

RF Banking Model for the 21st Century

Developing the Shari'aa-Based Finance Model

This chapter will detail the unique financing model that we pioneered at American Finance House LARIBA, which we based on the Law (Shari'aa) in contrast to the “Shari'aa-compliant” approaches discussed in Chapter 9. This unique and pioneering model embodies the true spirit and substance of the RF (riba-free) system.

In 1987, we started a humble effort by establishing LARIBA (American Finance House). We started our finance operations by using the Cost-Plus (murabaha) model, because we did not know better. We simply started with the interest rate of the day, calling it a “profit” index based on opinions and edicts (*fatwa*) by some of the Islamic finance Shari'aa scholars at that time. We would calculate the value of the dollar amount to be borrowed and compound it at the “index” (interest rate) to create an equivalent sale price at the end of 15 or 30 years, depending on the term of financing. The company would agree to sell the house back to the ultimate buyer at the original price plus a profit element, so that the total cash paid would be equal to the compounded value arrived at—just as if it were a regular interest-based transaction.

Many of us were not very comfortable with this approach, despite the fact that it was sanctioned by most of the well-known Islamic finance Shari'aa scholars at the time. At this juncture, the value of the educated and sophisticated believers in the Judeo-Christian-Islamic value system became useful. The educated and analytical members of the community objected to the system, because it did not make sense to change names, use the same exact approach used by riba-based conventional banks, and

then claim that we are providing Islamic finance services just because the name was different. We were severely criticized by many of the puritan and educated members of the community, who asked repeatedly: “What is the difference?” In fact, we concluded that they were right—there was not much difference. Within our first year of operation, we began to develop a model that is truly beneficial to the user and that follows Shari’aa. We call it the Shari’aa-based model or the LARIBA model, as it is known worldwide.

Through our development of this model, we asked a fundamental question: “Why does the RF system prohibit *riba* or the act of renting money for a price (the interest rate)?” We reasoned that if we stopped renting *money* and started looking at the rental rates of the *items* financed in the actual marketplace, then we were in fact investing in rent-producing cars, properties such as homes and commercial buildings, and businesses. If the transaction is profitable because of the rent it generates, then it makes prudent economic sense to invest in it with those who come to us for finance. We also concluded that based on the fact that money is a fungible thing that cannot be rented, then giving it to a customer in the form of debt financing (*dayn* in Arabic, compared to *qard*, or *loan*, as explained in Chapter 2) is actually as if we are investing with this customer.

THE PUZZLE AND THE CHALLENGE OF DEVELOPING RF BANKING AND FINANCING

It is useful to document the many challenges we faced while trying to solve this puzzle with the humble tools and the limited resources available at the time. The intention is to document what our team did for the record and for the benefit of future generations. When we started, our goal was to come up with a solution to the problem of living a full American life without violating the laws of Shari’aa and to uphold the laws of the land without participating in the culture and practices of *riba/ribit*. It may have been easy to articulate that goal; in practice, though, it was a big and daunting challenge and a hard dream to realize!

The following sections comprise a review of the many currents faced in developing an RF financing and banking regime.

Legal and Financial Categories

First, let us review what we learned in Part One in each category of the subject that had an impact on the development of the RF financing and banking brand.

The Law (Shari'aa)

- Shari'aa has as its main goal the protection of the self, the family, the assets and wealth, and the faith in the community.
- Shari'aa focuses on the intent and not the form. The real test is the outcome.¹
- The main objective of Shari'aa is to maximize the benefits to the family and the community at large while pushing away what is harmful.
- Shari'aa requires those who make edicts (*fatwa*) to be knowledgeable of the faith, the community, and the local conditions and systems where the edict is solicited and applied.
- Shari'aa states that if it (the Law) cannot be applied in full, that does not give believers an excuse to abandon it completely without attempting to the best of one's abilities to apply whatever is possible.²
- Shari'aa does not allow the use of ruses (deceptive tricks, *heelah*) or circumventive structures that look Shari'aa compliant but in fact ignore the intent and spirit of Shari'aa.

Money

- Money is a thing and is fungible, like an apple or a loaf of bread. Fungibles cannot be rented because the minute they are given to another, they become an "investment" that is entrusted with those who accept it.
- Money cannot be rented by paying a price for using it. In the past, the payment of a price or the use of the money was called *usury*; now it is called an *interest rate*.
- Money is a measuring device and is useful only if invested. It can only be invested in a useful activity, such as the purchase of an asset, a service, or a business. Money does not grow on its own if not used. It must be invested in a productive activity that produces a useful outcome.
- Money cannot be loaned, except in the form of a good loan to those who need it. A loan is conceptually looked at as a bite (*qard*) out of the assets of those who have a lot of money; it is to be given to the poor and needy without expecting any increase.
- Money is a measuring tool that is used to measure the value of the product or service produced by this economic activity. The success or failure of that activity is measured by how much value—measured in money—is produced by that asset. The concept of *return on investment* is a measurement of the success or failure of that investment.
- Money must be real money, and real money must be a base commodity. It can be gold, silver, or a basic food staple. Paper (fiat) money can be used as a convenient tool of exchange and trade, but it must be related

and indexed to these basic real money reference commodities. That is, one can use U.S. dollars, British pounds, and/or the euro, but such currencies must be referred and indexed to a reference commodity to be fair to all by keeping fair pricing and free and balanced markets without deception (*gharar*).

- When basic commodities—that is, gold, silver, and food staples like wheat, rice, corn, salt, dates, and the like—change hands, they must be exchanged for the same amount if they are of the same element. That is, gold is exchanged for the same amount of gold, and corn for the same amount of corn. The exchange must be done on the spot, hand to hand. If the exchange involves two commodities that are different but used for the same purpose—for example, gold and silver, which are used as a pricing reference (real money), or corn and wheat, which are used as a food staple—the exchange can be made with an increase but it must be done on the spot. For example, it is allowed to exchange one ounce of gold for seven ounces of silver because both are used as pricing commodities, or one bushel of wheat for three bushels of barley because both are used as a food staple. The exchange must be done on the spot. No delayed delivery is allowed. If the two commodities are different in element and in use, they can be exchanged for an excess amount, and the exchange can be done on the spot or for delivery at a later date for a different price. However, if delivery is not completed at the agreed-upon date for a legitimate reason, such as a change in the economic environment or climate conditions, no increase over the agreed future exchange ratio is allowed to compensate for the delay in payoff, because it is considered *riba*. For example, an ounce of gold can be exchanged for seven bushels of wheat hand to hand; subject to agreement between the two parties it can be exchanged for fifteen bushels of wheat after one year. If the wheat is not available after one year for reasons that are considered *force majeure*, no further increase is allowed. This concept was introduced in Chapter 5 as the *commodity indexation rule*.
- In case one wants to exchange an item for another item of higher quality—for example, exchanging small oranges for larger, higher quality oranges—the exchange must be done in equal quantities. However, to perfect the exchange, the small oranges should be first exchanged in the market for a different element, such as gold or corn; then the gold or corn can be used to buy the larger oranges. This way, markets are kept fair and fair pricing is achieved without deception (*gharar*). This concept, called *marking to market*, was introduced in Chapter 3.

Interest Rates

- Interest can be defined as an excess—*riba* (in the Qur’aan) or *ribit* (in the Jewish Bible and the Old Testament)—over the original amount of the capital given as a loan (*qard*). The increase is divinely prohibited (*haram*) in case of a *qard* to the poor and needy. Any increase in whatever form—be it in the form of excess money, compensation through free and unpaid labor, the free use of the borrower’s facilities, or publicizing the borrower’s indebtedness—is not allowed.
- In a *fiat* money regime, the interest rate used by central bankers to decide on the policy of how much money to print or to withdraw out of the market—called the Fed Fund rate in the United States—is different from the *riba* prohibited by Judeo-Christian-Islamic values.
- Interest charged as a price for renting money to those who do not have it is what the prohibition of *riba* (and usury) is all about. Interest charged for a transaction that implies the renting of money to a user of money for credit (*dayn*) without marking it to market is considered *riba* or *ribit*, and is not allowed by Shari’aa.

Money and Commercial Transactions

- The original teachings of the Judeo-Christian value system focused on the abuse exercised by the rich against the poor in agrarian societies in order to expropriate their land, crops, and properties and render them slaves in their own originally owned land. The Judeo-Christian-Islamic value system reinforced that ruling, which prohibited *usury* (or *interest*), the act of charging for the use of money, which is considered an act of *riba* or *ribit*. The system encouraged helping those who need money through the system of *qard hassan*, a good loan that does not charge any increase over the original amount in any shape or form.
- As commerce developed, the Judeo-Christian-Islamic system expanded upon the Judeo-Christian system to allow buying and selling at different prices, but not renting the use of money (*usury*, now called *interest*). Buying and selling transactions that involved an increase due to profit making are not like charging *riba* by charging for the use of money, as revealed in the Qur’aan. For buying and selling to be perfected, the title of the item to be acquired must change hands from the seller to the buyer in a documented buy-sell agreement. Different models developed to put this rule in effect were used during the Muslim reign and adapted in the 1700s by the rabbis in the eastern European areas in their “*Hetor Iska*” models (also known as *Musharaka* or Joint Venture in Islamic RF banking applications).

- To perfect the buy-sell transaction, the two parties must participate in all risks (including profit and loss) as defined by the buy-sell contract.
- The buy-sell contract must be fully documented, free from any deceptions or undefined parameters and risks, and should be transparent. The concept is called *gharar-free* (which means deception-free.) *Gharar-free* rules also require that trading in risk, as in cases of sale with a guaranteed buyback at a future date at a predefined price (called *eena* in Shari'aa), uncovered short sales, naked options, and futures, as well as financial derivatives, involve major aspects of *gharar*, and they are prohibited.
- Future sale prices cannot be set ahead of time because such practices interfere with the free market system as defined by the Judeo-Christian-Islamic value system. Only God knows the future. That is why a contract that includes two sales (i.e., buying a property from someone at a price and promising to sell it back to him/her at a future date in the same contract at another prefixed price—an *eena* sale), is prohibited. Contracts of this type are considered divinely prohibited (*haram*) contracts and a means of *gharar*.
- If the person who was entrusted with the money cannot make the payments for legitimate reasons, such as unexpected changes in the economy or a sudden war—*force majeure*—foreclosure is not allowed unless one of the parties committed fraud or deception. In this case, the asset is sold and the proceeds are distributed between the contracting parties as per partnership agreement.
- In a joint venture, a predefined profit is not allowed. However, the percentage participation in profit and loss, or the rent for the use of the property, or the service between the parties can be agreed upon between them.
- One cannot sell what one does not own.
- Ruses and circumvention (*heelah*) of the rules of Shari'aa are not allowed.

Banking and Securities Laws and Regulations

- In the United States, these regulations are rooted in the Judeo-Christian-Islamic value system of fairness, transparency, full disclosure, truthfulness, trust, and preservation of people's assets and properties. These regulations encourage the people to reinvest their savings in the community, thus generating job opportunities and economic prosperity and allowing equal opportunity for all, regardless of faith, skin color, gender, marital status, language, national origin, social status, and/or relationships.

- The laws and regulations are designed to supervise, identify, and discover abusers of the system and to examine the safety and soundness of the institutions entrusted with people's hard-earned deposits, investments, and assets.
- The laws and regulations are based on the vast body of recorded human experience throughout history.
- The laws are designed to prevent fraud by those who attempt to defraud people in the marketplace and those who want to take advantage of people who do not have knowledge, are not educated, or are not well informed, by insisting on full disclosure, transparency, and fair representation.
- The regulations are in continual development because they are adapted to correct previous faults in the design of the system, with an objective to reach perfection as closely as is humanly possible.
- The laws and regulations require that any financial transaction must be translated into an implied interest rate (as required by Regulation Z in the United States) that includes the effect of all fees and expenses so that the consumer can make a fair comparison and an educated decision in his or her financial dealings.
- The regulations do not allow depository institutions (i.e., banks) to own properties except in cases where these properties are owned by default, such as foreclosure (this concept is known in U.S. banking as *other real estate owned*, or OREO). Banks are encouraged to dispose of these properties as soon as practically possible.
- The laws and regulations include a safety valve that gives borrowers who cannot meet their obligations ways and means to restructure and reorganize in an orderly fashion without destroying their facilities or their investments, which might cause the loss of jobs and create more problems (U.S. bankruptcy laws).
- The laws prohibit the payment of interest on bank demand deposits (Regulation Q in the United States). Interest-paying accounts are only allowed with strict conditions and limited withdrawals (see Regulation D in the United States).
- The regulations offer standardized, frequently used, and fundamentally needed contracts, such as those used to finance home mortgages or automobiles. This cohesiveness helps maintain quick settlements of disputes and avoids lengthy and expensive legal proceedings.

Participants in the Development of Modern RF Banking

It is important to recognize all the wonderful people from different professions, with diversified training in many fields, Muslim and non-

Muslim alike, who did and are still doing their best to bring full life back to the “Islamic” RF banking industry. This effort has not been attempted nor tried since the 19th century, in a world that has seen quantum leaps in the business of riba-based banking and finance since that time.

The following is a listing of the different professionals and customers who actively and sincerely participated in the development or the use of services of modern Islamic banking and finance since it was first conceived in the second half of the 20th century.

