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Is Islamic finance wanted in Australia?

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Abstract
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Is Islamic finance wanted in Australia?

In the first instalment of a special series, DR GEORGE MICKHAIL looks at Islamic finance developments in Australia and the challenges hindering the growth of the Australian Islamic finance industry.

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A recent research working paper by the IMF investigated the relationship between Islamic banking development and economic growth in a sample of low and middle-income countries, using data over the period of 1990-2010. Its results showed that, notwithstanding its relatively small size compared to the economy and the overall size of the financial system, Islamic banking is positively associated with economic growth (Imam and Kpodarby, 2015).

That rapid growth in Islamic finance in value and geographical reach is significant with an estimated 38 million consumers of Islamic banking products, despite having a small share of global finance. However, the main interest in Islamic finance lies not only in the relative stability of the funds held in Islamic banks, but also due to its contribution to economic growth.

The demand
The 2011 census identified 476,291 people, or 2.2% of the total Australian population as Muslims, with 40% born in Australia and the rest from more than 30 countries of origin. According to the 2011 census, the unemployment rate among Muslims was 12% (double the national average and the worst of any religious group), with some groups having much higher unemployment rates, like Iraqi-born Australians (70%) and Lebanese-born Australians (60%).

It was not a surprise then that the labor force participation rate among Muslims was far below the national average. The rate of home ownership for Australian Muslims was less than half the national average, and 25% of Muslim households had above-average household income compared with 35% for non-Muslim households. These figures only highlight the stark economic realities and material stress for Muslims in Australia, which no doubt places considerable pressure on any attempt to have disposable income available for investment, and may also explain the weak demand for Islamic finance services.

The supply
On the 7th December 2014, the Australian government released the final report of the Financial System Inquiry with 44 recommendations. The focus of its recommendations was two-fold: (a) funding Australia’s economy and boosting competition, and (b) five specific areas: resilience; superannuation and retirement incomes; innovation; consumer outcomes and the regulatory system.

Since the close of submissions from all stakeholders, including industry and members of the public to respond to the report’s recommendations on the 31st March 2015, there has been no decision by the government to the 237 submissions, including 11 submissions (4.6%) that mentioned Islamic finance in their response, to the most important review of the financial system in Australia.

This rather small number of submissions to the Financial System Inquiry that...
were concerned with Islamic finance is a reflection of the small market of Islamic finance in Australia. There are three institutions offering Shariah compliant finance products (MCCA, Islamic Co-operative Finance Australia and Iskan Finance) and two Islamic equity funds (Crescent Investments and LM Investment).

Crescent Wealth helped create its own ASX Islamic index (Thomson Reuters Credit Wealth Islamic Australia Index) from some 142 firms that represent 55% of the ASX’s overall market capitalization. Meanwhile, there are no Sukuk and fewer Islamic REITs due to the lack of Australian legislation allowing for the sale of Sukuk (with their increasingly complex structures) and the tax complications (eg double taxation on capital gains and income streams) for Islamic financial transactions. The regulator: Ambiguity, avoidance or simply wait and see?

The Twin Peaks regulatory model pioneered in Australia after the Wallis Commission inquiry in 1996 resulted in prudential regulation being placed in the hands of the Australian Prudential Regulation Authority (APRA), while the responsibility for regulating the conduct of business was given to the Australian Securities and Investments Commission.

Australia, as well as other nations, has unevenly integrated consumer protection in their regulatory structures post the 2008 global financial crisis. However, few of them actually adapted their structures to address the unique risks of Islamic finance, especially with the divergent views on Shariah as a source of law in cross-border insolvencies. In their response, Islamic finance industry bodies have developed and issued standards, but without any uniformity in their adoption across countries.

No doubt, a stable financial system hinges not only on consumer protection, but also more importantly ensures sufficient disclosures by institutions so that consumers with reasonable financial literacy would avoid taking on excessive debts due to a poor understanding of the risks inherent in financial products.

There are neither obvious nor publicly stated regulatory impediments to establishing Islamic financial institutions in Australia. Recently, the APRA, the banking regulator, signed an MoU on the 30th of July 2015 with its counterpart in the UAE, the Dubai Financial Services Authority (DFSA) concerning cooperation in banking and insurance supervision (including Islamic finance).

However, the APRA does not have a member status or even an observer status with the IFSB. There are 30 institutions from non-Islamic countries out of a total of 188 members on that board, and none of them is Australian. There is not one Australian institution that is a member of AAOIFI or the International Islamic Financial Market.

The issue is not whether the regulators in Australia are ignoring the weak demand for Islamic finance products and a small market that has not grown much in the last few years, but whether they are only too aware of a global system that “needs reforms to address consumer vulnerabilities from current practices with respect to profit-sharing investment accounts, Ijarah Muntahia Bittamlik, and conventional deposit insurance schemes as well as to address the legal risks for investors in Sukuk, particularly in cross-border default cases” (Lukonga, 2015).

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