debate as the Islamic finance industry matures – and thus setting the stage to overcome the next challenge.

A number of the important innovations with global implications that have already been discussed were achieved in part as a result of these regulatory milestones. As noted earlier, these include some of the first leveraged private equity buyouts, residential and commercial mortgage financing structures, and acquisition financing generally. As such, this would be a strong argument in favour of actively regulating Islamic finance in the form of advisory guidance (rather than statutory amendment, for instance) so that Islamic parties can properly and comfortably navigate the U.S. regulatory framework when doing business.

Islamic finance and certain Islamic transactions have also come before various U.S. courts in what are important examples of common law "regulation" of Islamic finance from which, it is hoped, Islamic finance in the U.S. can continue to grow, adapt, and flourish. The Board of Governors of the Federal Reserve System of the U.S. recently successfully defended itself against a lawsuit alleging that it violated the establishment clause[13] of the U.S. Constitution through its "bail-out" funding of American International Group (AIG) in the recent economic crisis. AIG, readers are reminded, provides Islamic financial and insurance products, including a home insurance product in the U.S. The Court found that the plaintiff "failed to produce evidence sufficient for a reasonable observer to conclude" (i) that the government's stated reasons. . .are disingenuous, a sham, or merely secondary to a religious objective", (ii) "that AIG is a sectarian institution" or that its activities "have resulted in religious indoctrination", and (iii) that the primary effect "has been the advancement of Islamic religious beliefs".[14] The Court also stated, "Viewing Plaintiff's allegations collectively there is no evidence to suggest that the government. . .encourage[d] others to adhere to Islamic tenets or that the government otherwise commented on the propriety of Islam or Islamic financing".[15]

[11] For a detailed explanation and corresponding diagram of such leverage structures, see Moghul, Separating the Good from the Bad: Developments in Islamic Acquisition Financing, American Univ. Int'l L. Rev., Vol. 23, No. 4 (2008).

[12] As is more often the case in the retail American Islamic finance market.

[13] The Establishment Clause provides that "Congress shall make no law respecting establishment of religion." U.S. Constitution, Amendment 1. "The defining principle of Establishment Clause jurisprudence is that the First Amendment mandates government neutrality between religion and religion, and between religion and non religion. ACLU v. Grayson County, 591 F.3d 837,844 (6th Cir. 2010) (citing McCreary Cnty. V. ACLU, 545 U.S. 844, 860 (2005) (quoting Epperson v. Arkansas, 393 U.S. 97, 104 (1968))).

[14] Kevin Murray v. T. Geithner and the Board of Governors of the Federal Reserve System, No. 08-15147 (E.D. Mich. Filed Jan. 14, 2011).

[15] See id.

While this case does not evaluate Islamic financial law, it does highlight an aspect of the environment towards its presence in the U.S. To some extent, this decision eases the pressures and challenges upon Islamic finance and Islamic finance practitioners may take some comfort in the objective applicability of the rule of law.

As many Islamic transactions contractually stipulate U.S. laws (such as those of Delaware or New York) as governing, legal practitioners have expected that U.S. courts would generally have been enforcing the agreements and documents as written. In the wholesale market, we have most recently seen the East Cameron Gas sukuk project before a U.S. bankruptcy court. Here, the court has likely established an important legal precedent, vindicating the theory of asset-backed Islamic finance by holding that the asset transfer under the sukuk constituted a true sale and thus the assets should be distributed to the sukuk holders. While further implications of this case remain to be realized, it does appear that the decision will likely provide comfort to potential U.S. sukuk issuers.[16] And in the retail segment of the American Islamic finance market, we have seen a number of residential mortgage financings come before various courts, providing the industry with further instruction and insight. These courts have generally enforced documents and contracts written and interpreted on the structures as secured financings.[17] Courts in the U.S. and other non-Islamic jurisdictions are likely to continue to interpret or resolve disputes with Islamic transactions.

It is worth noting that the East Cameron sukuk like, for instance, the Dar al-Arkan 2010 sukuk issuance, relied on the aforementioned Rule 144A. This rule allows issuers to market the sukuk to onshore U.S. investors by providing a safe harbour from registration for certain private resales of restricted securities to qualified institutional buyers, generally institutional investors that own at least USD 100 million of investable assets.[18] Some contend that the use of Rule 144A generally increases liquidity, and in the case of sukuk, this may very well assist with much needed secondary market trading. Moreover, because of their familiarity with this rule, conventional parties may be made more amenable to the sukuk market.

