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Introducing islamic banking in Italy. Challenges and Opportunities to diversify funding sources at a time of a crisis.

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Introducing islamic banking in Italy

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SUMMARY[01]: 1. Introduction: aim of the research. - 2. Analysis of the different impacts of the crisis on the area of conventional finance as compared with the area of Islamic finance. – 3. Profit and loss sharing as a method to increase control in loan markets: new rules on debt financing and opportunities in the prohibition of uncertainty surrounding deritvatives, forward and future contracts. – 4. The Sukuk market: a new market for government debt and for infrastructure financing. – 5. The Islamic bank around the world: a new challenge. - 6. Islamic banks and the principles of the Basel Commitee. - 7. Islamic banking and Italian law. - 8. Analysis of the crisis and new challenges. - 9. *Shari'a*-compliant project financing of infrastructure. - 10. Conclusion.

1. At this very moment of global crisis, particularly in its European dimension, the financial model embodied by the Islamic banking system can certainly help provide a viable route out of Italy's current economic crisis. Despite some doubts about its compatibility with the different national laws and regulations, Islamic banking is the correct way to re-start growth. This can be achieved in dual ways. The first, being commercial in nature, relates to the opportunity to attract Middle Eastern and Islamic investors into Italy. The second, being plainly structural, relates to the urgent need to induce the Italian banking system to 'change its mind' or, more accurately, show a willingess to endorse an additional method of finance over conventional commercial banking. Such model would be based on the encouragement of finance tools (*Shari'a*-compliant or otherwise), that asset a '*Risk Sharing*' model and to move to prohibit or heavily regulate speculative financial products (including some types of derivative products) whilst reintroducing 'ethics' as the cornerstone of the global banking industry (notwithstanding the role of religious teachings) in a country that gave the world its first ever modern commercial banks in the fourteenth century, the most famous of which was the Medici Bank established in 1397.

It is important to recognize that Islamic finance is not solely a matter of religion. The differences between the conventional financial systems we are experienced with and an Islamic banking system should be looked at from an objective standpoint without any conditioning of a religious nature which could mar its introduction. The *Osservatore Romano*, the official newspaper of the Vatican State, pointed out, in 2009, the great opportunities that Islamic finance could offer to the Western world in

01 The present article is the result of joint research efforts. However, it is understood that sections 4,5,6,8,10 are to be attributed to Prof. Ayman H.A. Khaleq, whereas sections 1,2,3,7,9 are to be attributed Prof. Tommaso Vito Russo.

crisis. The article emphasized that Islamic finance could contribute to the establishment of new rules for Western banking, especially in the previous and current critical economic climate. The journalists further wrote that the crisis was not a result of a lack of liquidity only, but that it was by and large rooted on a universal lack of confidence in the banking system itself. In their opinion, the international banking systems needed to put business ethics at the forefront of the economic discourse and find new methods to raise money with a view to rebuilding the reputation of a model that had, for all intents and purposes, failed[02].

All of the above should be read whilst being mindful of the need in Italy for the expansion of public and private infrastructures and for growth of the renewable energy sector amidst the continuing money deficiency. The European and Italian banking system may then be able to think about the opportunities associated with issuing financial products compliant with the principles of *Shari'a* (including *Sukuk*, which are the equiavalent of conventinal bonds or asset-backed securities) in Italy, thus utilizing the surplus wealth readily available in the Middle East, and the need to convince 'Institutional Islamic Investors (Islamic Funds)' to open their minds to a new and interesting market[03].

Given the current economic climate, it is crucial to encourage such investments through an overhaul of both the Italian banking system and the regulations that underpin it. As the two facets go hand in hand, any suggested change to the Italian banking system would necessitate the introduction of far-reaching changes in the banking legislation that currently exists in Italy, which would in turn, have its own obstacles to overcome.

In order to implement the Islamic banking model, the first step for Italy could be the creation of Islamic finance departments or teams (but not necessarily dedicated windows) within the conventional banks in Italy to introduce the concepts and practices to the region. This may be an invaluable learning tool for the Italian banking system in relation to the procedures and functioning of the Islamic Finance regime and if a market for the same exists in Italy. Thereafter, the transition to a '*dual banking system*', akin to Malaysia, Bahrain, Jordan, United Arab Emirates, Qatar, Turkey, Yemen, Gambia and Kuwait, as well as

02 L. Napoleoni and C. Segre, *Dalla finanza islamica proposte e idee per l'Occidente in crisi*, in *L'Osservatore Romano*, 4th march 2009 http://rassegnastampa.mef.gov.it/mefnazionale/PDF/2009/2009-03-04/2009030412006886.pdf

03 For a recent analysys see T.V. Russo, *I contratti Shari'a compliant. Valori religiosi e meritevolezza degli interessi. Contributo allo studio*, Napoli, 2014.

United Kingdom where Islamic financing co-exists alongside the conventional banking laws could be more plausible.[04] This dual banking system would permit a separate set of standards for those Islamic investors wishing to transact in the region in a *Shari'a* compliant manner which would, in theory, boost private investments in Italy, especially in infrastructure and renewable energy if the focus is placed in such sectors.

Additionally, the growth of the 'project financing model' and of its market in Europe can be seen as a valuable common ground for introducing and developing *Shari'a*-compliant products in Italy, particularly given that project financing is a 'risk sharing' financial technique employed both in the conventional banking systems and in Islamic finance, and also because there are multiple precedents where Islamic banks co-funded project with conventional banks.

For the reasons stated above, this research paper aims to explore ways by which the Islamic banking industry can provide a viable route (to be added to other policy reform agendas currently put on the table) to put an end to Italy's current economic crisis. In particular, we seek to identify the extent to which *Shari'a*-compliant funding mechanisms, in the context of an asset-rich country like Italy, can help tackle the growing infrastructure investment and energy needs of this country, and facilitate the implementation of a feasible privatisation program. The paper also intends to demonstrate that Islamic financial instruments could, if deployed correctly, innovatively and intelligently, play an imperative role for the economic and financial growth of Italy[05] for the long haul.

04 See, T.S. ZAHER and M.K. HASSAN, *A comparative Literature Survey of Islamic Finance and* Banking, in *Financial Markets, Institution &* Instruments, Vol. 10, November 2001, New York; Cfr., D. MULJAWAN, *Risk Managment in Islamic Finance: Issues, Challenges and Strategies to Mitigate the Risk.*, in M. DAUD BAKAR and E.R.A. ENGKU ALI, *Essential Readings in Islamic Finance*, Kuala Lumpur, 2008, p. 365, who underlines that "In order to promote a sound Islamic Finance system, the banking authorities have also been in their effort to set prudential standards and regulation dedicatedly designed for Islamic banking".

05 For previous studies about Islamic finance in Italy see *La banca islamica e la disciplina bancaria europea*, by G. Gimigliano and G. Rotondo, Milano, 2006; E. GIUSTINIANI, *Elementi di finanza islamica*, Torino, 2006; *Fondi sovrani arabi e finanza islamica*, by A. Dell'Atti e F. Miglietta, Milano, 2009; F. CASTRO, *Il modello islamico*, Torino, 2007; *Banca e finanza islamica. Contratti, peculiarità gestionali, prospettive di crescita in Italia*, by C. Porzio, Roma, 2009; R. HAMAUI and M. MAURI, *Economia e finanza islamica. Quando i mercati incontrano il mondo del profeta*, Bologna, 2009; L. DONATO and M.A. FRENI, *Islamic Banking and prudential supervisory in Italy*, in *Islamic Banking and Finance in the European Union. A challange*, by M.F. Khan and M. Porzio, Cheltenham, 2010, p. 179 ff.; P. ABBADESSA, *Islamic banking: impression of an Italian jurist*, ivi, p. 197 ff.; T.V. RUSSO, *Finanza Islamica*, in *Digesto delle Discipline Privatistiche, Sez. Commerciale*, Agg. VI, Torino, 2012, p. 389 ff.; T.V. RUSSO, *Contrattazione Shari'a compliant e meritevolezza degli interessi. Prime riflessioni su un differente approccio al mercato finanziario*, in questa *Rivista*, 4/2014, p. 11 ff.; T.V. RUSSO, *I contratti Shari'a compliant*, *passim*.

2. An analysis of the impacts the crisis had in the conventional finance arena compared with the Islamic finance market should firstly be undertaken by conducting a preliminary analysis of the underlying principles governing Islamic finance.

It is well known that the term 'Islamic finance' refers to the complex contractual and financial structures which are based on Islamic laws and, more specifically, on *Shari'a* principles which are not confined to specific legal systems, but are characterized by significant moral connotations[06]. The whole system of life, not only of legal relevance, of the Islamic world is based on a clear distinction between what is permissible (*Halal*) and what is forbidden (*Haram*) by *Shari'a*[07]. For this reason it is said that Islamic finance, rather than be shaped by the experiences of practices and jurisprudence, is a 'prohibition-driven finance' system[08].

The proper allocation of financial resources, from a perspective not driven solely by the laws of economic efficiency is the key approach to Islamic finance, a system that has discovered, before the Western-conventional economic system, the so-called ambit of 'ethical finance'[09] . Nonetheless, we should not think that the Islamic finance system is useful solely for social purposes. Islamic banks play an important role in the economic market, in the same way as (and in competition with) conventional banks, and aim to capture investors and interested parties from all religious backgrounds, not solely

06 One of the first studies about the impact of Islam on economic matters is by A'La Maududi, *The Economy Problem of a Man and its Islamic Solution*, Lahore, 1947. See too the interesting analysis made by M.D. Bakar, *Developing modern Islamic financial system via* ljtihad*: an overview*, in *Essential readings*, cit., p. 27 ff.

