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# Foreign Experience in the Introduction of Islamic Banking Products in Uzbekistan

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**Abstract:** The banking system plays an important role in the development of the economy of Uzbekistan. The expansion of digital business and the introduction of new technologies create additional opportunities for the promotion of financial products and services, including traditional commercial banking. Today, the Islamic financial network is one of the rapidly developing and innovative financing mechanisms in the world. In 2021, the total assets value of global Islamic finance markets amounted to about 3,95 trillion USD. The projected total asset value for the global Islamic finance markets will amount to 5,9 trillion USD by 2026 and are growing by 10-20 percent per year. The development of this network is especially relevant for countries where the majority of the population is Muslim[1].

**Key words:** bank, business, Islamic financial, financial products, Islamic banks, commercial banks, profitability.

**Introduction.** Digital technologies are having an increasing impact on banking activities. Their widespread implementation contributes to improving the operational efficiency of banks and expanding opportunities to attract new customers.

The informatization of internal processes and the use of digital service channels make it possible to optimize infrastructure and maintenance costs. Converting most operations to an online format reduces the cost of maintaining offices and staff.

At the same time, digital marketing provides banks with additional tools to attract new customers. The use of online advertising, mobile and Internet applications, and social networks can significantly expand the reach of the audience. Personalized offers and convenient digital channels help attract new holders of payment cards and accounts.

Improving operational efficiency and expanding the customer base creates prerequisites for the growth of financial indicators of banks. An increase in the number of operations and the volume of funds serviced leads to an increase in revenues and profits.[2]

Thus, digitalization is an important source of increasing the competitiveness of the banking sector as a whole. The active introduction of advanced technologies and digital marketing tools opens up new opportunities for increasing the efficiency and profitability of commercial activities.

**Literature review.** The history of Islamic finance in the United States began with the grassroots efforts of American Finance House-LARIBA, which in 1987 began offering Sharia compliant home financing products. LARIBA is a finance lender in Pasadena, California that began using investment capital from individual American Muslims to provide home financing to other American Muslims. As early, as 1993 a major international bank worked with both a US mortgage bank and a key Islamic bank to structure an Islamic home finance program. In 1997, the United Bank of Kuwait (UBK), operating in the United States as a Federal branch under the National Bank Act, applied to the Office of the Comptroller of the Currency (OCC) for guidance on a Sharia-compliant ijara (lease-to-purchase) home financing product it sought to offer to US customers. This program was named Al-Manzil, Abdulkader Steven Thomas, who made the request on UBK's behalf, said of its importance: "The pioneering regulatory interpretations obtained by the United Bank of Kuwait have begun to open both the door to scalable funding for Islamic finance in America, the development of securitization, including participation by the government sponsored entities". In 1999, the OCC issued guidance to UBK that approved murabaha (cost-plus-profit) home financing products. Al-Manzil began offering its home financing products in California[3].

Thomas explained that the program took a longer time than most to become established because there was a lot of "customer training" required to educate customers about the features of the Islamic product, since it was newly developed and unfamiliar to consumers. However, after this initial period UBK expanded the Al-Manzil program to eleven states, and financed small ticket commercial properties as well as single-family homes. However, in 1999 UBK merged with Ahli United Bank and, because the US operation was the bank's smallest, Ahli made a strategic decision to leave the US market in 2000. At that point Al-Manzil had provided financing for sixty homes. The Al-Manzil program was also in place in the United Kingdom and its operation continues to today under the successor bank. Since UBK left the market, no bank offering Islamic products has operated under the National Bank Charter or the supervision of the OCC. For this reason the Office has issued no further guidance on Islamic products. However the state regulators that supervise the state-chartered bank providers – Devon Bank and University Islamic Financial Corporation – have followed the guidance of the OCC's interpretive letters on ijara and murabaha products in granting approval for these financing facilities, since state-chartered banks must comply with national regulations in addition to any further regulations mandated under state law[3].

**Analysis.** Currently there are three types of Sharia-compliant financing facilities offered by U.S. providers: ijara, murabaha, and musharaka. One company also offers a deposit product on a mudaraba model. The specifics of the contracts establishing the products differ among providers, and the provider's legal engineering to make the contract compliant both with Sharia and with the US real estate laws are closely kept proprietary secrets. Likewise, many of the providers have developed their own English terminology to refer to their products. For ease of definition, particularly in relating these products to Islamic finance forms found outside of the United States, this paper will refer to the products principally using their Arabic names. However, the terminology used by each provider will be noted in chapter four's discussion of each company.