Muslim Puritans The word *puritan* is advisedly used because of its American roots.³ It was used first in England to describe a group of early American settlers who immigrated to America so that they could apply the true spirit of the Judeo-Christian values as articulated by the Protestant reform leader Martin Luther to their daily lives. The Muslim Puritans emigrated from many Muslim countries around the world to the United States to escape persecution in their own former lands and/or to seek new opportunities in America. It is believed that the first responsibility of the RF banking brand is to help this category of citizens solve the problem of living the American dream without the use of riba/ribit. The challenge that RF bankers have to resolve is how to convince these puritans that an RF banking approach is acceptable, in order to bring them into mainstream America and get them to move out of small apartments they do not own and into a nice home that they do own in a nice neighborhood. This, it is believed, could help them and their families become viable and effective U.S. citizens, because they will get to know their neighbors, send their children to neighborhood schools, and become fully involved in the American way of life. They would eventually transform, becoming owners of a “piece of the rock.” We have had the honor of meeting wonderful professionals who have lived a puritanical life in the United States, without borrowing with interest or depositing their money in conventional riba-based banks to earn interest on a time certificate of deposit, because they believe that doing so is haram (divinely prohibited). Many of these families lived in humble crowded apartments for more than 20 years to avoid taking a loan with interest to buy a home. They went on saving as much as they could to pay for their dream home. In fact, when we started LARIBA, some of these wonderful new Americans had saved up to 80 percent of the price of their home and contacted us so they could finance the rest riba-free. Because of their meticulous attention to detail regarding the RF models and procedures used, and their commitment to not participate in any religiously prohibited transaction, many of these puritans wanted proof that the techniques used were sanctioned by a fatwa from a recognized and trusted scholar. We were happy, patient, and delighted to meet that challenge.

To satisfy the needs of these customers, we wanted to expose them to all the edicts and Shari'aa opinions (fatwas) by displaying these fatwas in full on the www.LARIBA.com Web site. We urged our customers to read these edicts carefully before they decided to use our services. We also made it clear on the Web site that including these edicts on our Web site did not mean that these scholars have given us an edict to sanction our own model, and that we shall never use the names of the scholars to sell our products and services. In addition, we made our Shari'aa supervisor available to answer any questions from these customers. The Shari'aa supervisors used to spend approximately 3,000 minutes a month on their mobile phones answering questions about Shari'aa and the details of the LARIBA finance model. This strategic decision proved to be an important one, because it made us serve and meet those highly analytical, deeply religious, and intellectual customers who are interested in reading and analyzing. They are disciplined to reach their conclusions on their own, without being influenced by superstar names or persuasive marketing and advertising. It also was very fortunate that they were so well-disciplined, because of the highly diverse nature of the many scholars (some of whom are self appointed), who have opinions that in many cases differ from one scholar to another, depending on their country of origin and the religious subgroup they represent. This situation made us address the customer base in a direct and transparent way.

Monetarists^{4,5,6} These research-oriented Muslim scholars in the field of monetary theory believe that the use of *fiat* money and credit creation in the modern banking system through the multiplier effect, as explained in Chapter 5, are the main reasons for the ills of the international riba-based conventional monetary and finance systems, and that truly Islamic banking should not be part of these. They sincerely believe that Islamic banking scholars and practitioners should start a serious effort to use gold as a monetary base. Efforts toward that goal were attempted in the late 1980s with the introduction of the gold dinar in Malaysia. The prime minister of Malaysia, Dr. Mahathir Muhammad, was one of its supporters. Many of these monetarists believe that Islamic banking in a *fiat* monetary regime is in fact a mere change of names and brands without resolving what they believe to be the fundamental problem of *fiat* money and riba-based conventional banking monetary expansion techniques. It is believed that resolving this major concern will take a very long time, and it would not be practical to wait until it is resolved, because it involves major structural changes in the world's monetary and political systems. It is the duty of RF bankers to develop wise solutions that can be applied now to benefit all people by applying the tenets of Shari'aa in an intelligent, prudent, and productive way.

This approach will achieve our goal of helping people transact their business in an RF way, according to the values of the Judeo-Christian-Islamic system, and hopefully in a way that will normalize the effect of such a variable and major concern.

To attempt to meet this important challenge without having to wait for a solution that may take many years to achieve, we followed what is believed to be two wise solutions that are based on Shari'aa. One was an ideal solution in which we would apply the *commodity indexation rule* described in Chapter 3. The approach was to replace *fiat* money with a reference commodity, such as gold or silver or even a staple food commodity like wheat, rice, or soybeans—or a combination of all of these, as James Baker, III recommended in 1987 and which is detailed in Chapter 3. However, this solution would be complicated and impractical. It would take years and the support of many of the countries that command strong economic, diplomatic, and military power—exactly as happened in 1948 in the Bretton Woods agreement. That is why it was decided to use these reference commodities as a tool to decide, in a macro way, whether an economic bubble is perking in the type of asset we intend to finance (by this we implicitly mean “to invest in”). The other solution we use is to *mark the property to market* using the rule described in Chapter 3. Applying the mark-to-market rule normalizes the effect of *fiat* money and its growth by evaluating the return on the investment in the property at hand based on its actual lease or rental rate in the marketplace. Doing it this way—going to the live market and researching the lease that such a property or a business could command in the open market—enables us to evaluate the economic viability of the capital investment. This way we can ascertain that the actual market rent or lease rate of this property is used, and not interest rate, which is the rent of money.

Religious Leaders We deal with many categories of religious leaders. These differ not only by their role but also by their country of origin and the school of thought in Shari'aa they subscribe to. They are:

Popular Thought Leaders in the Muslim World These recognized leaders write extensively on many religious, social, political, international, and jurisprudence issues that have to do with Islam in general and business transactions and finance in particular. They became recognized and highly respected stars in the field of religious leadership over the past 50 years. Because of their status, they were the first to be contacted by those who wanted to develop Islamic banking practices. These leaders did the best they could, based on the knowledge on hand at the time, to start the “engine” and get it going. Their biggest challenge was their lack of understanding and education in the fields of banking and finance. However, their

religious knowledge was complemented by the Muslim and non-Muslim professionals who worked in the *riba*-based conventional banks as bankers, attorneys, and entrepreneurs. They were able to lay down the foundation of what is now documented as a set of opinions that are based on Shari'aa.

Perhaps one of the more significant, pioneering, and influential efforts was the annual symposium that was pioneered by Dallah Al Baraka⁷ to "Islamize" different banking products and services. The annual symposium pioneered by Dallah Al Baraka was by invitation only and was attended by most of the recognized religious, banking, and Shari'aa experts in the world. Sheikh Saleh Abdullah Kamel, a visionary leader in the field of RF finance and the founder of Dallah Al Baraka in Jeddah, Saudi Arabia, must be recognized for the historic effort that laid the foundation for the growth and globalization of RF banking and finance. Many of the tools, techniques, edicts (*fatwa*), and research centers at Al Azhar Seminary, Al Azhar University in Cairo, and other universities in Saudi Arabia, Malaysia, and Pakistan that are available today were pioneered and generously financed by the important and historic effort of Sheikh Saleh Abdullah Kamel. Most of the invited scholars came from the Arabic-speaking world in Egypt, the Sudan, Jordan, Syria, the Gulf oil-producing countries, such as Saudi Arabia, Kuwait, and Bahrain, and English speaking countries like Pakistan, India, and Malaysia. These scholars have since served as active members of the Shari'aa Boards—a new profession pioneered by Sheikh Saleh Kamel in most of the Islamic banks around the world. As these scholars became involved, their reputations increased and respect for them grew, from the wealthy banks in the oil-producing nations of the Gulf to the masses at large (particularly in the Indo-Pakistani subcontinent and Bahrain). Their services were solicited by 40 to 70 different Islamic banks around the world. As a result, it became both difficult and expensive—if not impossible—to obtain a famous name (super star) religious scholar to sit on the Shari'aa Board of an Islamic bank, to approve a product, or to issue a *fatwa* that would sanction and legitimize the activities of a new Islamic bank or finance company.

Local Community Religious Leaders, or Imams The imams are the leaders of the community *masajid* (mosques). *Imam* means *prayer leader*, and in particular the leader for Friday congregational prayers. Imams are also considered religious leaders who act as counsels for the community. Most of them are qualified scholars in the Qur'aan and the *Hadeeth* (pronouncements and sayings of Prophet Muhammad [pp]), but few of them have a good command of the details of Shari'aa, especially in topics having to do with *riba*, business transactions, banking, and financing. They rely on the easy way out by honestly stating that *riba* is haram and that they cannot recommend a certain model because they are not familiar with the details. Others rely on the opinion of the scholars discussed in the previous category.

Some of these local leaders are first-generation immigrants from the Muslim world, and they usually resort to checking with their teachers in their home country. Communication, translation, and familiarity with the local norms, cultures, and ways of doing business in the United States, Europe, and the West in general are a real challenge with this group. Others, who can be considered the new generation of American (Western) imams, are either raised or are born in the United States. It is our sincere hope that these imams will bring a new dimension to the study and implementation of Shari'aa that will be useful and beneficial to all.

Community Leaders These are professionals who took a keen interest in organizing the communities in general and religious services for the communities in particular. These professionals became the heads of the national Islamic organizations in America and in the European countries, and the heads of the local communities in major American states and in countries such as the United Kingdom, France, Germany, and the rest of Europe. They mostly are self-educated in religion and are well read. Some of them have even decided to go to religious seminaries to learn more about the Qur'aan; in some cases, they memorize all of it and decide to be further educated in Shari'aa. They usually take a neutral, well-advised position of not sanctioning any commercial activity, business, or company, because they are afraid of the repercussions that may impact the whole community if the company or bank they recommend fails or uses practices that result in the loss of the community's investments and assets.

Academics and University Professors of Economics and Finance These university professors and recognized research scholars in the field of finance and economics have invested their life in research in the field⁸ of finance and economics at the highest academic levels. Some of them, by the nature of their discipline in research and analysis, have attained a very high level of proficiency and scholarship in the field of Shari'aa and in particular the science of commercial transactions and business. Many have been critical of the models used in Islamic banking (the Shari'aa-compliant models developed in the 20th century) as it is practiced in the world. They concluded that the methods and contracts used may fulfill the requirements of Shari'aa on paper and in form, but these solutions do not achieve what the spirit and intent of RF financing was instituted to do.

Dr Abdul Hamid Ahmad Abu Sulayman,⁹ formerly Rector of International Islamic University—Malaysia and a Saudi Arabian religious scholar, stated:

Islamic Banking is a good example of a field where basically the Western system has been partially "Islamized," but in many aspects

“Islamic” names have been given to various transactions that do not truly reflect the goals or vision of Islam. The result of this frame of mind is called al-hiyal al-shari’ yah, “shari’aa tricks,” where forms, terms, and words are changed rather than the substance when the need is really for a new vision.

In fact, a new term was coined by one of the distinguished academic researchers in the field and the first professor to hold a Chair in Islamic Finance and Economics at Rice University, Professor Mahmoud Elgamal.¹⁰ The term he uses is *Shari’aa arbitrage*, by which he means that a new arbitrage has been created for Shari’aa scholars’ sanctioned models. Such arbitrage does not really add anything to the transaction. It only adds an increased cost due to the fees and added cost of legal maneuvers and ruses (*heelah*) used to make the existing riba-based contracts compliant—at least in form—with Shari’aa. Professor Elgamal complains bitterly about the added cost and sophisticated structures that have been used with one benefit in mind—keeping the form intact without trying to preserve the spirit and intent of the riba-free value system. As a matter of fact, legal fees may have been very high for the first few deals, but as the contracts were standardized and used in a large number of transactions, the costs became much lower. It is believed that the concern should not only be about the cost, but about the real economic benefits of going through the many sophisticated ruses, deceptive tricks, and special-purpose limited liability companies (LLC) that have no economic or even structural or legal benefit except to make things look Shari’aa compliant. It is the responsibility of the academics to reveal, through dedicated and thorough research, the real benefit of the RF system to rescue all people from a lifestyle that may mean a bleak future for all of us. We need to focus on the spirit and intent of the RF value system.

Politicians The attitude of political leaders toward Islamic banking varies depending on the country, the region, and the political orientation of the leader. In many of the Arabic-speaking Middle Eastern countries, Islamic banking has been a big challenge to many of the politicians. Some are afraid of giving the Islamic political groups or political parties added legitimacy and power that may undermine their ability to rule. Others have resorted to allowing it as an expedient political solution, but with many limitations and restrictions. Other politicians in the West have been sensitized by politically motivated lobbyists who are interested in casting the Muslims as terrorists and disloyal. Another concern has been the creation of a back door to implement the Law (*Shari’aa*), which is frequently criticized as being backward and medieval. In the oil-rich Gulf countries and in some Asian countries (Malaysia, Indonesia, Pakistan, and Bangladesh, for example),

Islamic banking is offered side by side with *riba*-based banking to meet the growing market demand for Islamic banking.

To meet this challenge, LARIBA organized an annual seminar on RF financing, which included a prestigious awards dinner to recognize outstanding contributors to RF banking from all countries in the world. We invited local and national politicians to the dinner, as well as religious and community leaders, diplomatic core representatives, and the press in Los Angeles. In one of these galas, we recognized the Prime Minister of Malaysia, the honorable Dr. Mahathir Muhammad, in Chicago for his unique efforts to rescue the economy of Malaysia during the 1997–1998 Asian currency crisis and for his support of RF banking in Malaysia. These efforts have helped us introduce many in the political arena to what we are trying to do, increase their understanding of RF banking, and help them feel comfortable about the integrity and worthy ideals RF banks stand for. This effort has had a definite positive impact on the acceptance of RF financing in the United States.

The Media We were contacted and were covered by many media outlets, including television, radio, newspapers, and magazines. These outlets included organizations such as ABC News, National Public Radio, Voice of America, Malaysian TV, *The Wall Street Journal*, *Time Magazine*, *The Los Angeles Times*, *USA Today*, *The Dallas Morning News*, *The Washington Post*, *The New York Times*, the *Chicago Tribune* and many other newspapers and magazines. It was very difficult to explain to the reporters what we do, because it is very involved and required a lot of attention and concentration. We learned that reporters are looking for “sound bites” and simple, fast statements. We also learned how to do that, but we insisted that they get a piece of paper and a pencil, and we went through the LARIBA model from A to Z. Many of them were impressed. In fact, the coverage we received was the envy of many in the field. Our competitors asked who was our public relations officer. The fact of the matter is that we never had one. We received all these calls from all these reporters without even seeking or expecting them. They must have been a gift and recognition from the “higher authority.”

