Developing the Islamic Financial Services Sector in Italy: An Institutional Theory Perspective

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Abstract

The growth of the Islamic financial services (IFS) sector has received much attention recently due to the resilience demonstrated by the sector during the financial crisis. While IFS continue to grow rapidly in much of Asia, there has been limited institutional support for the development of the sector in Europe, which has historically been slow to realize the sector's potential. Italy is one such country in Europe that has a growing Muslim population but has yet to develop the IFS sector. Using the institutional theory perspective, we highlight the role the Italian government can play in developing the regulative elements that facilitate the establishment of the IFS sector, and the introduction of Islamic financial products in the country. We propose that a developed IFS sector in Italy would help attract investment from countries in the Middle East and North Africa region, and would also facilitate the financial inclusion of the Muslim population in the domestic market.

Keywords: Islamic financial services, *Shariah*-compliant, Institutional theory, Italy

1 – Introduction

The Islamic Financial Services (IFS) sector has experienced wider consumer acceptance and rapid growth since its commercial launch in the 1970s. This growth has primarily been in countries in Asia such as Iran, Malaysia, Pakistan, and the Middle East region. Although non-Muslim majority countries like Hong Kong and Singapore have taken positive strides in developing the sector, European countries have lagged behind their Asian counterparts (Daily Times, 2013). Europe is host to a large Muslim population, but the lack of developed Islamic financial institutions means that the potential of IFS product offerings is yet to be fully realized in the region (Volk and Pudelko, 2010).

The example of countries like Iran, Malaysia, and Pakistan highlights the role of the government in institutionalizing and promoting the sector, which has led to its subsequent growth. However, such State led initiatives have been lacking in Europe, and there has been a shortage of specialized studies that attempt to address the potential issues that could be faced in attempting to develop the IFS sector under the European legal framework (Belouafi and Belabes, 2010).

We address this issue by using the case of Italy to highlight the potential for IFS to be introduced and promoted in countries in the European Union (EU). As little is known about the regulatory environment's suitability for the introduction of IFS in the EU, the exploratory case study method provides us with the opportunity to deepen our understanding of the issue (Ghauri, 2004; Yin, 2003). Using the institutional theory perspective, we analyze the Italian laws and regulatory environment for contextuality, which provides explanations for the opportunities and challenges the development of the IFS sector and introduction of Islamic financial products would face in Italy in particular, and the wider EU context in general (Gibbons *et al.* 1994).

The remainder of the paper is structured as follows: the next section details IFS and the institutional theory, followed by a discussion about the experience of other European countries with the IFS sector. We then analyze the barriers that the IFS sector faces in Italy and the opportunities for its development. The article concludes by discussing the role of the State in providing appropriate regulatory support for the institutionalization and promotion of the IFS sector in Italy and the EU region.

2 – IFS and the Institutional Theory Perspective

The operations of Islamic financial institutions differ substantially from conventional ones, as they use asset-backed financing arrangements to earn profits and returns (The Economist, 2013), and are not permitted to engage in transactions that involve uncertainty or encourage speculative behavior. In addition, the Islamic financing system prohibits the use of *riba* (translated as interest) and applies the profit and loss sharing (PLS) model, based on an equitable sharing of risks and profits between the parties involved in a financial transaction. Therefore, Islamic banks have relationships of trust with their clients, who are not creditors or debtors as is the case in conventional banks, but rather investors and traders, or buyers and sellers.

In 1975, the Islamic banking sector was commercially launched with the establishment of the first Islamic bank, the Dubai Islamic bank. Since then, the IFS sector has grown at a rapid pace, and new financial products have been introduced that meet the *Shariah* (Islamic law derived from the *Qur'an*) requirements. These products include the PLS arrangements known as *mudaraba* and *musharaka*, the mark-up based *murabaha* agreement, the lease-based *ijarah* contract, and Islamic bonds known as *sukuk* (Rammal and Zurbruegg, 2007). Appendix 1 provides a glossary of the Arabic words and their English meaning used in this paper.

With the exception of Iran and Sudan, the IFS sector operates alongside the conventional financing system. Islamic financial products are offered by full-fledged Islamic financial institutions, Islamic subsidiaries of conventional banks, stand-alone branches of conventional banks, and Islamic windows (Islamic products offered through a dedicated window operation in a conventional bank). As the IFS sector is still in its infancy, it lacks an established regulatory structure and systems. The role of the central banks has therefore been crucial in promoting the sector within their national territory, and providing support to the two main standard setting bodies: Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and Islamic Financial Services Board (IFSB). The AAOIFI and IFSB are located in Bahrain and Malaysia respectively, and their establishment was supported by governments of Muslim countries through their central banks with the aim of providing standards that would harmonize the activities of the IFS sector (Rammal and Parker, 2013).