The ijarah (lease-to-purchase) contract, alternately called a lease-to-purchase or net-lease, was the first Sharia-compliant financing form offered in the United States. An ijara contract is structured so that the mortgagee purchases the home on behalf of the mortgagor and, in most cases, holds the title in trust over the term of financing. The mortgagor's monthly payment to the provider is divided into two sections: a payment on principal and a "rent" payment, which affords the mortgagor, exclusive rights to live in the property. The rent portion of the payment can be indexed to a market interest rate (as it is in the case of bank providers) or to the local rental market (as finance company LARIBA does)[4].

The murabahah (cost-plus-sale) contract is structured such that the provider purchases a home on behalf of the customer under an agreement that the customer will buy the home back from the provider at a price that includes a pre-arranged profit premium over the original cost of the home. The customer then pays this marked-up price on an installment basis over the term of the financing.

The musharakah (partnership) financing form is not approved for use by banks, but is used by the two financial services company providers – Guidance Residential and LARIBA. Guidance uses the contract for home finance, while LARIBA uses it only for business finance. In a business venture, a musharakah financing facility is similar to the concept of joint venture, in which both investor and business operator contribute capital and own a proportionate share of the business. Each of the parties is entitled to a portion of the profits according to its share of ownership. Also in LARIBA's musharakah business financing facility, the customer has the option to buy out the company's ownership share over time.

In November 2022, the 20 top companies in the United States were evaluated by the Islamic sustainable agency for ESG rating and Sharia regulations.

**Table 1.** ESG rating of top 20 companies in USA by the Islamic sustainable agency[5]

| Name | Nation | Business Activity | E | S | G | Overall ESG Rating | Shariah Compliance |
|---|---|---|---|---|---|---|---|
| Apple Inc | United States | Consumer Electronics | 96.5 | 76 | 69.5 | AA | PASS |
| Microsoft Corp | United States | Software | 94 | 65.5 | 87 | AA | PASS |
| Alphabet Inc | United States | IT Services / Consulting | 88 | 56.5 | 82 | A | PASS |
| Amazon.com, Inc. | United States | Retail – Department Stores | 49.5 | 58.5 | 49 | BB | FAIL |
| Tesla Inc | United States | Auto / Truck Manufacturers | 71.5 | 46 | 88 | BBB | PASS |
| UnitedHealth Group Inc | United States | Managed Health Care | 74 | 61.5 | 70 | BBB | FAIL |
| Exxon Mobil Corp | United States | Oil / Gas Refining / Marketing | 71.5 | 91.5 | 92 | AA | PASS |
| Johnson & Johnson | United States | Pharmaceuticals – Diversified | 100 | 83.5 | 72.5 | AA | PASS |
| Visa Inc | United States | IT Services / Consulting | 88 | 73 | 72 | A | FAIL |
| Walmart Inc | United States | Food Distribution / Convenience Stores | 55.5 | 52 | 81 | BBB | FAIL |
| JPMorgan Chase & Co | United States | Banks | 88 | 62 | 77 | A | FAIL |
| NVIDIA Corporation | United States | Semiconductors | 95 | 91 | 64 | AA | PASS |
| Chevron Corporation | United States | Oil / Gas Exploration / Production | 75 | 71 | 88 | A | PASS |
| Eli Lilly and Co | United States | Pharmaceuticals – Diversified | 84 | 79 | 83.5 | AA | PASS |
| Procter & Gamble Co | United States | Personal Products | 66 | 61 | 83.5 | A | PASS |
| Mastercard Inc | United States | IT Services / Consulting | 88 | 79 | 79.5 | AA | FAIL |
| Bank of America Corp | United States | Banks | 94 | 61.5 | 63.5 | A | FAIL |
| Meta Platforms Inc | United States | IT Services / Consulting | 93 | 55.5 | 77 | A | PASS |
| AbbVie Inc | United States | Pharmaceuticals – Diversified | 93 | 73 | 68.5 | A | PASS |
| Pfizer Inc. | United States | Pharmaceuticals – Diversified | 94.5 | 77 | 74.5 | AA | PASS |

ESG stands for Environmental, Social, and Governance: three crucial criteria considered by socially conscious investors to screen investments that are most likely to outperform in the future, while being consistent with their own values. Environmental criteria refers to a company's focus and direction towards the environment, including Net Zero policies (greenhouse), for example. Social criteria examine how the workplace deals with ethics, diversity, inclusion with employees, suppliers, customers, and the communities where it operates. Governance is about a company's leadership, Board of Directors, executive pay, audits, internal controls, and shareholder rights. 13 out of 20 companies were positively evaluated from the point of Sharia, which means 65 percent[5].