The most interesting experience was a call we received from a senior business reporter, Elliot Blair Smith, at *USA Today*. The newspaper had published at least three articles about LARIBA. When we took the call, Smith explained that he had spent more than a year in Pakistan investigating money laundering and transfers involving terrorists. He wanted to investigate and know more about LARIBA. We explained to him in great detail what LARIBA is and what we have done at LARIBA, as a responsible American finance company that abides by Judeo-Christian-Islamic values.

The phone call lasted more than 60 minutes. At the end of the call, he said, “Can I come to visit you?” He flew from Washington, DC to meet everyone at LARIBA in Pasadena, California. Over lunch, he told us that he was looking for “blood” and illegal activities and that he was extremely impressed with what he experienced. He published a wonderful article about us at LARIBA in *USA Today* on the front page of the Money section.¹¹

Bank Regulators Bank regulators are required by law and their job description to make sure that the depository institutions (banks) under their jurisdiction operate according to regulations and that the laws of the land are upheld to the fullest in a safe and sound way to preserve the assets of the citizens and the reputation of the system. Regulators have been willing to listen graciously and with great interest, and to entertain new products and service ideas.

The first attempts to engage the banking regulators were made in the United Kingdom, when Al Baraka Bank was started in London in the mid-1980s. The charter was withdrawn later by the U.K. bank regulators because of a number of violations and the fact that the owner entity—Dallah Al Baraka in Saudi Arabia—though licensed there to operate as a finance and investment company did not have a licensed operating banking institution that was chartered by the central bank of the country of origin, Saudi Arabia.

Another attempt was later made by a Kuwaiti bank (United Bank of Kuwait) at its U.K. branch in London and its U.S. branch in New York. The New York branch representatives explained to the regulators—the OCC, in this case—how their finance scheme and model for home mortgages, called *Al Manzil*, worked.¹² After long evaluation, research, and deliberation, the OCC concluded, based on the detailed supporting documentation supplied by the applicant, that there was no difference between the scheme and the regular interest-based contract, and pronounced it acceptable.

When an entity (like Fannie Mae, Freddie Mac, the IRS, or the OCC) decides that a new product or scheme looks fine, they list it under the category of *exceptions to the norm*. This term was used by Fannie Mae and Freddie Mac in order to accept the modified Shari’aa-compliant contracts. That is well and good in good times, but that “exception” can be taken away any time, rendering the RF bankers’ many years of effort worthless. That is not what we are aiming to do. The challenge, for those who believe in RF banking and way of life, is to devise legal documents that abide by the laws of the land, using ways and means that comply with the regulations and the laws of the land while not violating the basic values of the Judeo-Christian-Islamic value system.

Professionals Who Serve and/or Benefit from the New Islamic Banking Industry

Shari'aa Scholars Shari'aa scholars come from diversified backgrounds; they have accumulated a respectable body of knowledge and command the respect of all. The demand for Islamic finance Shari'aa scholars has outstripped the available supply, which elevated many of the scholars, especially those who have a good command of the English language, to the level of "superstars." In RF banking, the Shari'aa scholars serve three important operating functions.

1. Developing the proper models to be used in financing
2. Developing Shari'aa-qualified banking products and services
3. Ensuring that the bank operates according to Shari'aa (religious compliance)

The Shari'aa scholars also serve another important function, and that is the marketing of the bank they represent. The Islamic bank with the most superstar scholars on its Shari'aa Board will carry more credibility to its operations and will attract more depositors and customers. Shari'aa scholars also participate in and attend seminars, symposia, and international conferences to represent the banks they work for and the products they developed. They hold training courses, give television and radio interviews, and go on talk shows (some are beamed live to the United Kingdom and the United States), which brings a lot of customers to do business with the banks they represent. For example, as a prerequisite for their success and their ability to sell their shares to the public, new Islamic banks make sure that their *Shari'aa* Boards include some of these superstar scholars. A typical Shari'aa Board member commands an annual retainer of approximately \$50,000 (or more) and a first-class plane ticket and accommodations when he travels. Scholars with this superstar status sit on the Shari'aa Boards of an average of 50 to 70 banks. This raises very serious conflicts of interest, confidentiality, and insiders' concerns and issues. It is hoped that a major effort will be designed to increase the supply of these scholars by producing a new generation of scholars to serve in the future.

Attorneys Many Western attorneys became involved in the field of Islamic banking, because world banking laws and regulations are set according to Western standards. Most of the attorneys involved specialize in tax planning, business structuring, and financial engineering. These disciplines are important because the attorneys invited to "Islamize" the banking agreements, finance contracts, deed of trusts, promissory notes, and arbitration were requested to improvise these legal documents so that they would be acceptable to both Shari'aa experts and to Western countries like the United

States, the United Kingdom, France, Germany, and other countries in Asia and the Middle East that use these laws. The author has participated in, attended, and was exposed to many of the meetings between representatives from Islamic banks or finance companies and specialized lawyers. The time spent by the lawyers, and the fees charged, were unbelievably high. Once one of my attorney friends telephoned me after concluding one of these contract “Islamization” programs—and earned a handsome seven-figure fee. He asked me, “Why are you Muslims doing it this way? You end up with a contract that looks Islamic on paper but it does exactly what any other standard conventional finance contract does—but of course it costs a lot more just to remove the word interest from the contract to make it look as if it is a buy/sell agreement, which it definitely is not.”

Riba Bankers These are professionals with a proven track record and experience. In the early stages of the development of “Islamic” banking, they brought the products, services, and techniques of the riba-based conventional banking system to the Islamic banking arena. They are useful in explaining the conventional banking business to the scholars, which helps them create Islamic products and services that comply with Shari’aa. They also brought their experiences in conducting efficient banking operations.

Organizers for Seminars, Industry Group Conferences, and Training Programs In the beginning of the Islamic banking movement, seminars were organized by semi-government and government organizations—mainly in Malaysia and Bahrain—to discuss, promote, and present papers on new products and services that are RF qualified. Professionals who were known to make true and pioneering contributions to the field of RF banking and finance based on their research work were invited to present their papers at these conferences, seminars, and workshops.

As the business of training conventional bankers on “Islamic” banking grew, and demand increased from many banks throughout the world, commercial seminar organizing companies took over the business. These seminar and training companies organized educational training programs and (promotional) conferences in the field of Islamic Banking and Finance. These conferences were run for profit, which is why the organizers invited a predefined roster of superstar scholars and speakers to attract participants, who paid thousands of dollars to register in these seminars. These seminars were turned into marketing forums for large investment banks and conventional commercial banks, which paid to speak or participate in a panel. Fees paid to include the name of the company on the program and to invite the company to speak in the conference ranged from \$10,000 to \$100,000. These entities would present their new, revolutionary, and extremely

profitable “Shari’aa-compliant” products, which were designed and approved by no less than the superstar scholars, who were of course present at the conference as speakers and as supporters of the “marketing and sales” cause.

After this practice became the norm, LARIBA’s board of directors decided not to participate in any conference that required that we pay to speak. Our position has always been that we do not believe in the practice of “pay to play.” We consistently told the organizers that if they thought we could add value and substance to the seminar or the conference because of what we achieved, we would be happy to participate. The result was, of course, that not many of these organizations invited us to such conferences.

RF Banking Consumers and Potential Users

Four types of customers have contacted us for RF financing:

1. *The puritans.* These customers “shake in their boots” when the word *riba* is uttered. They contact us because they are looking for an RF solution to a financing situation. They are willing to pay more to save themselves from participating in the haram act of dealing in *riba*. These are the best customers any financial institution would hope to add to their books. They have some of the best credit scores and are devout customers who are the best in fulfilling their contractual obligations. However, it takes extreme patience and knowledge of the products and services, as well as a long time, to explain the models used and to convince them of (and make them comfortable with) the true RF nature of the transaction.
2. *Average consumer.* These are customers who would be interested in RF financing if it were made available at competitive prices, costs, and terms as compared with conventional *riba*-based banks. These customers can be Muslims or non-Muslims. At LARIBA and the Bank of Whittier, we have had the great honor of adding many of these customers, who come to us from all faiths and backgrounds through referrals because they appreciate the unique, sincere, and high-quality service as well as the added value of the RF bankers.
3. *Customers who claim that they are coming to RF banks because they want RF finance,* but after further investigation it is discovered that they have been to every bank to seek financing, and after they failed to get it, they came to us, the RF bankers, to see if we could help. These customers need to be handled with great care and scrutiny. One such experience was a potential customer who had a printing shop. He stated that he liked RF financing because the RF bank “participates” in the

profit and loss. After scrutinizing the application and exercising prudence, we found out how much loss he had. We declined the financing (i.e., the investment).

4. *Educated and sophisticated customers.* These are the young American-educated and trained professionals who are used to asking questions and who are keen on getting straight convincing answers that make sense. They respect the opinion of scholars, but they want to know why things are done in a certain way and how the scholars arrived at their edicts (*fatwa*). They want answers that appeal to the mind and to the intellect. They demand answers that prove that the RF finance makes economic sense and offers advantages over the alternative conventional *riba*-based system. They are savvy, Internet-conversant, and sophisticated in analysis and in reaching conclusions. These customers are, in fact, the best customers for a bright RF banking future.

SHARI'AA AND THE LAWS OF THE LAND

The many different and sometimes opposing undercurrents, mainstream constraints, and varying participants detailed above make the process of developing a true RF banking operation a huge challenge. These challenges had to be met and resolved wisely, and all the pieces of the puzzle had to be put in place to pioneer *the art of Islamic banking and finance* in the United States. It was a huge challenge. Here is a list that gives an overview of the major issues:

- Where should we start? We did not have the capital to apply for a bank charter, and even if we did, how could we apply for the charter of a bank run without *riba* in a business environment that only knows and recognizes *riba*-based conventional banking and finance transactions?
- Who would run the bank or the financial institution? There are very few experts and practitioners in the field. It was also challenging to know that those with banking experience are employed by established banks and are paid high salaries. Bankers with Islamic banking expertise are employed with very high salaries by the well-capitalized and rich Islamic banks in the Gulf oil-producing countries.
- Where could we find an attorney that had the expertise and was affordable, given our limited resources?
- What financing model should we use, and would it comply with the laws and regulations of the United States—our country—without violating Shari'aa or the Judeo-Christian-Islamic set of values?

Developing the Art of Islamic Banking and Finance

The art of Islamic banking and finance is the process by which all of the undercurrents described earlier are put together to come up with a new brand of banking. The RF banking (riba-free banking) brand merged all of these undercurrents to produce a banking service that would be able to satisfy the market demand. The goal was to develop the RF banking system as an optimum and meaningful financing approach that would benefit all people and help them to live a life free from riba.

The Approach Used to Develop the Art of Islamic RF Banking

The challenge we faced was how to develop an RF bank (with the limited knowledge we all had then; please note that in 1987 we called it *interest-free Islamic banking*) that would abide by Shari'aa and at the same time would comply with the laws of the land. In trying to do so, a prior experience I went through in 1972 in Dallas, Texas was useful. At that time, I was the chairman and one of the imams (religious leaders) of the first organized Islamic Center in Dallas (and maybe one of the first in the state of Texas), the Islamic Association of North Texas, or IANT. One of my responsibilities was to perform weddings according to Islamic Law (Shari'aa). The Board of the Association asked me to start working on getting Texas state officials to recognize an Islamic wedding contract, instead of the state-sanctioned civil marriage license. Our group talked to lawyers, state officials, and to the clergy in the Christian and Jewish faiths. Soon we learned that other faith leaders had tried earlier, but it was not possible. A wise religious leader shared with us the fact that the civil marriage certificate carries with it the weight of the law of the land in order to protect the two parties in the marriage contract. In addition, the civil marriage contract can be signed by a civil official (e.g., a justice of the peace), which makes it civil, or by a religious leader, which makes it religious. Without the power of the state's legal system, law enforcement system, and legal codes, this leader pointed out, no institution would be able to prevail in case of a dispute.

It was a personal experience that made us see the light. One day I performed the wedding of a wonderful young lady who had come to the United States from a Muslim country to study. She met a young man, and they decided to get married. I officiated the wedding using a "homemade" Islamic wedding contract. Six months later, the young lady contacted me with tears in her eyes and told me that her husband had left her and disappeared. We tried to help by calling the police. I showed the police the "Islamic" marriage certificate. We were told that it might be a useful document, but it did

not carry the weight of an official civil marriage certificate issued by the municipality involved. After searching my heart, I concluded that we should use the civil marriage contract. We concluded that what makes a marriage Jewish, Catholic, Methodist, Protestant, or Islamic is not only the religious vows and the signature of the religious leader. What makes it any of these things is what the parties do at the time of dispute. The couple can go to the religious leader (e.g., the rabbi, priest, or imam) to preside over an arbitration process that is conducted according to the tenets of the faith, and that will make it religious. Or they can go to a civil court and that will make it civil. After this experience, which deeply touched us all, we recommended to all Islamic Centers in the United States and Canada that no imam or certified community leader be allowed to perform a wedding without a civil marriage certificate, in order to protect each party. This ruling stands today.

