

Faculty Scholarship
Cornell Law Faculty Working Papers

Cornell Law Library

Year 2009

Islamic Governance, Capital Structure,
and Equity Finance: Examining the
Possibilities of American Financial
Shari'ah Boards

Rafel Mahmood
Cornell Law School, rm364@cornell.edu

ISLAMIC GOVERNANCE, CAPITAL STRUCTURE, AND EQUITY FINANCE: EXAMINING THE POSSIBILITIES OF AMERICAN FINANCIAL *SHARĪ'AH* BOARDS

RAFEL MAHMOOD

ABSTRACT

In this world of misinformation and predatory ideologies, a basic economic connection may be the difference between the success and failure of American foreign policy in the Middle East. In times of conflict, establishing the commonality of shared financial values is the best way to build trust, the European Coal and Steel Community is one example, therefore it is remarkable that the world's largest and most advanced economy has failed to develop the simple financial mechanisms—using Islamic finance and *Sharī'ah* boards—to connect with Muslims across the globe. Even if the United States' central focus remains combating terrorism, it is clear that the more financial information the United States can gather, the better equipped it will be to fight the war on terror. Attendant to this informational capital are significant reputational advantages that the United States would not otherwise have. For instance, an Islamic-American corporate institution could be certified by multiple clerics in Iraq, thus offering new momentum to the humanitarian mission by preventing the numerous belligerent attacks that terrorists might subject a non-Islamic American corporation. The great Edward Said would describe the current apathy towards Islamic finance in the United States as a “clear case of orientalism.” Now, America's increasing domestic failure to develop a compatible framework for Islamic finance is verging towards negligence. Consider that economists estimate the outflow of *Sharī'ah* capital from Gulf countries to be approximately \$1 trillion, growing 20% per annum, that Gulf countries are currently set to spend upwards of \$10 trillion on new infrastructure over the next decade using *Sharī'ah* compliant financing vehicles, and that the world currently has roughly two billion Muslims, some of which will one day demand, or at least prefer, *Sharī'ah* compliant financial products. If the United States does not develop the administrative and legal framework to cater to this market, foreign financial institutions surely will. In fact, economists currently value the Islamic finance industry in the United Kingdom at \$12 billion. In stark contrast, in the United States this same market comprises only \$150 million in assets. This Article will examine the necessary mechanics of establishing a Islamic-American corporation in Delaware for the purposes of conducting transactions with the Middle East, and analyze in detail the essential Islamic financial governance structure—the *Sharī'ah* board.

INTRODUCTION:

The single distinguishing feature of any Islamic corporate institution¹ is the *Sharī'ah* advisory board.² For an institution to claim Islamic compliance it must appoint a supervisory

¹ See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 313 (1976) (“It is important to recognize that most organizations are simply legal fictions which serve as a nexus for a set of contracting relationships among individuals. . . . The private corporation or firm is simply one form of legal fiction which serves as a nexus for contracting relationships and which is also characterized by the existence of divisible residual claims on the assets and cash flows of the organization which can generally be sold without permission of the other contracting individuals.”); Melvin A. Eisenberg, *The Conception that the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm*, 24 DEL. J. CORP. L. 819, 829 (1999) (“More generally, an organization consists not only of assets, persons, and relationships among persons, but of the rules that organize those assets, persons, and relationships. Some of those rules are contractual, but most are bureaucratic in the sense that they are hierarchically adopted and persist over time as persons, assets, and relationships come and go.”). Within the context of Islamic finance the American corporate form has yet to be fully tested. See *infra.*, Section II for a detailed discussion of how Islamic restrictions, customary procedure, and *Sharī'ah* boards are incorporated into the American corporate form.

board, committee, or group of advisors, comprising between one and three Islamic legal scholars who have particular expertise in economic and financial transactions.³ This group of advisors is called the “*Sharī’ah* board.”⁴ Its function is to assure the institution’s clients that the business renders services in a *Sharī’ah* compliant manner.⁵ Whenever an Islamic corporate institution wishes to structure a financial transaction in accordance with Islamic law, the firm will consult either an external or internal *Sharī’ah* board. The initial consultation typically leads to multiple review sessions followed by amendments to the structure and the documentation of the agreement after each review, as well as further monitoring and consultation after the transaction if necessary.⁶

² *Sharī’ah* boards will often examine in detail both the structure of a proposed transaction, or financial product, and the documentation giving effect to the actual exchange. For example, “[t]he approach most widely adopted currently is to establish independent bodies of knowledgeable agents. These bodies are usually internal to the institution and part of its governance structure. They include *Sharī’ah* Supervisory Boards and *Sharī’ah* review units.” Wafik Grais & Matteo Pellegrini, *Corporate Governance and Sharī’ah Compliance in Institutions Offering Islamic Financial Services*, Policy Working Paper 4054 The World Bank Financial and Private Sector Development Network, at 3 (Nov. 2006), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=940711 (last visited February 10, 2009; see also ISLAMIC FINANCIAL SERVICES BOARD, GUIDING PRINCIPLES ON SHARĪ’AH GOVERNANCE SYSTEM 1 n.2 (Dec. 2008),

[http://www.ifsb.org/docs/eng_IFSB%20Exposure%20Draft%20on%20Shariah%20Governance%20System%20\(Dc08\).pdf](http://www.ifsb.org/docs/eng_IFSB%20Exposure%20Draft%20on%20Shariah%20Governance%20System%20(Dc08).pdf)) [hereinafter GUIDING PRINCIPLES] (“*Sharī’ah* boards are usually comprised of a panel of *Sharī’ah* scholars acting as special advisers to the institutions, and may alternatively be called a *Sharī’ah* Committee or *Sharī’ah* Supervisory Board. However, in recent years there has been an increasing trend for corporate entities, including Islamic financial institutions themselves, to perform this function in the form of ‘*Sharī’ah* advisory firms.’”).

³ Grais & Pellegrini, *supra* note 2, at 4 (“In principle, the role of this board covers five main areas: certifying permissible financial instruments through *fatwas* (ex-ante *Sharī’ah* audit); verifying that transactions comply with issued *fatwas* (ex-post *Sharī’ah* audit); calculating and paying *zakat* (a tax on wealth) to charity; disposing of non-*Sharī’ah* complaint earnings; and advising on the distribution of income or expenses among shareholders and investment account holders. The *Sharī’ah* Supervisory Board also issues a report to certify that all financial transactions comply with the above mentioned principles.”).

⁴ See *supra* note 2–3.

⁵ Grais & Pellegrini, *supra* note 2, at 5 (“The functioning of a *Sharī’ah* Supervisory Board raises five main issues of corporate governance: independence, confidentiality, competence, consistency, and disclosure.”); see *supra* note 3.

⁶ GUIDING PRINCIPLES, *supra* note 2, at 7 (“An Islamic firm would want to ensure that its *Sharī’ah* Governance System covers the relevant *ex-ante* processes, namely (i) issuance of *Sharī’ah* pronouncements, and (ii) compliance checks before the transaction is accepted. . . . For good risk management the firm would want to ensure that its *Sharī’ah* Governance System covers the relevant *ex-post* processes—namely, internal *Sharī’ah* review and *Sharī’ah* governance reporting. Without such follow-up, the firm would not be able to monitor the consistency of its *Sharī’ah* compliance and effectively manage any *Sharī’ah* compliance risk that may arise over time.”).

This Article argues that although the *Sharī'ah* board is in obvious tension with the United States' corporate governance structure that traditionally leaves all decision-making power in the domain of the Board of Directors (and the executive officers appointed thereby),⁷ this tension is not irresolvable. Specifically, this Article will propose the structure *Sharī'ah* boards should take, the role they should play, and the types of conduct they should regulate in the United States corporate governance system. Moreover, this Article will seek to alleviate such aforementioned tension by examining how an internal *Sharī'ah* board would operate in a Delaware reporting corporation. In this discussion, particular consideration is given to the significance of engendering reputational capital for U.S. *Sharī'ah* boards and Islamic-American corporate entities, as well as, the process and value of developing American answers to the positivist questions surrounding customary practice of modern Islamic finance.

I. THE ROLE AND NORMATIVE POWER OF PRIVATE AMERICAN *SHARĪ'AH* BOARDS

The *Sharī'ah* (or customary Islamic law) is both the unwritten and written code of rights and obligations that represent the attempt to define the will of God with regard to each and every sphere of human activity.⁸ Accordingly, Islamic finance is based on the financial principles

⁷ For example, if a *Sharī'ah* board did not approve a transaction *ex-ante* that had been recommended by the board of directors, then one might ask what the proper procedural framework is for the board of directors to follow if it nonetheless wishes to conduct the transaction. See *infra*, Section II (giving a detailed analysis of how an Islamic corporation in Delaware would answer this question by integrating Islamic law principles of procedure into the shareholder agreement).

⁸ W.M. BALLANTYNE, *ESSAYS AND ADDRESSES ON ARAB LAWS* 58 (2000) ("The *Sharī'ah* runs like a gold thread through the jurisprudence of the Gulf States."). The classical theory teaches that Islamic law fundamentally constitutes a pre-ordained system of God's commands relating to the duties of each Muslim. Islamic law is based on four main principles or roots (*'usul al-fiqh*): (1) the *Qur'an*; (2) the early Islamic traditions of the Prophet which are recognized and incorporated into an understanding of the textual interpretations of the *Qur'an* (*ahadith* or *sunna*); (3) the consensus of religious scholars within historically accepted legal schools of Islamic thought (*ijma*); and (4) the method of juristic inference by analogy (*qiyas*). See REINHARD LEOPOLD KLARMANN, *ISLAMIC PROJECT FINANCE: A LEGAL STUDY WITH PARTICULAR REFERENCE TO THE LAWS OF SWITZERLAND AND THE UNITED ARAB EMIRATES* 13–21 (2003) [hereinafter KLARMANN, *ISLAMIC PROJECT FINANCE*]; see also NOEL J. COULSON, *COMMERCIAL LAW IN THE GULF STATES*, 10–41 (1984); HANS KUNG, *ISLAM: PAST, PRESENT & FUTURE* 176–81 (2007). See generally MAHMOUD A. EL-GAMAL, *ISLAMIC FINANCE: LAW, ECONOMICS, AND PRACTICE* 26–32 (2006) [hereinafter EL-GAMAL, *ISLAMIC FINANCE*]; LAWRENCE ROSEN, *THE JUSTICE OF ISLAM: COMPARATIVE*

established by customary *Shari'ah* and new interpretations thereof, called *fatwas*. *Fatwas* are “legal opinion[s] issued by a qualified Muslim scholar on matters of religious belief and practice.”⁹ *Fatwas* are central to Islamic finance. For instance, scholars issue *fatwas* as answers to questions of compliance for novel financial transactions, thereby affecting customary practice and establishing accepted financial norms that then become part of the *Shari'ah*.¹⁰ To interpret *Shari'ah* jurisprudence and thus issue a *fatwa*, any duly qualified Muslim scholar (or scholars) would use either the method of judicial consensus or the method of juristic inference by analogy.¹¹ By these methods scholars can determine whether complex financial transactions are Islamic compliant. Given that *fatwa* are *fiqh*¹² (or human comprehension of divine law), there is an accepted amount of variation in individual interpretation from one *Shari'ah* board to another and a resulting multiplicity of views on any specific financial issue.¹³ But one thing is clear: To

PERSPECTIVES ON ISLAMIC LAW AND SOCIETY 24–37 (2000); JOSEPH SCHACHT, AN INTRODUCTION TO ISLAMIC LAW 10–56 (1964); BERNARD WEISS, INTERPRETATION IN ISLAMIC LAW: THE THEORY OF *IJTIHAD* (1978), *reprinted in* ISLAMIC LAW AND LEGAL THEORY 273 (Ian Edge ed., 1996); Ann E. Mayer, *The Shari'ah: A Methodology of a Body of Substantive Rules?*, in ISLAMIC LAW AND JURISPRUDENCE 177, 177–198 (1990).

