Navigating Islamic-Compliant Finance

Helping Newcomers Build Wealth Safely and Avoid Exploitation

Many newcomers who practice Islam adhere to Islamic-compliant finance principles,[1] which emphasize ethical practices and prohibit certain transactions common in the U.S. banking system. As a result, finding financial products that align with these principles and ensuring safe wealth building can be challenging. Although some U.S. banks and community development financial institutions (CDFIs) offer products designed to be compliant, not all institutions fully adhere to these principles. In some cases, clients may be exploited under the guise of compliance. Service providers play a key role in addressing these challenges by understanding Islamic-compliant finance and supporting clients as they make financial decisions. This guide aims to help service providers identify legitimate Islamic-compliant products and evaluate the safety and credibility of financial institutions.

Islamic-Compliant Finance and Banking

Islamic-compliant finance refers to financial services and practices that adhere to religious law derived from the Quran and guided by Islamic principles and ethical rules.

These principles emphasize **fairness**, **equity**, and **social responsibility** in financial transactions, grounded in the belief that money is merely a medium of exchange and does not hold inherent value.

[1] "Islamic-compliant finance" can also be referred to as Islamic banking, Islamic finance, or Sharia-compliant finance, which are financial activities and products that follow Sharia, Islamic law. It is important to remember that no person or entity in Islam has the sole authority to definitively interpret Sharia, and not all Muslim clients wish to receive Islamic-compliant financial services. For more, see Ilias, S. (2010, November 30). *Islamic finance: Overview and policy concerns.* Congressional Research Service. https://crsreports.congress.gov/product/pdf/RS/RS22931/6.

> "Islamic finance is equity-based, asset-backed, ethical, sustainable, environmentally and socially responsible finance."
>
> —World Bank

Guiding Principles of Islamic Finance

- **Prohibition of Interest:** Charging or paying *riba* (interest) is strictly prohibited. This is based on the belief that interest leads to exploitation and unfair financial gain, as it benefits one party without risk while burdening the other with additional costs.
- **Proscription of speculation:** *Gharar* (speculative) activities and *maisir* (gambling), which rely on chance instead of productive effort or tangible economic assets, are forbidden. Financial gains must come from legitimate business activities.
- **Equity:** Islamic finance focuses on fairly sharing profits and losses based on business performance. This ensures that no one party bears all the risks or enjoys all the rewards. The sharing of profits and losses is agreed upon in advance and is based on the actual success or failure of the business.
- **Risk Sharing:** Risk sharing ensures that the financial risks are distributed among the parties involved, rather than one party taking all the risk. In the case of a partnership, both the financier and the borrower share the risks and rewards based on the performance of the business or investment. This helps protect both parties from extreme financial losses, as they are equally invested in the outcome.
- **Ethical Investing:** Islamic finance prohibits investments in industries that are considered harmful, such as gambling, alcohol, and tobacco, and instead prioritizes supporting projects that align with ethical values and contribute positively to society.

Understanding Financial Approaches

Islamic-Compliant Transactions

Islamic-compliant finance operates in significantly different ways from conventional banking in the U.S. The following financial instruments or services represent some of the options available for individuals and businesses to engage in financial transactions that align with religious principles.

Murabaha **(myur-ab-a-ha):** an Islamic financing method where the buyer and seller agree upfront on the cost and markup of an item. In a typical Murabaha agreement, the financial institution (bank) purchases the item on the buyer's behalf and sells it at a higher price, allowing the buyer to pay in installments. The markup replaces riba (interest), and the buyer becomes the legal owner of the item only after all installments are fully paid.

Mudarabah **(moo-dah-rah-bah):** a profit-sharing partnership where one party (such as a lender or investor) provides the capital and the other contributes expertise, skills, or labor. The profits are shared based on a ratio agreed upon at the start of the partnership. However, any financial losses are assumed solely by the party providing the capital, while the other party loses only their time and effort. This arrangement allows for collaboration while minimizing risk for the party providing the expertise or labor.

Musharakah **(moo-sha-rah-kah):** "an equity-partnership agreement with one or more partners to jointly finance an investment project." The ratio of how profits and losses are shared is agreed upon beforehand. This arrangement avoids interest, allowing the financier to earn a return based on the actual performance and success of the business. Both parties share the risks and rewards, ensuring that everyone has a vested interest in the success of the venture.

Ijara **(ee-jah-rah):** an Arabic word that means lease, rent, or hire. In Islamic banking, "Ijara resembles a lease-to-own arrangement that includes both repayment of principal and a rental fee for exclusive use of the asset." This method avoids interest by ensuring that the financial transaction is based on the use and benefit derived from the asset rather than on interest-based earnings.

Sukuk **(soo-kook):** financial certificates comparable to bonds. Unlike traditional bonds that pay interest, sukuk provides returns to investors with returns generated from ownership in tangible assets or projects.