The salient question this raises is why have Islamic parties so often chosen Delaware or New York (or U.K. laws for that matter) as governing. Certainly, these stand as preeminent bodies of law with respect to business matters, and courts in these jurisdictions have, among their contemporary peers, some of the most sophisticated commercial experience. And generally speaking, the law of a nation or state must be utilized as the governing law of a contract. But beyond this, their use informs us that Islamic parties view these laws as capable of comprehending Islamic financial principles and structures, resolving disputes in a manner that is fair and just – in accordance with the parties' intent to comply with Islamic tenets, and enforcing the various contracts and documents as written. In other words, Islamic investors may hold that the U.S. legal framework can practically include within it Islamic financial laws and practice.[19] This is then again evidence in support of the practical congruence of Islamic and American laws and of the sufficiency of the latter when transacting in compliance with the former.[20]

24.5 Regulating the market

The objective of (simply) transacting and the success Islamic investors have had in doing so in the U.S. is an argument against the need for regulation specific to transactions compliant with Islamic laws. With regard to the wholesale market, existing regulation in the United States is equally applicable to all investor and investment types, whether Islamic or conventional. It is, moreover, evidently sufficient since in our experience we do not find anything in the contemporary practice of Islamic transacting per se to warrant specific, additional regulation or controls. Practically speaking, what differentiates the wholesale Islamic financial market from the conventional one are considerations of the ethical sort (e.g., what type of business may be acquired) – considerations regarding which U.S. laws do not generally express concern and which fall under the broad freedom to contract discussed above. We do find merit in the notion that regulatory guidance, such as that of the OCC letters discussed above, has been of great use in furthering Islamic market. More importantly, however, if tax regulations could be amended to place Islamic finance on an equal footing with its conventional "counterparts", that would be helpful in alleviating characterization and recharactertization issues. But such amendments would of course not alleviate the challenges that result from fitting into the dominant conventional economic paradigm. Of much greater concern is that such amendments may even slow the direction of Islamic finance towards further qualitative Shari'a-compliance by cementing existing structures as final and not works in progress.[21]

With respect to the American Islamic retail market, again we do not find any overwhelming need for additional specific regulation. Consumer regulation and securities regulations, for instance, are fairly robust and broad in their conception. It would probably be of comfort to this market though if accommodation could be made with simple lesser matters, such as legally-mandated disclosures in home financings where terminology more indicative of the underlying Islamic structure could be used.

Where we find most merit for regulating Islamic finance is with respect to an Islamic bank the establishment of which has been a long standing goal of American Muslims. While there is no such bank per se currently, there are banks offering products, such as Islamic savings accounts, checking accounts and certificates of deposit, under the purview of parent licenses. One may, however, counter that regulations regulating the business of banking should be amended to accommodate Islamic finance or that a parallel system of regulation should be designed. Before we address this contention, it is important to first have defined Islamic finance. Will the regulated Islamic finance be one in which banks can take on asset or market risk (which we might term asset-backed) or will banks be permitted to only bear risks that are incidental to the asset (what we might term as loosely asset-based), as per the OCC advisory letters?

Given that Islamic risk-reward allocation principles cut through the heart of U.S. banking regulation and such regulations would be so significant and novel and dis-

[16] Mohammed Khnifer, *Lex Islamicos: When sukuk Default – Asset Priority of Certificate-holders vis a vis Creditors,* available at http://www.opalesque.com/OIFI181/Lex_Islamicus_sukuk_Default_Asset_Priority81.html (last visited December 7, 2010).

[17] See Keith Varian and Jennifer Rockwell, *Islamic Financing and Foreclosure, Real Estate Issues*, Vol. 34, No. 1, (2009).

[18] See 17 C.F.R. § 230.144A.

[19] As mentioned earlier, it is possible to incorporate aspects of Islamic law as contractual terms and utilize a local law as governing. This seems in our experience to be the prevailing practice.

[20] An interesting alternative to relying exclusively on the U.S. court system would be to utilize arbitration and appoint persons with knowledge and experience with Islamic matters.

[21] See e.g., Muhammad Taqi Usmani, sukuk and Their Contemporary Applications (trans. Yusuf Talal DeLorenzo).

turbing to the very model of banking, one would not expect any regulations adopted for the former possibility (i.e., asset-backed) anytime soon. This leaves us with regulations of some kind for the latter conception of Islamic finance (i.e., loosely asset-based). This would be a tremendous undertaking which if successful could further span growth through increasing knowledge and comfort in the marketplace. The key questions are what form this kind of regulation would take place in and what issues or subjects it would address given the paucity of issues (once we leave aside issues of financier risk). One area, mentioned previously, would be placing Islamic financings on an equal footing with conventional finance in tax regulations. Perhaps Islamic investors could simultaneously seek to locate alternative, more flexible sources of funding that are not subject to banking regulations and that have learned of the soundness of Islamic financial principles so as to break free from certain customary practices. In jurisdictions other than the U.S., a separate somewhat parallel regime that speaks to what truly distinguishes Islamic from conventional banking (namely its risk-reward allocation requirements) would seem to be more viable and appropriate.