⁹ Grais & Pellegrini, *supra* note 2, at 4; *see also* ISLAMIC LEGAL INTERPRETATION: MUFTIS AND THEIR FATWAS (Muhammed Khalid Masud, Brinkley Messick, & David Powers eds., 1996); Wael B. Hallaq, *Usul al-fiqh: Beyond Tradition*, in Wael Hallaq, LAW AND LEGAL THEORY IN CLASSICAL AND MEDIEVAL ISLAM (1995); Wael B. Hallaq, THE ORIGINS AND EVOLUTION OF ISLAMIC LAW (2005).

¹⁰ *See, e.g.* ISLAMIC FINANCE: THE CHALLENGE AHEAD 173–74 (Nafis Alam & Bala Shanmugam eds. 2007) [hereinafter Alam & Shanmugam].

¹¹ *See* Grais & Pellegrini, *supra* note 2, at 4. *See also infra*, note 12.

¹² *Fiqh* is the academic discipline, implying a human activity, by which scholars describe and elaborate the *Shari'ah*. Two principle types of legal writings exist in Islam: 1) '*usul al-fiqh* (or the literature defining the sources of law and methodology used to deduce the rules of the divine revelation); and 2) *furu al-fiqh* (or jurisprudence - the form commonly used today by Islamist jurists when expounding the principles of Islamic law). *Furu al-fiqh*, quite simply consists of the interpretation and application of the primary sources, the *Quran* and *Sunna*. However, for any Islamic legal interpretation to carry authority it must show a respect for the traditions of the legal schools of Islam; for instance, a strict observance of the primary sources in the interpretation demonstrates such capital authority. *See* Klarmann, ISLAMIC PROJECT FINANCE, *supra* note 8, at 14–16; *see also* El-Gamal, ISLAMIC FINANCE, *supra* note 8, at 6–20; Zamir Iqbal & Abbas Mirakhor, AN INTRODUCTION TO ISLAMIC FINANCE: THEORY AND PRACTICE 32–52 (2007); Yasaar, *Glossary of Islamic Financial Terms*, YASAAR.ORG, <http://www.yasaar.org/glossary.htm> (last visited Feb. 26, 2009) [hereinafter Yasaar]; Mahmoud A. El-Gamal, "*Interest*" and the *Paradox of Contemporary Islamic Law and Finance*, 27 *FORDHAM INT'L L.J.* 108, 120–21 (2003) [hereinafter El-Gamal, *Interest*]; Miriam Sophia Netzer, *Riba in Islamic Jurisprudence: The Role of 'Interest,' in Discourse on Law and State* (Apr. 26, 2004) (unpublished Master thesis, Tufts University), at 13–19, *available at* <http://fletcher.tufts.edu/research/2004/Netzer-Miriam.pdf> (last visited Feb. 20, 2009).

¹³ These variations occur even though *Shari'ah* scholars strive to achieve a consensus on difficult and novel issues, such as those involved in the development of new financial instruments and commercial products. *See* Grais &

determine that a novel financial transaction is compliant under *Sharī'ah* law, a *fatwa* must be issued by a qualified scholar.

Not surprisingly, and given the speed at which the financial world moves, Islamic compliant corporations and funds require a constant stream of *ex-ante fatwas* on a variety of topics. The reputation of any *Sharī'ah* board issuing these proclamations is influenced by investors who ultimately determine acceptance through the price they are willing to pay for the asset or equity. Thus, although Muslim scholars have some autonomy in issuing a necessarily growing number of financial *fatwas*, this would not give scholars in the United States free reign to issue *fatwas* as a matter of corporate expediency. Any *Sharī'ah* board in the United States must issue rulings and decisions consistent with those of the *Sharī'ah* boards of foreign supervisory agencies.¹⁴

An important effort towards achieving international consistency was the creation of two multilateral institutions: (i) the Accounting and Auditing Organization for Islamic Financial Institutions (“AAOIFI”), which issues internationally, recognized *Sharī'ah* standards on accounting, auditing, and governance issues; and (ii) the Islamic Financial Services Board (“IFSB”), which issues standards for the effective supervision and regulation of Islamic financial institutions. Finally, the Islamic Fiqh Academy, inaugurated in 1988 in Jeddah under the auspices of the Organization of the Islamic Conference, has earned the respect of Muslim scholars around the world. Although not officially binding, its rulings and opinions on economic and financial matters are certainly taken into consideration by Islamic finance practitioners and policy-makers.¹⁵

Pellegrini, *supra* note 2, at 4 (“A *fatwa* must not be mistaken for mandatory jurisprudence; it is a legal opinion and therefore should be considered as legal doctrine. . . . Therefore it is possible to encounter contradictory *fatwa* referring to the same issue.”). *See also supra* note 12.

¹⁴ *See* GUIDING PRINCIPLES, *supra* note 2, at 17.

¹⁵ Juan Solé, *Islamic Banking Makes Headway*, INTERNATIONAL MONETARY FUND (Sept. 19, 2007), available at <http://www.imf.org/external/pubs/ft/survey/so/2007/RES0919A.htm> (last visited Feb. 10, 2009). For a description of the Accounting and Auditing Organization for Islamic Financial Institutions, *see* AAOIFI – Accounting and Auditing Organization for Islamic Financial Institutions, Overview, <http://www.aaofi.com/> (“AAOIFI [] is an Islamic international autonomous non-for-profit corporate body that prepares accounting, auditing, governance, ethics and *Sharī'ah* standards for Islamic financial institutions and the industry. Professional qualification programs . . . are presented now by AAOIFI in its efforts to enhance the industry’s human resources base and governance structures. AAOIFI was established in accordance with the Agreement of Association which was s registered on 27 March, 1991 in the State of Bahrain. As an independent international organization, AAOIFI is supported by institutional members . . . including central banks, Islamic financial institutions, and other participants from the

For any Islamic-American institution, the importance of seeking expertise from a *Shari'ah* board can be emphasized by means of an example. Accepting any form of *riba*¹⁶ (interest) is strictly forbidden under accepted interpretations of the *Qur'an*; and yet, the primary sources (the *Qur'an* and *ahadith*) do not always give adequate answers to many of the questions that arise regarding the definition of *riba* (interest) in modern financial transactions.¹⁷ The practice of *ijtihad*¹⁸ (or creative effort) is the method of juristic inference used by Muslim religious scholars,

international Islamic banking and finance industry, worldwide. AAOIFI has gained assuring support for the implementation of its standards, which are now adopted in the Kingdom of Bahrain, Dubai International Financial Centre, Jordan, Lebanon, Qatar, Sudan and Syria. The relevant authorities in Australia, Indonesia, Malaysia, Pakistan, Kingdom of Saudi Arabia, and South Africa have issued guidelines that are based on AAOIFI's standards and pronouncements.”).

For a description of the IFSB see IFSB, Islamic Financial Services Board, <http://www.ifsb.org/> (“The IFSB is an international standard-setting organization that promotes and enhances the soundness and stability of the Islamic financial services industry by issuing global prudential standards and guiding principles for the industry, broadly defined to include banking, capital markets and insurance sectors. The IFSB works closely with relevant international, regional and national organizations, research/educational institutions and market players.”).

¹⁶ *Riba* means any addition over and above the principal sum lent, and includes usury as well as interest at any rate. See El-Gamal, *Interest*, *supra* note 12, at 125–31; see also Netzer, *supra* note 12, at 7–19; BALLANTYNE, *supra* note 8, at 198 (“There is no doubt that the prohibition on *riba* stems from the *Qu'ran* itself, and is forbidden in the strongest terms in many verses.”).

¹⁷ The imprecise understanding of *riba* is due to variations in interpretative evidence from the primary sources of Islamic law and the contemporary practice of Islamic financial institutions. See El-Gamal, *Interest*, *supra* note 12, at 108–09 (“Almost all contemporary writings in Islamic law and Islamic finance proclaim that Islamic law [*Shari'ah*] forbids interest. This statement, however, is paradoxical in light of the actual practices of Islamic financial providers over the past three decades. In fact, the bulk of Islamic financial practices formally base rates of return or costs of capital on a benchmark interest rate such as the London Inter-bank Offer Rate”); see also KLARMANN, ISLAMIC PROJECT FINANCE, *supra* note 8, at 38 (“The virtual absence of a detailed explanation of the term *riba* in the *Qur'an* combined with the uncertainty of the position as presented by the *sunna* which varies significantly on various *riba*-related issues, makes it impossible to give firm answers to many of the questions that arise as to the precise meaning of *riba*.”). Another area of variation is on the issue of indexation of debt. In addition to the various justifications provided in favor of positive time value of money in the context of debt, one important argument relates to inflation and the consequent decrease in the value of money. Economists argue that a debt, when repaid at a later date, has lower purchasing power due to persistent increases in the general prices of commodities. Hence, the creditor in a debt loses while the debtor gains because the debtor repays less. The rate of interest on debt includes a premium or compensation for expected inflation, according to conventional economists. Arguably, it would be unfair if the debtor is not compensated for the loss of purchasing power. A method that has been subject to considerable debate among Islamic scholars involves linking a debt directly to purchasing power of the currency or the unit of account, as measured by a macro-economic commodity price index. Should the commodity prices increase resulting in a decrease in the real value of money, an offsetting increase in the nominal value of debt would follow. However, such indexation has push-back on the ground that rules of *riba* or any other divine rule cannot be relaxed for man-made problems like inflation. See, e.g., IQBAL & MIRAKHOR, *supra* note 12, at 59–62; Netzer, *supra* note 12, at 4–9, 14; see also El-Gamal, *Interest*, *supra* note 12, at 2–3; Netzer, *supra* note 12, at 46.

