

Islamic Finance: What Is the Outlook for Italy?

Paolo Pietro Biancone

Abstract---The spread of Islamic financial instruments is an opportunity to offer integration for the immigrant population and to attract, through the specific products, the richness of sovereign funds from the "Arab" countries. However, it is important to consider the possibility of comparing a traditional finance model, which in recent times has given rise to many doubts, with an "alternative" finance model, where the ethical aspect arising from religious principles is very important.

Keywords— Banks, Europe, Islamic Finance, Italy.

I. INTRODUCTION ON ISLAMIC FINANCE IN EUROPE

LITERATURE in the Western world has only recently dealt with Islamic finance in aspects of its tumultuous development in countries where it professes the religion of Mohammed [9] and regarding its slow but gradual spread in the Western financial system [13].

Islamic finance is a phenomenon that cannot be limited to only the Islamic countries, especially given the growing number of Muslims in the West [1]. Muslim communities in non-Islamic contexts are characterized by being highly fragmented in terms of language, socio-economic status and ethnicity, but on a steady rise in terms of income. Older generations of laborers and small shopkeepers have been replaced by a growing number of professionals. This evolution represents a very significant reality in the international financial environment, especially in regard to the growth rates and the number of people involved. However, there have been very different growth rates from country to country in which it has spread, with specific reference to European countries that do not have a religious Muslim tradition.

Particularly in the UK, where there is a well-established presence of Muslims, Islamists are fueling a growing demand for financial services in line with the Shari'ah. Traditionally well-advanced in the financial sector, the United Kingdom was the first European jurisdiction to amend its tax legislation to allow the execution of financing transactions in line with the precepts of the Shari'ah, avoiding, thus, a legal transaction tax penalty compared to traditional financing, in the case wherein said burden was attributable exclusively to the peculiar financial structure put in place. Besides the United Kingdom, notable attempts of dissemination of Islamic banking have also been made in Germany and Denmark.

France, despite the significant presence of Muslim immigrants, has developed an interest with conscious delay on the Islamic finance phenomenon. Most of the big Western

financial institutions, following the model of Citibank, which in 1996 opened its own Islamic subsidiary in Bahrain, are now engaged in this type of activity in the form of branches, or Islamic windows or financial products intended for the Muslim customer [5]. However, the recent development of Islamic finance is attributed to strong support from the French authorities, who have built a proper and welcoming environment [4].

Currently most European Muslims manage their own financial assets through conventional banks, because the leading providers of Islamic financial services are not present in the retail market. The majority is served by large institutions rather than small banks and only a few uses the European branches of Islamic banks [7]. The agreements reached allow the use of credit cards issued by banks of the Islamic world in ATMs of other banks, but this does not fully meet the needs of customers, who often find a limited range of automated services and are penalized with extra charges if they withdraw cash from banks other than their own.

In general, in Italy there are no obstacles to granting authorization to the exercise activities of a bank that establishes in its statute that their banking activities will be carried out according to Islamic norms, but the supervisory authorities must examine, prior, to giving their assessment, the characteristics of each initiative for the corporate purpose of the Islamic bank [15]. Potentially, these features may not be compatible with the Banking Act (Testo Unico Bancario) which art. 14 provides for the authorities that are conventionally focused on the function of collecting deposits and lending.

The operative reality in Italy is that many brokers are licensed as banks, yet do not carry out the functions of typical banking, but rather focus on specialization in investment services, since the bank does not only participate in banking activities, but also acts as an intermediary authorized to carry out other financial activities, as long as it is not confidential by law to other categories of intermediaries (such as insurance activities).

Therefore, the specific operating characteristics of Islamic banks are compatible with the Italian financial system [9]. With regards to the question of the religious motivations that underlie the relationship between Islamic banks and traders, the experience of Banca Popolare Etica in our country and provision of ethical savings products demonstrates the legitimacy and recognition motivated by different financial choices, so that in fact the legislation cannot be applied in a different manner. What has also been debated is the concept of a "joint venture", governed by art. 2549 of the Civil Code, in reference to the operating scheme of certain Islamic financing

Prof. Paolo Pietro Biancone, Director of Centre for Research on Islamic Finance, Department of Management, University of Turin, Italy (e-mail: paolo.biancone@unito.it).

operations, which could lead to two problems in the relationship between banks and non-financial institutions:

- Interference in the management of the bank by unauthorized persons and banks;
- Risk of dominant position of influence in favor of third parties associated with the transmission of profits or losses.