Navigating Islamic-Compliant Finance

Service providers play a critical role in helping newcomers navigate a new financial system, empowering them to make informed and safe financial decisions that respect and honor their values.

Consider these best practices when working with clients interested in Islamic banking principles:

- **Equip** yourself with a thorough understanding of Islamic-compliant practices
- **Ensure** clients are educated on key differences between financial systems
- **Assist** clients in comparing Islamic-compliant and conventional U.S. banking products
- **Demonstrate** cultural humility in all interactions
- **Encourage** informed decision making

Evaluating Financial Products and Identifying a Trusted Islamic-Compliant Lender

Newcomers should identify dependable lenders who not only offer compliant products but also uphold standards of transparency, ethical conduct, and accountability. Some financial institutions will seek a *fatwa* (legal opinion and accreditation), issued by a supervisory board, to certify that their financial products align with Islamic principles. If a financial institution does not have a certification, individuals can visit their local mosque to consult with a scholar knowledgeable in Islamic-compliant finance, who can advise them and help review specific products.

When helping clients determine if a financial institution or lender is trustworthy, ensure that the lender:

- **Provides a verifiable physical address** and clear contact information
- **Has positive reviews or references** from other customers
- **Clearly explains their financial services** in a simple, easy to understand format with no unclear language
- **Allows time for clients to ask questions** and make sure they fully understand the product before agreeing to it

When supporting clients in evaluating a financial product, be sure that the product:

- **Clearly defines terms,** including fees and repayment conditions
- **Outlines all conditions upfront,** ensuring both parties agree to the terms before commitment
- **Features a reasonable and fair fee structure,** free of hidden charges or excessive costs
- **Operates and is implemented ethically,** in full alignment with Islamic principles

Accessing Safe Fee-Based Loans

Fee-based loans provide an alternative to paying interest by charging a flat service fee, making them a compliant option for various financial needs under Islamic finance principles. These loans can often be found through Islamic banks, credit unions, and some nonprofit community development financial institutions (CDFIs) that specialize in compliant products.

Islamic-Compliant Banks

You may be able to assist clients in establishing accounts with reputable banks that offer Islamic-compliant products and trustworthy options for banking and borrowing. Below are examples of formally recognized, pre-vetted banks that specialize in Islamic-compliant finance services here in the U.S.:

University Islamic Financial (UIF): specializes in offering alternative financing options for mortgages, home refinancing, and other financial products; they also offer profit-sharing deposit and saving accounts that have been issued a fatwa.

Devon Bank: offers Islamic financing designed to avoid conventional interest

Alternative Islamic-Compliant Institutions

Non-bank institutions such as community development financial institutions (CDFIs) and nonprofit lenders can offer safe fee-based loan options. Below are examples of alternative financial institutions that offer Islamic-complaint financial services:

CEDS Finance: provides Islamic-compliant loans for small business owners, offering an ethical, nonprofit, mission-driven lending solution. As a community development enterprise, they ensure transparent and Islamic-aligned financing for business growth.

The Center for Economic Opportunity (CEO): offers fee-based alternatives for financial products, including credit building ladder loans, auto purchase loans, education and training loans, and business loans.

II Community Development Corporation (IICDC): a 501(c)(3) CDFI committed to supporting immigrants and refugees to establish their businesses according to their religious beliefs, offering riba-free loans.

Guidance Residential: a home financing company that provides Islamic-compliant options

LARIBA American Finance House: offers Islamic-compliant home financing solutions

Traditional Banking

Clients may feel most comfortable relying on an Islamic-compliant bank, especially if they plan on purchasing a large asset like a car or home in the near future. However, some clients may find it more convenient to use a traditional bank while still adhering to Islamic-compliant financial principles by making intentional choices about how they engage with these traditional bank services. For example, an individual may opt to place money solely in checking accounts that do not accrue interest. Additionally, clients may opt to place money in a saving account and gift any accrued interest to charitable causes or rely on a combination of these two accounts.

Avoiding Scams

Unfortunately, bad actors frequently exploit Islamic-compliant finance principles by targeting members of a particular group and leveraging shared identity markers to create a deceptive sense of trust. Other lenders promote advance-fee, Islamic-compliant loans for homes, automobiles, or paycheck advances but fail to provide the loan capital after collecting the fees.