¹⁸ The creative aspect of the activity of Islamic jurists is called *ijtihad* (or literally effort), and can be defined as “the process of recognizing the manifest meaning of the *Quranic* rules or deriving a novel rule by analogy therewith.” See KLARMANN, ISLAMIC PROJECT FINANCE, *supra* note 8, at 15. The space for creativity, however, is limited

or qualified *Sharī'ah* Boards, when the two primary sources—the *Qur'an* and *ahadith*—do not contain direct examples allowing an easy solution to a specific case by analogy.¹⁹ In these situations, where a formalistic deduction of the primary sources is not possible, the novel sets of financial facts are to be addressed with a *fatwa*, an authoritative legal opinion based on manifest meaning or an expansive analogy of Islamic religious tenets.²⁰ This process shows why *fatwa*'s are the most important proclamations issued by qualified *Sharī'ah* scholars.²¹ Simply, this process comprises Muslim scholars, called *muftis* or *imams*, who are exercising their right of *ijtihad* (or creative effort) on a particular financial question of Islamic law.²²

The authority of a particular *fatwa* is largely dependent on the reputation of the issuing author or *Sharī'ah* board.²³ Additionally, a *fatwa* is not binding upon other Muslims,²⁴ yet these proclamations do provide a distinct form of persuasive authority. As noted above, given the forward-looking nature of a *fatwa*, it may form the basis for customary financial norms to develop, based on accepted practice. In turn, practice is based on the pious assurance of a *fatwa* certifying compliance.²⁵ Therefore, one positive externality in any regulatory framework, of a

considering that “the Muslim jurist never invents rules, but formulates, or attempts to formulate rules which God has already decreed and which are concealed in the sources.” *See id.* For example, the flexibility of *ijtihad* cannot extend to the express provisions of primary sources within Islamic law. While the early jurists of Islam were relatively free in their *ijtihad*, the possible scope of activity for the modern Muslim jurist is constrained by “[t]he fact that the classical theories have achieved a virtually canonical status” within the jurisprudence of Islamic Law. *See id.* In fact, in some instances, the Muslim jurist is bound to observe what are considered traditional interpretations of the primary sources by past authorities, a doctrine known as *taqlid* or imitation. However, numerous academic scholars cite the right of *ijtihad* as the key to any further development or modernization of Islamic Law. *See generally* ROSEN, *supra* note 8, at 39–98; *see also* Netzer, *supra* note 12, at 13–18; EL-GAMAL, ISLAMIC FINANCE, *supra* note 8, at 28–35; Yasaar, *supra* note 12; El-Gamal, *Interest*, *supra* note 12, at 111–18.

¹⁹ *See supra* notes 17–18 and accompanying text.

²⁰ *See supra* notes 9–13.

²¹ *See infra* note 27 and accompanying text.

²² *See generally* KLARMANN, ISLAMIC PROJECT FINANCE, *supra* note 8, at 15.

²³ *See id.* at 30–38. *See also* GUIDING PRINCIPLES, *supra* note 2, at 10–12.

²⁴ *See* KLARMANN, ISLAMIC PROJECT FINANCE, *supra* note 8, at 16 (“A *fatwa* must not be mistaken for mandatory jurisprudence; it is a legal opinion and therefore should be considered as legal doctrine. . . . Therefore it is possible to encounter contradictory *fatwa* referring to the same issue.”). *See also* ANGELO M. VENARDOS, ISLAMIC BANKING AND FINANCE IN SOUTH-EAST ASIA 99–101 (2005).

²⁵ *See generally* notes 9–13 and accompanying text; KLARMANN, ISLAMIC PROJECT FINANCE, *supra* note 8.

financial *fatwa* issued by either a national *Shari'ah* board, or the private trade association equivalent, is the development of institutional and reputational capital.²⁶ The unrecognized possibility, in the United States, is to use the implied normative power of *Shari'ah* Boards and *fatwa*'s to develop a distinctively American customary practice in the field of Islamic finance.²⁷

The criteria of the Dow Jones Islamic Market Indexes,²⁸ is the best example of the type of positive Islamic financial norms that financial *Shari'ah* boards in the United States are in the position to influence using *fatwa*'s.²⁹ Dow Jones,³⁰ and later Financial Times, launched their

²⁶ For example, a respected private national *Shari'ah* board would establish regulatory standards that are ultimately accepted or rejected by the global *umma* (or world-wide Muslim community); as American standards are made competitive, and innovations are brought to the marketplace in the United States, the prominence of the institution and the political capital of an internationally recognized American *Shari'ah* board become important assets.

²⁷ See BALLANTYNE, *supra* note 8, at 200 (“Perhaps what is required in today’s climate is not just a restructuring of the *Shari'ah* to fit Western economic concepts, but some restricting of those concepts in order to meet the *Shari'ah*.”). Therefore, *Shari'ah* guidelines never impose a burden on a soul beyond its capability and have certain flexibilities in light of prevailing circumstances in a given society. For example: “Some flexibility is given to Muslims living in non-Muslim lands. The *fatawa* (religious edicts) issued by Ayatullah Sistani (Iraq’s most prominent *Shi'i* cleric) seem to accommodate many forms of conventional finance for those Muslims Likewise, the prominent Sunni jurist Yusuf Al-Qaradawi issued a similar *fatwa* allowing Muslims in North America to finance their home purchases with conventional mortgages . . . [invoking] the rule of necessity.” EL-GAMAL, *ISLAMIC FINANCE*, *supra* note 8, at 19. At the heart of these flexibilities is a central principle of Islamic finance (and much of Islamic jurisprudence in general) that all concepts and solutions are assumed to be permitted in Islam unless expressly prohibited under Islamic law. See Humayon A. Dar & John R. Presley, *Islamic Finance: A Western Perspective*, 1 INT’L J. ISLAMIC FIN. SERVICES 1, 1–4 (2001); El-Gamal, *Interest*, *supra* note 12, at 108–16 (2003); Netzer, *supra* note 12, at 7–12; see generally KUNG, *supra* note 8, at 612–16; IQBAL & MIRAKHOR, *supra* note 12, at 32–52; BILL MAURER, *PIOUS PROPERTY* 20–33 (2006).

²⁸ See Business Intelligence Middle East, *Over US \$7 Billion Benchmarked to the Dow Jones Islamic Market Indexes*, <http://www.bi-me.com/main.php?c=3&cg=3&t=1&id=31823> [hereinafter BIME website] (“Dow Jones Indexes, a leading global index provider launched its first Islamic index in 1999 and commemorating its 10th anniversary Dow Jones Islamic Market Indexes were created to serve as an indication or benchmark for institutional investors when deciding their portfolio or comparing the performance of their portfolios. Today, this index family is used as benchmark and basis for many investment products as they reflect investor sentiment. . . . Over the past decade, the Dow Jones Islamic Market Index series has expanded to more than 100 indexes for all major established and emerging financial markets, regions and sectors. Amongst these are Islamic indexes for the ASEAN, BRIC and GCC regions as well as for global and Malaysian blue-chips.”). See MOHAMMED OBAIDULLAH, *ISLAMIC FINANCIAL SERVICES* 213–20 (2005), available at <http://islamiccenter.kau.edu.sa/english/publications/Obaidullah/ifs/ifs.html> (last visited Feb. 20, 2009) (“The Dow Jones Islamic Index appointed Mufti Taqi Usmani as head of its *Shari'ah* board. The index analyzes, on a quarterly basis, all the World’s main trading indices . . . and applies criteria by which it can identify all those companies which meet *Shari'ah* criterion in a manner similar to that for property funds. This in turn allows any fund manager access to a wide range of *halal* (or permissible) companies which can then be considered alongside other factors such as the firm’s management, the industry potential, government regulation, charging structure, timeframe for investment, and other relevant factors.”).

²⁹ See OBAIDULLAH, *supra* note 28, at 219 (“Islamic funds have also been using a financial screen to exclude company that rely on excessive interest-based debt and derive a significant portion of their income from interest.

Islamic indices in the late 1990's, and continue to add various other Islamic indices paralleling their other conventional indices, this is useful for any Western *Shari'ah* equity fund manager as a basis for rate of return comparison because "the firm no longer has to create its own *Shari'ah* compliant benchmark indices for meaningful comparison."³¹ This Article is the first to argue that these financial criteria are positive norms that should be used as a relative basis for *Shari'ah* compliant comparison in the operations and capital structure of Islamic corporations in the United States.³²

As exemplified by Dow Jones, one way to influence such norms is through reputational capital.³³ The fact that speaks to the reputational strength of the Dow Jones Islamic Market

However, the nature of such screens has also undergone changes over time. For example, the Dow Jones Islamic Market Indexes screen in its current form appears as follows: exclude companies that have unacceptable lines of business; exclude companies if Total Debt divided by Trailing 12-Month Average Market Capitalization is greater than or equal to 33%. Note: Total Debt= Short-Term Debt + Current Portion of Long-Term Debt +Long-Term Debt; if the sum of Cash and Interest Bearing Securities divided by Trailing 12-Month Average Market Capitalization is greater than or equal to 33%; if Accounts Receivables divided by Total Assets is greater than or equal to 45%. Note: Accounts Receivables = Current Receivables + Long-Term Receivables. However, major changes have taken place in the screen over recent past. One of the financial criteria initially was: Exclude a company if interest income is more than 9% of their operating income. This was subsequently changed to: Exclude a company if non-operating interest income / revenue = or >5%. Apparently, this was called for considering the anomaly that if a company has non-operating interest income but the net income is negative, it is excluded. This criterion was again replaced subsequently with: Exclude a company if the sum of Cash and Interest Bearing Securities divided by Trailing 12-Month Average Market capitalization is greater than or equal to 33%.")

³⁰ The index analyzes, on a quarterly basis, all of the world's main trading indices (such as FTSE, Dow Jones, etc.) and applies criteria by which it can identify all those companies which meet *Shari'ah* criteria in a manner similar to that for property funds. See EL-GAMAL, ISLAMIC FINANCE, *supra* note 8, at 16–120; IQBAL & MIRAKHOR, *supra* note 12, at 132–52; Yasaar, *supra* note 12.

