Islamic banking in Germany

In the fifth year of its establishment, the German Islamic banking sector is still in its early stages. Only one fully-fledged bank is in operation to date. Sole market groundbreaker KT Bank was granted a German banking license by the regulator for the deposit and credit business in 2015. By contrast, the German market share of the global Islamic sector is one of the most promising due to its current Muslim population of at least 4.7 million. FERDI ILKHAN writes.

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Before KT Bank entered the market as the first bank with an Islamic business model, some conventional banks had established Islamic windows within their portfolio. In 2018, the most recent market entry diversifying the sector came in the form of an Islamic fintech partnering a German tech company that holds a banking license.

The first introduction of Islamic banking to the German market goes as far back as 15 years. In 2004, KT Bank's mother company Kuveyt Türk Participation Bank, which has been leading the Islamic banking market in Turkey for three decades, opened a German representation office to launch a long-standing information campaign on Islamic banking. In 2010, KT Bank officially entered the German market, then holding the license for non-European Economic Area deposit broking.

The full banking license application was handed in two years later. The licensing process duration has to be evaluated in correlation with the innovation factor of the project. The Islamic banking business model was to be sustainably developed in a foreign environment. This included start-up issues such as cost and risk-related topics due to the positioning of the bank in a completely new market, namely within the traditional finance sector in Germany.

A major challenge in that context was the incorporation of Islamic banking principles into German legislation. The German authorities welcomed the Islamic model yet requested compliance with all regulatory, legal and fiscal requirements applicable to conventional banks. The greatest obstacle was in the area of taxation, specifically concerning the avoidance of double taxation to accommodate Islamic banking products like real estate financing.

Dealing with the given tax infrastructure in the Islamic way resulted in real estate financing products being set up in line with the model of German civil law association. The future growth of the Islamic banking sector would be substantially facilitated if the legal, fiscal and regulatory framework of Germany's banking industry allows exemptions and foundation work for an Islamic Banking Act in Germany.

Comparing the relatively young German Islamic banking sector with a more established situation in a western market like the UK, it becomes evident how far the sector has come in Germany in a relatively short period of time. In the UK, the Islamic banking sector has a much longer history. It currently features six licensed banks with an Islamic business model, over 20 international banks offering Islamic financial products, as well as 67 presently listed Sukuk and three Islamic exchange-traded funds at the London Stock Exchange.

The UK's Islamic finance sector started to establish crucial fundamentals such as the basic understanding of Islamic banking among society or the definition and demand of necessary tax and regulatory frameworks a decade earlier than in Germany. The foundation of research and publishing houses such as the Institute of Islamic Banking and Insurance in 1994 promoted and advanced education, training, research and publications on Islamic finance principles. Establishing a scientific base like this drove awareness of Islamic finance tools across the UK and determined regulatory necessities to address policymakers.

Ten years later, in 2004, the first retail bank with a Shariah compliant business model, the Islamic Bank of Britain, debuted in the UK. These developments are contrary to those in Germany, where the research and scientific development process went hand in hand with the operational implementation by the private sector. A key performance driver for the faster development of the German Islamic finance sector could thus be an equally faster, stronger and more targeted distribution of the scientific groundwork.

At the sovereign or government level, a more intense showcasing of the already existing Shariah compliant financing opportunities in Germany would be needed in foreign relations. This could result in pulling in significant foreign direct investment from predominantly Muslim countries. The Emirates Air Line cable car across the River Thames in London illustrates a UK project example in that area. Moreover, at the federal, municipal or even corporate level, the German Islamic banking industry could be greatly supported by the provision of more investment opportunities or

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financing instruments, similar to the 2004 Saxony-Anhalt Sukuk issuance of over EUR100 million (US$111.34 million).

A further way to push the sector would be the entry of more players to utilize the existing millionfold client potential. KT Bank's public awareness campaigns highlighting the universally ethical qualities of Islamic banking's Quran-based values resulted in attracting not only Muslim target groups, but value-conscious clients of all religions. The Shariah compliant finance model has by now been established in the public eye as a new field of socially responsible investment (SRI), which is generally in high demand since the financial crisis.

KT Bank with its 98 employees and four branches, with a fifth in the works, is a medium-sized venture with no shortage of client influx. The demand for Islamic finance products is real. And yet, the level of client consultation needed for the individual Islamic banking products according to the respective needs is time-consuming. Over time and with increased digitization, Islamic banking products in Germany will become more established, standardized and renowned. This will guarantee faster processing and will contribute to more efficient contract closure with customers.

Another measure that could prove effective in stimulating the economic growth of the sector on a greater scale is to boost Takaful. To date, the Islamic insurance business model is underrepresented in Germany. Yet the country's growing Muslim population provides a perfect client base for Shariah compliant insurance. Muslims are accumulating substantial wealth. Their average savings rates are higher than those of the rest of the population in Germany. These developments are accompanied by a rising risk awareness resulting in a wider tendency to insure property and casualty risks.

On a microeconomic scale, performance drivers to push Islamic banking tools and profitability range from expanding the product variations and digital infrastructure, to customer outreach, participation in b2b communities, information campaign scores, sales calls and many more.