We use the institutional theory lens to understand this involved role of the State and the central bank in attempting to regulate the sector, and analyze the potential for developing the sector in Italy. Scott (2001) explains institutions as social structures that are composed of regulative, normative, and cultural-cognitive elements that provide stability and meaning to social life. The regulative elements refer to rules, laws, governance and power systems; normative elements refer to values, expectations and authority systems; and cultural-cognitive elements include structural isomorphism, and objects that possess symbolic value (Scott, 2001). We emphasize the regulative element of institutional theory, and the role it plays in establishing normative social obligations and expectations in regards to the IFS sector. The use of the institutional theory perspective for this study is justified as the IFS sector's development relies heavily on the regulative changes made to the banking and finance sector in various countries to facilitate the operations of Islamic financial institutions. For the sector to be developed in Italy, similar regulatory measures would need to be taken.

Our choice of Italy as a case study in Europe is based on a number of historical and demographic reasons. The geographic position of Italy in the center of the Mediterranean Sea has historically facilitated relationships between Italy and the Arab world. These relationships date back to the 9th century when regions of the Italian peninsular belonged to the Muslim world, and Sicily was the crossroad of a prosperous economic and cultural kingdom whose boundaries ranged from the current Turkey to Morocco. Historical accounts reveal that the coin of Sicily (the golden *tarì*) was used across the Mediterranean Sea as means of payment and storage of value and that some specific Islamic financing contracts were used for trade. After this period, the instruments of Islamic finance were not used in Italy, even if Islamic financing shared its main values with Catholic economic thought (at least until the 13th century) (Brugnoni, 2008). However, Italy has continued to maintain privileged political and economic relationships with the Arab world. On the political side, Italy has tried to stimulate the Euro-Arab dialogue, playing an important diplomatic role in the Israeli-Palestinian conflict and taking the initiative in shaping a new European Mediterranean policy. On the economic side, Italy has had strong trade relationships with countries in the Middle East and North Africa (MENA) region, which represent a significant portion of Italian balance of payments (Tami, 2013). In 2012, the trade relationships of Italy with Arab countries recorded a strong growth (approximately 23%), with values increasing from 57.4 to 70.44 billion Euros. Italian institutions have also increased efforts to enhance trade and investment between Italy and the countries in the Arab world (Porzio, 2009). One such organization is Banca UBAE, which was established in 1972, and provides trade and non-trade finance services to business and financial institutions operating in MENA (Banca UBAE, 2014).

Italy also boasts a rapidly growing Muslim population. It is estimated that the number of Muslims in Italy will double from 1.6 million in 2010 to roughly around 3.2 million by the year 2030 (Pew Research Center, 2011). With these strong relationships and a growing Muslim population, Italy has the opportunity to become a new frontier for Islamic banking and could attract significant amounts of investment from the Middle East if a vibrant IFS sector was established. We discuss these opportunities further in the Section called "Potential for IFS for Italy".

3 – IFS Sector in EU

Europe is the major destination for global migration, hosting 32.6% of the world's immigrants, with Asia and North America hosting 28.7% and 23.4% of immigrants respectively (United Nations, 2010). This intense migration pattern has been an important factor in the growth of the Muslim population in Europe, which has increased from 29.6 million in 1990 to 44.1 million in 2010, and is expected to exceed 58 million by 2030 (Pew Research Center, 2011). Before analyzing the Italian case, we deepen our understanding of the potential for the IFS sector in the region by looking at the example of the UK, France, and Germany, three EU countries where some efforts have been made to introduce Islamic financial products.