³¹ See generally STANDARD & POOR'S, ISLAMIC FINANCE OUTLOOK 2008 p. 57 (2007) [hereinafter S&P 2007].

³² Growing unanimity over the general screens used by Islamic mutual funds has enabled Islamic private equity and investment banking boutiques to thrive. Those institutions typically collect investor funds in GCC countries (investors from Saudi Arabia, Kuwait, and the U.A.E.) through local subsidiaries or partners in the West (United Kingdom being the primary destination for investment funds). See EL-GAMAL, ISLAMIC FINANCE, *supra* note 8, at 116–29. Collected funds are used to acquire real estate and small companies that pass the above mentioned screens or whose debt can be restructured to pass them (often through lease-based leveraged buy-outs, a popular Western mergers and acquisitions tool of the 1980's and 1990's). See *id.* There are 134 registered equity funds, six hybrid funds, six *sukuk* funds, two *Takaful* funds (insurance), five leasing funds, and eight real estate funds. This allows any fund manager access to a wide range of *halal* (or permissible) companies which can then be considered alongside other factors, such as the firm's management, the industry potential, government regulation, charging structure, timeframe for investment, and other relevant factors. See *id.*; S&P 2007, *supra* note 31, at 8; see also OBAIDULLAH, *supra* note 28, at 225–27.

³³ See BIME website, *supra* note 28 ("Dow Jones Islamic Market Indexes have not only been chosen to underlie the first-ever Islamic exchange-traded funds worldwide, but have also won a total of sixteen prestigious industry awards

Indexes is that they have modified their rating system for Islamic equities at least three times; this also shows that criteria used in Islamic financial compliance rating systems are not free from controversy, temporary flux, or even substantive difference in jurisdictions such as New York, Saudi Arabia, and Malaysia.³⁴ This implies that the Dow Jones Islamic Indexes criteria, or other financial criteria that may be developed,³⁵ are subject to continuous transformation in the light of new insights and market guidance.³⁶ Simply, financial criteria are taken as interpretative rules,

for Islamic index innovation and excellence.”); *see also* Dow Jones Indexes, *Dow Jones Indexes Named Best Islamic Index Provider of the Year*, http://www.djindexes.com/mdsidx/html/pressrelease/press_hist2008.html#20080205 (Feb. 5, 2008) (“Dow Jones Indexes, a leading global index provider, today announced that it has been named best Islamic index provider of the year by *Euromoney* magazine.”).

³⁴ *See* OBAIDULLAH, *supra* note 28, at 220 (2005) (“To cite an example, opponents of the one-third debt/equity exclusionary rule, or 33% percent rule used in the screen of the Dow Jones Market Indexes, cite the following *hadith*: The Prophet advised Abu Bakr not to donate more than One-Third of his wealth, and commented that ‘One third is too much (*Al Thuluth Katheer*).’ The following *fiqh* rule is also cited against the rule ‘Whether a commodity that is part gold and part brass qualifies as gold for purposes of applying the rules of *riba* is resolved by the percentage of gold in the commodity, i.e., if greater than a third, it is ‘gold.’ Critics of the one-third rule assert that it involves an out-of-context use of the above *hadith* and also an out-of-context use of the above *fiqh* rule. Arguably, the one-third rule could be applied to other ratios as well. There is indeed an element of arbitrariness over applying the one-third rule (even if it is a correct application) to a specific ratio. . . . It may also be argued that replacement value of assets, and not market capitalization may be a better denominator to determine the nature of a mix.”); *see also* Yasaar, *supra* note 12; El-Gamal, *Interest*, *supra* note 12, at 108–09; Netzer, *supra* note 12, at 46 (using a 1) strict textualist interpretation; 2) “the invocation of higher *qawa'id* (social justice) principles;” and 3) *darura* (exigency) to “argue[] that in a time of moral corruption, given the temptation of the bank to understate profits and cheat the investor . . . pre-fixing profits as a percentage of capital [or interest] is the only way to give the Muslim investor the certainty of a fair return.”).

³⁵ *See* OBAIDULLAH, *supra* note 28, at 220 (“Islamic jurists decided to impose three financial screens: (i) exclude companies for which accounts receivables constitute a major share of their assets; (ii) exclude companies that have too much debt; and (iii) exclude companies that receive too much interest.”); *see also* EL-GAMAL, *ISLAMIC FINANCE*, *supra* note 12, at 88; Yasaar, *supra* note 12. After experimentation with different cutoff marks for financial ratios, the set of rules selected by the Dow Jones Islamic indices became globally accepted: (i) exclude companies which have receivables accounting for more than 45% of assets and (ii) exclude companies which have a debt-to-moving average of market capitalization exceeding 33%. *See* SALAHUDDIN AHMED, *ISLAMIC BANKING FINANCE AND INSURANCE: A GLOBAL OVERVIEW* 106–10 (2006); *see also* IQBAL & MIRAKHOR, *supra* note 12, at 132–52; Yasaar, *supra* note 12. *See generally* KLARMANN, *supra* note 8, at 130–38. Many add a third rule related to the first: exclude companies which have an interest income exceeding 5% (or, for some, 10%) of total income. To invest in the shares of a company, the company must be *Shari'ah*-compliant; therefore, the company must meet a set of three financial ratios concerning the permissible limits of debt, accounts receivable, and any interest income. *See* AHMED, *supra*, at 346 (“Investment in shares of a company should comply if the debt/equity ratio is not more than 33 percent; interest derived earnings do not exceed more than 5 percent; or assets comprise cash and receivables exceeds 49 percent.”).

³⁶ *See* OBAIDULLAH, *supra* note 28, at 214 (“Shariah Fund Inc. claims to have developed innovative risk management tools that replicate options trading, short sales, and balance sheet leverage with *Shari'ah* compliant equivalents. Shariah Funds, Inc. also claims to have designed a proprietary software engine that screens transactions for *Shari'ah* compliance and allows real time, web interface portfolio access for monitoring purposes. Skeptics note that Islamic financiers must be aware of the dangers of creative accounting, creative structuring and of over

with the persuasive authority of *Shari'ah* compliance, or positive norm creation power, tied directly to the reputation of the institution and its *Shari'ah* board.³⁷ For example, consider the subjectivity involved in the compliance screen prescribed by the Malaysian *Shari'ah* Council.³⁸ In foreign jurisdictions like Malaysia the consistency and uniformity of *Shari'ah* compliance is supervised by a National *Shari'ah* Advisory Council.³⁹ The screen uses descriptive financial criteria such as “good public perception or the image of the company; importance of the company’s core activities to the Muslim community and the country; very small non-compliant element; customs and the rights of the non-Muslim community.”⁴⁰ This shows the institutional strength of the Malaysian *Shari'ah* Council, and illustrates how a recognized private equivalent

engineering contracts for the sake of raising margins rather than efficiency gains. Innovation must be a genuine response to investor needs that reaches *Shari'ah* compliance and not simply unnecessary layering of products.”).

³⁷ See *id.* (“Though it is widely believed that Islamic hedge funds are not a possibility, some recent attempts at developing such a product are note-worthy. For instance, the Saudi Economic Development Company (SEDCO) is in the process of developing an Islamic hedge fund product that would basically use the *bai-salam* contract to synthesize forwards and futures based on stocks where the price of the shares is determined and paid up-front, and the shares are to be delivered at an agreed future date. It is also examining the possibility of using *bai-al-urbun* as an alternative to prohibited conventional options.”).

³⁸ See *id.* at 221 (“Criteria set by the *Shari'ah* Advisory Council (SAC) of Malaysian Securities Commission for Approved List of Securities. The Council excluded stocks from the approved list based on the following criteria. 1. Operations based on interest such as activities of commercial and merchant banks and financial institutions. 2. Operations involving gambling 3. Activities involving the manufacture and/ or sale of products such as liquors and pork; and 4. Operations containing element of *gharar* (uncertainty) such as conventional insurance business. As for companies whose activities comprise both permissible and non-permissible elements, the SAC applied several additional criteria, 5. The core activities of the company must be activities which are not against the *Shari'ah* as outlined in the four criteria above. Furthermore, the prohibited element must be very small compared to the core activities; 6. Public perception or the image of the company must be good; and 7. The core activities of the company have importance and to the Muslim community and the country.”).

³⁹ See VENARDOS, *supra* note 24, at 159 (“Bank Negara Malaysia established the national *Shari'ah* Advisory Council on May 1, 1997, as the highest authority on Islamic banking and *takaful* in Malaysia. The primary objectives of the Advisory Council is to act as the sole authoritative body to advise on Islamic banking and finance, as well as analyze and evaluate compliance of new business schemes.”); GUIDING PRINCIPLES, *supra* note 2, at 6 (“In some jurisdictions, supervisory authorities have their own *Shari'ah* board that works together with them in issuing standardized *Shari'ah* pronouncements/resolutions, as well as aligning relevant policy and regulatory frameworks with the *Shari'ah*. Although they may be known by different names . . . their functions are similar – i.e. to become the highest body issuing *Shari'ah* pronouncements/resolutions in the country. Some of these supervisory authorities have even gone one step further, whereby they prohibit the members of the national *Shari'ah* panel from sitting on a *Shari'ah* board of the market players. In addition, each member of the *Shari'ah* board is restricted in terms of the number of *Shari'ah* boards of market players that he or she can serve. This restriction is intended not only to minimize the conflict of interest and maintain an appropriate firewall to preserve confidentiality, but also . . . to ensure that the members of a *Shari'ah* board can dedicate adequate time and effort to each institution that they serve.”).