Recognizing Red Flags and Common Scams

It is important to learn how to identify and flag potential scams to help protect clients from losing personal information, money, and property. Some common red flags include the following scammer behaviors:

- **High-pressure tactics:** creating a sense of urgency to force or trick victims into making hasty decisions
- **Requests for personal information:** asking for sensitive information such as Social Security numbers, bank account details, or credit card information; asking victims to state their name and address to record these details for identity theft purposes
- **Guaranteed returns:** promising fixed returns or guaranteed profits, which contradicts Islamic finance principles
- **Upfront fees or payments:** requesting advance payments or fees for nonexistent services, products, or job opportunities
- **Lack of transparency:** being vague or unclear about terms and conditions, especially regarding fees or services
- **Unprofessional communication:** using poorly written emails or text messages to communicate with potential victims
- **"Too good to be true" offers:** promising high returns on investments, lucrative job opportunities, inexpensive housing, or valuable goods at a fraction of their real value; notably, these offers are often paired with a request for upfront fees or payment

In addition to these red flags, it is also important to understand the **different types of scams that may target newcomer clients**. Some of the most common scams include the following:

- **Affinity Scams:** Scammers target specific groups, often religious or ethnic communities. The scammer may be, or pretend to be, a member of the group in order to gain trust.
- **Imposter Scams:** Scammers pretend to be someone else, such as a government official, tech support agent, or loved one in trouble. They often use scare tactics to trick people into sending money or personal information.
- **Job Scams:** Fake job postings or job offers that require upfront fees, personal information, or payment for training materials, and which promise high-paying work-from-home opportunities or easy money for little work.
- **Immigration Services Scams:** Fraudulent immigration consultants or lawyers who promise to help with immigration paperwork or legal status but often charge exorbitant fees or provide false information.
- **Auto Repair or Purchase Scams:** Dishonest mechanics or car dealerships that overcharge customers for unnecessary repairs or sell cars with hidden problems.

- **Phone Scams**: Unsolicited phone calls where scammers try to cheat people out of their money or personal information using tactics such as posing as government agencies, offering fake prizes, selling fraudulent products, or pretending to be from a charity.
- **Credit, Debt, or Loan Scams**: Fake lenders or debt relief companies that charge high fees or fail to provide promised services.

Reporting Scams

With a thorough understanding of the red flags and common scams targeting newcomers, you can empower clients to make informed decisions and reduce the risk of financial harm. However, despite preventative measures, scams may still occur. It is important to know how to make a report to the Consumer Financial Protection Bureau (CFPB) and the Federal Trade Commission (FTC). Since scams vary, it may also be helpful to assist clients in contacting local, state, and federal agencies. Reporting scams provides valuable information to government agencies dedicated to protecting consumers and preventing fraudulent activities from impacting others.

Making Online Reports to the Consumer Financial Protection Bureau (CFPB)

The Consumer Financial Protection Bureau (CFPB) is a U.S. government agency dedicated to **making sure individuals are treated fairly by banks, lenders, and other financial institutions**. CFPB enforces federal consumer financial laws and holds banks, companies, and individuals accountable for the products they offer. If your client is a victim of deceptive or fraudulent financial practices, guide them to submit a complaint on the CFPB website. Once a complaint is submitted, CFPB will route it to the appropriate company or government agency for review and work to get a timely response. No personal information will be shared with the bank, lender, or financial institution. By filling a complaint, clients not only address the scam they experienced but also contribute to uncovering patterns of misconduct that may impact others.

Making Online Reports to the Federal Trade Commission (FTC)

The Federal Trade Commission (FTC) is a U.S. government agency that works to protect and empower consumers by promoting fair business practices and preventing deceptive marketing tactics. The FTC strives to educate consumers and service providers on how to keep personal information secure and make safe, informed financial decisions in the digital marketplace.

One of the FTC's key functions is to **investigate reports of potential scams and fraud and pursue enforcement actions against wrongdoers**. The FTC becomes aware of possible misconduct through their online reporting tool. This tool collects information on the type of scam or fraud that occurred, how the scam was presented to the consumer, the bad actors involved, and any other relevant details. The FTC then uses this information to initiate investigations and act against those who engage in dishonest behavior.

The FTC also leverages the vast pool of reports to detect patterns of unlawful practices and develop educational resources for consumers. These resources provide up-to-date guidance on the latest strategies employed by scammers, as well as tips for safeguarding against such activities. Visit the FTC's Scam Alerts page for materials you can incorporate into financial literacy programming.

Conclusion

Understanding Islamic-compliant finance is essential for effectively assisting newcomer clients who wish to follow Islamic banking principles. By clarifying differences between financial systems, guiding clients toward trustworthy financial institutions and products, and empowering them to safeguard against scams and exploitation, you can deliver meaningful, practical support that aligns with their unique financial needs.

Resources

Blog: Three Ways to Support Newcomers' Personal Financial Health (2023)

Blog: Sharia-Compliant Finance: How Newcomers Can Safeguard Wealth and Avoid Exploitation (2024)

Blog: Personal Finance: Resources to Guide Newcomers on Measuring their Financial Well-Being and Managing Money in the United States (2022)

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