We commence the comparison by first analyzing the IFS sector in the UK, which is attempting to establish itself as the gateway for Islamic finance in Europe (UK Trade & Investment, 2013). Although some *Shariah*-compliant financial transactions have been conducted in the UK since 1980, most of the growth of the IFS sector has occurred since the beginning of the 2000s (Ercanbrack, 2013). This growth is a result of the initiatives taken by the UK government, which recognizes the value of the IFS sector in attracting international investments, generating local jobs, and increasing tax revenues. The UK government established an Islamic financial center in the City of London with the purpose of attracting and managing the enormous liquidity surpluses of the Gulf Cooperation Council countries caused by the sharp rise in oil prices since 2003, and guaranteeing equal access in the financial marketplace to the Muslim community. In 2004, the Financial Services Authority (FSA) licensed the Islamic Bank of Britain, the country's first wholly *Shariah*-compliant retail bank, and now the UK hosts five Islamic financial institutions, and seventeen conventional banks have established Islamic windows (The CityUK, 2011). According to figures published by the United Kingdom Islamic Finance Secretariat, these initiatives have resulted in the increase of Islamic finance assets in the UK from US$509 billion in 2006 to US$1,290 billion dollars in 2011 (Tami, 2013).

The UK government's approach to the sector has been to emphasize assimilating Islamic finance principles into the regulatory system rather than creating a dual regulatory system that exists in countries like Malaysia. Consistent with the neutral approach, the *Financial Services and Markets Act* of 2000 states that all financial institutions authorized by the FSA to operate in the UK must satisfy the same standard, regardless of their country of origin, their industry, and their religious principles (Ainley *et al.*, 2007). This neutral approach is oriented to guarantee the equal dignity of citizens and to refrain from taking legislative positions on particular religious and cultural norms (Amin, 2007). Since 2003, all legislative acts relating to finance and regulatory provisions use the phrase "alternative financial instruments" when referring to general Islamic finance. In order to increase demand for Islamic financial products, in 2003 the *Finance Act* eliminated the capital gains tax and stamp duty (land tax) for *sukuk* issuances and *Shariah*-compliant home mortgages respectively. Eventually, as the UK statutory law requires capital certainty for all bank deposits, in case of loss, the bank is required to provide funds from its own reserves. Although Islamic financial institutions have to comply with these regulations, customers using IFS are given the right to choose whether they want to accept or to refuse full repayment (Amin, 2010).

The second country we analyze is France, which has the largest Muslim community in Europe (approximately 5 million), and has historic relationships with countries in the MENA region (Cekici and Weill, 2011; Pew Research Center, 2011). In recent years, the French regulatory authorities have taken a number of steps to promote IFS to encourage the integration of Muslims in France, and to access new liquidity pockets, such as the Arab sovereign funds (European Central Bank, 2013). For example, a number of changes were made to facilitate *sukuk* offerings in the country. In 2008, the listing of *sukuk* on the French regulated market was authorized, and compensation paid by *sukuk* issuers is, for tax purposes, treated just like interest on a traditional bond and is deductible from taxable income. Additionally, the compensation paid to non-resident *sukuk* investors is exempt from withholding tax in France, regardless of whether an offering is governed by French law or the laws of another country. And finally, the French government removed double stamp duty, and the payment of a capital gains tax on property, which facilitates the transfer of ownership of assets under the Islamic financing system. Despite these tax provisions, no specialized Islamic financial institutions operate in France (Cekici, 2013). Some industry experts believe that as the majority of the French Muslims have migrated from Northern Africa, where Islamic financing is a more recent phenomenon, their basic banking needs can be satisfied by conventional banks. Others believe that the growth of Islamic finance in the country would undermine the French constitutional principle of *laicitè*: the separation of the State and the church.

The final country we analyze is Germany, where about 4.1 million people or 5% of the total population is Muslim (Pew Research Center, 2011). The German federal state of Saxony-Anhalt was the first non-Muslim state to tap into the *sukuk* market in 2004, when it issued a

5-year *sukuk* to raise 100 million Euros (Farhoush and Mahlknecht, 2013). Since 2005, Deutsche Bank has been issuing *sukuk* in cooperation with Saudi Arabian banks. At the end of 2009, Kuveyt Turk, a Turkish participation bank, received a license from the Federal Financial Supervisory Authority (BaFin) to open a branch in Mannheim (Farhoush and Mahlknecht, 2013). Despite these initial steps, little progress has been made recently in the German marketplace. There are a few explanations for the limited growth of the IFS sector in Germany. First, although there are no explicit regulations that restrict the use or introduction of *Shariah*-compliant products, the German legal and financial system is not yet geared towards the development of Islamic finance within the national borders. This means that issues such as transfer of assets from seller to financial institution and ultimately to buyer may be taxed twice. While France and the UK have made some regulatory changes to accommodate these unique features of Islamic finance, Germany is yet to initiate any such moves. Second, unlike the UK, not many wealthy families from the Gulf have settled in Germany and the Turks, the biggest immigrant community, have historically conducted their banking with conventional savings banks. Finally, the third-generation German Muslims have different consumer preferences, and their attitude towards Islam and its moral and ethical precepts is distinct from that of their parents. Therefore, they have not actively sought the establishment of the IFS sector in the country (Farhoush and Mahlknecht, 2013).