⁴⁰ See *supra* note 38-39.

in the United States would be in the position to determine similar financial norms for other asset classes; such as the terms for refinanced sub-prime mortgages repackaged and sold as Islamic compliant securities in foreign markets, or defining the issuance of Islamic bonds thus providing a new way to sell American debt abroad.⁴¹

Recently, Japan announced the formation of the Japanese National *Shari'ah* Advisory Board,⁴² moves to create “superstructure” Islamic governance bodies within existing domestic financial regulatory regimes is strong evidence that market reputation, low up-front costs for determining compliance, legal regulatory guidance, and investor confidence in compliance, are all considered paramount in the Islamic finance industry around the world.⁴³ A perfect example of such a regime is the United Kingdom, where it is not uncommon for private institutional *Shari'ah* boards to seek the assistance of the Financial Services Authority (‘FSA’) regulators directly in interpreting and developing particular *fatwas*.⁴⁴ Financial regulators in the United States have been slow to develop anything close to the type of quasi public-good Islamic

⁴¹ See KPMG INTERNATIONAL, GROWTH AND DIVERSIFICATION IN ISLAMIC FINANCE 1 (2007), available at <http://www.kpmg.co.id/kpmg/pdf/Growth%20and%20Diversification%20in%20Islamic%20Finance%202007.pdf> (last visited Jan. 15, 2009) (“The logistics of a pooled property funds are such that investors pool their funds together collectively within a unit trust managed by a respectable firm which then issues units to the investors in exchange for their capital. These are shares in a company which in turn invests the money in providing Islamic mortgages to the general community. The repayment paid by the occupier of the mortgaged property and serves as a return to the investor on his property shares, after deducting the administration expenses of the firm running the scheme. This concept is a great way of providing true Islamic finance for homebuyers, yet simultaneously generating return on capital. The only organization in the UK currently engaged in this form of investment-based financing is Ansar Finance in Manchester. Ansar is a community based co-operative aimed at providing interest-free loans and Islamic Mortgages to its’ members. The scheme sells shares in Units of £100 with a minimum investment level of £5000. Currently Ansar holds over £400,000 in such client investments. The money is then utilized to provide compliant mortgages for members of Ansar Finance. The *Ijarah* based mortgages typically provide a return of around 6.5%. Ansar’s expenses on this return are 2.5% which leaves a net 4% to be repaid to the investors. Ansar aims to streamline administration expenses further in an attempt to push up the net dividend received.”); see also Sufyan Ismail & Bashir Timol, *Shari'ah Compliant Investments*, 1st Ethical Charitable Trust Research Paper (Jan. 1, 2007), available at <http://www.1stethical.com/downloads/ShariahCompliantInvestment.pdf> (last visited Feb. 28, 2009).

⁴² Manabu Hara, *Japan Moves Carefully Toward Islamic Finance*, RIBH ISLAMIC FINANCE (Dec. 12, 2008), <http://ribh.wordpress.com/2008/12/13/japan-moves-carefully-toward-islamic-finance/>.

⁴³ See *infra* note 79.

⁴⁴ See Errico, Luca & Mitra Farahbaksh, *Islamic Banking: Issues in Prudential Regulation and Supervision*, IMF Working Paper 98/30 (Washington: International Monetary Fund). See *infra.*, note 79. See also “Islamic Banking in the UK,” Briefing Note BN016/06, Financial Services Authority, 2006, available at www.fsa.com.

governance structures in Asia;⁴⁵ in the U.S., further regulatory expansion preferably would come from the private sector but without a body to conduct the type of regulatory coordination that the FSA conducts American institutional competitiveness is in a steep relative decline.⁴⁶

Islamic finance in the United States would be made easy with a private U.S. financial equivalent to the Malaysian *Shari'ah* Council. Foreign and domestic Muslim investors clearly have an interest in constructing an equity portfolio consisting of various individual shareholdings, in the United States, that are free or low cost in determining *Shari'ah* compliance and a good investment.⁴⁷ The American Islamic finance industry could be investor driven with loose controls by a free private national financial *Shari'ah* board that develops regulation through its' reputation; similar to Dow Jones, however importantly this financial board should be

⁴⁵ The regulatory dilemma in the United States is also that given both structural and constitutional limitations, the creation of a United States *Shari'ah* advisory board as a "superstructure" administrative body located within the Treasury Department seems remote. In the United States, state financial regulators may appoint their own *Shari'ah* experts to provide advice on the instruments and services offered by the financial institutions in their jurisdiction. Consultation with these experts would be crucial to ascertain whether the legal and tax regulations issued with regard to Islamic institutions, as well as the licensing of different activities, are compatible with Islamic principles.

⁴⁶For instance, since 2004, the Treasury has hosted only one in-house Islamic scholar for the \$200 to \$300 million invested domestically in *Shari'ah*-complaint securities. See Daniel Bases, *U.S. Islamic Finance Market Underserved*, REUTERS (Feb. 8, 2008) ("We are seeing on a daily basis [Gulf] money going to Europe, and the U.K. . . . due to lack of *Shari'ah*-complaint product in the United States . . . [W]e have to catch-up."); Shirley Chiu et al., *Islamic Finance in the United States*, SOCIETY 64, 66–67 (Sept./Oct. 2005) ("[T]he Treasury currently hosts an in-house Islamic finance scholar . . ."); John Taylor, Under-Secretary for Int'l Affairs, *Treasury Launches New Islamic Finance Scholar-in-Residence Program*, U.S. Dept. of the Treasury Office of Public Affairs June 2, 2004, <http://www.treas.gov/press/releases/js1706.htm> (last visited Oct. 12, 2008); see also Her Majesty's Treasury Office of Public Affairs, *City Minister Works With Industry to Improve Access to Retail Islamic Finance Products*, Dec. 3, 2007, http://62.164.176.164/press_136_07.htm (last visited Oct. 19, 2008) (discussing the achievements in the United Kingdom from 2006–07 of the Islamic Finance Experts Group, established by Chancellor Gordon Brown in 2006, which consults on the growing \$10 billion Islamic finance industry) ("The Chancellor announced in Budget 2006 a commitment to work with the financial sector to establish a High-Level Group, with senior representatives from across the financial sector, to develop and support a new strategy to promote London as the leading international Islamic financial centre. The Islamic Finance Experts Group was established as a result."); see also Islamic Bank of Britain, Press Release, *FSA Gives Approval for Launch of First Islamic British Bank*, <http://www.islamic-bank.com/islamicbanklive/PressRelease1/1/home/1/home.jsp> (last visited Oct. 15, 2008) (Iqbal Asaria, chair of the Muslim Council of Britain Business & Economics Committee states, "The Muslim Council of Britain welcomes the Islamic Bank of Britain, the first fully Islamic bank to be setup in the U.K. Its founding comes at the end of a unique partnership between the Muslim community and the regulatory authorities in the U.K. which has seen the overcoming of many misconceptions about Islamic Banking and finance.") (internal quotations omitted). The United States is behind in developing a similar understanding and capacity in Islamic finance.

⁴⁷ Islamic fund management came to prominence in 1996, "when the *Shari'ah* scholars of the *Fiqh* Academy in Jeddah, Saudi Arabia issued a *fatawa* approving the launch of *Shari'ah* compliant equity funds." AHMED, *supra* note 35, at 346–49.

open for all investor questions and not require a licensing fee—unlike Dow Jones— to see the financial and accounting standards developed. This is an important quasi public-good characteristic that will help engender the development of this potentially large and de-leveraged domestic industry.

II. THE ISLAMIC-AMERICAN DELAWARE CORPORATION

This Section will first outline necessary provisions in the corporate charter to alleviate the tension between the traditional role of both the Board of Directors of a Delaware corporation and a *Sharī'ah* board. Included in this discussion will be hereto unconsidered procedural norms and Islamic governance mechanisms⁴⁸ that—for a either a new corporation or an existing corporation in Delaware—would attract Islamic equity investment from both domestic Muslim investors and foreign Muslim investors.

The first measure that an Islamic corporate institution in Delaware must undertake is to construct a corporate charter that will effectively address the tension between the Board of Directors (the “BOD”) fiduciary responsibilities and the supervisory nature of a *Sharī'ah* board.

⁴⁸ “Corporate governance can be interpreted as the process in which the company is administered and controlled by a few parties such as board of directors, management, auditors etc. These parties have the duty to ensure that the company is heading towards the mission as well as the vision of the company. At the same time, they are also accountable to the companies’ stakeholders (Abdul Rahman 1998; Shahul, 2000 u.p.). In Malaysia, the Finance Committee on Corporate Governance (1998) describes corporate governance as: “the process and structure used to direct and manage the business and affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long-term shareholder value, whilst taking into account the interest of other stakeholders”. It is basically the governing bodies which are responsible to the life of the institution as a whole. It takes into the consideration all the matters that affect feasibility, proficiency and ethical character of an enterprise. Detomasi (2002) suggest three independent elements to achieve effective corporate governance. First, a strong public sector governance is needed detailing how financial reporting and auditing practices are to be conducted. Second, a community of well trained managers and executives that are able to formulate and execute effective corporate strategies within the boundaries set by law and securities regulation. Finally, independent auditors capable of performing neutral and objective auditing practices of corporate behavior must complement the work of managers and legislators. Therefore, in the United States a main tension arises with respect to Islamic corporate governance that relies on the *Sharī'ah* board for accountability and the traditional sphere of the board of directors to determine what is in the best interests of the corporation.” Contribution of the Islamic Worldview Towards Corporate Governance, Mohamed Asri & Mohamed Fahmi, MSc Accounting Sem 2 2003/04; available at http://www.iiu.edu.my/iaw/Students%20Term%20Papers_files/Asri%20and%20Fahmi%20IslWWandCG.htm

One way to reduce this conflict is to define the corporation as one which fully adheres to the principles of Islamic Law (i.e. state that this is an Islamic corporation) in the corporate charter. This gives protection of Business Judgment to decisions of the BOD that might be challenged by shareholders—and allows the BOD to act in a manner that may not promote the financial interests of shareholders but is in the best interests of the corporation.⁴⁹ Furthermore, anytime the corporation decides to take a business action that calls into question principles of Islamic law,⁵⁰ a separate board of qualified Islamic scholars will always meet as defined in the corporate charter.⁵¹

A clear tension exists between the decisions of the *Shari'ah* committee when the BOD respectfully disagrees with their determination, and wishes to move forward without the approval of any *Shari'ah* board. Under Delaware cooperate law, the final decision is clearly a power reserved for the BOD, yet Muslim investors will surely require greater protection of their investment. There is a risk to Muslim shareholders that the BOD is attempting to push too hard past the appropriate point of acceptability for the average Islamic investor. However, there is also a risk of insider compliancy, or shirking, by the *Shari'ah* board in terms of becoming lack with standards or unwilling to reform in directions that are accepted by Muslim shareholders and the *Shari'ah* boards of other institutions. The best way to deal with this tension is in the

⁴⁹ See Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 14 (no. 3) J. APPLIED CORP. FIN. 8–9 (2001) (“The main contender to value maximization as the corporate objective is called ‘stakeholder theory.’ Stakeholder theory says that managers should make decisions that take account of the interests of all the stakeholders in a firm. Stakeholders include all individuals or groups who can substantially affect, or be affected by, the welfare of the firm Enlightened stakeholder theory uses much of the structure of stakeholder theory but accepts maximization of the long-run value of the firm as the criterion for making the requisite tradeoffs among its stakeholders.”).