Our team at LARIBA reflected on this experience when we started looking for ways to bring RF banking to America, in order to solve the puzzle and optimize the process of merging the many currents and players in the field. We were concerned and troubled by the standard approach used by many “Islamic” bankers who were interested in establishing an Islamic bank in the West. It is sincerely hoped that this frank discussion will not offend any of the wonderful, well-intentioned, and believing Islamic bankers in the world—Muslims and non-Muslims—who want to use this approach. The standard approach used starts by requiring local authorities in other non-Muslim countries to change their laws, regulations, and procedures to fit the requirements of the Shari’aa Board of those banks. Your author was privileged to have been exposed to many of the detailed discussions that led the U.K. Financial Services Authority (FSA) to license an Islamic bank (*The Islamic Bank of Britain, IBB*). The legal costs involved, the compromises arrived at, and the monetary guarantees offered could only be done by a very rich entity that could afford it and would be capable of providing the guarantee from the central bank of the country involved. We respectfully ask those who use this approach to reverse roles. Imagine that a bank in the United Kingdom comes to a Muslim country, presents itself as a Christian bank, and calls itself “The Christian Bank of Country X”—and demands that the laws of the Muslim land be changed in order to transfer large sums of money and open that bank. It does not require much imagination to project the reaction of the country. It is wished that this attitude will be changed, because it may be temporarily accepted by some non-Muslim countries’ officials to achieve a short-term goal, like securing “Islamic” funds for an “Islamic” bond (*Sukuk*) in a European city. Alternately, it will be accepted from those who happen to have the funds to spend today, but after the funds dry up then there will be no more guarantees and the license is withdrawn or the special conditions are removed. It is

also important to note here that complying with the United States banking regulations and satisfying the regular periodic examinations conducted by the bank regulators is a very important and essential aspect of running a viable bank—both RF and conventional—in the United States and most other Western nations, as well as other nations in the world.

In our efforts to establish a viable RF banking operation in the United States, we started by realistically listing the facts. Here is a list of what we came up with:

- The OCC¹³ ruled that the Islamic banking models of cost-plus (*Murabaha*) and lease-to-own (*Ijara wa Iqtinaa*) proposed by the United Bank of Kuwait—which follows the Shari’aa-compliant model—are in fact regular finance transactions with different names.
- Almost all Shari’aa-compliant contracts we reviewed and analyzed were in fact similar to the regular finance contracts, but with different names and procedures that make them look “Islamic” on paper. In fact, the contracts stated implicitly that they are indeed regular finance contracts in case they are brought to the courts of law.
- There is sensitivity associated with the mixing of religion with business and also the stereotyping of Muslims in many Western societies. These sensitivities intensified after the heinous attacks of September 11, 2001.

While developing an RF finance model in the United States, we decided that our goal was to find a workable solution that would abide by Shari’aa and would not violate or attempt to change the laws of the land. We drew on our experience in developing the Islamic marriage procedures and contracts in the United States. There were many reasons for us to adopt this strategy. The first is that we do not have the money, the human resources, or even a standardized and universal working legal code that we could present as a foundation. The basis of our strategy was to achieve small successes in our endeavor to prove the viability of this new RF banking and finance system, and not to limit our growth and success potential by trying to achieve impractical and unrealistic goals. We started from the fact that the United States has, as described earlier in the book, the most sophisticated and fair banking system representing the fruits of many years of improvisation; it is rooted in the fairness of the Judeo-Christian-Islamic set of values. In our efforts to develop RF banking and finance, we decided that we should not start from ground zero and reinvent the wheel, but should draw on the huge body of human experience in banking and finance, which cannot simply be ignored or thrown away, as that approach would not be fair and wise and indeed would have been counterproductive. Our priority was to prove

to ourselves first that we had a working concept with proven success and to chart a track record for applying this new brand of banking and finance. We knew that this approach would require a lot of hard work to raise capital; to put systems in place; to locate, identify, recruit, and train human resources; to clearly understand how conventional *riba*-based banking works; and to develop models and products that are easy to understand by the RF bankers and customers and that comply with *Shari'aa* while at the same time upholding the laws of the land. Most importantly, we wanted to develop an investment (loan) portfolio that proved that we have a small but viable and proven alternative. We firmly believed that American Muslims as a minority—and, for that matter, the minority of all minorities in America—must be humble, respectful, and understanding in this effort to develop RF banking and finance without violating *Shari'aa* but while also upholding the laws of the land.

An important aspect of the RF banking business is its faith-based credentials. History has shown us time and again that religious fervor, when instigated, can be very strong; it can be the source of great emotional energy, which can be used for marketing products and services. It has happened in the United States, when religious groups (including some Muslims) raised capital from innocent and trusting members of their communities, promising them great returns in this life and God's acceptance in the hereafter, only to see the trusting customers lose everything when the promoters disappear. One recent episode was the Madoff hedge fund, which attracted money from many Jewish nonprofit organizations as well as many wealthy investors and banks all over the world. It turned out, apparently, to be a type of Ponzi scheme that lost its investors billions of dollars.¹⁴ Another episode was that of Sunrise Equities, a Chicago, Illinois company that not only offered "Islamic" investments but also had its own "Shari'aa Board," which the company had imported from India to add legitimacy to its operations. In one of the financing applications we received from a customer, we noticed an investment certificate from Sunrise Equities that promised the investor 15 and 20 percent annual returns on investment. We met the representatives of the company during a New York conference in October 2007, took them to the side, and told them that what they were doing was wrong, illegal, and damaging—not only to themselves and their victims but to all of us in the new and emerging RF banking and finance industry. They shrugged their shoulders and walked away smiling. Earlier that year, a delegation from LARIBA had flown to Chicago to discuss the matter with their "scholar" and his team and to alert them to what was being done in the name of religion. We were discounted. It was saddening to learn that in September 2008 the Indian Muslim community—mostly from Hyderabad—lost all of its investments, and the "bearded" and "turban-dressed" religious business "leader" disappeared

with his staff. Episodes like these, which have also been experienced in Egypt, Turkey, and many other places. We at LARIBA have disciplined our operations from the time we began in 1987 to go slowly; to have prudent; never to use faith in our advertising; to learn systems, techniques, and operations from the pros in conventional banks; to attract professionals to join our team; never to promise what the return will be, because only God knows the future; and to always underpromise and overdeliver. These are, in fact, some of the aspects and character foundations of the Judeo-Christian-Islamic value system that make RF banking a uniquely positioned brand name in banking.

In conclusion, we decided to first understand the laws of the land and to try to apply these laws in the same way that the civil marriage process was developed in the United States.

MAJOR OBJECTIONS OF SHARI'AA SCHOLARS TO THE CONVENTIONAL RIBA-BASED FINANCE CONTRACT

Most modern Islamic finance scholars who reside in some of the Muslim countries made the following recommendations to change the riba-based conventional banking system:

- The contract must be changed to fix some of the noncompliant features it suffers from. The Shari'aa-compliant contract (as ruled by these scholars) must:
 1. Not show the word *interest*. As discussed in Chapter 7, this stands against Regulation Z (the Truth in Lending regulation). As discussed in Chapter 9, there is a clear edict (*fatwa*) from the most senior and respected scholars which states that if the laws of the land require using the word interest, then it can be used. This fatwa is conditional on not using interest—money renting—in the actual process of financing.
 2. Show a buy-sell transaction in which the bank buys the item from the seller, then sells that item to the buyer. As discussed in Chapter 9 and in many parts of this book, U.S. banking regulations stipulate that banks cannot act as buyers of properties. In addition, in most Western systems, any buy-sell transaction triggers a tax event, and the profits are taxable. In addition, as was concluded in Chapter 9, all the buy/sell schemes are synthetic in nature and are in fact ruses and deceptive tricks (*heelah*) used to get around and circumvent Shari'aa.
 3. Late payment fees cannot be applied unless the payments were intentionally made late without an acceptable excuse. These late payment

fees should be paid out to a charity, and should not be added to the bank's profit. This was an easy requirement to implement.

4. Any income realized by the bank due to an unavoidable interest source must be paid to charity and not added to bank profit. This condition is also achievable.
5. In a lease-to-purchase model, insurance premiums must be shared by the two participants in the transaction in proportion to their ownership. Most scholars suggested that the monthly payment of the buyer be increased to reflect that cost, and add the portion of the insurance premium to the monthly payment. Per U.S. bank regulations and for the sake of transparency and straightforwardness, the bank must disclose in full the payments made and what they were used for. In response, it was decided that if an RF bank uses the LARIBA Shari'aa-based RF model, the bank must tell the customer openly that he or she is responsible for the insurance; because he/she own the shares from the beginning and that he/she is the one benefiting from the use of the facility in an operating lease.
6. Maintenance must be shared. Again, because the buyer uses the facility, regular maintenance is not only required, but must be paid by the user to keep the property in the best of all shapes.
7. Customers' deposits must be exposed to bank profit and loss. Investment products cannot guarantee a certain interest rate or return. It is believed that it is unfair, in a banking scheme that offers Federal Deposit (FDIC) insurance on funds, that peoples' hard-earned savings and deposits are exposed to the risk of loss. We are aware of the scheme used in the United Kingdom, in which the customer must be offered the guarantee *and* offered the option of refusing it in order for that condition to be applicable.
8. The bank should have a supervisory board that specializes in Shari'aa to ensure that the bank's products, services, and operations are compliant with Shari'aa. The Shari'aa Board is given the power to render bank operations not compliant. That condition can be implemented as a part of, and a complement to, the annual onsite regulatory examination conducted by the concerned regulatory authorities. As discussed earlier in the book, many of the aspects of the regulatory onsite examination ensure compliance to regulations. It must be frankly admitted that the bulk of the regulations, which are in fact Judeo-Christian-Islamic in nature, are not even considered by the Shari'aa Boards of the Islamic banks in many of the Muslim countries. As an example, the fairness of treating expatriate workers needs to be closely examined and evaluated by the Shari'aa Board of the bank or finance company. Another example is applying the basic

human right of obtaining credit in a host country. The Shari'aa Board in the setting we propose should complement the onsite regulatory supervision to make sure that the models used are in fact the same as advertised and that these models comply with Shari'aa and that the bankers and their representatives apply Shari'aa when they "sell" these products and services. Unfortunately, the extent of the Shari'aa Board's involvement in the operations of many Islamic banks has been minimal, and their job ends at sanctioning a model or a product. Unfortunately, the "Islamic" bankers use the names of these respected scholars to advertise and seek acceptance in the market. The question we have is: Does every light bulb we buy have to have the signature of Mr. Thomas Edison to make it an acceptable light bulb?

- It is interesting to note that the focus of the scholars was concentrated on the legal aspects of the contract but did not include some of the basic requirements that define the substance and spirit of the true RF banking and finance system. For example:
 1. Very little is mentioned about the aspect of social responsibility of "Islamic" RF finance. It is true that the rules put forward by many Shari'aa Boards and scholars prohibit participation in financing the businesses that involve the manufacturing or selling of intoxicants, gambling, illegal activities, or promiscuous activities, as well as socially irresponsible activities such as environmentally damaging industries, businesses that do not treat their employees and customers fairly, and institutions that use false advertising to con their customers. However, one would notice little or no mention of the responsibility of the RF banker to local communities by investing the deposits gathered from a community back into that community—as in the U.S. Community Reinvestment Act (CRA)—before allowing bank deposits to be invested outside the communities (and in some cases, outside the country), depriving the local communities of the opportunity to help their citizens grow and prosper and to create job opportunities for all. Also, it is noticed that there is no mention of treating people equally, without discrimination based on national origin, wealth, tribal ties, skin color, gender, or language.
 2. There was no significant sign that the scholars of the Shari'aa and the "Islamic" bankers tried to benefit from the vast body of bank regulations that deal primarily with fairness and respect of human rights in the communities, as well as to protect those who experienced unexpected and unfortunate circumstances beyond their control, as we see in the bankruptcy law and codes in, for example, the United States.

3. It is peculiar to note the posture of most of the Shari'aa finance scholars, who ignore what is believed to be the basic revolutionary aspect of the RF finance system: the *commodity indexation rule*, which neutralizes the effects of *fiat* money fluctuations, and the *mark-to-market rule*, by which each of the items to be financed is marked (compared) to the market to identify any market bubbles and help investors make prudent investment decisions. We believe in prudently evaluating the potential investment in terms of *return on capital* invested, by pricing, for example, cars, homes, or equipment based on the actual lease rate they would command in the open market system. It is believed that these rules are the most important, and add fundamental unique aspects to the RF financing approach. There is no mention, for example, of paper (*fiat*) money and how it may lead to unfair and deceptive aspects of a transaction.

In conclusion, it is believed that in a fair and viable RF banking regime, all the banking regulations that were discussed in Chapter 7 should in fact be part of Shari'aa requirements. It is the real intent, and not merely the words in a convoluted contract, that in fact makes the RF banking and finance system unique and beneficial. Many of the Shari'aa-compliant contracts are in fact designed by force-fitting the conventional *riba*-based contract into language that "complies" with Shari'aa in form, but that in most cases does not satisfy the real spirit and substance of why Shari'aa prohibited *riba*.