With reference to the first aspect, the Bank of Italy does not give any decision-making power to the associates or management, since it considers that the joint venture does not constitute a joint management of the subject, but only involves the division of profits and losses in exchange for a contribution that is economically assessable, unless there exist contractual clauses that influence the management decisions of the bank.

Fear of supervisory authorities suggests that the contractual constraints could lead to a dominant position of influence in favor of non-financial associations with violation of the principle of separation [14]. The association agreements on participation, however, must be approved beforehand by the supervisory authority.

The new provisions of the Civil Code in relation to company law have facilitated the construction of Shari'ah compliant contracts, thus broadening the range of instruments for the financing of an enterprise and disciplining the assets for contribution to business with third parties. The total investment in economic participation must be contained within the capital. However, to ensure the performance of Islamic banking activity in Italy, surpassing the prohibition of interest and the Islamic sector, which contrasts with the general principles of separation between the bank and the Company, and the protection of depositors, the Banking Act should be accordingly modified and adapted.

The rules to protect investors also require adherence by an Islamic bank to the Interbank Guarantee Fund of Deposits for obtaining authorization. Deposit insurance is, next to the supervisory mechanism and the lender of last resort, one of the key components of a safety net aimed at ensuring the stability of the banking system. The Statute of the Interbank Deposit Protection Fund is in accordance with the national legislation transposing the directives on deposit-guarantee schemes, including the protection afforded to depositors' claims relating to the funds acquired by the banks with repayment obligation in the form of deposits or in any other form, including bank drafts and comparable securities. The application of different prudential standards lower than those required cannot be assumed even for Islamic banks in Italy. The typical risks of financial intermediation involve the need to apply different forms of prudential supervision to intermediaries and activities for regular management and avoid the repercussions of certain systemic crises.

In addition, the Islamic Bank will have to define the role and responsibility of the *Shari'ah Supervisory Board*. Not having executive power cannot interfere in the management of the bank nor can decisions be made on behalf of the management, only to verify the conformity of transactions with Islamic laws and regulations and the admissibility of the

transaction, unless the nature of the relations of the Board with the bank, which may take various forms with members appointed by the shareholders, and with members selected by the Board of Directors are approved by a general Council. The existence of these Councils of the Islamic bank should not interfere with the tasks of officials and internal control audits.

II. DEVELOPMENT PERSPECTIVES OF ISLAMIC FINANCE IN ITALY

Italy is one of the fastest growing markets in Europe. A series of initiatives have been taken by the Italian authorities to study the issues related to an expanded presence of Islamic finance. The Bank of Italy, for example, has hosted a series of conferences on the subject [12]. ABI, the Italian Banking Association was established on a voluntary basis and, besides not having any profit, has set itself the goal of working to promote the activity and promote the interests of the banking and financial system. In its relations with the business world, the ABI has given rise to international meetings to strengthen economic cooperation. With particular attention on the Gulf countries to develop trades, investment, and financing opportunities through, amongst others, the introduction of Shari'ah compliant instruments in Italy. It is currently coordinating a working group on the issue of a sovereign or corporate sukuk.

The spread of Islamic finance and compliance with the prohibitions set by the Muslim religion from a theoretical point of view would lead to reduced intermediation activity of Islamic banks, and a redefinition of the paradigm of intermediation, in the sense of understanding the bank first as a partner of a company or business consultant and secondarily as a lender [3]. From an operational point of view, the bank behaves like a conventional bank in terms of costs for companies and returns for depositors, but adopts a different *modus operandi* to compete in international and local contexts with Western banks [6]. Consequently, its "safe" intermediation operations opens growth perspectives in Italy, taking into account on the one hand the actors who can build a dedicated offer to customers and the Islamic community and other factors that may coordinate the development of this same offer. In Italy as many of 1.3 million people are Muslim, which amounts to 2% of the Italian population, but there is no offer of financial services or products for the Islamic community in Italy.