07 See M.H. Khamali, *Shari'ah law: An introduction*, Oxford, 2008, p. 17, who suggests a further dufference between *Haqq Allah* (*rights of God*) that concerns the civil rights of a person and *Haqq Al'Abd* (*rights of man*) that concerns the rights that belong to a community in its entirety. See, also, the analysis of Y. DeLorenzo, *The Religious Foundations of Islamic Finance*, in *Islamic Finance: Innovation and Growth* (by Archer e Karim), London, 2002, p. 9 ff. Unavoidable is the study of M.T. Usmani, *An introduction to Islamic Finance*, Karachi, 1998.

08 M.A. El-Gamal, *Islamic Finance. Law, Economics and Practice*, New York, 2009, p. 8, who analyzes the results of the different approaches to economy in the different theories of Richard Posner and Adam Smith.

09 According to authoritative scholars, the Western economic system, whereby capitalism (even in the absence of ethical rules) is able to self-correct the economic processes in order to maximise satisfaction of human interests, has been unsuccessful enough to be a sufficient cause for a massive economic crisis: in this sense, see M. Ahmad, *Economics of Islam. A comparative study*, Lahore, 1972. See, also, R.N. Kayed, M. Mahlknecht e M.K.Hassan, *The Current Financial Market Crisis: Lessons Learned, Risks ad Strenghts of Islamic Capital Markets Compared to the Conventional System*, in *Islamic capital markets. Products and Strategies*, by M.K. Hassan and M. Mahlknecht Singapore, 2011, p. 613 ff.

followers of Islam[10].

The most well known and relevant prohibition that governs Islamic finance is certainly entrenched in the notion of *Riba*. It is considered appropriate to identify *Riba* with usury concepts or with the conventional concept of interest. The determination as to whether the prohibition has been contravened does not take place exclusively in respect of currency alone, but also turns on examining the quality of goods used for the exchange[11]. In financial transactions, the term Riba is referred to as the "*premium that must be paid by the borrower to the lender along with the principal as a condition for the loan or for an extension in the duration of loan*"[12].

That is, of course, a rule that marks the most significant difference between the conventional finance system, characterized by an interest-based approach (*Riba*-based), and Islamic finance, which is characterized instead by an asset-based approach. In brief, and beyond the religious origins, the different 'ideological and economic' approach to finance exists due to the different value given to money under the two systems. Under the conventional system money is not considered as just an exchange of goods or as an instrument to measure the value of an asset or object of a transaction, but instead as an '*asset in re ipsa*', a real asset capable of generating wealth by itself, and more precisely, interest. Conversely, in Islamic finance, money is seen just as an exchange of goods and does not represent the asset itself[13].

It should be noted that the prohibition of Riba does not apply where the loan is asset-based, in which case it is said that a loan made in such circumstances has its foundation not on the remuneration of the

10 See S.Y. Mohd Sultan, *Islamic Banking: Trend, Development and Challenges*, in *Essntial Readings in Islamic Finance* cit., p. 89 ss

11 See M.A. El-Gamal, *Islamic Finance*, cit., p. 51 f.; M.D. Bakar, Riba *and Islamic Banking and Finance*, in *Essential Readings*, cit., p. 3 ff., esp., p. 19 "In Islam, a growth in wealth cannot always be inferred from the making of an accounting profit, and an accounting profit does not always arise from a growth in wealth [...] there is no direct wealth creation and wealth transfer in *riba*-based lending activities. If there is any, it solely for the benefit of the lenders".

12 Z. Iqbal e A. Mirakhor, *An Introduction to Islamic Finance. Theory and Practice*, Wiley, Singapore, 2^ ed., 2011, p. 97.

13 M.D. Bakar, Riba *and Islamic Banking and Finance*, cit., p. 19 "The practice of *riba* is made possible by considering money as a commodity [...] Islamic banking and finance cannot deal with money directly to generate income or profit [...] Money, in Islam, does not earn money without collaboration between capital and effort"; see, also, T.V. Russo, *I contratti Shari'a compliant*, cit., p. 34 ff.

currency but that it is linked with the underlying assets which can generate profits to be distributed and therefore is able to realize the purpose of risk sharing.

Like *Riba*, there is not a precise definition of *Gharar*, traditionally attributed to the concept of 'excessive uncertainty'[14]. The uncertainty inherent in *Gharar* concerns the subject matter of the contract, such as the price, quantity or quality of the goods or services being provided. The uncertainty prohibited by the holy book of Islam, the *Quran*, must also be understood as a result of information processing or the mutual control of the parties of a contract[15].

With reference to Islamic financial transactions, the lack of information can lead the borrower to find himself in a situation of moral hazard if he invests the borrowed money in *Haram* areas, or in activities that could cause a high probability of default[16].

Unlike the prohibition of Riba, in this case, the prohibition of *Gharar* is not absolute, because the prohibition mainly relates to absolute uncertainty, *Gharar Fahish* (or *Major Gharar*) (meaning those transactions in which the lack of control of the operational risks can involve speculation or hazard) which is strictly forbidden[17].

The high risk nature of financial instruments called 'Derivatives', characterized by unscrupulous leverage, as used in conventional finance transactions – the legitimacy of which is now being discussed

14 W.M.W AHMAD, *Some issues of* Gharar *(Uncertainty) in Insurance*, in *Essential Readings*, cit., p. 247 ff. "The word *gharar* comes from the root verb *gharara* signifying to reveal oneself and one's property to destruction without being aware of it. Generally it means danger, peril, jeopardy, hazard or risk"

15 See, B. KETTEL, *Introduction to Islamic Banking and Finance*, Singapore, 2011, p. 76; see, also, W.M.W. BAKAR, *Some issues of* Gharar, cit., p. 252, who says that "*Gharar* is the uncertainty or indeterminancy involved in transactions where the quality and the quantity of the commodity on sale is not predetermined and known. [...]Basically the reason or cause of *gharar* can either be asymmetrical or lack of information (*jahalah*), or (which is broader in scope) *jahalah* and lack of control. Lack of information which includes ignorance of the nature and attributes of an object; doubt over its availability and existence; doubt over its quantity; lack of information concerning price and terms of payment or prospect of delivery".

16 B. KETTEL, *Introduction to Islamic Banking and Finance*, *ibidem*, who argues that "Moral hazard is the consequence of asymmetric information *after* the transaction occurs". See also Z. IQBAL e A. MIRAKHOR, *An Introduction*, cit., p. 111 f.

17 W.M.W. BAKAR, *Some issues of* Gharar, cit., p. 253, "*Gharar fahish*, which means excessive risk, is the one that can affect a contract, that is, nullify it. [...] The other kind of *gharar* is known by *gharar yasir*, which means small in amount or trivial. Since all contracts and conducts contain some element of uncertainty in its outcome this *gharar yasir* is tollerated".

by economists and jurists - is a clear example of the recurrence of *Gharar Fahish*, since, as is well known in these kinds of transactions, the goods which are the subject matter of such transactions do not exist at the time of the formation of the 'derivative agreement' and may never come into existence[18].

The precise meaning of the prohibition of *Gharar* can be understood only upon an analysis of the main principles governing Islamic finance, which make Islamic finance an attractive model to imitate. The role money plays in Shari'a, in addition to the prohibition *of Riba* and the need for commercial transactions to produce a mutual benefit for all contracting parties, help reveal the meaning of the 'risk sharing' principle and the goal of this principle within Islamic finance. This model is something that could benefit conventional finance transactions in the current climate.

3. In the world of conventional finance 'profit-loss sharing' means that a lender is not limited to the activity of granting credit but must also participate in the business risk of the borrower, thus must share in the gains and losses of the borrower. Such 'profit' is the only type of profit permitted by the Holy Quran in Islamic financing activities. It is well known that in any economic system, one of the main activities of the management of a company or its advisors, whether legal or financial, lies in risk management. It is interesting to note that the conventional approach to risk management is not worlds apart from the approach adopted in Islamic finance transactions. The main difference is that in the latter, all elements of uncertainty must, if possible, be turned into risks in order to ensure that their effects can be effectively managed through suitable risk management activities[19].

Uncertainty, *prima facie*, is not forbidden in conventional finance because it is not deemed an insurmountable obstacle, especially in insurance transactions as it provides for a form of consideration, however it is absolute and in some instances material uncertainty, as we have seen, that is forbidden

18 For a very interesting analysis of derivatives in the Islamic perspective, see A.S. THOMAS, *Risk management amd derivatives*, in *Structuring Islamic Finance Transactions* (by THOMAS-COX-KRATY), London, 2005, p. 184 ss.; see also, W. EDWARDES, *Key Financial Instruments: Understanding & Innovation in the World of Derivatives*, London, 2000; M.H KAMALI, *Islamic Commercial Laws: An Analysis of Futures and Options*, Selangar, 2002; for a comparative analysis between conventional and Islamic derivatives, see S.B. KUNHIBAVA, *Flexibility versus Fairness conventional derivatives and Islamic derivatives*, in *Essential Readings*, cit., p. 561 ff.

19 Cfr. T.V. RUSSO, *Contrattazione Shari'a compliant e meritevolezza degli interessi*, cit., p. 7 ff.; T.V. RUSSO, *I contratti Shari'a compliant*, cit., p. 31 ff.

in Islamic finance, although it can be 'purified' only under certain conditions[20]. From this perspective, risk-sharing is the ideal means through which cooperation may take place. It was considered that this 'democratic' approach to finance, '*without transferring risks of any venture to a particular class or to the whole society*' was the only one able to fulfill the Quran's precepts[21].