Our comparison of these three countries shows that the development of the IFS sector requires both elements that we refer to as push and pull. The push element is a result of State led initiatives and is supported through regulatory changes to facilitate the growth of the sector. With regard to the UK, the State has realized the potential of the sector in facilitating inward investment from oil-rich Gulf countries and has responded at the regulatory level as well as the establishment of related institutions. In addition, the migrant Muslim population is primarily from the South Asian region, where the base of the commercial Islamic financing was laid (Rammal and Parker, 2013). Hence, the pull element is strong and the financial institutions have responded accordingly by offering Islamic financial products. On the other hand France, which hosts the largest Muslim population in Europe, has experienced some level of push element with the French government making regulatory changes to attract buyers for the *sukuk* offerings. However, domestic demand is low due to the demographics of the Muslim population, and therefore financial institutions are yet to establish operations that would facilitate Islamic consumer banking. Germany's experience has some similarity with that of France. However, while both countries have focused primarily on *sukuk*, Germany has not made any regulatory changes to incorporate the unique features of the Islamic financial system.

Using the experiences of these three countries, we analyze the obstacles and the opportunities for the development of the IFS sector in Italy.

4 – Potential for IFS in Italy

In Italy there are no IFS providers. We highlight some of the issues that have prevented Italy from having a direct and practical experience with Islamic financial institutions. For ease of discussion, we group these features in two categories: demand conditions and supply conditions.

We start from the demand side as the market, that is people's initiatives or demand, selects the financial institutions and the products and services needed for firms and families (Donato and Freni, 2010). With regard to Islamic banking in Italy, demand inertia dominates. The Muslim population in the country tends to have low literacy and income levels. Hence, Muslim consumers do not constitute a critical mass that would generate active interest in creating and launching *ad hoc* Islamic financial products by institutions that, with little foresight, have implemented no-long term strategy in order to remove many regulatory and supervisory obstacles. However, this could change as the Muslim population increases.

From the supplier perspective, there are many options available for financial institutions to service the Italian market. The model most appropriate for serving the Italian market would depend on the level of *Shariah* compliance required for the Italian market, and whether Italian regulators would permit both domestic and EU-based banking institutions to operate in the Islamic banking sector. In terms of compliance, we argue that the level of *Shariah* compliance mechanism is more extensive in institutions that only deal in Islamic financial products (known as pure or full-fledged Islamic banks) than the so-called Islamic windows that are established by conventional banks. Using the experience of Malaysia, Pakistan, Indonesia and other countries, we find that the number of *Shariah* board members, and the interaction between senior bank management and *Shariah* scholars is more extensive in full-fledged Islamic banks. Another factor that would influence the potential operating mode of Islamic banks in Italy is the banks' country of origin. Since Italy is a member state of the EU, financial institutions from across the region can take advantage of the European single market in banking services, and open their branches in Italy without seeking any extra operating permits (Trakic, 2012). However, the Italian central bank and other regulatory agencies would determine what level of control they want over the banking institutions operating in the Islamic finance sector. If a high-level of control is required then there is a possibility that only Italian banks (including foreign banks' subsidiaries that are registered and incorporated in Italy) would also be permitted to offer such products in the country. Using these two factors, Figure 1 illustrates the various operating models for Islamic banking in Italy.

[Insert Figure 1]

The establishment of a pure Islamic financial institution in Italy is a possibility. In September 2007, the Italian Banking Association and the Union of Arab Banks signed a *Memorandum of Understanding*, and the first Italian Islamic bank was to be established by the end of 2008 (Hamaui and Mauri, 2008). However, the financial crisis may have influenced the completion of the agreement, and the establishment of the bank remains only a declaration of intent.