The birth of the first Italian Islamic bank was expected by 2008 between ABI (Italian Banking Association) and UBA (Union of Arab banks), but the financial crisis has slowed down the development [2]. However, the latest agreement now wants to overcome the limitations of fiscal and financial legislation, as has happened in the UK, where the Institute of Islamic Banking of Britain was activated with only a tax review, always taking into account the degree of consistency with the Islamic Shari'ah compliance, which is a dependent variable according to banking projects conceived in optical Islam or born of an economic western entity.

Alongside offering developmental perspectives of Islamic finance in Italy, Italian Islamic banks could also explore the

Islamic windows of Italian banks. Opening a window on the Islamic world can be a growth opportunity for those banks that want to become first distributors of products in accordance with the Koran, and second packagers of products of this type. Initiatives dedicated to Islamic finance may also be provided by banks that have launched social banking or banking to welcome initiatives as an international trend. In this context we can also consider the Islamic windows of foreign banks. In fact there are large banks with international vocations, such as the British HSBC and the OIZ TSB, who have offered full Islamic services extending basic banking services to the needs of customers of Islamic origin [11]. Considering Islamic banks on the basis of European Community legislation, they are free to offer their services to customers in any country of the European Union, by virtue of the investiture obtained by the supervisory authority of the country of origin. In England, considered for its qualification as a portal of Islamic finance as a reference point in the future development of Islamic finance in Italy, Islamic banks are licensed on the basis of certain requirements verified by the FSA. Other subjects may also be involved in the process of construction experience in Islamic Italy, in the opinion of some scholars.

So, besides the ABI-UBA agreement, there are also other Italian banks (UBAE bank, Unicredit bank, Banca Etica and Banca Sella) nearby to offer Islamic products, even if they currently do not have structured products. Notable European Islamic banks are the Islamic Bank of Britain, the European Islamic Investment Bank, and other banks licensed in the UK to retail and wholesale. Another English bank very active in the international arena, and the first to have understood the potential of Islamic finance, is HSBC and its subsidiary HSBC Amanah. These are the people who may be interested in defining an Islamic offer in Italy. Considering now the factors for the takeoff of Islamic finance in Italy, we can say that this, from a systematic point, depends on the following factors;

- regulatory disposition,
- fiscal disposition.

Downstream from conditioning and economic opportunities of the main factors for the intrinsic compatibility of Islamic contracts with Italian law are;

- accounting,
- communication,
- the distribution,
- staff training.

The greater opportunities for Islamic banks in Italy arise from the geographical proximity of Italy to the Middle East and North Africa. Italy is considered a bridge between Europe and the southern shores of the Mediterranean. Based on the trade and good business relationships that bind Italy to the Islamic countries, we can usefully analyze the activity of the Bank UBAE Union of Arab Banks and European banks, which act as a link between the countries of North Africa and Europe. UBAE Bank has developed unique capabilities to assist trade between countries of the Arab world and with international trade. They have become highly regarded as so-called expertise in trade finance or financial assistance for the acquisition of raw materials or the early liquidation of the

receivables associated with the foreign market. The relational capital of UBAE Bank is a good starting point for the establishment of the first Islamic Bank in Italy.

The opportunities for Islamic windows in the Italian bank scene may be summarized as follows: the banking needs of the Islamic community in Italy of the first generation with access to these facilities are based on financial needs related to remittances, savings and some investment. The second generation will have more refined financial needs as they trigger entrepreneurial activities that require bespoke services. In some regions of the north this is already happening. Basic banking services should be offered to attract the interest of the emigrants and enable initiatives to promote financial integration of communities of immigrants in Italy. Particular opportunities exist for European Islamic banks to exploit the success of the Islamic finance in Britain. The Islamic Bank of Britain is only one of the five authorized that specialize in retail. Its eight branches are a bench-mark for other Islamic banks.

III. THE TRAINING PROJECT

Economic relations between Italy and the Middle Eastern countries are facilitated by geographical contiguity. Italy is the ideal partner in the effort of both Arab and Islamic countries (such as Iran, Turkey and others) to expand their production base, on account of Italian specialization of low and medium intensity production of capital and the flexibility of the national production system, favored by the high density of small and medium enterprises.