In theory, the mudarabah (profit- and loss- sharing) contract form could be used as a financing facility. This model bears some semblance to a venture capitalistic model. In this case the financier provides capital to a business entrepreneur for a product that the financier believes will be profitable. If there are profits, then the financier and the entrepreneur divide them based upon a prearranged agreement. However if there are losses, they are borne solely by the financier as the entrepreneur has lost all of the efforts of his labor. This type of Islamic venture capital arrangement is not offered by any of the providers surveyed. Banking regulation in the US works largely on a market-driven model. This means that it is generally not within the purview of regulators to promote certain types of financial products, but rather they respond to applications and inquiries from banking concerns wishing to offer new products. Regulators at the Office of the Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC), the Federal Reserve, and state regulatory bodies have developed decisions on Islamic banking products on a case-by-case basis as banks or companies seeking to offer Islamic products have approached them.

In the United States Sharia-compliant three types of financial organizations offer home financing products: banks, financial services companies, and non-profit community development organizations. An organization's structure determines what types of financial products it will be able to offer. It is significant to note, however, that the legal process for gaining approval for a product is the same no matter the legal classification of the lending organization or the specific structure of the product. Because there is no legislation or regulation specific to Islamic finance, the providers of Sharia compliant products submit applications to regulators showing that their product is the "functional equivalent" of an already permissible product. Currently two banks offer Islamic financing products: Devon Bank of Chicago, Illinois and University Bank (and subsidiary University Islamic Financial Corporation) of Ann Arbor, Michigan. Both banks are licensed to offer their Islamic financing products in several states besides their home states.

Over the past ten years, the Islamic finance industry has steadily expanded and developed. While its growth is modest compared to the explosion of the industry abroad, the nascent industry in the United States is beginning to develop the infrastructure that will allow it to expand in more scalable manner moving to the future. This includes developing further avenues for securitization and experimentation with deposit products that could bring the industry greater liquidity and eventually make possible a fully Islamic bank. The industry has also begun to seek alternatives to conventional types of insurance, although sometimes from necessity utilizes conventional insurance where no alternative exists. As the industry has grown, there has been regular contact between providers and regulators. Usually there are just a handful of people at each regulatory agency familiar enough with Islamic finance to work with providers, but the agencies are training more staff and preparing for the industry to grow moving into the future. Historically new products are motivated by market demand at the grassroots – in some cases, Muslims walking into community bank branches and asking for financing that does not violate their religious beliefs. Regulators have worked with providers in order to approve products that are the functional equivalents of secured lending or deposit products already offered. Government-backed investors Freddie Mac and Fannie Mae have become the primary investors in Islamic mortgage products and between them securitize almost all of the Islamic mortgages issued in the United States. As the industry in the United States has slowly grown and developed over the past decade, it has begun to build infrastructure and develop methods to solve conflicts between Sharia and regulatory demands. Islamic investment funds have purchased interests in securities issued by Freddie Mac and backed by Islamic mortgages. A bank has developed and is offering a deposit product. Even during a recession, Islamic mortgages have maintained strong performance. These slow but steady improvements are a firm foundation upon which the US Islamic finance industry will likely build. In the near term, it is difficult to gage how quickly further development will happen, since many actors are holding their current positions while the financial market and regulatory environment stabilizes. It is clear that in order to grow at a faster pace, Islamic finance institutions will need to attract more "capital," either from US Muslim investors and depositors or from Islamic finance concerns abroad. However, strong performance through this recession and increasing infrastructure for the sector might highlight Islamic finance as a strong, if small, section of the US mortgage market.

**In conclusion**, As mentioned above, we can observe that the banks of Islamic countries have certain aspects. That is, in order to give loans based on Islamic principles, commercial banks will have to attract resources based on Islamic principles. In particular, if commercial banks attract interest deposits and give loans to customers based on Islamic principles, bank customers may not benefit from this loan. Because deposit attraction does not meet the Islamic principle. In this regard, we need to do certain things in our country, first of all, to increase financial literacy in our society regarding Islamic finance.

When studying the experience of the USA and Kazakhstan in the field of Islamic financing, the following found practical confirmation[6]:

a) according to experience of the USA, early Islamic financing was in the form of mortgage loans;

b) in American experience, banks were gradually transferred to the Islamic banking system, depending on the demand;

c) based on the experience of Kazakhstan, a “Road Map” was initially developed for the establishment of an Islamic financing system;

d) in the experience of Kazakhstan, Islamic financing was tried not in banks, but in non-banking organizations;

e) dualistic-Islamic system was chosen according to the financial system of America and Kazakhstan;

f) “Islamic banking services window” is a separate structural unit that offers banking services based on Islamic principles within a traditional commercial bank, unlike an Islamic bank that does not provide traditional banking services. But today there is no "Islamic banking services window" in the experience of USA and Kazakhstan. Because it is a structure used in countries, where there is no legal basis. That is, the creation of a legal framework is required for the Islamic financing system to function fully and properly.

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