The existence of risk is, therefore, an inherent character of all commercial transactions and the search for an appropriate balance in the sharing of this said risk is often set out as one of the main objectives of parties who want to enter into a 'fair' contract. What differentiates Islamic finance from conventional finance is without a doubt the greater significance placed on this balance of risk sharing to validate a contract in the Islamic finance arena. The prohibition of interest (*Riba*) also realizes this need and forbids that the risks and the costs associated with a transaction rest on just one of the parties in a transaction.

It is therefore plausible to assert that the conventional system of risk transfer, alongside the use of speculative financial instruments which are not based on any tangible underlying asset, can be considered structurally unstable and therefore, whilst the instruments may be able to yield significant margins and returns, they are also easily exposed to increased chances of default and devastation.[22]

The fragility of an economic system based entirely on highly speculative debt financings and the use of money as an asset has become evident in light of the ongoing defaults we can see in the market

20 Cfr. Y. DeLorenzo, *Shari'a Supervision of Islamic Mutual Funds*, in *Proceedings of the Fourth Harvard University Forum on Islamic Finance*, Harward, 2003, p. 69, who distinguish the *fiscal purification*, concerning the gain of the mutual fund, and the *moral purification* through the participation of the *Shareholders* in the corporate governance. See, also, I. Asaria, *Screening and Purification Criteria: Shari'a Application to Investment*, in Aa.Vv., *Islamic Finance. A Guide for International Business*, cit., p. 125 ss.; B. Kettel, *Introduction to Islamic Banking*, cit., p. 53.

21 Z. Iqbal e A. Mirakhor, *An Introduction*, cit., p. 157: they say that "This would be in sharp contrast to the results of the recent global financial crisis in which the risks associated with dubious financial innovations were away from financiers in such a way that while the gains were privatized, the pain was socialized"; in the same sense Sheng, *From Asian to Global Financial Crisis. An Asian Regulator's View of Unfettered Finance in the 1990s and 2000s*, New York, 2009, p. 375 ss.; see also A. Mirakhor, *Whiter Islamic Finance: Risk Sharing in a Age of Crises*, in http://www.iais.org.my/en/attach/Dr%20Abbas%20Mirakhor%20Whither%20I%20%20Finance.pdf

22 Interesting remarks by Warren Buffet on *Economist* of 15.3.2003, who said that "derivatives are *financial weapons of mass destruction*, carrying dangers that, while now latent, are potentially lethal", the rich american business man also said, in an agreeble way, that "The errors usually reflect the human tendency to take an optimistic view of one's commitments. But the parties to derivatives also have enormous incentives to cheat in accounting for them. Those who trade derivatives are usually paid, in whole or in part, on "earnings" calculated by mark-to-market accounting. But often there is no real market, and "mark-to-model" is utilized.

today. Due to the back-to-back risk-transfers that were being conducted in the conventional market, a domino-effect of defaults resulted which was difficult to limit.

Accordingly, this interpretation to the approach of Islamic finance has proven to be less risky from a macroeconomic perspective as well as more protective from a social standpoint.

The ongoing modernization of Islamic finance, resulting from the demands of 'keeping pace' with conventional finance, has convinced Middle Eastern Scholars to consider the compatibility of aspects of conventional financial instruments with the principles of Shari'a in the capital markets, from equities and bonds to securitization transactions. The research perspective of such financial transactions, especially for long-term ones, can be appealing not only to investors but also to savers who typically invest in bonds.

The need to respect the principle of 'profit-loss sharing' makes Islamic finance incompatible with the pure debt market as understood in conventional financings as a result of the prohibition of *Gharar*. It also limits the ability of muslims to invest in some financial capital markets such as buying the stock market shares of a conventional bank or shares of a wine company.

With reference to this sector there is no doubt that the stock market, if not for purely speculative purposes, constitutes the natural field for risk sharing, useful for the realization of Islamic precepts.

The market for Islamic investment funds saw its development in the late eighties following on from the experiences the Western financial market had. Islamic investment funds typically raised capital from *Shari'a* compliant investors who were typically of a Muslim origin and invested such funds as agents in real estate, commodities or venture capital companies which undertake *Shari'a* compliant activities. The portfolio of an Islamic investment fund, akin to the West, though subject to compliance with *Shari'a*, is composed of short-term and long-term instruments with different risk margins and profit expectations. It has been recognized that the very purpose of Islamic investment funds investing in 'socially responsible' markets has increasingly attracted non-Muslim investors that are interested in the recent phenomenon of the so-called 'ethical finance' model to such investments[23]. Moreover, the limited investment that has taken place in activities and markets not accustomed to pure speculation has led

23 Z. Iqbal e A. Mirakhor, *An Introduction*, cit., p. 251.

to significantly better results in such markets compared to investments in conventional investment funds, or has at least created a degree of resistance to those uncontrollable events ensuing in the conventional markets that have been prevalent in the recent global crisis.

4. The use in the Islamic loan markets of instruments akin to conventional market bonds is not new to Islamic finance. However, the most recent and interesting developments in debt securities is to be found in the increasingly popular instruments, which have echoes of securitizations, whose certificates are defined as *Sukuk*[24]. The growth and popularity of the issuance of *Sukuk* around the world increased from a value of US$ 7.5 billion in 2000 to US$ 118 billion in 2008. The market did, however, see a downturn due to the global economic crisis in 2011, when the value of *Sukuk* issued in such year dropped to US$85 billion. In 2012, the issuance increased again to US$ 121 billion [we need to up-date to reflect 2013 as it was a good year for sukuk[25].

Sukuk denotes certificates representing ownership of an asset, debt, project, business or investment, for a defined period of time which gives the owner the right to a proportionate profit from the cash flows arising from the use of such instrument[26]. *Sukuk* do not place any obligation on the issuer but give a proportional interest in the ownership of an asset or a right of usufruct, projects or activities which are always to be *Shari'a* compliant[27].

The most significant difference between *Sukuk* and bonds lies in the fact that the latter represents only a debt of the issuer, while *Sukuk*, not only import the risk arising from the solvency of the issuer, but also represent a stake in the ownership of an existing or 'well defined' asset as well as a project. This form of participation in the business risk by the subscribers of certificates is what ultimately

24 For a first analysis, see N.J. Adam e A.S. Thomas, *Sovereign* Sukuk*: applications and implications*, in *Islamic Bonds: Your Guide to Issuing, Structuring and Investing in* Sukuk, by Adam e Thomas, London, 2004, p. 82 ss.; E.A.E. Ali, *Issues in Islamic debt securitization*, in *Essential Readings*, cit., p. 443 ff.; M. Al-Amine, *The Islamic bond market: possibilities and challenges*, ivi, p. 497 ff.; T.V. Russo, *Finanza islamica*, cit., p. 415 ff.; T.V. Russo, *I contratti Shari'a compliant*, cit., p. 96 ff.; F. Miglietta, *I bond islamici alla conquista dei mercati. Opportunità, rischi, sfide dei sukuk*, Milano, 2012.

25 According to Thomson Reuters report, global demand for sukuk is expected to reach $421 billion by 2016; http://www.reuters.com/article/2012/12/11/islamicfinance-sukuk-idUSL5E8NB2LA20121211

26 For a closer examination, see A.H. Khaleq and C.F. Richardson, *New Horizons for Islamic Securities: Merging Trends in* Sukuk *Offerings*, in *Chicago Journal of Intrnational laq*, 2007, 2, p. 409 ff.; S. Mokhtar, S. Rahman, H. Kamal and A. Thomas, *Sukuk and the Capital Markets*, in *Sukuk* (by A. Thomas) Petling Java, 2009, p. 17 ff.

27 Z. Iqbal e A. Mirakhor, *An Introduction*, cit., p. 264.

characterizes *Sukuk* and characterizes the most interesting difference between it and securitizations in conventional financing[28]. If a securitization transaction can be done by way of issuing *Sukuk* instead, the majority of *Sukuk* issued in the world would not be comparable to traditional securitizations as their characteristics would go further than that of the conventional model[29].

The original owner of the assets in a *Sukuk* transaction, defined as the *originator*, is generally a government agency or a large company, but can also be a bank or other non-banking financial institution. Such persons need not be Islamic nor do they need to be based in an Islamic jurisidction.

It is well known that the basic prerequisite for the issuance of *Sukuk* is the availability, for the originator, of an asset or pool of assets: such must be tangible assets even if they are combined with financial assets. Once identified, the assets are transferred to a *Special Purpose Vehicle* (SPV) at a specified price. The asset transfer involves the originator's exit from the assets whereby the relevant asset no longer forms a part of its property collateral. This transfer, once established, is an essential profile for the subscriber of certificates which relies on the destination, for its own benefit, of the segregated cash flows from those assets[30].

Although theoretically a hybrid of debt and equity, *Sukuk* can be structured to offer a fixed return similar to that of a conventional bond, making such investments attractive to Muslim investors seeking to diversify their portfolios. That said, it is not permissible for the return of a *Sukuk* offering to be

28 For a further analysis, see A. Jobst, *The Economics of Islamic Finance and Securitization*, in *Journal of Structured Finance*, 2007, 1, p. 16

29 Eminent Scholar has distinguished *Islamic bonds* from the operations of *Islamic asset securitizations*: the former are substantially in debt securities that give the participation in a business; the latter, however, involve the participation of the ownership packed by the originator of the assets to an SPV: see M. McMillen, *Contractual Enforceability Issues: Sukuk and Capital Markets Devolpment*, in *Chicago Journal of International Law*, Winter 2007, p. 428; according to A. Thomas, *Opportunities with* sukuk *and securitisations*, in *Structuring Islamic Finance Transactions* (by Thomas, Cox and Kraty), London, 2005, p. 154, "The legal structure and format of *sukuk* certificates may be considered analogous to US trust certificates and *sukuk* certificates may be listed and rated".