The training project, proposed by us, to bring Islamic finance into our country is a profitable opportunity to further enhance our knowledge and share it with our financial community and academia. The aim of the course is to provide a complete picture of Islamic finance, the analysis of the founding principles and the potential for development of the sector with reference to the Italian market, and the more technical aspects relating to individual financial instruments at the disposal of Islamic Banking. This can be achieved in addition to gaining knowledge on the mechanisms that regulate the commercial and financial processes from a perspective of interaction between the market and Western finance institutions and those of the Islamic culture.

There are a growing number of established international financial centers, such as London, Tokyo, Hong Kong and Singapore, all of which have started projects of integration between Islamic finance and other financial systems. The evolution of Islamic finance has aimed at strengthening its development. With this endeavor, two important institutions, namely the IFSB founded in 2002 and the AAOIFI founded in 1990, have both become points of reference to ensure uniformity of architecture and ensure the financial stability of the Islamic system.

Our mission is to start a training, education, research and professional consultation center and promote the dissemination of Islamic finance at national and international levels, spurring the possible integration of our banking system and the alternative that will undoubtedly deliver significant

benefits to the Italian economy. The Center also serves as a bridge in order to examine best practices in banking and finance from proffers studies that compare traditional practices with those in the Islamic world.

The School of Management and Economics (former Faculty of Business and Economics) is part of the University of Turin (Italy), founded in 1404. The faculty celebrated its first centenary in 2006; it was renamed School of Management and Economics in 2012 and divided into two departments: the Department of Management, and the Department of Economic and Social Sciences, Mathematics and Statistics. It now has 70,000 students, a staff of more than 220 full, associate and assistant professors and offers a wide range of Italian and English taught programs both at undergraduate and graduate levels [10].

The Department of Management is assembling a Bachelor's degree and a Master's degree course in English, intended to train both Italian and international students interested in learning study issues related to Islamic finance.

IV. DEVELOPMENT PROJECT OF RETAIL PRODUCTS

The migrants are included in the economic and social Italian structure to such an extent that they represent a very significant segment of the market. Therefore, the present project aims to create alternative financing and investment routes that are immediately usable within the legal and fiscal Italian system, for Islamic investors and the community of immigrants from the southern shores of the Mediterranean and resident in Italy.

Development, in the medium term, of Shari'ah compliant finance in Italy not only responds to the need for investment, but also the need to save by the Islamic community in our country. In particular, the progressive sophistication of financial needs related to the presence of the second generation of immigrants and the gradual development of business activities, requires an assessment of the potential of the Italian market in offering Shari'ah compliant retail financial products.

The articulation of the retail offer could be targeted to meet the basic financial needs (liquidity, investment, financing for home purchases and capital goods for the development of productive activities), but the structuring of the supply and the choice of which business model to adopt must be determined in order to best exploit profitability perspectives for the bank, customers' convenience and operational complexity. With this aim, we propose to carry out compatibility studies of Islamic products and collaborate with micro-credit banks, cooperative credit and the big banks from which the traditional products will be emulated and adapted into Islamic products.

Until now, the supply / demand focus has been on money transfer services (remittances, payment instruments) prevalently provided by the postal channel and skilled operators, and it is this particular phase of the Islamic community's financial markets that is an interesting segment for banks, and therefore the development of a Shari'ah compliant commercial option is being carefully evaluated.

Currently in Italy the needs of Muslim residents are being fulfilled by the experience of the staff in the multiethnic project "Agenzia Tu", within the banking group UniCredit. The specific objective of this project is to meet the needs of foreign citizens who are struggling to gain access to bank services, such as consumer credit or home loans. It is in this way that the initiative is aimed at UniCredit Bank, which is dedicated to new players of the economic and labor market.

Thus, the role of our project is to facilitate the process of social integration, giving the Muslim community the opportunity to choose financial products and unconventional investments. This will address a real financial need that is otherwise often exacerbated by the inability to resort to conventional finance products. Worth noting is that Muslim residents' (amounting to approximately 1.3 million individuals) savings are estimated at over 500 million per year (excluding savings for remittances to their countries of origin).

So, we have a situation in favor of the development of Islamic finance. In the short term, however, we must address some of the issues already settled by other large EU countries, such as the lack of specific regulations and the need for changes to the Tax Code so as to not affect the transactions of Islamic finance. Then there are cultural factors and difficult to dispel myths, such as the belief that Islamic finance is only for Muslims, that it is a primitive financing method, that it is more risky and expensive than conventional finance, which is governed only by Shari'ah principles, and the mentality that the conventional system does not need replacing.