We want to share with the reader a personal experience that we hope will shed more light on the unfortunate practice of some of the "scholars" who have in fact risen to positions of fame despite very little being known about their education, training, research, scholastics, and/or any proven track record of documented, debated, and critically reviewed research.¹⁵

At LARIBA, we once decided to engage a well-educated economist who had completed a Ph.D. in economics in the United States, had authored a number of books on "Islamic" economics, presented himself as a scholar in Shari'aa, and acted as an advisor to some of the most prominent law firms active in "Islamic" finance legal services. We wanted this economist to evaluate the LARIBA Shari'aa-based RF model as a foundation and develop a set of documents that he would feel satisfied what he believed to be the Law (Shari'aa), in his opinion. We gave him the fruits of our 27 years of research, supported with references and research papers to read. He came back with a big smile on his face, saying, and I quote, "This is really unique and is different. I think you have something that will be very useful." We gave him our instructions, which consisted of making sure that the research we documented was included and articulated in his efforts and ensuring that we had

followed the laws of the land and the norms required by the U.S. banking regulations—something we later discovered that he knew very little, if anything, about. He asked us to supply him with copies of the standard deed of trust and promissory note used in standard banking transactions. After a few weeks, he e-mailed us his products. Upon investigation, and after matching the Microsoft Word documents using the edit-tracking facility, we can summarize what he did as follows:

1. Replaced the word *interest* with *rent* or *profit*. We had told him that we take care of that in the process of finance preparation, and that doing it this way creates a completely different set of documents that will require us to obtain an exception to receive detailed approvals from the regulators, which would expose us to a lengthy and expensive process. We also stated that this approach might compromise the interests of the customer, especially in a court of law where it would result in utter confusion among the judge, the prosecutors, the defense attorneys, and the jury. We also stated that it does not matter—based on many references in Shari’aa—what you call that percentage as long as it does not imply the “renting” of money, indicating a *riba*-based transaction.
2. Made the process look like a buy/sell agreement. We told him that in a buy/sell transaction—based on the laws of the land and Shari’aa—we should include a documented and properly recorded transfer of title from the seller to the bank (the buyer), which violates U.S. bank regulations and credit policy, and subsequently from the bank to the ultimate buyer. In addition, this claimed buy/sell step is, in reality, synthetic, because we know that the bank never intended to buy the property and that the process is done this way to make it look Islamic. We told him that metaphorically, it reminded us of a man who wanted to enjoy a few nights with a lady. He proceeded to marry her with the intention of divorcing her after he got his pleasure—definitely a deceptive trick designed to make the process look religiously acceptable on paper, though the intention was anything but! We also told him, based on our long-time banking experience, that this approach might open the bank (as a buyer of the property) to punitive actions by the regulators and a potential capital gains tax that could be significant. He said, to our amazement, that changing title was not necessary, because at the time of Prophet Muhammad (pp), there was no change of title! We told him that we obviously were no longer living in that age. We also told him that it would be counter to our claims to be trying to uphold Shari’aa if we did not tell the truth, which is one of the most important foundations of any faith, let alone the Judeo-Christian-Islamic value system.

3. Included in the documents was a very interesting disclosure, in which he stated, and I quote: “This is a finance contract . . .” Our response was, “If this is the real intent, what is the point? Why go through all these changes and maneuvers?” He said that we needed this to be done in order to be compliant with Shari’aa.

We canceled his consulting contract. He reacted by saying that he was not surprised, because he felt that we had no respect for scholarship! He is still being invited to teach scores of European and Western bankers in training seminars, short courses, and conferences on how to structure “Islamic” contracts that would “comply” with Shari’aa. These are the same seminars organized by the same groups that have controlled the “Islamic” banking promotion domain with one goal in mind: presenting scholar participants who will help promote the “Shari’aa-compliant” banking that conforms to the methodology promoted and signed on by the very Shari’aa scholar “superstars” created by such promoters.

In another experience, one of our staff members was sharing the challenges we face as a minority in the United States with another “scholar.” The staff member shared with the scholar that we all should be wise, honest, and creative in order to offer true RF banking that would be based on Shari’aa without violating the laws of the land and the U.S. banking regulations, while at the same time offering real economic substance and an advantage to the user of RF financing techniques. This scholar’s advice was that we get ourselves a good lawyer who is well connected with the regulators and/or a retired regulator—as they had done earlier, in another European capital—and all would be taken care of. We shared with this scholar that in the United States, it is not the usual practice to buy your way in; even if you were successful, it would cost you a lot of money and result in many restrictions—as happened in the aforementioned European country—that would render RF financing a “joke,” something that satisfied the form but not the spirit and the substance of the Judeo-Christian-Islamic value system based on Shari’aa.

While developing this LARIBA Shari’aa-based RF model, we had to come up with solutions to the many challenges discussed previously in this book and we had to merge many of the opposing undercurrents. The following is a list of the major guidelines used to develop the model:

- It should reflect and embody the real spirit and substance of Shari’aa.
- It should be based on Shari’aa (notice here the phrase *based on*, not *compliant with*) and not force-fitted, as is done in the Shari’aa-compliant approach.
- It must reflect the benefit to the user when compared to the models used by the riba-based system and the Shari’aa-compliant system.

- It must enforce and abide by the laws, regulations, and standards of the banking and financing system in the United States.
- It must be appealing to all users, regardless of their faith, skin color, national origin, ethnicity, gender, or language.
- It must be convincing to the educated and sophisticated users, offering a real economic advantage and benefit and not relying solely on the reputation of a famous religious scholar's endorsement.

BUILDING THE SHARI'AA-BASED FINANCE MODEL

After a thorough analysis of the Islamic finance models available on the market and used mostly in the oil-rich Gulf countries and in Malaysia, it was concluded that these “Shari’aa-compliant” models were in fact not much different from those used by the conventional banking system. What reinforced our conclusion was the ruling passed by the Office of the Comptroller of the Currency (OCC) in response to the application of the New York branch of United Bank of Kuwait to allow “Islamic” banking using the cost-plus (*Murabaha*) and lease-to-own models. The OCC concluded that these products were the same as interest-based financing. This fact made us conclude that we do not need to obtain special government approvals and exceptions that require a huge investment of time, money, and effort. We felt that what is needed is a system that would truly implement the Judeo-Christian-Islamic values of Shari’aa to benefit all.

Many attempts were made to devise a model that would satisfy our requirements. After a long search and extensive analysis, the effort focused on an analogy to our community’s experience with the development of marriage procedures and contracts in the United States. A marriage contract is considered in the Judeo-Christian-Islamic system as the most solemn, most binding, and “thickest” of all contracts (Qur’aan 4:21). Based on our community’s earlier experience with the development of an Islamic Shari’aa-based marriage system and procedures that utilize the civil marriage contract, we can draw a wonderful parallel with our efforts to develop a Shari’aa-based RF finance system. As is normally the case in marriage, a standard process is used. In this process, a number of preparatory steps must be followed before signing the standard civil marriage contract. For example, the two families would meet and agree on the details of the marriage agreement (e.g., the dowry), and the wedding details (e.g., the religious leader (the rabbi, priest, preacher, or imam) who will officiate the wedding). Then, the couple to be wedded would apply for a standard civil marriage license that has a space in it for a religious leader’s signature. The religious leader would meet with the two families and the couple to be

wedded to explain in full detail the meaning of the marriage contract according to the rituals and processes of the faith and to consult with and agree upon the details of the process. It was also reasoned that what makes a contract Islamic, Catholic, or Jewish is not only the religious ceremony and the religious wedding vows and rites pronounced, but also where the couple goes if they have a dispute. If they seek religious arbitration, that makes it a real faith-based marriage; if they seek the civil courts, that makes it a civil marriage.

There are two important considerations that need to be included in the development of the Shari'aa-based RF finance system:

1. That money is not rented. This stipulation is met by ensuring that the property is marked to market.
2. That, in the case of a dispute, the contracting parties use a board of arbitration that abides by Shari'aa. This makes the contract "faith-based," depending on the faith involved.

Another important parallel experience of the American Muslim community and its development was our 1969 attempt to make available to the American community *halal* (divinely permissible) meat products from chicken, cattle, and animals in general that are slaughtered according to the rules of Shari'aa. I tried to arrange for the famous Oscar Mayer meat company in Madison, Wisconsin to give us beef that was slaughtered according to Islamic rites, as it is conceptually done for kosher meat.¹⁶ I went to Oscar Mayer's general slaughterhouse and participated in making the slaughtering according to Shari'aa and witnessed firsthand a rabbi doing the same for kosher meat. In an effort to systemize this process, one can state that the meat production involved a number of subsequent steps. These are:

1. *The Preparation* of the animal. It had to be clean, clear of any illness, and able to pass the standard regulatory tests of the veterinarian.
2. *The Faith-Based Action* to slaughter the animal, which differs by faith.
3. *The Processing*, which includes proper slaughtering and cutting and complete drainage of the blood; the details of this process also differ by faith.
4. *The Packaging* can include the label *kosher* (for Jews) or *halal* (for Muslims) in addition to the U.S. Department of Agriculture (USDA) label and emblem, which are required to sell the product according to the laws of the land as described in the universal standards set by the USDA.

Our strategic group reasoned that this process, too, could be copied and used in the development of RF financing without the need to incur huge expenses in trying to reinvent the wheel.

Applying this vision based on the analogies and the stepwise approach described above, we reached the following process as it pertains to RF financing:

1. *The Preparation:* This step includes taking an application from the customer and processing it by evaluating the customer's credit scores to check on his/her credit character profile, to learn where the property is in order to be ready for an appraisal, and to learn the customer's financial details.
2. *The Faith-Based Qualification:* This step includes the application of the LARIBA Shari'aa-based RF finance model to decide whether investing in and buying the property makes economic and prudent sense.
3. *The Processing/Underwriting:* This step includes the analysis of all the information gathered, the assembly of all the documents needed, and the decision as to whether we should join in investing in the property with the customer.
4. *The Documentation:* This step includes documenting the agreements according to the standard and universally used documents that follow the banking laws and regulations of the United States. To record the process we used, we developed what we call the LARIBA Agreement. It is a rider that is added to the agreements and contracts. It describes in detail the prohibition of *riba*, the process that was used, and the U.S. banking regulatory reasons why the phrase *implied interest* was used.

We are aware that others in the field of Shari'aa-compliant "Islamic finance" in the United States and other parts of the world—in their sincere attempts to comply with Shari'aa—have used expensive lawyers and costly and sophisticated structured corporate vehicles for the purpose of "financial engineering." We are also aware that others use ruses (*heelah*, or deceptive tricks and practices) to make the financing agreement look Shari'aa-compliant on the surface, but when the intent, the fine print, and the methods used are investigated, one can clearly and readily conclude that the contract is intended to circumvent the Law (Shari'aa). Based on thorough research in the original sources, on our consultations with many scholars in Shari'aa since 1987, and our soul searching, we decided to be fully transparent about the LARIBA model methods and not to mislead or misrepresent facts by using "financial engineering" techniques such as the use of a special purpose vehicle (SPV) as discussed in Chapter 9.

It was also decided never to use the names of the eminent scholars in Shari'aa for advertising purposes to make it easy to "sell" our products and services. We feel that doing so takes away respect and eminence from those respected scholars and, in fact, is counterproductive, because it is important that educated and sophisticated users understand the concepts used

in order to be responsible for his/her actions and decisions in this life and the life after.

The Unique Features of the LARIBA Shari'aa-Based Model

As described earlier, in today's banking terminology, one can conceptually define *riba* as the rent on money and/or lending to rent this money at a price or rate called interest rate. *Riba*-based conventional financing may involve unsecured and noncollateralized credit that is not asset- or service-based. The *riba*-based conventional financing system uses an index called interest to define the cost of "renting" money to the customer. In an RF finance setting, the bank's financing activity is looked on as an investment by the bank in the individual (or company), in order to help that entity acquire tangible assets and/or services. In this capacity, the RF finance officer makes sure that the finance facility has economic merit by measuring the return on investment using the market rent of the facility, the service, or the business. Please note that in RF financing, we prefer to use the word *finance*, not *lend*, because the financing is looked upon as a true investment with the customer. The only loan in Shari'aa, as detailed earlier, is *qard hassan* (a loan that is returned with no additions to the original value, which is made for a good cause).

The other important aspect of an RF banking transaction is that there is no predetermined value measurement for the renting of money, called *interest* in *riba*-based conventional banking transactions. In an RF banking transaction, the return on investment is obtained as a result of the investment process or the leasing process of the asset in question. That return on investment is the real measure of the value of the investment activity, with its unique characteristics. In doing so, the RF banker marks the item to be invested to the local market, instead of using a unified interest rate to rent money at a predetermined level throughout the country. For example, a house rent should reflect the value of that house and not a *capitalization* rate, as is done in most leases and in many models used by some "Islamic" bankers. The rent of two similar homes—one in Alabama, which has a smaller economy, and another in California, the eighth largest economy in the world—should be different, because of the difference in the economic characteristics of each state. That difference should be reflected in the financing process by the lease rate of the item to be financed in each state, as dictated by the market forces of supply and demand.

The following are some of the unique features of the LARIBA Shari'aa-based RF finance model:

1. The RF model is based on a belief that can be articulated as “*We do not rent money; we invest in you.*” Applying this model requires that the RF banker approach each transaction as an investment (using The Declining Joint Venture Lease-to-Own Model) instead of lending. The RF banker advises the customer, to the best of his/her abilities, as to whether the transaction is a good investment or it is better for the customer to rent. This process prevents the buyer and the finance company/bank from participating in an economic bubble and from buying an overpriced facility or business.
2. The RF model requires that the RF banker does not calculate the monthly payment by starting from an interest rate, as is done in riba-based finance. Homes, cars, and businesses can be rented at a fair market value that is defined and agreed upon by the RF banker and the customer after studying the market. The monthly payment is based on the market rental value of the property to be financed. The rental value is determined by going to the market—both the customer and the RF bank finance officer independently—to measure the rental rate of a similar property in the same neighborhood by asking real estate agents in the area. The fair rental value is determined by mutual agreement between the customer and the RF finance entity. In this process of *marking to the market*, the house buyer calls three different real estate agents to get the actual market value of the rent of a similar house, if it were to be used as an investment property. In addition, the RF bank finance officer does the same. This way, the RF bank obtains a marked-to-the-market, agreed-upon property market rent that the RF bank finance officer subsequently uses in its calculation of the rate of return on investment to decide whether buying the property makes prudent economic sense. Prudence in investing is an important ingredient of the spirit of RF financing.
3. The RF model requires that the RF bank or finance company work with clients in a humane, merciful, and fair way (*tarahum*) in times of trouble. To do this, the RF bank helps families that are in trouble by counseling them and offering them the facility of an RF *qard hassan*, a “good loan,” without any increase or interest, from a nonprofit organization that can assist in making part or the whole of the monthly payment until the difficulty is eased—for example, when the husband gets a new job to enable him to resume the payments.