⁵⁰In the case of need for a default rule, anything that would change the character of the corporation this is not likely to get challenged since clearly rules exist as to compliance with covenants that are not required to be in corporate charters. See George G. Triantis & Ronald J. Daniels, *The Role of Debt in Interactive Corporate Governance*, 83 CALIF. L. REV. 1073, 1073–76 (1995).

⁵¹ See *CA, Inc. v. AFSCME Employees Pension Plan*, 953 A.2d 227 (Del. 2008) (leaving open the question of whether the procedure by which the board consults with a *Shari'ah* advisory committee must be in the bylaws or corporate charter, but making clear that the less ambiguous and preferable route is to use the corporate charter.).

corporate charter. There must be a default escape clause in the charter for the Board of Directors in case they do not agree with the recommendation made by any appointed *Sharī'ah* committee.⁵²

This default escape provision is related to the placement of the *Sharī'ah* board in the Delaware corporate form, this Article suggests three options either: 1) within existing corporate board as special committee with simply reserved spots for three Islamic scholars in the charter; 2) ad-hoc independent panel; 3) panel of recognized Islamic scholars that serve on the *Sharī'ah* boards of financial institutions like Dow Jones Indexes. For an American-Islamic firm incorporated in Delaware, the first option is most prudent; there should be reserved spots in the charter for Islamic scholars. This is the easiest method of reducing investor concerns over compliance and monitoring. A special committee of the board is also the most effective method of incorporating *Sharī'ah* boards into the Delaware corporate form. This structure allows for the BOD decisions to be made internally and is currently one preferred route for many business decisions made by corporations today.⁵³ Currently, special committees of the board of Delaware corporations need to have independent members and these same restrictions should apply here.⁵⁴ With the default rule being that unless three independent Islamic scholars are elected to the board

⁵²This Article is the first to argue that if the board wishes to act but cannot obtain the consent of any *Sharī'ah* advisory panel, then it should submit the issue to shareholders. *See infra* text accompanying note 57.

⁵³ *See also*, US SECURITIES AND EXCHANGE COMMISSION, THE TRUE VALUE OF CORPORATE GOVERNANCE, GLOBAL CORPORATE GUIDE 58–73 (2004) (discussing the role of independent audit committees); JAMES D. COX & THOMAS LEE HAZEN, CORPORATIONS, 171-81 (2003); FRANKLIN A. GEVURTZ, CORPORATION LAW, 498–524 (2000). *See generally* EDWARD P. WELCH, ANDREW J. TUREZYN, ROBERT S. SAUNDERS, & RODMAN WARD, 1–3 FOLK ON THE DELAWARE GENERAL CORPORATION LAW (5th ed. 2006).

⁵⁴ *See In Re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 947 (Del. Ch. 2003) (making clear that the independence inquiry is not about whether the members of the Special Litigation Committee acted consciously to favor one side or the other, but “[t]he inquiry recognizes that persons of integrity and reputation can be compromised in their ability to act without bias when they must make a decision adverse to others with whom they share material affiliations.”).

of directors then, in order to give this special committee at least three independent members, consult as compliance issues arise with a defined number of outside independent scholars.⁵⁵

As explained above a *Sharī'ah* board is similar to a special committee of board that is formed to conduct independent review of certain transactions.⁵⁶ Of course, the BOD must not be required to act according to the *Sharī'ah* committee and must have the power to go against this panel. As described above, the best way to deal with the information asymmetries from the view of the Muslim investor is by forcing a procedure that must be followed where doubt exists as to the compliance of the proposed action.⁵⁷ Based on all of the aforementioned considerations, the following provision should be inserted into the corporate charter: If the Board cannot call a special committee of at least three independent Islamic scholars to approve any transaction that calls into question *Sharī'ah* compliance then the Board must consult an independent panel of at least three scholars to determine the Islamic compliance of the suggested transaction and if the Board chooses to go against the findings of this panel then the proposed transaction must be submitted to shareholders for a vote.

There is a need to have a consistent and rigorous approach that Muslim investors will feel comfortable with during such “compliance” shareholder votes—when the BOD and *Sharī'ah* board cannot agree on a way forward—the best place to look for such procedures is the

⁵⁵ See *supra* note 2–5 (explaining that a *Sharī'ah* board should comprise at least three members); see *infra.*, note 69.

⁵⁶ GUIDING PRINCIPLES, *supra* note 2, at 2 (“Once a *Sharī'ah* pronouncement/resolution is actually implemented, it becomes a “*Sharī'ah* ruling” with full legal effect that binds the institution. A *Sharī'ah* pronouncement/resolution shall be issued only through appropriate due processes.”).

⁵⁷ See OBAIDULLAH, *supra* note 28, at 151–52 (“A majority of scholars opine that a joint stock company is basically different from a simple partnership in the classical Islamic legal sense. While in a partnership, all the actions of a partnership are rightfully attributed to each partner, the policy decisions in a joint stock company are taken by the majority. Therefore, each and every action taken by the company cannot be attributed to every shareholder in his individual capacity. By implication, if a company is engaged in a compliant business, however, it keeps its surplus money in an interest-bearing account, wherefrom a small incidental income of interest is received, it does not render all the business of the company unlawful. As regards the issue of the company borrowing on the basis of interest, here again the same principle is relevant. If a shareholder is not personally agreeable to such borrowings, but has been overruled by the majority, these borrowing transactions cannot be attributed to him.”).

customary evidentiary and burden shifting devices of Islamic courts.⁵⁸ Islamic law procedural norms state that the party wishing to change the status quo is the side that begins first with an explanation of the circumstances. In all cases, the BOD would be the party changing the status quo since the BOD is attempting to contradict the normal procedure of simply accepting the decisions of an independent *Sharī'ah* committee. The chairman of the BOD should therefore be allowed to present first the BOD's explanation with limited questions, followed by a response from the chair of the independent *Sharī'ah* committee explaining the decision from their prospective. This procedure should involve as many traditions and customs as can be adapted to fit within the traditional Delaware shareholder vote, such as; having an independent moderator asking questions of both sides similar to the role of an Islamic judge, oath taking, and a supermajority vote for approval of a resolution put forward by the BOD in certain "character" changing votes.⁵⁹

The preferable route for dealing with such procedural mechanisms lies in the shareholders' agreement regulating the internal affairs of the company.⁶⁰ It would also not be incompatible with a *musharaka*⁶¹ structure, for example, to stipulate that certain decisions would require the

⁵⁸ See COULSON, *supra* note 8, at 425–70 (discussing the procedural norms of appointment of Islamic judges for certain matters and defining the role of Islamic judges throughout the history of Islamic jurisprudence). See generally IBN RUSHD, 2 THE DISTINGUISHED JURIST'S PRIMER 553–72 (1996) (explaining the meaning of the Book of *Aqdiya* (or judgments) in six chapters: first, identification of persons whose judgments are permitted; second, the identification of matters in which judgment is permitted; third, identification of procedures on the basis of which judgment is rendered; fourth, identification of persons for, or against, whom judgment is rendered; fifth, the mode of judgment; sixth, the time of judgment.).

⁵⁹ See *id.*

⁶⁰ See *CA, Inc. v. AFSCME Employees Pension Plan*, 953 A.2d 227, 235 (Del. 2008) (Examples of procedural nature of bylaws, for instance 141(b) authorizes bylaws to fix the number of directors on the boards, number of directors required for a quorum, and the vote requirements for certain actions. Therefore, one reasonable conclusion is that the Board may be required to follow certain process-creating functions as outlined in the bylaws.).

⁶¹ See OBAIDULLAH, *supra* note 28, at 57–64, 155–71 ("*Musharaka* aims to revive the true ideal of Islamic finance, the precise method of trading utilized by the Prophet Mohammed in his dealings with fellow traders . . . A joint venture based on *Musharaka* involves a partnership in which both the bank and its customer-client contribute to entrepreneurship and capital. It is an agreement whereby the customer and the bank agree to combine financial resources to undertake any type of business venture, and agree to manage the same according to the terms of the agreement. Profits are shared between the bank and the customer in the pre-agreed ratio. Losses are shared strictly

consent of not only the majority shareholders, but all, or at least a higher percentage of the board of directors.⁶²

A final measure that an Islamic corporate institution in Delaware must undertake is to appoint either a *Sharī'ah* board⁶³ or, at a minimum, a *Sharī'ah* counselor.⁶⁴ This initial step is essential for the future operations and market reputation of the firm.⁶⁵ This preliminary step is necessary to reduce investor concerns over *Sharī'ah* risk, or the risk that the firm's actions do not effectively comply with Islamic jurisprudence and the gains obtained thereof are thus not valid under Islamic law.⁶⁶

This Article is the first to argue that many of the same criteria currently applied by Islamic fund managers to create Islamic equity indices, like Dow Jones, might also be applied as general terms governing the operation of an Islamic-American corporation thereby reducing *Sharī'ah* risk.⁶⁷ Significantly, such criteria all accept that the amount of debt an Islamic corporation may

in proportion to their respective capital contributions"); see also Bilal Gohar, *Islamic Finance Alternatives to the Western Model*, 23 FLETCHER F. WORLD AFF. 145, 145–59 (1999).

⁶² See *id.*

⁶³ See GUIDING PRINCIPLES, *supra* note 2, at 7 (“A *Sharī'ah* board should have at least three members, possibly of different nationalities, or trained in different schools of jurisprudence, and to have a mix of more experienced and less experienced members. In addition to their *Sharī'ah* expertise, members of the *Sharī'ah* board should possess some exposure in the areas of commerce or finance—e.g. in retail banking or capital market products.”).

⁶⁴ See *id.*

⁶⁵ See Mohamed Asri & Mohamed Fahmi, Contribution of the Islamic Worldview Towards Corporate Governance (2003–04) (unpublished Master of Science seminar paper, International Islamic University Malaysia), available at http://www.iiu.edu.my/iaw/Students%20Term%20Papers_files/Asri%20and%20Fahmi%20IsIWWandCG.htm (“The *Sharī'ah* board should be in balance in terms of the number of executives and non-executives directors. This recommendation is aimed at ensuring that neither particular individual nor group of people can exert their power as well as their influence to control the decision making. This will also allow the development of a sense of stewardship, responsibility and accountability to shareholders, who are the legal owners of corporations.”).

⁶⁶ Grais & Pellegrini, *supra* note 2, at 5 (“In consequence, the contract or agreement could be declared (partially) void in a *Sharī'ah* court, or even in a U.S. court that applies *Sharī'ah* principles to the agreement.”).