V. DEVELOPMENT PROJECT OF AN INVESTMENT FUND FOR SMES FINANCED BY ISLAMIC INVESTORS

The overview of the implementation of the model of Islamic finance outlined so far is necessary in order to assess the ways in which Italy can further open up to the Islamic investment funds' market. The objective is to contribute and to increase the flow of Arab capital and strengthen bilateral economic relations.

The current Islamic investment fund seems to be the instrument with the lowest degree of discretion among those proposed in a western market. To measure the performance of Shari'ah compliant investments, we have created some indices that summarize the performance of a basket of securities that, by their nature, may be subject to investment by funds. We mention the main *Islamic Dow Jones market* index on the square in New York and the *FTSE Global Islamic Index* on the London market [8].

The Islamic indexes currently cover equities of companies in 46 countries. There are two Italian titles in the lists of titles compatible with Islamic finance: ENI and ENEL. To be included in these indices and overcome the difficult examination of Shari'ah compatibility allows access to a huge Islamic market, as well as providing an opening and the capacity for a dialogue with a different culture. A certification recognized by Islamists is not the prerogative of only large corporations. *A certification by a recognized Islamic body of an Italian company listed or not listed would make a great "business card" for companies that want to present themselves*

on the Islamic Middle Eastern markets or observant Muslims who would like to invest in Italy.

Almost all Islamic funds on the market are equity funds, since the purchase of bonds that generate interest would itself be impossible. They are therefore usually risky instruments targeted at experienced investors with a time horizon extending over the long term. Which market in Italy? Also keeping in account that the majority of immigrants of Islamic faith in Italy come from North Africa, while the area of greatest spread of Islamic banks is in Asia. These immigrants often have contacts with western banks in their countries and so it is logical to assume that even here can be integrated into ordinary system. Furthermore, the social class of Muslims in Italy is not very well-off and has limited remittances to their countries of origin rather than using traditional banking services (except perhaps for their mortgage) or investment. Other potential investors could be subscribers of "ethical funds", which are also not Islamic, or large investors in the Middle-East, to Islamic specialist funds such as Italian companies.

The only product currently located is an investment fund proposed by BNL BNP Paribas: BNP Paribas Islamic Fund - Equity Optimizer. It is an equity fund originally founded in France and Bahrain, subsequently brought to Italy by BNP (a French bank also present in our country through the branches of BNL). The fund selects, via the process of an annual review, 30 actions from the component securities of the Dow Jones Islamic Market Titans 100 Index, each with a weight of 3.33% on the entire portfolio. The selection is made according to the highest rate of return on equity and respects Islamic principles. The establishment of the fund and the investment process are validated by the Shari'ah Supervisory Committee. Investment activities are addressed in order to comply with the directives relating to the criteria of the Islamic Shari'ah, so it is not permissible that the fund pays or receives interest, although it is permissible to receive dividends. If this happens, the amount of dividend income will be donated to charities.

The UK remains the hub of Islamic finance and Switzerland, the cradle of international banks, is willing to participate in Islamic finance in the future, at least in terms of collection, but Italy certainly has a prime location at least from the point of view of geography, potentially establishing itself as a protagonist on the world stage of the situation in the Mediterranean. The current political and economic situation, however, could represent an opportunity to regain lost ground. While Islamic banks are located in Switzerland, the UBS has recently opened a branch in Bahrain, the Noriba, in accordance with the Shari'ah. Italy can be regarded in the same sense, and attract investments by institutions or sovereign funds belonging to Islamic States and use these investments as a means of financing for small and medium Italian enterprises.

Statistical analysis, theory and empirical tests have amply demonstrated the importance of small and medium-sized enterprises that compose the industrial structure of our country of approximately 4.5 million. Today, employment in large manufacturing firms appears to accommodate 16.3% of the

total workforce, compared to 83.7% of small and medium businesses. In fact, in the Italian experience, the industrial districts are the spontaneous response to an economic system peripherally packed with great potential.