The Stages Used to Implement the Shari’aa-Based LARIBA Model of Financing

The LARIBA Shari’aa-based RF finance model is based on the original and pioneering fatwa and model developed for financing homes in the United

Kingdom by Al Baraka Bank in London. However, the model has been modified and expanded to include in it the two basic foundations of the true spirit of removing *riba* from financing transactions: the *commodity indexation rule* and the *mark-to-market rule*.

The process consists of three major stages:

- A. Formulating the *riba*-free Shari'aa-based agreement
- B. Documenting the RF financing for compliance with U.S. laws and banking regulations by transforming the agreement into a U.S. government-sanctioned and standardized financing (mortgage) note and contract
- C. Signing the *LARIBA Agreement*, which explains the prohibition of *riba*, the terms in the standard U.S. contract, and the process used to mark the property to the market so the transaction is Shari'aa based

A. Formulating the Financing According to Shari'aa

Fatwa There are a number of edicts (*fatwa*) issued by some of the highest-placed scholars in RF banking and financing (detailed in Chapter 9). The edict used by the LARIBA model is based on that developed for use by Al Baraka Bank of London. In this model, the scholars divided the property rights of an item into two rights: The first is the right to own title of the property (*milk ul raqabah*), and the second is the right to use/operate the property—such as the use of a home, a car, or a business (*haq al manfa'aa*, meaning usufruct).

The procedure used by the model goes through the following stipulations:

1. The model allowed the RF finance institution or the RF bank to assign the buyer to act as an agent (*wakeel*) of the bank and to proceed to negotiate the purchase price and other conditions on behalf of the RF bank.
2. The RF bank agrees to form a conceptual partnership with client to buy the property together, with the following stipulations: Registering the title of the item to be financed (home title, for example) in the partner's name, based on trust, from the inception of the contract is permissible under Shari'aa. Registering the property's title in this manner does not contradict the agreed-upon partnership, especially as the partner's ability to sell the home is restricted until full ownership of the property is established. In this regard, the scholars took into consideration the fact that this registration of title is a form of documentation insured by the officially established lien on the property, according to the conditions agreed upon with the partner.

3. The bank would finance the purchase jointly with the buyer in the form of a joint ownership (Musharaka):
 - a. The RF bank would sell its entire share back to the buyer immediately and record the property (the house or the car) in the buyer's name.
 - b. The RF bank would exercise and perfect a lien that makes the RF bank a lien holder, and get a contractual promise from the client to pay back the bank share over a certain period of time (the term of the buy back) by the customer. In this step the buyer would be the owner of the title (milk ul raqabah).
 - c. The RF finance company or the RF bank would participate in and share in the benefits of using the property (haq al manfa'aa)—in the case of a car, it is the lease rate of the car; in the case of a house, it is the lease rate of the house—over the years in the proportion of its changing implied ownership (the RF bank's implied ownership—through the lien—and hence the share in the usufruct declines as the buyer progressively pays back his owed part of the purchase price).
 - d. The bank or the finance company can use the word interest to satisfy the laws of the land to describe the payments share of the rental of the property. However, the opposite (taking interest and calling it profit) is not allowed.

The word *lien* has been mistranslated to Arabic as *rahn*, which means *pawn*. There is a world of difference between the two in legal definition. In general, in case of *rahn*, or pawning the property, the property itself and its use are both arrested and placed in the custody of the pawn holder. That means that the right to use the property (haq al manfa'aa) is confiscated until the riba loan is paid back. If it is not paid, then the rahn-holder would take over the property (milk ul raqabah) without legal action, because it is in the possession of the rahn-holder.

DEFINITION OF PAWN¹⁷

Verb: To deliver personal property to another in pledge or as security for a debt or sum borrowed.

Noun: A bailment of goods to a creditor as security for some debt engagement; a pledge; a deposit of personal property made to a pawn-broker as security for a loan. That sort of bailment when goods or chattels are delivered to another as security to him/her for money borrowed of him/her by the bailor. Also, the specific chattel delivered to the creditor as a pledge.

DEFINITION OF A LIEN

Lien is defined as the right to take and hold or sell the property of a debtor as security or payment for a debt or duty.

It is also defined as a claim, encumbrance, or charge on property for payment of some debt, obligation, or duty.¹⁸ Additionally, it is defined as a *qualified* right of property which a creditor has in or over specific property of his debtor as security for the debt or charge or for performance of some act. It is further defined as a right or claim against some interest in property created by law as an incident of contract. It is also defined as:

- Right to enforce charge upon property of another for payment or satisfaction of debt or claim
- Right to retain property for payment of debt or demand
- Security for debt, duty, or other obligation
- Tie that binds property to a debt or claim for its satisfaction
- A charge against or interest in property to secure payment of a debt or performance of an obligation

The Meaning of Establishing a Lien Based on the definitions of pawn and lien, one can establish that liens, which could not have existed without a searchable title database in order to make sure that the property is free and clear and that there are no unknown claims against it, are a form of ownership right that is different from the classic pawning (*rahn*) contract. Here are some facts to support our conclusion:

- A lien is defined in the dictionary¹⁹ as “a conveyance of title to property that is given to secure an obligation—as a debt or promise to perform a financial obligation—and that is defeated upon payment or performance according to stipulated terms.”
- An acid test of the above consists of the response to two events: The first is that when the house experiences damage of some sort, the insurance company issues the check in the name of the title owner and the co-mortgage—or lien—holder. Second is the fact that the process of releasing the lien is called “re-conveyance” of title.

Based on these facts, the conceptual definition of a mortgage and the perfection of a lien in favor of the RF bank is like a *diminishing partnership*

(*musharaka mutnaqisah*) between the two entities—the property (home or business) buyer, called the mortgagee, and the RF bank or RF finance (mortgager) entity.

As a result, it can be concluded that there is no need for the creation of an SPV or the incurring of additional expenses and significant legal complications and confusion that would render RF financing more expensive and liable to complicated legal suits in case of a dispute.

We significantly modified the Al Baraka model described in Chapter 9. This modification produced the model known as the Shari'aa-based LARIBA RF finance model, which is based on Shari'aa in contrast to the other approach and models, called *Shari'aa-compliant*, which have been used since the latter part of the 20th century. As was discussed in Chapter 9, the Shari'aa-compliant proponents use the approach of force-fitting the existing *riba*-based models to Shari'aa. In contrast, the LARIBA Shari'aa-based RF finance model uses the commodity indexation rule to normalize the effects of paper (*fiat*) money regimes (to avoid participating in an inflated economic bubble as discussed earlier) and the market-to-market rule to introduce, for the first time, the real spirit, intent, substance, and wisdom of modern Islamic RF banking to the finance field. Following are the modifications introduced by the LARIBA model to the Al Baraka model:

1. LARIBA Model *Modified Step 1*. In this step, the actual rental rate of a similar property (a car, a home, or a commercial building) or a business in the same neighborhood and with similar specifications (in case of a home or a commercial building, in terms of dollars per square foot) is researched in the market by contacting automobile or real estate agents active in the area. The customer and the finance officer each come up with three documented estimates. The average of the six estimates, or a mutually agreed-upon rental value, is used. This rent is used to evaluate the rate of return on the investment, using the patent-pending LARIBA model. This way, the bank and the investor act as if the purchase of the car, the home, or the business is an investment. This will be discussed later in further detail.
2. LARIBA Model *Modified Step 2*. The costs, including recording fees, maintenance, and other fees are booked to the account of the customer, who now owns the facility and is its operator. The insurance is not shared, because of the strict consumer compliance requirements that demand full disclosure of the items involved in every payment. (The recommendation made in the original fatwa could not be applied.) This way, the customer will have the freedom to choose his/her own insurance provider.

Monthly payments include an installment to repay the capital forwarded by RF bank and a rental component:

1. The monthly repayment of the RF bank capital invested with the buyer is paid back, on a monthly basis, on an agreed-upon schedule and on an interest-free basis. This component is called the *return of capital* and was given the acronym *RofC* (pronounced “rofsee”), which is called in riba-based financing the payment of principal.
2. The rental component is the RF banker’s share in the rent, based on the proportion of the capital returned to the RF bank. This component represents the profit or income the RF bank collects as a benefit in co-owning the right to use the property. This is called in the RF finance model *return on capital*, and its acronym is *RonC* (pronounced “ronsee”), which is called in riba-based financing the payment of interest. It is important to note here that the *RonC* is based on the actual market rent of the property, not the rent of money, in contrast to the portion of payment in a riba-based conventional banking setting in which the interest is really calculated using the rent on money (*riba*), which is prohibited by the Law (*Shari’aa*).

It is important to note that the above steps are done independently without preconditions, and none of the steps is a precondition for the other to take place. If the process is not done this way, it will not be based on *Shari’aa*, because it may be considered as “two sales contracts in one contract,” as explained in cases of the sale of *eena* in Chapter 9.

Calculation of the Economic Viability and Prudence of the Investment An important and truly unique aspect of the LARIBA *Shari’aa*-based RF finance model is prudence in investing one’s assets. It is the responsibility of the RF banker to act as a wise and prudent investment adviser, preventing the customer from digging a deeper hole of debt for himself and his family by investing in a property, a business, or a house. If it would not make prudent economic sense to invest in it if it were rented to a third party as an investment, it would not make prudent sense for the customer.

Appraising the Property or the Business There are two approaches to appraising the property. The first approach is that obtained by the standard appraisal, based on the last few sales in the neighborhood. But this approach may be extremely misleading in an inflated market, like the ones experienced in Houston, Texas, during the 1980s housing and commercial real estate bubble, in Silicon Valley in the 1990s, and during the nationwide

bubble experienced in the United States for housing and commercial real estate, which reached its peak in 2006 and burst in 2008.

This is the real spirit and real intent of the prohibition of *riba/ribit* in the Jewish Bible, the Christian Bible, and the Qur'aan. In fact, based on the LARIBA model, LARIBA may be the only finance company that would decline financing a property or a business if the return on investment based on the actual market rent of similar properties were not attractive, using market parameters that will be detailed later.

Applying the Rule of Marking the Property to the Market Each property has a market value, which is best defined by what its lease value would be if it were leased on the open market. The model assumes that the property is leased at fair market value, as defined by the location and specifications of the property, and as mutually agreed-upon between the client and RF bank. Here is the detailed procedure:

1. The customer is asked to research the actual long-term rental of a home, car, property, or businesses with the same specifications and in the same neighborhood. This can be done, in case of buying a house for example, by calling three different real estate agents in the area and documenting the findings. The RF bank officer does the same.
2. Based on the six data points collected above, the customer and LARIBA agree on a *fair market rent* value of the property.
3. The RF bank calculates the customer's monthly payment. This monthly payment consists of two parts: the RonC (portion of the rent that belongs to the RF bank for renting its share of the usufruct of the item) and the RofC (repayment of the capital paid as interest-free credit to the customer).

The Unique Features of the LARIBA Shari'aa-Based Model In a *riba*-based conventional banking setting, the customer will approach the bank to ask, "If I take a loan of \$240,000, and repay it over 20 years to finance the purchase of a house, how much would the monthly payment be?" The *riba*-based banker would look at the interest rate of the hour on that day and tell the customer that if he or she qualifies, the bank can lend them \$240,000 at an interest rate (money rental rate) of, say, seven percent. The *riba* banker would start an amortization computer program and input the amount to be financed, the number of years, and the interest rate. The unknown here is the monthly payment.

When the unique LARIBA model is used, the customer will be told that the RF bank cannot calculate the monthly payment before we know the location of the property, its specifications, and its rental/lease rate on the

open market—based on the rent of comparable properties in the same area—because we do not rent money (which is *riba/ribit*), but we rent properties and businesses. We also assure the customer that if the investment makes economic sense based on our RF finance model, the monthly payment will be competitive with that offered by the conventional *riba*-based banks. To evaluate the economic viability of owning a property in contrast to not buying it and instead renting a similar property, the RF banker inputs the monthly rent obtained from the market survey process described above, the number of years to pay back, the purchase price, and the down payment into the patent-pending and copyright-protected LARIBA computer program. The unknown here is the rate of return on invested capital, which is called the *implied interest rate*. It is actually the rate of return on investment for this property. This rate of return is compared with the expected rate of return by the investor in the RF bank or finance company. There are three possible outcomes:

1. *The rate of return on investment, based on the actual market rental value of the property, is higher than the RF return on capital expected by investors.* In this case, the RF bank would inform the property buyer that the property purchase makes economic sense and that because the investors (those who invest with the RF bank and its shareholders) are looking for a lower return to compete with the *riba*-based conventional banks, the RF bank will unilaterally reduce the agreed-upon rent so as not to hurt the community member who wants to abide by Shari'aa. This makes RF financing competitive with the rest of the market.
2. *The rate of return on investment, based on the actual market rental value of the property, is very low compared to the return on capital expected by investors.* In this case, the RF bank officer advises the prospective buyer that the property market in this neighborhood is extremely inflated and is experiencing an economic bubble. The RF bank informs the customer that it cannot finance the property. In fact, some markets in northern California, Arizona, Nevada, Washington, D.C., and Massachusetts have been suffering from this problem since late 2005 to mid-2006. The appraised value by sales comparisons is acceptable, but the economic viability based on the unique LARIBA marking-to-market RF finance model is not valid. The LARIBA model may make the RF bank the only RF finance institution that would reject financing, despite the fact that the buyer may be a great customer for any bank to deal with—because investing in the property does not make economic sense. It is important to state that we, at LARIBA, have saved many customers in the aforementioned states from participating in the most recent real estate bubble. In fact, because of this feature of

the model, we have realized the following achievements at LARIBA and the Bank of Whittier:

- a. The mortgage portfolio produced by LARIBA and the Bank of Whittier was rated as one of the best 64 performing portfolios in the United States. This was reported to us by United Guaranty Insurance Co.
- b. Fannie Mae informed us that our mortgage portfolios with them were one of the ten best-performing portfolios in the Western region, which extends from Colorado to Hawaii.
- c. The delinquency and foreclosure rate is a fraction of the national average.