30 The AAOIFI defines Sukuk as "*certificates of equal value representing, after closing subscription, receipt of the values of certificates and putting it to use as planned, common title to shares and rights in tangible assets, usufructs and services, or equity of a given project of a special investment actvity*". The same AOOIFI has classified *Sukuk* in four branches: 1) *Asset based Sukuk* (Ijarah e Manfah Sukuk); 2) *Debt based* (*Istisna e Murabahah Sukuk*); 3) *Equity based* (*Mudarabah e Musharakah Sukuk*); 4) *Agency based* (*Wakala Sukuk*). See, the analysis of F.J. Fabozzi and V. Kothari, *Introduction to Securitization*, Singapore, 2008, p. 86 ss.; M. Obaidullah, *Securitization in Islam*, in *The Handbook of Islamic Banking* a cura di Hassan e Lewis, Northampton, 2007, p. 194.

directly linked to a 'prime rate', such as the London Interbank Offered Rate ('LIBOR') or similar market benchmarks, because such benchmarks are interest-based. However, a properly structured *Sukuk* may generate a profit-based return that essentially replicates a prime rate or LIBOR[31].

The *Sukuk* market is not a market reserved for the Middle East or just for Islamic investors; this is evidenced by the increasingly common issuances of *Sukuk* by both financial and governmental institutions that are not directly related to the Islamic world[32].

In Europe, a significant indication of this trend is the initiative of the State of the Federal Republic of Germany, Saxony-Anhalt, which in 2004 issued *Sukuk* by tying up, as underlying assets, a number of properties owned by the Ministry of Finance[33]. The certificates, for a total value of € 100 million were issued by a Netherlands SPV. Through a lease for a period of 100 years, the Federal Government, and on its behalf, the Ministry of Finance, gave the property to the SPV in return for a payment of rent paid in a lump sum which was equal to the issuance of the *Sukuk*. The SPV thereafter entered into a contract to lease the assets back to the Ministry of Finance for a period of five years, thus ensuring a cash flow able to repay the certificate yield. The issuance was fully subscribed, 60% by investors from Bahrain and the United Arab Emirates, and 40% by European investors. In order to make the product attractive, the Sukuk had been listed on the stock exchange of Luxembourg (Bourse de Luxembourg) and Bahrain (Bahrain Bourse).

This was an issuance on the basis of *Ijarah* (lease, rent or wage), to ensure that the certificates were freely tradable in the secondary market and therefore easily convertible into currency by the subscribers.

The reasoning provided by the Minister of Regional Finance in Germany for the issuance was significant when rationalizing the decision taken by the local government to turn to Islamic finance in this instance. The first reason was economic, as the prevalence of Islamic investors and the opportunity

31 A.H. KHALEQ and C.F. RICHARDSON, *New Horizons for Islamic Securities*, cit., p. 411.

32 See A. THOMAS, *Opportunities with* sukuk *and securitisations*, cit., p. 165; A.H. KHALEQ, *Islamic capital markets: the case for a more intelligent positioning in an evolving global industry*, in *Islamic Investment Banking: Emerging Trends, Developments and Opportunities*, by Jaffer, London, 2010, p. 144 ff.; A.H. KHALEQ e C.F. RICHARDSON, *New Horizons for Islamic Securities*, cit., p. 417.

33 See T.V. RUSSO, *Contrattazione Shari'a compliant e meritevolezza degli interessi*, p. 5.

to provide them with appropriate products was an attractive proposition. The second stemmed from 'international courtesy', and the need to show acceptance and respect for other cultures that had different investment rules[34].

Sukuk have also been issued recently in the United States of America, Luxembourg, Germany (by a private issuer in this case) and Great Britain by private companies; on the London Stock Exchange since 2006; and by the World Bank in 2005 with a value of US$ 200 million.

The same Catholic newspaper mentioned above (the Osservatore Romano) maintained that Western banks could use the secure nature of *Sukuk*; in fact, the article suggested they should directly issue *Sukuk* with a view to stimulating economic growth [35.]

In contrast to the crisis of 1929, the current financial crisis we are confronted with today presents us with an excess of stagnant liquidity that needs to be put in motion: *Sukuk* could be a suitable vehicle for this purpose. In the same way, the ethical principles that form the basis of Islamic finance may bring banks closer to clients and to the true spirit of service that should distinguish every banking service provider.

One of the most interesting aspects of *Sukuk* relates to the quality of the underlying asset. Whereas initially Islamic scholars and the Islamic banking system asserted the need to base *Sukuk* on tangible assets, a new perspective has recently emerged which demonstrates that this *Shari'a* compliant financial instrument is more flexible than had been previously imagined.

For example, in Malaysia, the largest national telecommunications operator (Axiata Group Bhd) set up a multi-currency *Sukuk* program worth US$1.5 billion backed by telephone airtime, in place of a tangible asset[36]. The chief executive officer of a consultancy company, which supported the issuance, stated "Airtime isn't physically tangible but its value, amount and quantity can be calculated and fixed,

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34 See T. Box and M. Asaria, *Islamic finance market turns to securitization*, in *International Financial Law Review*, 1, 2005 p. 22 ff.

35 L. Napoleoni and C. Segre, *Dalla finanza islamica proposte e idee per l'Occidente in crisi*, cit.

36 It has been reported that Emirates Telecommunications Corp adopted a similar structure and established a $1 million Shari'a compliant debt plan supported by airtime in November 2010. http://biz.thestar.com.my/news/story.asp?file=/2012/8/3/business/11784964&sec=business

therefore it can be used as a Shari'a compliant asset".[37]

Moreover, FWU A.G., a German financial services company, for an example, issued Sukuk in 2012 that were based on a proprietory software[38].

5. In order to provide an adequate analysis of the 'method' of the Islamic banking system, it is necessary to appreciate the obligation on the banking company to protect not only the interests of shareholders, but also those of all the stakeholders, who may be interested in improving their business management strategies, while remaining conscious of ethical business. Therefore, when discussing Islamic banks, it is essential to appreciate that this term refers to those banks operating in compliance with the precepts of *Shari'a* in all their businesses; this is not simply limited to their financial business and transactions but extends to the organization and management. In contrast, conventional banks refer to those which offer *Shari'a* compliant financial products and contracts through *Islamic windows*, as a separate unit created for customers wishing to observe Islamic principles. The needs of such Islamic customers of ensuring their investments are kept strictly separate from those made by non-Islamic customers make it necessary, in the case of *Islamic windows*, to separate the categories of funds and to have the necessary accounting systems in place in order to accomplish the required segregation.

In Islamic banks 'savings' are usually held in the form of investment accounts (which may follow the rule of the current account) that are based on a *Mudarabah* contract and are therefore paid through participation in the earnings of the bank; this can be contrasted to procedures in the conventional banking system. Additionally, the account can be restricted to a specific investment, as opposed to being allocated to an 'unrestricted investment funds' account or category . This entails a much higher level of protection for stakeholders than in the conventional banking system, even though the actual degree of protection is closely related to the *disclosure* of the investment strategy adopted[39].

If depositors in Islamic banks do not wish to share the bank's interest, they may enter into contracts of

37 Abas A. Jalil, chief executive officer of Amanah Capital Group Ltd, a consultancy company in Kuala Lumpur, in http://www.globalislamicfinancemagazine.com/?com=news_list&nid=2514.

38 http://www.islamicfinancenews.com/listing_article_ID.asp?nm_id=35159

39 See, on this point, C. PORZIO, *Intervento*, in *La banca islamica*, cit., p. 89, who suggest his favour for investment in Islamic mutual funds, because they have a lower degree of discretion for investment decisions, since the asset allocator must declare its policy ex ante.

deposit, called *Wadi'a* with a guarantee of repayment of the principal but without receiving remuneration. In any case, at the end of each financial year, the bank may, at its discretion, grant current assets in kind (*Hadiyya, i-kramiyya*), gifts of modest value (*hiba*), or preferential conditions for access to special forms of credit (*tamwil*).

Islamic banking is, of course, the predominant form of banking in the Muslim world. Nonetheless, in the last decade there has been a slow but interesting development of Islamic finance in countries with a non-Muslim majority population.

The experience of Malaysia, by providing specific and incentivizing tax rules, is certainly a point of reference for the application of instruments of Islamic finance to the wider banking and financial system. This opens up the possibility of providing investors with an option as to which system to use depending on the benefits they derive from them[40].

The Malaysian central bank (Bank Negara) has played the role of 'trailblazer' in the direction of a mixed banking system able to capture not only the interests of Malaysian investors and savers, but also foreigners beyond Malaysia and the Middle East. It has been rightly pointed out that it is not a coincidence that Malaysia has been made the host country of the Islamic Financial Services Board (IFSB), which has the task of drawing up the criteria for the prudential and financial stability of all institutions operating under *Shari'a* law[41].

In the Western world the British experience can certainly serve as a guide for the development of Islamic finance in a not-Muslim country[42]. During the 1980s London's financial markets (particularly the London Metal Exchange) assisted with transactions on a *Murabahah* basis, with the primary aim of providing liquidity to institutions from the Middle East. In the 1990s, some banks from the Middle East and Southeast Asia began to offer a financial products base (such as home financing). Finally, in 2004, the Islamic Bank of Britain began its operations as the first example of a retail bank providing *Shari'a*

40 In Malaysia, just half of the population is Muslim. The Constitution guarantees freedom of religion.

41 R. Hamaui and M. Mauri, *Economia e finanza islamica*, cit., p. 102

42 See R. Wilson, *Islamic Banking in the United Kingdom*, in *La banca islamica*, cit., p. 215 ss.; v., pure, M. Ainley, A. Mashayekhy, R. Hicks, A. Rahman and A. Ravalia, *The Development of Islamic Finance in the UK*, in *Islamic Finance. A Guide for International Business and Investment*, cit., p. 9 ss

compliant products in the UK; this example was followed by investment banks[43]. The UK approach was characterized by a particularly strong focus on the tax aspects of Islamic finance operations, and transactions often consisted of multiple transfers of assets, which may represent an obstacle to the economic efficiency of transactions (and which would serve no purpose within the system of conventional finance). Nevertheless, the local legislature did not introduce specific statutes for Islamic banks in order to avoid the risk of the religious factor becoming the central criterion for more favorable tax regulations (*no obstacles, but no special favors*). Within this framework, in 2003 and 2005, with the financial act the UK introduced an exemption from the double imposition for all transactions related to the specific structure of the *Murabahah* contracts, but did not limit it to this kind of contract[44]; they have also introduced more criteria for alternative finance returns and profit-sharing returns, which give investors preferential tax treatment[45].