Regardless of the option chosen, on the supply side the development of an effective regulatory and supervisory framework represents a major obstacle to the spread of IFS in Italy. The Consolidated Law on Banking of 1993 (art. 10, paragraphs 1 and 2) defines banking as the collection of savings from public and the provision of credit, and states that only the authorized banks can exercise banking. It is evident that the activities carried out by Islamic banks do not fall within this definition as Islamic banks can neither offer a fixed rate of return on deposits nor charge interest on loans. However, paragraph 3 of the same law does allow banks to carry out other financial activities (for example, investment services) in addition to banking, and Islamic banks could competitively perform them. The authorization issued by the Italian central bank, Bank of Italy, enables banks to undertake a wide range of financial activities that may include a certain percentage of banking in a strict conventional sense (Abbadessa, 2010). According to the supervisory authority, a bank is a universal financial intermediary that chooses freely its entrepreneurial spirit and, hence, Islamic banks are theoretically compatible with the Italian laws even if they may not exercise banking in the strictest sense of the word. To favor the development of Islamic banks, one could argue for the broadening of the concept of banking (as already done for electronic money institutions) or allowing an account holder to be free to accept or refuse the return offered by the bank even in the case of loss.

The PLS based Islamic financial products are also seen to be incompatible with Italian banking law's deposit guarantee principle (Castaldi, 2003; Napolitano, 2006). Because IFS providers cannot guarantee that investors' capital will not be affected by losses, full-fledged Islamic financial institutions are unable to gain membership of the Inter-bank Guaranteed Fund (Fondo di Garanzia Interbancario), which is one of the main requirements to obtaining the license to operate as a banking institution in Italy.

A third barrier that the instruction of Islamic banking system faces in Italy is the issue of paying additional tax and registration fees every time the assets change ownership. Since Islamic banking is an asset-backed system, banks do not lend money to clients to purchase an asset. Instead, the bank purchases the asset on behalf of the client and then re-sells it to the client using the various Islamic financing instruments. Therefore, in Italy, as in many other countries of the Western world, this ownership change would result in the price of the asset being appreciated as the cost of registration and transfer of ownership is paid twice.

The last obstacle to the spread of Islamic banking in Italy relates to staff training. The examples of UK and Malaysia highlight the importance of strong educational infrastructure in providing appropriate human resources to support the IFS sector. In the UK, higher educational institutions provide Islamic finance courses and degrees, while in Malaysia, the central bank of the country, Bank Negara, is a partner for the development of the International Centre for Education in Islamic Finance (INCEIF), a specialized Islamic finance training institution (INCEIF, 2013). In Italy, there is still no tacit and codified knowledge of Islam and shared practices, and developing training programs could also be useful in offering IFS to consumers who could be interested in accessing these products.

After describing the main obstacles to the development of the IFS sector in Italy, we discuss the steps the Italian government should take to remove them in accordance with the regulatory, normative, and cultural-cognitive elements of institutional theory.

Regulative Elements: In order to facilitate the establishment and growth of the IFS sector, the Italian government needs to take a number of regulative steps. This includes acknowledging the unique operating features of Islamic financing, where depositors can suffer losses under the PLS system, and changing the bank registration procedure to allow Islamic banks to be registered in Italy. The other regulative change required relates to payment of stamp duties on transfer of assets in order to make Islamic financial products less expensive and more appealing. Italy could follow the lead of other countries like the UK and France and exempt the IFS sector from double stamp duty. And finally, the Italian banking and finance authorities will need to develop appropriate governance structures to ensure that the operations of the Islamic financial institutions in Italy are *Shariah*-compliant.

Normative Elements: In order to develop appropriate governance structures in the IFS sector in Italy, the government and higher education sector need to provide appropriate training programs to address the human resource requirements. The example of UK, Malaysia, Pakistan and numerous other countries demonstrates the importance of appropriate educational infrastructure development to support the sector, and Italy would need to establish similar training institutions to support the regimes and authority systems, and to meet the objectives of the standards and governance structures established for the IFS sector. In Italy, such a move would require a joint effort by the central bank and the higher educational institutions. The central bank would help identify the areas of expertise required in the sector (such as *Shariah* advisors and auditors), and the educational institutions would provide the required training programs. This will ensure that Italy does not face a shortage of qualified professionals that may hinder the operations of banking institutions in the Islamic finance sector.

<u>Cultural-Cognitive Elements:</u> The final element relates to the structural isomorphism that would need to take place in the Italian financial sector to support the IFS sector. The financial and regulatory organizations need to make efforts to develop awareness about IFS within the finance industry and the consumers. This would require promoting the sector within the country, and promoting Italy as a potential Islamic finance hub in the EU. The Italian government would also need to encourage structural isomorphism to ensure that the operations of the sector demonstrate uniformity in application and interpretation of *Shariah* principles in the development of Islamic financial products. To achieve this, the Italian regulatory agencies will need to establish rules and procedures relating to operations of Islamic financial institutions in the country. As discussed earlier, AAOIFI and IFSB are two bodies that provide standards for governance and general operations of Islamic financial institutions. However, the lack of uniformity in operations globally has prompted national governments to establish and regulate minimum operating standards relating to number of *Shariah* advisors, *Shariah* audits, reporting, and capital adequacy requirements. A similar approach towards regulations would be required in Italy to ensure that industry standards are maintained, and that banks do not undermine the basic *Shariah* and social requirements that guide the sector and provide it legitimacy with consumers.