⁶⁷ For example, “jurists have provided the following conditions relating to investments in stocks: 1. The main business of the company is clearly not in violation of *Sharī'ah* principles; 2. If a company's main line of activity is permissible but it invests/ lends/ deposits its surplus funds in interest-bearing assets or borrows money on interest, the Islamic investor must express his disapproval against such dealings, preferably by raising concern against such activities in the annual general meeting of the company; 3. If some income from interest-bearing accounts is included in the income of the company, the proportion of such income in the dividend earned by the Islamic investor must be given to charity; 4. Stocks of a company are negotiable only if the company owns some (preferably at least 51 percent) non-liquid assets; 5. Exclude a company if the sum of Cash and Interest Bearing Securities divided by Trailing 12-Month Average Market Capitalization is greater than or equal to 33%.” OBAIDULLAH, *supra* note 28, at

hold is restricted to roughly one-third of its intrinsic value. This means that the residual claimants of an Islamic corporation will not benefit from a more leveraged capital structure that provides a “real time” check aligning the incentives of managers through external debt covenants.⁶⁸ This Article argues that instead, in an Islamic firm, typical principle-agent problems are addressed through reputational considerations that will properly incentivize managers and align the interests of other primary agents.⁶⁹

In fact, market reputation will ultimately determine the structure that lends sufficient credibility to the products and services, as well as an effective system for managing the reputational risk related to *Sharī'ah* compliance. Beyond this, the institution should look to create its' own compliance ethos in deciding the relevant *Sharī'ah* governance mechanisms to adopt.⁷⁰ Other supervisory authorities are concerned with “market deficiencies” and the need for

219. The last restriction was developed by the internal *Sharī'ah* board of the Dow Jones Islamic Indexes and it is important for its' implications on the capital structure of an Islamic firm. The genealogy of this criterion is both the one-third rule under Islamic inheritance principles and some contested interpretations of the sayings of the Prophet Mohammed or *ahadith*. See *supra* notes 33–35 and accompanying text.

⁶⁸ See Triantis & Daniels, *supra* note 50, at 1073 (“Intermediation resolves the problems of free-riding and duplicative monitoring efforts.”). See generally Iliia D. Dichev & Douglas J. Skinner, *Large-Sample Evidence on the Debt Covenant Hypothesis*, 40 J. ACCT. RES. 1091, 1091–1101 (2002).

⁶⁹ See Raghuram G. Rajan, *The Past and Future of Commercial Banking Viewed Through an Incomplete Contract Lens*, 30 J. MONEY, CREDIT & BANKING 524, 524–42 (1998) (explaining the importance of reputation both to borrowers, managers, and other market participants). This Article will assume that a primary agent of an Islamic firm is any individual or group of individuals who conduct compliance review, this process is commonly conducted through either an external or internal *Sharī'ah* board. See *supra* notes 2-6 and accompanying text.

⁷⁰ See GUIDING PRINCIPLES, *supra* note 2, at 6–7 (“In line with internationally recognized corporate governance standards such as those issued by the OECD, any Islamic-American entity should exercise proper discretion in choosing *Sharī'ah* governance structures so that they appropriately safeguard the fulfillment of fiduciary duties including good faith, care, skill and diligence towards all their stakeholders. Each organization should consider its size and, with a view to determining the impact of the number of members upon effective decision-making, decide what size *Sharī'ah* board is most appropriate, taking into account the scope and nature of their operations. As far as possible, they should aim for a *Sharī'ah* board with a mixture of experience and competencies. In this respect, it is envisaged that the *Sharī'ah* governance needs and requirements of different types of institutions although similar as a matter of principle, will be diverse as a matter of practice. For example, a conventional bank engaging in Islamic finance transactions on an ad-hoc basis, or an Islamic window of a conventional bank with a very limited offering of Islamic finance products, may not be expected to have an in-house *Sharī'ah* governance framework with the resources of a full-fledged Islamic financial institution, or an Islamic window with a very broad range of Islamic finance products. Similarly, an Islamic collective investment scheme (ICIS) or an Islamic fund management operation may require different skill-sets from its *Sharī'ah* board compared to what could be expected from such a board in a *Takaful* or insurance operation.”).

client protection.⁷¹ Therefore, some foreign jurisdictions require that each Islamic institution have a statutorily defined *Sharī'ah* governance system in place and seek some reassurance that this is the case.⁷² In practice, *Sharī'ah* boards in the United Kingdom examine a transaction and, if satisfied that it is *Sharī'ah* compliant, issue an approval.⁷³ The FSA does need to know, from a financial and operational perspective, the exact role of the *Sharī'ah* board in each authorized Islamic firm.⁷⁴ It needs, in particular, to know whether and (if so) how the *Sharī'ah* board affects the executive management of the firm.⁷⁵

Of course who is fit to serve as a *Sharī'ah* board member is a very important question. In the United Kingdom, any person acting as a Director of an authorized Islamic firm must be registered under the FSA Approved Persons rules.⁷⁶ To assess the suitability of any Director, the FSA has a standard known as the 'Fit and Proper test for Approved Persons'.⁷⁷ One issue that needs to be addressed in the United States, because of possible significant conflicts of interest, is

⁷¹ A few other supervisory authorities seem to take the view that *Sharī'ah* boards have a significant role to play in monitoring the health of the Islamic institution, similar to professional advisers such as lawyers, accountants and auditors. They then impose a requirement that each Islamic institution must have a certain minimum number of members of the *Sharī'ah* board, who must meet certain "fit and proper" criteria; similar to the assurance sought when banks are appointing their board of directors (BOD). See GUIDING PRINCIPLES, *supra* note 2, at 6.

⁷² See *id.*

⁷³ See FINANCIAL SERVICES AUTHORITY, ISLAMIC FINANCE IN THE UK: REGULATION AND CHALLENGES 13 (Michael Ainley, Ali Mashayekhi, Robert Hicks, Arshadur Rahman, & Ali Ravalia eds., Nov. 2007), http://www.fsa.gov.uk/pubs/other/islamic_finance.pdf ("The key point from the Financial Services Authority's perspective is that firms successfully show that the role and responsibilities of their [*Sharī'ah* board] are advisory and do not interfere in the management of the firm. The firms already authorized have been able to show this. The factors that the Financial Services Authority typically looks at with regards to *Sharī'ah* boards include the governance structure, reporting lines, fee structure and the terms and conditions of the [*Sharī'ah* board] contracts.")

⁷⁴ See *id.*

⁷⁵ See *id.* ("The Financial Services Authority has to be clear as to whether the *Sharī'ah* scholars have an executive role or one that is simply advisory.")

⁷⁶ See *id.*

⁷⁷ See *id.* ("One of the factors looked at is 'competence and capability'. So, for an individual to become a Director of an authorized firm, they should have relevant experience. If, therefore, *Sharī'ah* scholars are seen to have a directorship role, it is possible that some of them may not meet the competency and capability requirements. Second, and assuming that *Sharī'ah* scholars are Directors, their role is more likely to resemble that of an Executive Director than a Non-Executive Director as it might involve active participation in the firm's business.")

whether one person can serve on multiple *Sharī'ah* boards of different private firms or organizations.⁷⁸

Conclusion

Compared to the United Kingdom, the present lack of institutional capacity in Islamic finance at the regulatory level in the United States is a significant competitive obstacle to the domestic growth of this industry.⁷⁹ The current apathy in the United States toward developing a favorable tax regime, that does not result in the double taxation of many Islamic financial transactions, is in stark contrast to financial markets globally where undeniably the regulatory race to attract *Sharī'ah* capital has already begun. For example, in June 2006, the U.K. Chancellor of the Exchequer declared that London would become the global center for Islamic finance and wealth-management by offering new regulatory and tax regime measures to support

⁷⁸ Equally important for a firm is recognizing that *Sharī'ah* compliance is a continuous process, this means their products and services are adequately monitored. See Solé, *supra* note 15 (“Unlike conventional finance, this may implications for an Islamic firm’s prudential requirements as well as conduct of business—some products, if they breach *Sharī'ah* compliance rules, can adversely affect a firm’s solvency by converting an asset into a liability on the balance sheet.”); GUIDING PRINCIPLES, *supra* note 2, at 13–14 (“In some jurisdictions the regulatory framework permits the appointment of an individual member of the *Sharī'ah* board to also execute the *Sharī'ah* monitoring function. While such an approach might be justified by the cost factor, for a reporting corporation this almost certainly would put the firm at a disadvantage in terms of the collective credibility that can be achieved, compared with a *Sharī'ah* panel comprising several members. Furthermore, it might be argued that the independence of an individual member of the *Sharī'ah* board would be more questionable in terms of monitoring and quarterly audits. Therefore, effective monitoring of *Sharī'ah* compliance by an Islamic firm may involve reinforcing more remote oversight through a private *Sharī'ah* audit process and by developing more accounting expertise from within.”).

⁷⁹ See Alam & Shanmugam, *supra* note 10, at 14 (“As can be discerned from the progress of Islamic finance in many countries, there are many vital factors that ensure its successful implementation and growth. Some of these factors are proper legislation, full commitment from the government, creation of awareness among the public, focused research efforts, and innovative Islamic products and services.”). The current lack of consideration by American regulators means that, comparatively, all of those factors are increasingly underserved. For example, since 2004, the Treasury has hosted only one in-house Islamic scholar for the \$200 to \$300 million invested domestically in *Sharī'ah*-complaint securities. See Bases, *supra* note 46 (“We are seeing on a daily basis [Gulf] money going to Europe, and the U.K . . . due to lack of *Sharī'ah*-complaint product in the United States . . . [W]e have to catch-up.”); Chiu et al., *supra* note 46 (“[T]he Treasury currently hosts an in-house Islamic finance scholar . . .”); Taylor, *supra* note 46. The United States is behind in developing a similar understanding and capacity in Islamic finance, the establishment of a national *Sharī'ah* advisory board is a necessary first step in building a similar partnership between the American-Muslim community and the American regulatory authorities.

the creation of products that comply with *Shari'ah* law.”⁸⁰ The Islamic Finance Experts Group was established as a result.⁸¹

Currently, London competes nearly exclusively with Malaysia for supremacy as the next center for Islamic wealth-management, banking, and securitization.⁸² In comparison, New York, lacking a flexible regulatory regime, has failed to develop the institutional capacity to compete with London as one of the trusted destinations outside the Middle East for *Shari'ah* capital.⁸³ As