The UK's approach to the problem, based on criteria of integration and harmonization rather than separation, should be regarded as a desirable model for other nations, especially those in Europe, which are currently in urgent need of capital investment from the Middle East and/or other regions.

The interest in Islamic finance is growing by the day. On October 14th 2012, the World Bank and the Islamic Development Bank signed a memorandum of understanding ('Memorandum') to set out a framework for collaboration between the two parties and to lend support to global, regional and country efforts in the development of Islamic finance, with the common objectives of fostering, encouraging, and studying the expansion of Islamic finance globally.

The main purposes of the Memorandum are the following: a) knowledge sharing to identify and disseminate sound practices in the Islamic financial services industry; b) cross fertilization of

43 European Islamic Investment Bank, Global Securities House, European Finance House, Gatehouse Bank, Bank of London and the Middle East.

44 With the 2003 Financial Act, it abolished the double SDLT (double stamp duty land tax) on Islamic mortgage on the purchase of the property of the Bank from the seller and the re-sale of the property to the customer; with the Financial Act of 2005 there was an extension of the removal to Diminishing Musharakah. See Belouafi & Belabes, Islamic Finance in Europe: The Regulatory Challenge, in Islamic Economic Studies, 2010 http://www.irti.org/irj/go/km/docs/documents/IDBDevelopments/Internet/English/IRTI/CM/downloads/IES_Articles/Vol_17_No_2/Article2_Ahmed_Belouafi_and_A_Belabes.pdf

45 See R. Hamaui and M. Mauri, *Economia e finanza islamica*, cit., p. 106 s., who observe that in the English law, without ever mentioning directly the Islamic contractual structures, it is allowed that the canon of a *ijarah* on a real estate, or a *diminishing mushararakah*, is tax deductible as is the case for interest payments for a mortgage.

ideas with a view to fostering the development of Islamic finance critical for growth, efficiency and financial inclusion; c) encouragement of research and promotion of awareness of the appropriate risk-management framework for, in particular, Islamic financial institutions and the more generally Islamic finance industry; and d) capacity building in the Islamic financial services industry with a view to fostering financial stability and promoting increased access to Islamic financial services in markets around the world[46].

Islamic finance could certainly account for a substantial share of financial services in many countries in the coming years. Through this Memorandum, the World Bank and the Islamic Development Bank will explore Islamic Finance as a potential tool for supporting the efforts of countries to reach their development goals.

6. One of the most critical aspects in the operation of an Islamic bank is its exposure to risks, which are evidently higher than those facing conventional banks for a plurality of reasons relating to the observance of *Shari'a* principles[47]. The large-scale use of operations based on risk-sharing inevitably could involve a greater profit for the investor and, consequently, a higher cost for the bank, in addition to a significant liquidity risk due to the fact that a large percentage of the assets are by nature not liquid. Furthermore, one cannot disregard the high risks resulting from constant evolution and changes in the monetary and fiscal policies made by a number of Middle Eastern governments where Islamic finance is popular, as they have a significant impact on this banking system which often uses profit-loss sharing.

46 World Bank Managing Director Dr. Mahmoud Mohieldin stressed the importance of the memorandum for increased capacity-building and knowledge-sharing between the two organizations. "The MoU signed today between the IDB and WB will help us deepen our understanding of Islamic finance and build capacities to develop institutions and instruments to support sustainable inclusive growth and help societies to achieve their development goals with emphasis on poverty alleviation and shared prosperity," he said. "The signing of today's MoU between the World Bank and IDB aims to forge a strategic partnership between our two institutions in the area of Islamic finance to support inclusive growth, including greater access to finance for the poor, and financial stability in our mutual member countries. We expect to do this by expanding our knowledge base as well as our ability to support our member countries' efforts to build resilient institutions and develop instruments to achieve greater financial inclusion and sustainable development," said President of the Islamic Development Bank Dr. Ahmad Mohamed Ali Al Madani.

47 See the detailed analysis of Y. DeLorenzo, *Shari'ah Compliance Risk*, in *Chicago Journal of International Law*, 2007, winter, p. 397 ss., and of D. Muljawan, *Risk Management in Islamic Finance. Issues, Challenges and Strategies to Mitigate the Risk*, in *Essential Readings in Islamic Finance*, cit., p. 365 ss.; see also M. Miraglia, *Banche islamiche: criticità del sistema e profili di regolamentazione*, in *Riv. dir. econom.*, 2011, p. 338 ss.

Credit risk merits a separate mention. This is undoubtedly the most significant aspect for a bank when assessing the economic and financial viability of an investment. From a bank's perspective this is key to an accurate evaluation of the assets in relation to the 'weight' of their risk profile, relating to the *risk of default* (the risk of default of a customer and its impact on the bank's capital) and to the *risk of recovery* (measured using the so-called *loss given default*: the percentage of loss in the event of customer default)[48].

One of the most critical aspects affecting the circulation of Islamic financial products in European countries is their compatibility with the criteria imposed by the Basel Committee, with specific reference to the risk profiles[49]. Principle 6, on Capital Adequacy, is of great importance for our purposes: "*Supervisors must set prudent and appropriate minimum capital adequacy requirements for banks that reflect the risks that the banks undertakes, and must define the components of capital, bearing in mind its ability to absorb losses*"[50].

The relevance of the objectives set out by the Basel Committee to the world of Islamic finance is found in the regulations adopted by IFSB, which was established in 2002, on the initiative of Accounting

48 It indicates, essentially, the percentage of credit impossible to recover in the event of insolvency: the difference between the value of the loan at the time of default and the value of the claim that is recovered, net of legal and administrative costs incurred in the recovery and the financial cost of time between the occurrence of the state of default and the actual recovery (settlement of the dispute).

49 Created in 1974, on the initiative of the central bank Governors of the G10 countries, the Basel Committee on Banking Supervision is an institution for discussion with the aim of promoting cooperation between banking supervisors in order to achieve a more stable international banking system. The First Basel Accord on capital requirements dates back to 1988 and introduced a system for measuring capital adequacy of banks, with the provision of minimum capital requirements in relation to the so-called credit risk. The Second Based Accord was reached in 2004 instead, but subject to corrections up to 2006 (implemented in Italy in December 2006). In 2010 he was presented the Third Basel Accord, to become fully operational in 2019. Basel II follows the logic of c.dd. Three pillars, the first in terms of minimum capital requirements, the second in terms of prudential supervisory on capital adequacy, the third in terms of market discipline.

50 For a more complete analysis of the compatibility between the Regulatory System in Middle East and in Europe, see M.F. Khan, *Islamic Banking in Europe: the Regulatory Challenge*, in *The Islamic bank*, cit., p. 101 ss.; see also E. Montanaro, *Quale regolamentazione del capitale per le banche islamiche?* (What regulations of capital for Islamic banks?), ibidem, p. 117 ss, who emphasizes the 'paradox' that results from the evaluation of the Islamic bank in the light of the so-called prudential assessment based on the capital: the operations of Islamic banks, in a sense, it seems to be more risky, "and therefore destined to submit to a more restrictive regulation of capital", on the other hand, the nature of deposit contracts of participatory profits "seems to give this model a brokerage capacity to absorb unexpected losses far greater than their conventional banks," which puts "into question the very purpose of a constraint on capital".

and Auditing Organization for Islamic Financial Institutions (AAOIFI), with the aim of promoting and strengthening the stability of the Islamic financial services by setting prudent standards and guiding principles[51].

This also shows that in the world of Islamic finance institutions there is a strong need to follow a path of integration alongside the rules set by the Basel Committee and not the creation of separate institutions.

In December 2005, a number of standards on capital adequacy for institutions offering Islamic financial services were issued (IFSB-2), based on the standards suggested by the Basel Committee, in particular in respect of the first pillar, with the necessary adjustments in order to make these standards compatible with *Shari'a* compliant financial products[52].

Also relevant are the Guiding Principles on Corporate Governance, addressed exclusively to institutions offering Islamic products, with the exception of Takaful (IFSB-3), issued in 2006. It is recommended that all financial institutions establish a Governance Committee, consisting of no more than three members, including a member of the *Shari'a* board or other experts on *Shari'a* law. The main task of this Governance Committee is to protect the stakeholders, particularly those customers who have opened investment deposit accounts (participatory investment), who must nevertheless be given the power to monitor the progress of, and control, their investments and the level of exposure to the relevant risks.

Amongst other things, this paper seeks to also highlight the diversity of opinions of Shari'a scholars and their effect on decisions (*fatawa*) taken by their *Shari'a* boards. The objective of the harmonization of *fatawa* can only be reached through an analysis of all types of profiles of financial transactions, in an *ex*

51 The organization, based in Kuala Lumpur (Malaysia), consists, at present, of 153 members, including 53 Authorities, 8 Intergovernmental Organizations and 126 market operators, professional firms and industry associations operating in 43 different jurisdictions. It has so far issued more than 19 documents, including Standards, Guidelines and Technical Notes, in the most different areas, from Risk Management to Capital Adequacy, to Corporate governance, Transparency in the markets, etc.