For an Italian company to be included in an Islamic index and overcome the difficult question of "Shari'ah compatibility", as well as potentially accessing a huge market such as the Islamic population, could provide an opening opportunity for dialogue with a different culture, and an additional card for observant investors who would like to invest in Italy.

VI. CONCLUSIONS

The opportunity to attract foreign capital to sustain economic progress, on the one hand, and the intensity of trade and financial links with the southern shores of the Mediterranean, on the other, make it increasingly important that our country and its financial system are well equipped with the knowledge and tools needed to interact with operating systems' statements that comply with the Shari'ah principles.

The positive aspects arising from the combination of "greater liquidity funding from the Muslim community and a strong message of social integration" on the basis of establishments in London, Berlin, Paris, and Amsterdam should originate from Italy as the source dispersing then into the European banking scene. In the end, to summarize, we can say that the project aims to identify what could be a unique opportunity and promote it in order to intrigue the young people through training courses on Islamic finance and attract foreign capital and funds in terms of retail and investment.

Also, the opportunity to attract investment remains of utmost importance. As the authors suggest, it is legitimate to think "Islamic finance could be an effective means to attract Islamic investment in Italy". This is not a game of little consequence, considering that, according to the estimates of the United Kingdom Islamic Finance Secretariat, the volume of activity in Britain was 509 billion dollars in 2006 and reached 1.290 billion by the end of 2011. In this framework, therefore, the goal is to bring out the fact that Italy can meet the restrictive requirements, such as to represent investment opportunities for financial institutions (sovereign wealth funds, banks, asset management companies and others) looking for good opportunities.

REFERENCES

- [1] Akhtar S., "Financial Globalization and the Islamic finance services industry", IFSB, May 2008.
- [2] Vadala E., "La finanza islamica e I mercati finanziari europei", in E.M. Napolitano, *Il welcome banking*, Fondazione cassa di risparmio di Biella, 2006.
- [3] Paolo Pietro Biancone, "Il bilancio della Banca Islamica e la rappresentazione dei principali contratti finanziari" FrancoAngeli, 2012, pp. 1-184.
- [4] Patrick Cabanel, Paolo Di Motoli, Rummy Hasan, Mario G. Losano, Marjorie Moya, Gian Enrico Rusconi, Vladimiro Zagrebelsky, Nina ZuFurstenberg, "L'Islam in Occidente", *Quaderni Laici*, no.8, April 2013.
- [5] European Central Bank, "Islamic Finance in Europe", European Central Bank, occasional paper series No 146/June 2013.

- [6] Giallombardo R., "Cenni sulla Finanza islamica", Gianni, Origoni, Grippo & partners, 2010.
- [7] Giorgio Gomel , Angelo Cicogna, Domenico De Falco, Marco Valerio Della Penna, Lorenzo Di Bona De Sarzana, Angela Di Maria, Patrizia Di Natale, Alessandra Freni, Sergio Masciantonio, Giacomo Oddo, Emilio Vadala, "N. 73 – Finanza Islamica e sistemi finanziari convenzionali, tendenze di mercato, profile di supervision e implicazioni per le attività di Banca centrale", October 2010.
- [8] Guide to the Dow Jones Islamic Market™ Indices, http://www.djindexes.com/mdsidx/downloads/rulebooks/Dow_Jones_Islamic_Market_Indexes_Rulebook.pdf.
- [9] Porzio C., "Banca e finanza islamica", Roma: Bancaria Editrice, 2009.
- [10] Osservatorio sulla finanza Islamica: <http://www.m2a.unito.it/osservatorio-finanza-islamica/>.
- [11] Top 500 Islamic financial institutions, The Banker, 2013.
- [12] Ignazio Visco, opening address by Governor for the IFSB FORUM – "The European Challenge Rome", 9 APRIL 2013, pp. 1-5.
- [13] Rodney Wilson, Islamic finance in Europe, European University Institute, San Domenico di Fiesole, RSCAS Policy Papers,2007, www.ieu.it/RSCAS/WP-Texts/07_02.pdf.
- [14] Zambon S," The Managerialisation of Financial Reporting: An Introduction to a Destabilising Accounting Change", Financial Reporting, Special Issue, 2011.
- [15] Dell Átti A., Miglietta F., "Fondi sovraniarabi e finanza Islamica, Egea, Milano, 2009.