⁸⁰ Gordon Brown, Speech by the Chancellor of the Exchequer, the Rt Hon Gordon Brown MP, to Mansion House, London Islamic Finance and Trade Conference, Her Majesty's Treasury Office of Public Affairs (June 13, 2006), <http://www.hm-treasury.gov.uk/2014.htm> (last visited Dec. 30, 2008); *see also* Bases, *supra* note 46 (“The domestic U.S. Islamic finance industry needs to innovate and try to tap an underserved, generally well educated and affluent, Muslim American community.”); Chiu et al., *supra* note 46, at 64 (“[T]he few financial entities that offer formal Islamic finance in the United States are often motivated by grassroots demand . . . [R]egulatory issues have not been tested on a large scale, and decisions as to whether a bank may offer an Islamic financial product are typically determined on a case-by-case basis.”); J. Quinn Martin, *City Tries to Increase Share of Shari'ah Finances*, NEW YORK SUN, Oct. 9, 2007, at A1 (According to a senior Her Majesty's Treasury official, “making the U.K. and London a center for Islamic finance means putting in place the tax and legislative framework that is supportive of Islamic products.”); *Treasury Hopes to Make UK 'Gateway to Islamic Trade'*, ACCOUNTANCY AGE, June 13, 2006, <http://www.accountancyage.com/accountancyage/news/2158178/treasury-hopes-uk-gateway> (last visited Oct. 9, 2008); *Government Continues Commitment to London as Islamic Finance Centre*, UK TRADE AND INVESTMENT TODAY, Oct. 10, 2008, <http://www.ukinvest.gov.uk/OurWorld/4028763/en-GB.html> (“[T]he Government also announced amendments to legislation to classify alternative finance investments bonds as loan capital for stamp duty and stamp duty reserve tax (SDRT). In addition, changes to existing corporation tax and income tax rules on alternative Islamic finance arrangements by regulation could be made if and when required.”).

⁸¹ Her Majesty's Treasury Office of Public Affairs, *City Minister Works With Industry to Improve Access to Retail Islamic Finance Products*, Dec. 3, 2007, http://62.164.176.164/press_136_07.htm.

⁸² *See* Lionel Laurent, *Capitals of Islamic Finance*, FORBES, Apr. 21, 2008, http://www.forbes.com/2008/04/21/islamic-investment-dubai-cx_ll_islamicfinance08_0421cities_tearsheet_4.html (“Ratings Agency Standard & Poor's last year called London the ‘sole non-Muslim competitor’ of traditional Islamic financial centers. The agency also said that Britain's sovereign sukuk bond—when it eventually arrives—would be only the second sovereign sharia-complaint bond worldwide to get an ‘AAA rating.’”); *see also* KPMG INTERNATIONAL, *supra* note 41, at 1 (“[I]slamic bank branches increased in Malaysia from 126 in 2004 to 766 in 2006 . . . [I]n the U.K., for instance, two new Islamic banking license applications are currently being considered by the Financial Services Authority (FSA) following the authorization in the past three years of the Islamic Bank of Britain and the European Islamic Investment Bank.”); *see also* Tan Sri Dr Zeti Akhtar Aziz, *Islamic Finance: A Viable Alternative in Global Finance*, MALAY. BUS., Dec., 2007, at 4 (showing the global Islamic financial market is now worth more than \$1 trillion in net assets, comprises more than 300 international banks in London, Malaysia, Singapore, and Hong Kong, and a consulting firm named McKinsey & Co., predicts growth of at least 20% in this sector over the next five years); Tom Wright & Yuyu Yuniar, *Islamic Finance Widens Pitch*, WALL ST. J., Sept. 5, 2007, at B3.

⁸³ *See* MICHAEL R. BLOOMBERG & CHARLES E. SCHUMER, SUSTAINING NEW YORK'S AND THE US' GLOBAL FINANCIAL SERVICES LEADERSHIP 61–78 (2007) http://www.senate.gov/~schumer/SchumerWebsite/pressroom/special_reports/2007/NY_REPORT%20_FINAL.pdf (last visited Sept. 22, 2008) (explaining recent regulatory trends as inflexible and damaging to America's competitiveness in both the banking and financial services sector); Bases, *supra* note 46; Chiu et al., *supra* note 46, at 66 (“[T]here are no current plans to open an Islamic bank or branch in the U.S.”); Elisabeth Eaves, *Islamic Finance: God and Mammon*,

one senior European official recently commented, “[W]e find that in all the issues that matter political environment, legal and institutional framework, and access to skills London leads the world, London’s financial regulators are seen as some of the most supportive for *Shari’ah* investment globally.”⁸⁴ In fact, *Shari’ah* compliant financial offerings are virtually non-existent in the American capital markets.⁸⁵

One way for the United States to remain competitive in the financial services and banking sector, is through the creation of a free national *Shari’ah* board to attract Gulf investors and lower the real compliance cost of using American capital markets.⁸⁶ Analysis of the strong

FORBES, Apr. 21, 2008, http://www.forbes.com/2008/04/21/islamic-banking-interest-islamic-finance-cx_ee_islamicfinance08_0421intro.html (“[S]ome 200 billion dollars left the U.S. . . . Kuala Lumpur rivals traditional hubs like Dubai and Bahrain as a global center of Islamic finance.”). *See also* ALI PARSA, CURRENT TRENDS IN *SHARI’AH* PROPERTY INVESTMENT 1 (2006) (“The range of skills available in London is still providing the U.K. market with a key competitive edge in [the Islamic securities market.] Across all categories . . . the U.K. is seen as being the most supportive of *Shari’ah* investment.”).

⁸⁴ Elisabeth Eaves, *supra* note 83.

⁸⁵ *See* Thomas C. Baxter, Jr., Exec. V.P. & Gen. Counsel, NuBank, Regulation of Islamic Financial Services in the United States, Speech at the Seminar on Legal Issues in Islamic Financial Services in Islamic Financial Services Industry, at 2 (Mar. 2, 2005), <http://www.nubank.com/islamic/ROIF.pdf> (last visited Oct. 15, 2008) (“[F]ederal banking regulators have provided little formal guidance with respect to Islamic financial products.”); *see also* Mahmoud El-Gamal, Ph.D, Chair of Islamic Economics, Finance, and Management, and Chair of Professor of Economics and Statistics, Rice University, Islamic Finance in the United States and Middle East, Prepared Statement for U.S. Senate Committee on Banking, Housing and Urban Affairs Hearings, July 13, 2005, http://banking.senate.gov/public/_files/gamal.pdf (last visited Oct. 13, 2008) (“Towards that end, more coordination with regulators and enforcement agencies, including technical assistance and involvement in development of standards, remains crucial at this time.”); Bases, *supra* note 79, (“I will tell you, in my conversations with Islamic institutions, they clearly tell me if Islamic finance and the creation of Islamic finance products in the U.S. was motivated and stimulated there would be definite interest in the U.S. markets.”) (internal quotations omitted); Chiu et al., *supra* note 46, at 66 (“U.S. financial institutions that offer Islamic finance products typically offer *Murabaha*, *Ijara*, and *Musharaka* financing.”). *See generally* Growth in Islamic Finance Spurs Need for New Risk Management Methodologies, ENP NEWswire, Feb. 18, 2008; Tatyana Shumsky, *How to Make Money in the Middle East*, FORBES, Apr. 21, 2008, http://www.forbes.com/2008/04/21/middle-east-investing-islamic-finance-islamicfinance08-cx_ts_0421money.html (last visited Oct. 17, 2008) (“Middle Eastern economies are decoupling from the U.S. because so much of their growth is focused internally.”).

⁸⁶ *See* COMMITTEE ON CAPITAL MARKETS REGULATION, INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION 39 (2006), http://www.capmktreg.org/pdfs/11.30Committee_Interim_ReportREV2.pdf (last visited Oct. 18, 2008) [hereinafter COMMITTEE ON CAPITAL MARKETS REGULATION] (noting that, increasingly, the costs of a cumbersome U.S. regulatory structure combined with a legal environment seen as expensive and unpredictable outweighs the comparative benefits of using Wall Street’s proven financial expertise); INTERNATIONAL MONETARY FUND, GLOBAL FINANCIAL STABILITY REPORT: MARKET DEVELOPMENT AND ISSUES 82–85 (2005), <http://imf.org/external/pubs/ft/gfsr/2005/02/> (last visited Oct. 14, 2008) [hereinafter IMF GLOBAL FINANCIAL STABILITY REPORT] (showing a steep comparative increase in real and perceived regulatory costs after passage of the Sarbanes-Oakley Act in the United States, relative to other G-8 economies).

growth globally suggests an Islamic asset market derives foreign investor benefits from targeted regulatory reforms that are enacted in concurrence with an established domestic national *Shari'ah* board and based on a set of best-practices principles. A free national *Shari'ah* board in the United States that focused on simply financial matters would provide both advantages.

As financial regulators seek to reassert New York's competitive advantage in the financial services sector, emphasis should also be placed on specific reforms that target the creation of *Shari'ah* capital in the United States. If in the wake of the current financial crisis, the administration of Barack Obama considers implementing reform in the banking and financial sector, then concurrently, consideration should also be given to the standardization of a unique set of reporting requirements and accounting standards for certified investors wishing to sell or purchase Islamic securities in the United States.⁸⁷ A unique set of disclosure forms incorporating public offering requirements, developed by a free national financial *Shari'ah* board would legitimize Islamic securities being sold in the United States, and serve as a defining first step for this hopeful body.

⁸⁷ See, e.g., BLOOMBERG & SCHUMER, *supra* note 83, at 10–18 (calling for reform of regulatory practice through the development of a shared vision supported by a common set of principles, for the regulation of financial institutions, these principles include: for example, cost/benefit analysis, materiality tests, collaborative rulemaking and enforcement, and an escalation process for enforcement of matters); COMMITTEE ON CAPITAL MARKETS REGULATION, *supra* note 86, at 8–15 (calling for reform of the regulatory process including the systematic implementation of cost-benefit analysis when it comes to SEC proposed rules); SHAYERAH ILIAS, CRS REPORT TO CONGRESS: ISLAMIC FINANCE: OVERVIEW AND POLICY CONCERNS 6 (2008) (“[T]here is a debate about whether or not, or to the extent to which, regulators should apply rules on conventional products to Islamic product counterparts.”). A unique set of public offering requirements would legitimize Islamic securities being sold in the United States. Also, the American government should carefully consider how to issue sovereign *sukok* similar to efforts currently underway in Great Britain. See *supra* note 79–82 (providing examples of reforms underway in the United Kingdom).