52 See, http://www.ifsb.org/standard/ifsb2.pdf. In the introduction, point 4: "*The Standard covers minimum capital ade-quacy requirements based predominantly on the standardized approach in respect of credit risk and the basic indicator approach for operational risks of the IIFS, with respect to Pillar 1 of Basel II, and the various applicable measurement methods for market risk out in the September 1996 Market Risk Amendment*". The IFSB standards don't concern, at the moment, the conditions referred to the second and third pillar of Basel, which will be subject to separate regulations. For Islamic banks it is expected, as prudential standards, the objective of the *ratio* between capital and risk-weighted assets, equal to 8%.

ante and *ex post* perspective in order to assess not only the nature of *Shari'a* compliant contracts, but also to examine the obligations (and related services) stemming from such contracts.

7. With regard to Italy, no authorization has, to date, been granted in favor of institutions willing to carry out banking activities based on principles of Islamic finance. Furthermore, no *Islamic windows* have been opened by Italian banks, or by any other Western (and generally international) banks operating in Italy for that matter.

The opening up of Islamic banks in Italy shall be subject to all the standards imposed by European law, especially with regard to the Directive 2006/48/Ce of 14 June 2006 (adopted in Italy by law decree 27 December 2006, n. 297, changed into law 23 February 2007, n. 15)(hereafter refered to as the 'Directive') relating to the taking up and pursuit of the business of credit institutions, although concerning banks based in European Union[53]. The 'whereas' no 20 specifies that: "Agreement should be reached, on the basis of reciprocity, between the Community and third countries with a view to allowing the practical exercise of consolidated supervision over the largest possible geographical area." The 'whereas' no 44 specifies that: "In order to ensure that the risks and risk reductions arising from credit institutions' securitisation activities and investments are appropriately reflected in the minimum capital requirements of credit institutions it is necessary to include rules providing for a risk-sensitive and prudentially sound treatment of such activities and investments."[54]

The most relevant rules of the Directive, which are probably the most relevant for the purpose of this

53 According to the 'whereas' no 14, "Credit institutions authorised in their home Member States should be allowed to carry on, throughout the Community, any or all of the activities listed in Annex I by establishing branches or by providing services"; the 'whereas' no 18 "The Member States should ensure that there are no obstacles to carrying on activities receiving mutual recognition in the same manner as in the home Member State, as long as the latter do not conflict with legal provisions protecting the general good in the host Member State".

54 According to the provision of Art. 4, n. 37 " **'**traditional securitisation**'** means a securitisation involving the economic transfer of the exposures being securitised to a securitisation special purpose entity which issues securities. This shall be accomplished by the transfer of ownership of the securitised exposures from the originator credit institution or through sub-participation. The securities issued do not represent payment obligations of the originator credit institution". The following no 44 specifies that " **'**securitisation special purpose entity (SSPE)**'** means a corporation trust or other entity, other than a credit institution, organised for carrying on a securitisation or securitisations, the activities of which are limited to those appropriate to accomplishing that objective, the structure of which is intended to isolate the obligations of the SSPE from those of the originator credit institution, and the holders of the beneficial interests in which have the right to pledge or exchange those interests without restriction".

research, are:

Title IV deals with 'Relations with third Countries' and Art. 38 specifies that "Member States shall not apply to branches of credit institutions having their head office outside the Community, when commencing or carrying on their business, provisions which result in more favourable treatment than that accorded to branches of credit institutions having their head office in the Community. The competent authorities shall notify the Commission and the European Banking Committee of all authorisations for branches granted to credit institutions having their head office outside the Community. Without prejudice to paragraph 1, the Community may, through agreements concluded with one or more third countries, agree to apply provisions which accord to branches of a credit institution having its head office outside the Community identical treatment throughout the territory of the Community."

Art. 39 further provides that: "The Commission may submit proposals to the Council, either at the request of a Member State or on its own initiative, for the negotiation of agreements with one or more third countries regarding the means of exercising supervision on a consolidated basis over the following: (a) credit institutions, the parent undertakings of which have their head offices in a third country; or (b) credit institutions situated in third countries the parent undertakings of which, whether credit institutions or financial holding companies, have their head offices in the Community. The agreements referred to in paragraph 1 shall, in particular, seek to ensure the following: (a) that the competent authorities of the Member States are able to obtain the information necessary for the supervision, on the basis of their consolidated financial situations, of credit institutions or financial holding companies situated in the Community and which have as subsidiaries credit institutions or financial institutions situated outside the Community, or holding participation in such institutions; and (b) that the competent authorities of third countries are able to obtain the information necessary for the supervision of parent undertakings the head offices of which are situated within their territories and which have as subsidiaries credit institutions or financial institutions situated in one or more Member States or holding participation in such institutions. Without prejudice to Article 300(1) and (2) of the Treaty, the Commission shall, with the assistance of the European Banking Committee, examine the outcome of the negotiations referred to in paragraph 1 and the resulting situation."

It seems correct, and fair, to therefore conclude that an Islamic bank, based in a non-EU country, has to respect the same rules that must be observed by a EU bank seeking to open a branch in another EU Member State.

While the scope of this paper does not extend to an analysis of all the rules of the Directive; it seems whatever sufficient to report some of the most relevant:

Art. 12 provides that: "The competent authorities shall not grant authorisation for the taking-up of the business of credit institutions unless they have been informed of the identities of the shareholders or members, whether direct or indirect, natural or legal persons, that have qualifying holdings, and of the amounts of those holdings". Art. 22 further states that: "Home Member State competent authorities shall require that every credit institution have robust governance arrangements, which include a clear organisational structure with well defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks it is or might be exposed to, and adequate internal control mechanisms, including sound administrative and accounting procedures". Art. 23 deals with 'Credit Institutions' and specifies that: "The Member States shall provide that the activities listed in Annex I may be carried on within their territories, in accordance with Articles 25, 26(1) to (3), 28(1) and (2) and 29 to 37 either by the establishment of a branch or by way of the provision of services, by any credit institution authorised and supervised by the competent authorities of another Member State, provided that such activities are covered by the authorisation."

Thus, it is necessary to analyze the compatibility of the Islamic banking system with the provisions of the Italian consolidated law on banking (Testo Unico in materia bancaria of 1 September 1993, n. 385, as amended , hereafter referred to as 'TUB'), especially with the provisions of Articles 10 and ff . At the outset, Art. 10 specifies that the 'collection of savings' and the 'exercise of credit' are the essential elements of a banking activity, while Art. 11 adds that, for the purposes of the law, "it is considered saving collection the acquisition of funds with the obligation of redemption".

Upon such basis, it becomes evident that deposit insurance is of vital importance for the exercise of banking activities in Italy. Therefore, some problems complying with *Shari'a* principles may arise with regard to the obligation to repay the loan. The absolute ban on any provision of interests is the main source of incompatibility: The restrictions relating to setting up and carrying on the business of credit institution, as imposed by the Directive. Limits on the reimbursement of depositors could be met through the use of different methods other than the payment of interest. However, from the viewpoint of retail customers, this remains a matter of seeking the best option between the two competing banking systems.

More problematic is the 'exercise of credit' requirement, since the Italian system does not allow the structural participation in the risk of the borrower, which is a key feature of the Islamic system. However, a closer look at the range of financial activities carried out by Islamic banks reveals that, in practice, the two systems are not as different as it would initially appear, given that the 'exercise of credit' by western banks often coincides with traced activities, such as leasing, factoring, receivables as well as free loans[55].

The foregoing demonstrates the compatibility between Islamic banking activities and the provisions of Italian banking laws. The real question, once the Bank of Italy has issued the necessary authorizations, is whether an authorized bank may predominantly carry out the 'other financial activities', within the meaning of Article 10 of the Directive, such as, for example, the exercise of investment services covered by the Consolidated Finance Act (Testo Unico della Finanza, legislative decree of 24 February 1998, no. 58, hereafter referred to as 'TUF')[56]. An affirmative answer can be derived from the banking rules themselves, which clearly distinguish between a '*banking activity*' and a '*bank*'. Indeed, a bank is entitled to manage all financial activities that are not statutorily reserved for other categories of intermediaries[57]. Arguably and alternatively though, an applicant may also take the view that each Islamic banking activity is similar or, at least, comparable to its corresponding "*banking activity*' within the meaning of Article 10 of the Directive (e.g. mudaraba deposit, vs. deposit), with the reference to 'other financial activities' acting as a fallback position.

55 In this sense, see R. Costi, *Conclusioni*, in *La banca islamica*, cit., p. 241, who says that the problem is, at least, a problem of supervision.

56 See M. Rispoli Farina, *Intervento*, in *La banca islamica*, cit., p. 95 ff. who also suggests the solution to frame the Islamic banking business under the regulations of the financial intermediaries ruled at art. 106 ff. TUB. See the different analysis of P. Abbadessa, *La banca islamica: impressioni di un giurista* (Islamic banks: impressions of a Scholar), ibid. 142, who does not share the view that the TUB legitimize the existence of banks that would exclude *a priori* the banking activity as main activity, "or, while including this activity in its corporate purpose and own program, in fact they don't exercise"

57 In the same sense, see the interesting considerations of L. Donato and M.A. Freni, *Attività bancaria e controlli di vigilanza* (Islamic banking and supervisory controls), ibid. p. 170 ff., Exp., p. 187 s.: they exclude that the Italian banking regulations impose a prevalence criterion, by the bank, the exercise of banking activities in the strict sense. The analysis assumes significance even more significant because it came from two members of the field supervision of the Bank of Italy. See L. Donato and M.A. Freni, *Islamic banking and prudential supervision in Italy*, cit., p. 187 "In addition to banks the Italian and European financial system comprises other types of financial institutions that could serve as point of reference for operators interested in marketing Islamic financial products in Italy: for instance, SGRs (*società di gestione del risparmio* – asset management companies), which under the Consolidated Law on Finance may provide individual portfolio management services or institute collective investment funds, and SICAVs (*società di investimento a capitale variabile* – open-end investment companies)".