By following these steps, the Italian economy, as does much of Western Europe, could win the challenge of the development of the IFS sector within its territory, which in turn could provide much-needed financial boost to the country’s banking and finance sector. The two areas that we focus on are attracting international capital, and facilitating the financial inclusion of the Italian Muslim population.

Italy needs to attract international capital in order to boost the country's economy, and to reduce the mass of public debt. Islamic finance could be a strategic tool for attracting Islamic international capital in Italy. Many Muslim countries in the Middle East have huge funds ready to be invested in the Western world both by individual operators and by investment funds; and Italy has the opportunity to act as a bridge and build on its historical links with these countries. With some legislative measures, the Italian government could diversify its debt instruments with the issuance of *sukuk*, whose market is highly liquid (in the order of US$200 billion), but dominated by the Gulf countries and characterized by a small number of issuers and the absence of EU countries (Tami, 2013). Using these funds, the Italian government could pursue two objectives: financing of public works, and public securitization of real estate assets.

The second area of interest relates to the local Muslim population. One of the most powerful tools for migrant integration into the community is financial inclusion. Italy has the highest percentage of *unbanked* people in Europe. In 2012, the percentage of the population in Italy who were more than fifteen years old and did not hold a bank account equated to 29%. This is much higher than the European mean of 14%, and only Poland, Bulgaria, and Romania are ranked below Italy (Ufficio Studi Cgia, 2013). Italy also occupies the last position in the EU with regard to difficulties in obtaining access to credit, and only 5% of the population aged fifteen years or older have been able to obtain a loan during the year ending 2012, as compared to the European average of 12% (Il Sole 24 Ore, 2013). Focusing on the migrant population in Italy, the financial exclusion has been exacerbated due to religious beliefs of Muslims, which prohibits them from banking with interest-bearing financial institutions, and due to the historical lack of interest by financial institutions in establishing relationships with foreign nationals and foreign-born citizens residing in Italy. Even though Muslims constitute about 32.9% of the migrant population in Italy, there isn't any data source available that provides information about their financial exclusion. However, we use previous studies on Muslim population in Europe to argue the financial exclusion aspect. Corrado (2013) found that being a Muslim reduces the joint probability of using bank services by 15% in selected Western economies (France, Germany, Italy, Sweden, and the UK). In addition, Beck and Brown (2011) state that in countries or regions where Muslims are an ethnic minority they may face discrimination by banks or their employees. And finally, Napolitano (2006) conducted a study of 252 migrants resident in the Italian province of Biella (100 out of 252 migrants were Muslims), and found that more than one third would refuse a loan with interests.

5 – Conclusion

Through the institutional theory perspective we identify the importance of State led initiatives in the development of the IFS sector. The case of Italy in the study highlights the regulative, normative, and cultural-cognitive elements that would need to be addressed in order to develop and promote the sector.

Our study suggests that a developed IFS sector in Italy would not only help the Italian government attract much needed investment from countries in the Middle East, but would also help with the financial inclusion of the growing Italian Muslim population.

This study is based on analysis of the Italian and EU banking and finance regulations, and the domestic and international market conditions. Future studies could build on our case findings and conduct surveys of financial institutions and consumers to understand the demand for, and potential of the IFS sector in Italy and other EU countries.

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Appendix 1: Glossary of Arabic words used in the paper

Arabic Word	Definition
Ijarah	A lease based Islamic financing agreement
Mudaraba	A profit and loss sharing Islamic financing agreement
Murabaha	A mark-up based Islamic financing agreement
Musharaka	A profit and loss sharing partnership based Islamic financing agreement
Qur'an	The holy book of followers of Islam
Riba	Interest charged on the lending and borrowing of money
Shariah	Islamic law based on the teachings of the *Qur'an*
Sukuk	Islamic investment certificates; sometimes also referred to as Islamic bonds

Figure 1: Potential operating models for Islamic banking in Italy