It is interesting to share with the reader the experience we had when LARIBA's bankers first met with Freddie Mac to allow their representatives to inspect and look into what we do, so that Freddie Mac could proceed with its fact-finding and approval process. We explained our model to the four representatives. The head analyst asked us, "Do you really mark the house to market?" We said yes. He asked to review the files. He was impressed. It took Freddie Mac six weeks to approve LARIBA, compared to the national approval time needed of six months. Later, Fannie Mae followed Freddie Mac's lead.

3. *The rate of return on investment, based on the actual market rental value of the property, is marginally lower than the return on capital expected by investors:* In this case, the RF bank officer and/or credit committee would advise the prospective buyer to try to renegotiate the price to render the investment economically viable. At LARIBA, we have had a number of successful experiences where we helped a number of community members negotiate a lower price for the home.

Our customers may sell the property at any time and pay back the remaining capital owed to LARIBA (the balance of the financing amount). Partial prepayment may also be made at any time. Partial payments are applied against the purchase installments in inverse order of maturity, and the rental component is reduced proportionately.

B. Documentation of RF Financing for U.S. Compliance The banking and financing laws and regulations in the United States are among the strictest in the world. RF financing in America is offered using two approaches:

1. Start with the conventional riba-based banking product and devise ways and means to "force" fit it to an "Islamic" solution that would comply with (or at least look like it complies with) Shari'aa, using intellectual and expert help from experienced riba bankers, attorneys, and ex-regulators. One of the techniques is the creation of a special purpose

entity (SPE) or a special purpose vehicle (SPV), which would buy the property and either sell it back, in a Cost-Plus (Murabaha) scheme, or lease it back, in a joint venture with declining equity (Musharaka Mutnaqisah) scheme. The other idea, used in Musharaka Mutnaqisah, is to register the title of the property in both the financial institution's name and that of the property or business buyer to make the transaction appear to be a true joint venture.

2. Start with the LARIBA RF model to test the prudence of the investment and to calculate the monthly payments, based on the actual rental value researched in the market (by applying the mark-to-market rule). Financing contracts are drawn up according to the U.S. federal banking laws and regulations. The contract is supplemented by a proprietary "rider" called the LARIBA Agreement. The LARIBA Agreement explains the prohibition of riba and the process used.

It is believed that this second approach is a true manifestation of the Judeo-Christian-Islamic values because it is based on Shari'aa. Here are the reasons why:

1. The LARIBA RF finance model uses the standard mortgage documentation required. This documentation and its associated contracts have been in continual development by the U.S. banking and finance authorities since the Great Depression of the 1930s.
2. It can be easily compared to the conventional riba-based approach. This way, the customer can make a fair comparison (apples to apples) in his/her pursuit to make the right decision.
3. It offers protection of the customer, because it conforms to standard U.S. financial and banking industry norms rather than to special considerations that may require lengthy court deliberations in case of a dispute.
4. In the case of RF mortgage financing, the LARIBA RF financing model offers the customer the advantage of being able to deduct the rent-based payments as implied interest, using the statutory mortgage reduction laws in the United States. In comparison, the Shari'aa-compliant model uses an IRS Opinion Letter, which does not carry the weight of the law and is usually temporary in nature. It can be withdrawn and/or nullified at any time.
5. Because the LARIBA RF Shari'aa-based model records title in the name of the customer, it protects the customers. Companies that use the Shari'aa-compliant models require that the title be in the names of both the buyer and the financial institution. Recording title in both the name of the customer and the finance company or bank may expose the customer to any risks assumed by the finance companies.

The LARIBA RF finance model uses the following documents:

- *Promissory Note* that indicates the amount of financing, the agreed-upon monthly payments, and the imputed (implied) interest rate of the transaction
- *Deed of Trust*
- Other required regulatory documentation relating to truth in lending, non-discrimination, servicing of the financing, and so on
- The unique, copyright-protected *LARIBA Agreement*

C. The LARIBA Agreement The RF Shari'aa-based financing process (as is done at LARIBA) uniquely supplements the above standard documents (which use the word interest) with a specially devised rider called the LARIBA Agreement. This Agreement documents the process used in the LARIBA Shari'aa-based RF finance model to calculate the monthly payment using the market measured rental value agreed upon between the customer and the RF bank or financial institution. The LARIBA Agreement clearly declares that *riba/interest* charging and/or receiving is divinely prohibited (*haram*). It also summarizes the proprietary process and model used. In addition, it states that the calculated and agreed upon rate of return, using the actual market rental rate of the property, is called an *implied interest rate* in order to comply with the U.S. Regulation Z (the Truth in Lending Act, detailed in Chapter 7). The RF bank issues an Internal Revenue Service (IRS) U.S. form 1098 to allow for the deduction of the rental portion of the payments (as an implied interest) in the case of home mortgages, which is calculated at the beginning of the transaction and converted to an implied interest rate on the promissory note, as explained above.

Monthly Billing LARIBA has created a new billing format that, we believe, is a historic development in the RF movement. LARIBA's monthly billing breaks down the monthly payment in terms of RofC (called principal payment in the *riba*-based finance industry) and RonC (called interest in the *riba*-based industry). A copy of the monthly billing is shown in Exhibit 10.1.

Servicing the Financing Facility (*The Loan*) Servicing of the credit facility (loan) is the process of maintaining the finance facility after it has been funded. It includes billing the customer on a monthly basis, responding to customer inquiries, resolving any issues faced by the customer, escrowing taxes and insurance for the property, and maintaining records according to consumer compliance government regulations. Many finance companies and banks "sell" the servicing to outside companies, some of which are located outside the United States, for a handsome fee. This practice may



250 EAST GREEN STREET, STE 210
PASADENA, CA 91101
PH: (626) 449-4400
FAX: (626) 449-5315
LARIBA@LARIBA.com

ABCD
750 E. Green Street Suite # 210
Pasadena, CA 91101



www.LARIBA.com

Your community owned Bank, the Bank of Whittier, N. A. is offering SHARIA-COMPLIANT FDIC-Insured Certificate of Deposit (CDs) at competitive rates of return from income derived from Shari'ah Compliant Financing Portfolio.

Bank of Whittier's holding company is offering 300,000 shares at \$10 per share to Qualified Accredited Investors. This is the first RIBA-FREE Bank to be owned by our community in the history of the USA.

Please call Mr. Mike Abdulaziz (626) 349-4393 or Dr. Yehia A. Rahamat (626) 818-0855.

Account Information:

Account Number: 310610601
Statement Date: 7/21/09
Payment Due Date: 8/1/09
Priority Address:

Balance:

Enclosed (Unpaid Capital) 283,200.13

Year-to-Date Summary:

RoFC* Paid (Unpaid Interest) 699.82
RoFC* Paid (Unpaid Interest) 2,113.78
Late Payment Expense** 0.00

Payment Information:

RoFC* Paid (Unpaid Interest) 4,473.00 %
Monthly Payment (RoFC* plus RoFC**) 1,502.95
Escrow Payment (Taxes, Insurance PMI) 0
Number of Post Due Payments: 0
Post Due Payment Amount: 0
Unpaid Late Payment Expense** 0
Unapplied Payments: 0

Total Payment Due: 1,502.95

For Billing Inquiries Please Call:
1-888-1-ARIBA-1 Ext 112
1-888-527-422-1 Ext 112

**Late Payment Expense (from Charging of 2% CF will be applied if payment is not received by 8/15/09 (as explained in the Financing Note). This is the estimated administrative fee for LARIBA for handling overdue payments.

*The RoFC amount stated on this invoice represents the Payment of Capital using our nonrecourse lease-to-own right model of financing. The RoFC amount represents the Return on Capital calculated using our nonrecourse lease-to-purchase model of financing. It is presented at the forward rate for purposes of conformity with Federal and State laws, and it is intended to be mortgage interest under the Internal Revenue Code and not a loan tax law.

Please detach and return the bottom portion of this statement with your payment. Please enclose envelope (allow a minimum of 5 days for postal delivery).



AMERICAN FINANCE HOUSE - LARIBA
750 EAST GREEN STREET STE 210
PASADENA, CA 91101

PAYMENT COUPON

*Please include your account number on your check #

Account Number: 310610601
Statement Date: 7/21/09
Due Date: 8/1/09
Total Due: 1,502.95

Additional RoFC: _____

Additional Escrow: _____

Total Amount Enclosed: _____

Return portion

AutoPay check from and bill out the bank to pay all your future payments automatically

Change of billing address
Check here and make that get to the bank

EXHIBIT 10.1 LARIBA monthly billing.

expose the customers to customer service personnel and managers who are not from their community, are not familiar with RF finance, and are not trained in the moral authority required by the Judeo-Christian-Islamic value system. It is believed that this may not be permitted by Shari'ah. The

Shari'aa-based LARIBA RF model requires that the RF institution service the RF facilities it originated and that it cannot sell the servicing of those facilities to another company. When the RF institution services its facilities, community members who are well-trained and who understand the RF finance concepts, community values, culture, and languages are not only ready to serve and respond to inquiries, but also trained in the important Judeo-Christian-Islamic value of mercifulness and kindness (*tarahum*) to those in need.

Sources of Funds Used in RF Financing One of the biggest challenges to our effort to popularize RF financing in the United States has been the availability of capital. When we started in 1987, it was very difficult to raise the necessary capital. We were faced with many challenges. The first and most important challenge was the novelty of the effort. Many members of the community had talked about having a bank or a financial institution that serves our community, which is one of the most underserved by the banks and financial institutions because of the prohibition of *riba*. However, when many of these community members were contacted to invest, they politely regretted, with many excuses.

The other approach we thought of trying was to start a public drive to raise capital. That option was very expensive because it required the use of very expensive attorneys and SEC registration fees, which we could not afford. In addition, we did not have a proven track record of a working model with tangible results. It was simply a venture capital project that needed high-risk capital—and it is known that high-risk capital comes at a very high price.

We also thought of starting or acquiring a bank. This would have been a wonderful solution, because all depository institutions are allowed to take deposits that can be used to finance different projects. However, that was a formidable task because we did not have the capital or the qualified staff that could be certified and accepted by the regulators.

On another front, we went through the process of applying to start a credit union and we were very close to receiving a charter. However, after reading the details of how a credit union works, we found that every depositor is considered a shareholder. We found that regardless of the size of the deposit, each individual represents a vote. We became very concerned due to prior experiences in the field of political manipulations of elections and voting in many nonprofit organizations. We discussed the matter and decided to back off.

We finally decided to start a small finance company, organized as a small—Subchapter S—corporation. This option had its advantages and disadvantages. The main advantage was the flexibility of raising the

capital needed and the avoidance of double taxation. That means that the company's profits are not taxed at the company level. The profit is distributed to the shareholders, and they pay taxes according to their own situation. The disadvantages were many, but we had to start from what was possible to achieve what is impossible. The first disadvantage was that the number of shareholders was limited to a small number (it was 35 members when we started in 1987; as of 2009 it has expanded to 120 shareholders). In addition, a Subchapter S company cannot solicit funds from the public because that would require registration with the Securities and Exchange Commission (SEC). We started LARIBA in 1987 with a small capital of \$200,000 which we had gathered from close, lifelong friends in the United States. We had humble means, but our dreams and aspirations were greater. We started a Web site (www.LARIBA.com) that became very popular throughout the world. We financed cars, homes, and small businesses. It is true that we only did one or two financing deals per month, but those deals helped us to start a balance sheet, an income-expense statement, a financial ledger, and a successful track record for the company. The biggest challenge was the huge demand we received from the community. We were heartbroken to say to prospective customers, "We are sorry, but we do not have enough capital." We asked our friends who we knew could afford to participate but they refused. They indicated that they would be more comfortable if their funds were federally insured by the FDIC, something that was impossible at the time. We used to finance homes with a 40-percent down payment and a term of seven years. This financing term could only be afforded by a few, who were mostly the believing affluent puritans.

It may prove useful to share with the reader the size of the problem of raising the necessary capital by focusing on one aspect of the business, mortgage financing. If we wanted to finance only 50 homes a month at \$200,000 each, that would require that we come up with \$10 million a month or \$120 million per year. Knowing the community, we did not have this kind of money available. Some recommended that we contact the oil-rich countries. We tried, but the competition had gone ahead of us, promising returns of 20–50 percent rather than the more realistic numbers we, as responsible bankers and business people, projected with no guarantees. Of course, they put tens of millions into the companies that promised high returns but not into us. We decided to remain patient and never to compromise our standards and values.

Around the turn of the century, in 2000, demand for our services was so large that we could not meet it because of the lack of capital. One of our executives suggested that we close the company down because we could not meet the demand. My reaction was simple. I told him, with tears in my eyes,

that all God asks from us is to do the best we can with what we have. In a few months we received an e-mail from a person who used to work with Freddie Mac — Mr. Ahmad Elshal. He told us that he had visited our Web site and that he liked it. He called to inquire about the details of what we do at LARIBA. He asked one of the Freddie Mac executives at that time, Mr. Saber Salam, to contact us. The rest is history. As stated earlier, LARIBA received early approval from Freddie Mac, and we were elated. New problems erupted but they were much sweeter. Now, our problem was how to organize ourselves to serve the growing demand.