8. The study of the causes of the recent global financial crisis has prompted economists and governments around the world to analyze the different solutions including those envisaged by financial systems that have long adhered to the principles and rules of *Shari'a*. The result of this is the evidence that the Islamic banking system has in many cases proved stronger in withstanding the devastating impact of the crisis. The reasons have been widely identified as the rigorous nature of the aforementioned 'prohibitions' under *Shari'a* principles, with particular reference to the restrictions on the use of financial products which are not backed by an underlying asset, or other transactions involving a high degree of uncertainty (*Gharar Fahish*).

Economic historians have pointed out that the development of Islamic finance has been particularly strong in times of economic crisis. We must go back to the 1973 Oil Crisis, which, following a strong period of decline in the U.S. stock market, was the first time in history that the economic world began to take notice of financial instruments originating in Middle East.

Even the events of September 11, 2001 have contributed to its development: the 'psychological' impact of the tragedy led to many Western investors distancing themselves from the Middle East and Islamic financial institutions. The Bush administration declared some of these states and institutions '*abettors of terrorism*', while Congress, in 2006, declared what is arguably and in effect an embargo on Dubai Port World. In this context, many Middle Eastern customers moved billions of dollars away from Western banks and financial institutions although one unintended consequence of the said tragedy, is that the Islamic banking industry was forced to go through a soul searching process that ultimately resulted in the adoption of more regorous know-your-customer and regulatory policies, with Governments playing a more active role in monitoring the operations of such institutions.

Finally, the sub-prime crisis of 2008 played a role in increased interest in Islamic finance, spawned by the unscrupulous use of speculative financial instruments lacking any real connection to the underlying assets as a guarantee of the risks involved.

It is sufficient to look at the international trade press during the first half of 2013 and its coverage of the turmoil affecting both financial institutions and governments, to be able to make a strong case for adapting existing systems so as to allow and encourage investments by Islamic investors and institutions.

The advantages of Islamic finance are not limited to its banking and financial system, but to the potential benefits it brings to national economies as a whole. More and more countries are moving to adapt their regulatory framework in order to support the issuance of *Sukuk* in order to attract capital from the Islamic world.

By way of example, there has been a recent issuance took place in Kazakhstan, which placed *Sukuk* worth around US$ 500 million onto the market. The Turkish Treasury Minister has also prepared the issuance of *Sukuk* amounting to US$ 1.5 billion and the demand for subscription greatly exceeded expectations: two hundred and fifty investors sought to participate for a total of US$ 7.1 billion (five times the intended release). The success of the operation also reflects the confidence of global financial markets in *Sukuk*. With regard to the geographical participation, the largest share of subscribers come from the Middle East (58 per cent), followed by Europe (13 per cent), Asia (12 per cent), Turkey (9 per cent) and the U.S. (8 per cent). As to the nature of investors, the largest share is made up of banks (59 per cent), followed by asset managers (22 per cent), international institutions and central banks (10 per cent), asset managers (5 per per cent), and, finally, hedge funds (4 per cent)[58]. Jordan and Afghanistan are planning to issue *Sukuk*, while Ernst & Young has estimated the total value of *Sukuk* to reach US$ 900 billion by 2017[59].

The industry is in agreement that there is no doubt about the potential to use *Sukuk* to finance the infrastructure sector[60]. India and Azerbaijan are even considering making radical changes to their respective banking systems so as to move to an interest-free system[61].

More recently, in Russia, AK BARS Bank successfully allocated funds raised under its Syndicated

58 http://www.hurriyetdailynews.com/turkey-hopes-new-sukuk-will-become-benchmark.aspx?pageID=238&nid=30519

59 About Jordan http://english.alarabiya.net/articles/2012/09/16/238348.html

About Afghanistan http://www.gulfbase.com/news/afghanistan-eyes-sukuk-as-western-funds-retreat/208549

About Ernst&Young http://www.efinancialnews.com/story/2012-09-11/ernst-young-global-islamic-banking-report-global-demand-sukuk

60 M.McMillen, *Islamic Project Finance: An Introduction to Principles and Structures*, in *Global Infrastructure*, III, spring 2009, New York

61 About India http://www.sunday-guardian.com/news/rbi-ready-for-islamic-banking-wants-finance-minister-to-amend-law

About Azerbaijan http://en.trend.az/capital/business/2069170.html

Murabaha Islamic financing deal, in the amount of US$ 60 million. The Master Agreement was signed in September 2011 for a period of one year, and is the first public international *Shari'a*-compliant deal in Russia[62].

9. In the Western world, as well as in the Middle East, infrastructural works may follow an entirely private procedure or choose the scheme of Public-Private Partnership (PPP) for the construction of public works. In the PPP hypothesis, the asset involved in the public infrastructural works is transferred in concession to a private legal entity, which carries out the design, construction and operation phases for a defined period[63]. The private sponsors usually constitute a 'Project Company' and may be financed either directly, through another separate funding company, or through an agent.

In order to encourage the involvement of private capital in project financing, national or local governments often seek to provide incentives or benefits, such as tax discounts. This area of infrastructural projects, even outside the Middle East, stands out as carrying the closest connection with the rules and principles of Islamic finance.

To begin with, the area is strongly characterized by asset-based or equity-based investments, while it tends to involve investments characterized by a marked social impact. Together, these can be considered as the best basis to understand the opportunities available for Islamic finance in the infrastructure sector of Western countries.

In Islamic project finance, a transaction is structured around a Project Company (usually an SPV) which provides, in the first phase, for the collection of financing, both by participating in risk capital (equity) as well as by means of other *Shari'a*-compliant forms of financing, either directly or through an intermediary funding company, also established for the purpose. As in the case of conventional project financing, in Islamic project finance the Project Company may have recourse to a general contractor, or to an Engineering, Procurement and Construction (EPC) company during the infrastructure construction phase, as well as to an Operation and Management (OM) company, for the management of the same as well as for the sale of end user services.

62 http://www.akbars.ru/en/news/detail.php?ELEMENT_ID=102181

63 See, for the Italian law, T.V. Russo, *Il Project Financing*, , in *Tratt. dir. civ. Perlingieri*, Napoli, 2007; T.V. Russo and P. Marchetti, *Manuale di diritto e tecnica del project financing*, Napoli, 2010.

The two traditional sources of financing used in the field of infrastructure, as mentioned, can be referred to as the categories of equity financing and debt financing. In case of equity financing, the most widely used models are the *Mudarabah*, *Wakalah* and *Musharakah* models, while amongst the debt financing transactions one can find several contracts, such as *Murabahah* (cost-plus or mark-up sale), *Bai-Muajjal* (price-differed sale), *Istisna'a* (pre-production sale contract or object deferred sale), *Salam* (pre-paid sale) and *Ijara* (comparable, albeit with some variants, to Western leasing).

In addition to the use of traditional forms of financing, the rather costly infrastructural projects can be financed through syndications and club deals that utilize the foregoing finance techniques, or, alternatively, through the issuance of *Sukuk*, which are often referred to as Islamic bonds, although they are more akin to asset-backed securities. It is a widely known fact that infrastructure finance is traditionally related to interest-based (*riba-based*) transactions[64]. The most recent developments in the global economy, namely the financial crisis, while being global in its impact, affected Western economic systems most strongly and has highlighted the need to involve even those Islamic investors who are ideologically opposed to interest-based financing, into financial transactions through the development of an alternative form of project financing, suitable to the needs of both Islamic and conventional investors.

In order to encourage such involvement, the financial methods used in infrastructure financing must be reconsidered and revised in order to make them *Shari'a*-compliant. In this new perspective, the financing of the Project Company should be analyzed not only at the stage that the transaction is structured so as to comply with the techniques of Islamic finance, but also from the perspective of Western investors. The aim of the present analysis has been to study the techniques,the legal, and the financial structures which enable sources of Islamic finance and conventional finance to be used within the same transaction. The international nature of the transaction also calls for the need to assess any

64 M. McMillen, *Islamic Project Finance: An Introduction to Principles and Structures*, cit., p. 5, observes that the reason for this choice in the international business include: "a) the dominance of the western interest-based economic system over the last few centuries; b) the predominance of United States and European financial institutions, lawyers, accountants and project participants in the development and refinement of the most widely used project financing techniques; c) the refinement and exportation of Anglo-American law; d) the relative infancy of modern Islamic finance; e) the lack of familiarity with the operation of legal system in the Middle East and other OIC jurisdictions, and f) the general lack of knowledge of, and familiarity with, the *Shari'a*". The eminent Scholar says that "The consequence of this western orientation is that the risk allocations and implementing techniques and structures take little, if any, cognizance of variances that are necessary to achieve compliance with the *Shari'a*".

relevant issues of jurisdiction and applicable law, especially those affecting taxation.

In any case, the limits imposed by the principles of Islamic finance and the unwillingness of *Shari'a*-compliant investors to derogate from them must inevitably be used to convince Western investors to evaluate the opportunities offered by *Shari'a*-compliant financial instruments. This is especially important when one considers the strong demand for infrastructure projects in the emerging markets, especially in the countries of the Organization of the Islamic Conference (OIC), while also considering the availability of significant liquidity in those countries, due to the steady increase in the price of oilreserves.l[65]

Recent experiences in North and Central America in both the infrastructure and energy fields demonstrate that the recourse to forms of Islamic project finance may present a worthwhile opportunity, rather than simply a need, and show that the intervention of the Islamic banks in the Western world can guarantee the opening of new markets - the so-called 'Lay Markets' – without abandoning the principles of *Shari'a*.