Freddie Mac and Fannie Mae were originally organized as government-sponsored public companies (GSEs, which stands for government-sponsored entities) by the U.S government to provide necessary liquidity to the housing market in the United States. To accomplish this goal, Fannie Mae and Freddie Mac provide the liquidity to the institutions that finance homes (called mortgage companies) and banks, by authorizing the companies to act on their behalf to finance homes according to universally set but strict guidelines, and proceed to exchange the note for cash. The GSEs assemble the notes in the form of asset-based fixed income securities (bond-like) called mortgage-backed securities, or MBSs. The GSEs offer these securities for investment to institutions looking for high-quality asset-based bond-like investments that yield a higher interest rate. This way, the GSE generates cash to reinvest in mortgages.

In April 2001, LARIBA was the first ever RF finance operation in the West to be approved for investing Freddie Mac's money using the LARIBA Shari'aa-based RF home finance model. In 2002, LARIBA became the only U.S.-based Shari'aa-based RF finance company to be approved by the largest mortgage investor in the world, Fannie Mae. Later, LARIBA became the only RF finance company that issues—with Fannie Mae—RF MBSs.

It is also important to state for the record that LARIBA—and, for that matter, any RF finance company or bank—is not allowed by Shari'aa to borrow money with interest from Freddie Mac, Fannie Mae, and/or other investors. Freddie Mac and Fannie Mae are looked upon as investors in the RF LARIBA Shari'aa-based mortgages. In fact, we evaluate the financing of each home as an investment and we offer it to Freddie or Fannie online as investors in the LARIBA-financed homes. If approved, they indicate to us the expected return they need to realize as investors. This is the rate we use to measure the economic prudence of the investment (using the rate of return on investment based on the actual market rent, as explained earlier). If approved, LARIBA forwards the money from its own funds to purchase the house and is paid back within a week or less by Freddie Mac or Fannie Mae. Freddie Mac and Fannie Mae were the real major source of capital for all “Islamic” finance companies in the United States. We were fortunate at

LARIBA to have acquired a national bank—the Bank of Whittier, NA—which accumulated the deposits needed for financing.

Another important aspect of dealing with Freddie and Fannie has been the documentation used in the RF financing process. Such documents must follow the same standards called for by the industry and regulations. Our LARIBA Shari’aa-based RF finance model paid us a wonderful dividend, because we did not have to receive a special exception from the GSEs or regulators to be approved. The risk of receiving an approval with an exception is that this exception can be taken away when times are not suitable. While others went through expensive legal maneuvers to make the documents look “Islamic,” then diluted the Islamic content to bring it back to the standard codes, we at LARIBA started on the right and straightforward track. It is important to note here that the LARIBA Agreement described earlier is a required part of the documentation called for by the GSEs. Many of the “Islamic” MBS companies, which are based on Shari’aa-compliant models, were designed for sale to the “Islamic” banks in the Gulf and Malaysia. In contrast, the LARIBA RF MBSs were designed to be offered for investors and all entities in all markets, and are of the highest quality. These MBSs are “manufactured” by us at LARIBA. That is why they are not a mere “black box,” like other MBSs, because we simply know the components of each of the LARIBA RF MBSs.

Other sources of capital are the share capital of the company and investments from accredited and qualified high net worth and sophisticated investors. It is important to note here that not a single investor or shareholder has lost a penny since we started our operations at LARIBA in 1987. In addition, we consistently distributed dividends and profits that were at least one to two percent higher than what any *riba*-based institution would offer on a time certificate of deposit.

Advantages of the LARIBA RF Shari’aa-Based Model and Procedures

1. Applies the fundamentals of the RF Law (Shari’aa) of the Judeo-Christian-Islamic system. It does not use ruses (*heelab*) nor financial engineering and structuring techniques that are usually used in the Shari’aa-compliant models.
2. The LARIBA Agreement clearly spells out the bases from Shari’aa upon which the relationship, the process of financing, and the process of calculating the monthly payments are built.
3. It is universal and designed to benefit all people of all faith.
4. It is not based on renting money at a price called interest rate. It is based on the actual market-measured rent of the items to be acquired as measured—live—in the marketplace by the customer and the finance

- company/bank. It helps the customer make the decision to buy a property—or not to buy it, and instead rent until it becomes more economically sound to buy it.
5. It normalizes the monetary problem of paper (fiat) money by marking the property to the market, as called for by the mark-to-market rule, and by relying on pricing the property in terms of a reference commodity, as called for by the commodity indexation rule. Using this approach helps us to identify economic bubbles before they fester and become speculative bubbles. In this way, we avoid participating in such a bubble. We detected the real estate bubble in many states in the United States as early as 2005 and 2006. This raised a red flag that stressed to our underwriters the necessity of exercising diligent caution when evaluating the “investment” based on the mark-to-market rule and the commodity indexation rule.
 6. It benefits the customer and the financing entity, because its method is based on investing in a property or a business and not on renting money. It reveals the economic value of the purchased property which insures prudence in investing and protects against participation in an economic bubble.
 7. It relies on arbitration using experts who are well versed in Shari’aa that are chosen by each side.
 8. It uses the standard financing documents and notes. This makes it fulfill the U.S. banking regulations, meets the requirements of bank examiners, and makes it seamless in case other government requirements are implemented. This also helps the consumer and the financing entity settle any dispute before U.S. courts without confusion or misinterpretation that may cost a lot of time, money, and frustration. Using the standard finance document and notes allows the customer to declare its finances in an understandable and U.S. government-compliant way that benefits the customer in preparing and reporting their taxes and in reporting and complying with government agencies like the Labor Department, pensions, and/or retirement plans.
 9. It records the title of the property in the name of the customer directly. The model does not call for the title to be recorded in both the customer and the company’s name, as is required in some Shari’aa-compliant schemes. Doing it this way may expose the customer to the unknown liabilities and unknown corporate future of the financing entity/bank, and it limits the freedom of choice of the customer.
 10. It services the financing facility (servicing means billing, collection of monthly payments, escrowing of insurance and tax payments, and resolving any problems) and it does not sell servicing to an outside servicing company. The Shari’aa-based model requires that the RF finance

entity/bank keep the servicing in house, with the work done by community members. This practice helps the customers if a problem occurs, especially in cases when the customer loses his/her job or is temporarily disabled. The concept of mercifulness (*tarahum*) is applied. The customer is turned over to a nonprofit assistance organization to help meet the needs of the family until the problem is resolved.

THE RESULTS

The most important feature of the Shari'aa-based RF finance discipline and principles is that the investment decision is based on the actual market rates of rent of the property or the business, as measured by both the customer and the finance officer. The process does not take the rental rate of money—riba—and calculates the monthly payment. Because the process of buying a home, a car, a business, or a service is looked upon as an investment that must be prudent, not just as a buying exercise that obtains money by incurring debt at an interest rate. In this regard, the RF finance company/bank considers itself as an implicit co-investor in the activity as implied by the application of the lien.

That is why investing according to the Shari'aa-based LARIBA RF finance model has had superior results compared with the results experienced by conventional riba-based banks and other “Islamic” finance organizations that use the Shari'aa-compliant model. This success is because the RF banks rely on evaluating the prudence of the investment. It is clear that due to using the LARIBA Shari'aa-based RF finance model, delinquencies are essentially nonexistent—almost 1 in a 1000—compared to a delinquency rate as high as 10 percent—100 in a 1000—in some cases, as experienced by riba-based banks and financial institutions.

One day, after the revelations of the economic meltdown of 2008 and the subprime mortgage debacle, we received a call from the assistant editor of a major U.S. news magazine.²⁰ She had been following our progress since her first interview with LARIBA in 2002. She asked about our portfolio performance and how we were doing in the difficult market conditions. We told her that we are doing very well, and we shared with her the fact that LARIBA mortgage portfolio delinquencies are a small fraction of the national average.

Fannie Mae representatives were impressed by the performance of the home mortgage portfolio underwritten using the RF LARIBA Shari'aa-based model and process. Fannie Mae analysts explained to us that our portfolio is among the top ten performing portfolios in the Western region of the United States. We told them that the reason for our success is our

disciplined approach of marking every home we attempt to finance to the market. If the investment does not make economic sense based on the actual market-measured rental rate of a similar home in the same neighborhood, then we do not proceed with the financing, as explained earlier. It is also interesting to note that a United Guaranty insurance company representative came to visit us, asking how we at LARIBA could increase the size of our portfolio that is insured with them, because our portfolio—based on their analysis—is one of the best-performing portfolios among the top 64 U.S. companies and banks they underwrite for private mortgage insurance (PMI, the insurance required by industry standards if the down payment of the customer is less than 20 percent of the appraised value, as called for by standards and underwriting requirements). In addition, Bank of Whittier, which uses the LARIBA Shari'aa-based RF financing model, was rated a five-star bank (the highest rating by Bauer Financial; www.Bauerfinancial.com) because of its performance at a time when major banks were failing due to the 2008 economic meltdown.

NOTES

1. The Prophet pronounced in the Hadeeth: All deeds are dependent on the intentions (Niyat) and each will realize his/her real intention.
2. A well-known rule in Shari'aa (*mala yudraku Kulluhu la yutraku Julluhu*, in Arabic).
3. Yahia K. Abdul Rahman and Abdullah S. Tug, Towards a LARIBA (Islamic) Mortgage Financing in the United States – Providing an Alternative to Traditional Mortgages, Paper presented at The Islamic Finance Program, Harvard University School of Law, October 9 and 10, 1998; and Yahia Abdul Rahman, Mike Abdelaaty, and Gary S. Findley, The Challenge of Offering a LARIBA Financial Services Window in an American Bank, A Research paper presented at the Harvard Islamic Banking Symposium, Harvard University, October 1, 1999.
4. Tarek Diwany, *The Problem with Interest*, Kreatoc Ltd., London 2003. This is the most useful and educational book on the problem of charging interest and paper (fiat) money. The book has published two editions and was translated into Turkish, Bhasa Malaysian, and Arabic. Dewany is a thought-provoking researcher and a prolific author who disagrees with the approach that uses form over substance in Islamic banking.
5. Tarek Diwany's Web site is www.Islamic-Finance.com.
6. Ahmad Kamal Mydin Meera, *The Islamic Gold Dinar*, Pelanduk Publications, Malaysia, 2002.
7. For example: Fatwa of Al Baraka, available at www.lariba.com/fatwas/index.htm.

8. For example: M. Nejatullah Siddiqi, *Muslim Economic Thinking*, Islamic Foundation, Leicester, England, 1981. Professor Siddiqi was responsible for this highly praised work, which included for the first time some 700 references of works in English, Arabic, and Urdu in the field of Islamic Economics. He is a prolific author and was a LARIBA Fellow in Islamic Banking and Finance at UCLA, California.
9. Philip T.N. Koh, *Islamic Financial Instruments: The Civil Law and the Sharia Confluence or Conflict?*, presented at the 5th Islamic Finance Conference, Monash University, Kuala Lumpur.
10. Mahmoud Elgamal, *Islamic Finance—Law, Economics, and Practice*, Cambridge University Press, Cambridge, England. Professor Mahmoud Amin Elgamal holds the first ever Islamic Economics Chair at Rice University. He is a gifted researcher in economics, mathematics, game theory, and Islamic law, economics, and practice. He authored a pioneering book in the field. His bitter frustrations about the practices of scholars have landed him a lot of resistance and, in many cases, isolation by many conference organizers. In fact, some scholars refuse to appear in the same conference programs in which his name appears. He coined an interesting term, “Shari’aa arbitrage,” by which he means the added premium charged in Islamic banking and accepted by some banks and customers that create an arbitrage between the Islamic banking techniques and the conventional banking methods. His thesis has been that the methods used in Islamic banking sanctioned by many Shari’aa scholars focus on form and lack the real spirit and substance of the original Shari’aa sources, and that these methods are inefficient and costly while in fact they are the same as conventional banking.
11. *USA Today*, Web site posted 2/24/05 and updated 02/25/2005: www.usatoday.com/money/perfi/general/2005-02-24-islamic-finance-usat_x.htm.
12. OCC, Interpretive Letters #806 (1997) and #867 (1999). Please visit www.OCC.treas.gov. These letters were written regarding the United Bank of Kuwait’s Al Manzil Program: The OCC has issued two opinion letters, one on Murabaha and the other on Ijara home financing by the United Bank of Kuwait (UBK), which has since been merged into what is now Shamel Bank in Bahrain; the federal branch was closed in the early 2000s, only two years after it started offering these contracts.
13. Ibid.
14. Bernard Lawrence “Bernie” Madoff (born April 29, 1938) is an American businessman, and former chairman of the NASDAQ stock exchange. He founded the Wall Street firm Bernard L. Madoff Investment Securities LLC in 1960 and was its chairman until December 11, 2008, when he was charged with perpetrating what may be the largest investor fraud ever committed by a single person. Prosecutors have accused financier Madoff—the alleged mastermind of a \$65 billion Ponzi scheme—of intending to transfer up to \$100 million worth of assets to protect them from seizure, and they want him locked up immediately. Madoff was sentenced in June to 150 years in prison after admitting the fraud—the largest in history.

15. I had the good fortune of moderating a session on Shari'aa that was attended by some of the superstar scholars. As customary, I asked them to give me their CVs. I am sorry to state that they did not have enough formal education in Shar-i'aa to qualify them to assume that role. I am sorry but I cannot name them in respect for their privacy.
16. This occurred when I was in charge of the Muslim Students Association (MSA of the USA & Canada, now called Islamic Society of North America, ISNA) near Madison, Wisconsin, in 1969.
17. Henry Campbell Black, MA, *Black's Law Dictionary*, 6th edition, West Publishing Co., St. Paul, Minnesota, 1990, p. 1128.
18. *Ibid.*, p. 922.
19. *Black's Law Dictionary* editor: Bryan A. Garner.
20. Ms. Temma Ehrenfeld, Newsweek, private communication 4/16/2008.