Moreover, the 'Profit and Loss' sharing methodology, which characterizes Islamic finance does not seem to be too different from the logic behind the operations of pure project financing. The primary objective for those who intend to structure a 'hybrid' financial transaction is the fulfilment of the needs and goals of all the different lenders involved in the venture. In order to overcome the conflicts that may arise due to the different approaches to risk and guarantees, and particularly in cases in which it is important to segregate the investments of two lenders, practice has developed *dual-tranche* or *multi-tranche* project financing.

A possible solution to the issue of segregating investments may be to isolate a *Shari'a*-compliant tranche within a conventional operation, or the use the conventional financing method involving an SPV, whereby the Islamic investor is only connected through a *Shari'a*-compliant contractual agreement.[66] In

65 A survey by Morgan Stanley estimates that approximately 21.7 'trillions' of dollars is what the financial investment in infrastructure expected to see in the second decade of the century in emerging markets, including the world OIC.

66 In order to convert these structures into a product entirely Shari'a compliant (which does not provide in any case the use of structures that incorporate a conventional interest-bearing debt), it will be sufficient to replace conventional debt issuing a Sukuk or other debt instrument respectful of Islamic principles.

any case, there is the constant use of variants of a contract of *Istisna'a* (construction) or a contract of *Ijara* (lease), or both, for the entire operation or a part of it.

In order to avoid the same legal entity being directly involved in both types of financing, a 'bifurcated structure' through the creation of two SPVs becomes necessary: a Project Company for the collection of *Shari'a*-compliant funds and a second 'Funding Company' for the collection of non- *Shari'a*-compliant funds. The latter, at a later point in time, will converge with the assets of the Project Company through the use of *Shari'a*-compliant instruments[67]. The agreement between the Bank and the Islamic Funding Company is traditionally based on conventional financing principles (i.e an interest-bearing loan). By contrast, in the Funding Agreements between the Company and the Project Company, those of the Islamic investors and the Project Company, as well as those between the Project Company and the Off-Takers or Tenants are Shari'a-compliant.

Investors wishing to comply with *Shari'a* law provide financing to the Project Company, either through direct participation in the risk capital of the company or by providing debt financing. The capital contribution may take the form of cash or be in kind, through rights to real estate assets, contractual rights on such real estate assets, or through various forms of transfer of assets[68]. The operation can be carried out through the use of traditional Islamic finance contracts. It is usually applied through a *Mudarabah* agreement where the Project Company lacks significant equity, while the recourse to a *Musharakah* is preferred in case of an SPV with adequate equity. In practice, both these structures tend to be accompanied by a *Murabaha* agreement.

According to the above analysis of the 'bifurcated structure' of financing, the funds paid into the Funding Company by the lenders will be used for the acquisition or construction of the project. The Funding Company will retain the ownership of the assets during the development of the transaction provided that the structuring of such transaction should take into account that the hypothesis of bankruptcy is as remote as possible[69].

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67 See M. McMillen, *Islamic Project Finance*, cit., p. 24 ff.

68 See M. McMillen, *Islamic Project Finance*, cit., p. 26, who points out that in many transactions "the developer may also be an investor in the Project Company [...] often contributes the land for the project as a capital contribution [...] Sometimes the land may be leased to the Funding Company and then subleased back to the Project Company.

69 M. McMillen, *Islamic Project Finance*, *ibidem*.

Following this, the Funding Company, through an *Ijara* contract, will grant the project assets in favor of the Project Company (pursuant to the lease). As mentioned earlier, the structure most commonly used in the field of Islamic project financing is the *Istisna'a-Ijara*, constituted by an *Istisna'a* contract, which adjusts to the phase of the construction of the infrastructure and by an *Ijara* contract which governs the operations phase.

10. Given Italy's current economic crisis in the midst of a global calamity, introducing Islamic banking in Italy is the solution to rebound growth in the spirit of economic vitality. Implementing an Islamic banking model can be accomplished through commerical and structural means. To put it differently, an Islamic banking model ignited in Italy's financial market present a classic opportunity to entice Middle Eastern and Islamic investors into Italy as well as maximize awareness around Islamic banking as a means to garner support to execute an additional method of finance. Educational awareness of *Shari'a* compliant funding mechanisms under the umbrella of an Islamic banking model is the first step to receive the necessary 'buy-in' in order for the Italian banking industry to endorse an Islamic banking model over conventional commerical banking, the status quo.

Introducing an Islamic banking model in Italy have two-fold implications that will foster a win-win outcome. First, given the need in Italy for the expansion of public and private infrastructures as well as for development of the renewable energy sector despite a systematic lack of money, opportunity uses with *Sharia's* complaint financial products including *Sukuk* provide Italy with access to the excess wealth available in the Middle East. The opportunity uses with *Shari'a* compliant financial products in Italy also provide 'Institutional Islamic Investors' with supportive evidence in order to open their viewpoints to an innovative and what would be a novel Islamic banking market in Italy.

To introduce the concepts and practices to the region, the implementation of Islamic finance departments or teams within Italy's conventional banks is the first 'best practice' recommendation Italian banking systems should consider. The creation of Islamic finance departments or teams give rise to a 'dual banking system' where Islamic finance co-exists at the side of conventional banking laws. As a result of this dual banking systerm, a seperate and distinct set of standards for those Islamic investors with the aim to engage in *Shari'a* compliant transactions would trigger a spike in Italy's private investments - more specifically in infrastructure and renewable energy focus areas.

For the reasons stated above, this research paper explored the challenges and opportunity to diversify

funding sources in Italy as a means to overturn a crisis. An analysis of the different impacts of the crisis in the area of conventional finance as compared with the area of Islamic finance was therefore examined to provide precise meaning and unsterstanding around the prohibition of *Gharar* with respect to the main principles governing Islamic finance. The prohibition of *Riba* and the need for commercial transactions mutually benefit all contracting parties in order to assist with the unraveling of the 'risk sharing' principle. As a method to increase control in loan markets with respect to profit and loss sharing, new rules on debt financing and opportunities with forward and future contracts in the prohibition of uncertainty surrounding derivatives.

The *Sukuk* market for government debt and for infrastructure financing could be a means to put in motion an excess of stagnant liquidity. The emerging flexibility of the *Sukuk*, as a *Shari'a* financial instrument, stretch beyond tangible and underlying assets. However, with every opportunity present challenges. The Islamic bank around the world present a new challenge in the sense that banks should operate in compliance with the precepts of *Shari'a* in financial business and transactions, organizational structure, and management. The banking company, in return, must appreciate the obligation to protect not only the interests of shareholders and stakeholders who may be focused on improving their business management practices while maintaining 'ethical' consciousness of business matters. However, exposure to risks is one of the most critical aspects in Islamic bank operations which are greater than the risks facing conventional banks. GSE, as an example, promote the use of electricity produced by renewable sources to include but not limited to 'Green Certificates', 'the Feed In Tarrif', 'the Feed in Scheme', and the 'Italian Power Exchange'. Such incentives for renewable energy in Italy can be used as cash flow arising out of the production of electricity. The cash flow, in return, is an asset to be securitise for the issuing of *Sukuk*.

No authorization has been granted to Italy in favor of institutions willing to carry out banking activities based on the principles of Islamic finance. The opening of Islamic banks in Italy shall be subject to the standards imposed by European law pursuant to the Directive. Practically speaking, it is correct and fair to therefore require an Islamic bank, based in a non-EU country, to abide by the same rules governed by a EU bank seeking to open a branch in another EU Member State.

As evidenced by economists and governments around the world, financial systems that adhered to the principle rules of *Shari'a* within an Islamic banking system consequently proved to be stronger in enduring the devastating impact of the global financial crisis. The reason for such strong measurables

is due to the rigorous nature of the prohibitions under *Shari'a* principles, with an emphasis on the use of financial products that are not backed by an underlying asset, or transactions involving a high degree of uncertainty '*Gharar Fahish*' which minimizes risk..

In addition, Italy's use of Sharia's compliant project financing of instrastructure presents an opportunity for economic and financial growth that will assist in the reversing of the country's current crisis. The two traditional sources of financing used in the field of infrastructure are deployed in equity and debt financing. In case of equity financing, the most conventional used models are the Mudrabah, Wakalah, and Mushrakah models. Amongst the debt financing transactions one can find several contracts, such as *Murabahah*, *Bai-Muajjal*, *Istisn'a*, *Salam*, and *Ijara*.

Italy's historic contribution to the world, the first ever modern commerical banks in the fourteenth century, is deserving of the maximum financial preservation an Islamic banking model could offer. By use of *Shari'a* compliant finance tools, a Risk Sharing model will put an end to risky and speculative financial products in exchange for 'ethical' financial producs as the foundation for a global banking industry that is sustainable across the Italian banking system.

ABSTRACT

Il contributo analizza il fenomeno della finanza islamica e, nello specifico, il suo modello di Banca, al fine di evidenziarne i pregi e valutarne la compatibilità con un sistema finanziario, quale quello convenzionale, eccessivamente ancorato al metodo degli interessi e fin troppo distante dalla logica del *Profit-Loss sharing.* Le recenti aperture da parte di alcune nazioni europee al mercato dei *sukuk* segna la strada da seguire, non soltanto al fine di realizzare benefici di natura economica rivenienti dall'intervento finanziario da parte di investitori islamici, quanto e soprattutto sul piano dell'integrazione socile e culturale.