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Investigating Islamic banking in Italy

Business-based and cultural-based analyses as complementary approaches

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Abstract

Purpose – The purpose of this paper is to contribute to the existing body of work in the area of Islamic banking by investigating the regulatory accommodation process of Islamic banking in Italy.

Design/methodology/approach – The method used is essentially based upon an analysis of laws, regulations and jurisprudence/legal doctrine.

Findings – In Italy, where Muslim represent, from a religious point of view, the second largest immigrant community, no Shari'a-compliant institution has been authorised yet, but no legal obstacle is laid down.

Research limitations/implications – The paper examines the accommodation process of Shari'a-compliant banking within the Italian system of banking and business law. Therefore, the paper is mainly based on the Italian jurisprudence/legal doctrine. Moreover, no comprehensive analysis of Islamic banking principles is provided.

Practical implications – The paper, investigating the accommodation process of Islamic banking in the Italian banking system, shows any legal and regulatory obstacles refraining Muslims living in Italy from living according to Islam and complying with the general regulation of undertakings.

Originality/value – Examination of the topic is originally undertaken because the investigation of Islamic banking in the Italian legal framework matches the business-based approach with the cultural-based approach as complementary analyses.

Keywords Italy, Islamic banking, Accommodation process, Banking and financial regulation

Paper type Conceptual paper

1. Context and objectives

"Islamic banking" indicates *Shari'a*-compliant business: as in conventional banking, Islamic banking operates an intermediary and risk-transformation function, but additionally, it performs as an interest-free, real-asset-based and equity-based activity which refrains from taking on risks that could be equated to gambling.

In recent years, Islamic banking has been spreading throughout Europe: the latest case is the Kuveyt Turk Finance Group in Germany. However, in Italy, no *Shari'a*-compliant financial intermediary has been authorised as yet.

One might reasonably suppose that this depends on the small number of Muslims on the territory. In fact, while there is a continuous flow of immigrants from the southern countries of Mediterranean area, they are used to step by Italy just to reach northern European countries, like France, Germany or Finland. However, the 2014 Caritas Statistic Dossier on immigration shows that there are currently more than one million Muslims in Italy, and, from a religious point of view, they represent the second largest immigrant community. Therefore, there seems to be a potential demand for Islamic

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financial and banking activities. Alternatively, one might suggest that there are huge legal obstacles preventing *Shari'a*-compliant banking intermediaries from entering the Italian market. This sounds like a sensible argument.

This paper is far from being an overview either of Islamic banking principles or of *Shari'a*-compliant products and intermediaries (Hassan and Lewis, 2007). Rather, it endeavours to ascertain how Islamic banking may operate within the Italian legal system (Biancone and Radwan, 2014)[1].

To undertake this investigation, two different perspectives can be embraced: a business- or a cultural-based approach. Generally speaking, both are processes conducive to the interpretation and the application of rules and regulations.

On the one hand, the business-based approach investigates banks from a functional standpoint, namely, paying attention to the activities they perform. A legal interpreter examines the activity performed and the operations it comprises to subsume the entity under one or the other legal category (banks, investment firms, collective investment funds, asset management companies and so on) and apply the associated statute. It is essentially based upon the idea, firmly established in the Court of Justice case law, of an entity being an "undertaking" when it performs an economic activity regardless of the legal status and the way it is financed. Therefore, the Court and the EU Commission have applied a functional approach when they come to the application of competition rules on the ground that "substance prevails on the form" (Louri, 2002).

On the other side, the cultural-approach looks at *Shari'a* rules and *Shari'a*-compliant financial operations as cultural phenomena, where the adjective "cultural" implies that Islamic finance should be conceived as a set of ways of thinking and behaving which every Muslim endorses step by steps thanks to a socio-educational process (Abbagnano, 1971). The cultural approach highlights any values and objectives pursued by the entity (banks, investment firms, asset management companies or collective investment funds) to ascertain whether they comply with *Shari'a rules*. The reference is made to the business goals chosen by the bank directors, the position of the bank and the Muslim customer in the contracting relationship in the provision of banking services as well as the initiatives undertaken by the bank on the markets, just to give some examples.

Till present, the legal doctrine in Italy has analysed Islamic banking and the accommodation process of Islamic banking in the Italian jurisdiction solely according to a business-based approach. In particular, the Italian doctrine has mostly examined the supervisory and liquidity regulatory challenges that might be raised by *Shari'a*-compliant banks in Italy (Montanaro, 2010; Porzio, 2010; Gomel, 2010). Alternatively, Italian scholars and practitioners have focused on the governance of *Shari'a*-compliant financial products and financial institutions based in Italy (Starita, 2009; Alvaro, 2014). Finally, Abbadessa argued for fostering the institution of Islamic-based investment funds through the constitution of investment management companies (Abbadessa, 2010).

Conversely, this article analyses the banking business from the perspective of its main legal aspects and draws a comparison with the Islamic banking model. In particular, the paper argues that the business- and the cultural-based analyses should be considered as complementary normative approaches. In fact, when a Muslim living and working in Italy prefers a financial intermediary claiming to be *Shari'a*-compliant rather than a conventional one, he is trying not only to save or invest his money profitably but also to fulfill his idea of money, property and community relationships. Therefore, in an

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effort to incorporate Islamic finance within the Italian framework, this paper shows how both approaches are to be applied and addresses the legal issues to deal with on the premise that Islam shapes the financial system and, generally speaking, the whole economic system: in this sense, a Muslim believer living in Italy should have the opportunity to live according to Islam (cultural approach), while complying with the general regulation of undertakings (business approach). Indeed, as Bilal wrote, "Islam, according to believers, is a social system imparted by Allah (God) to mankind. Allah is the creator and ultimate owner of the universe, and thus man and its institutions (financial and otherwise) have a vice-regent role to play" (Bilal, 1999). At the core of Islam, *Shari'a* is the "way to the source of life" and, thus, covers every aspect of human life. It is rooted in the Sacred texts, the *Qur'an* and the *Sunna*, but only through the interpretation of *Shari'a* scholars (*fiqh*), God's message, as embodied in the Prophet Muhammad, has been made *manifest* and translated (and is still being translated) into rules to be complied with (Cattelan, 2010). In summary, it is *only* by appropriately performing these rules (cultural approach) that the commercial undertakings by Muslims (business approach) could find full accommodation in the Italian legal system: the business- and cultural-based approach complement one another.

In the light of this, this article is divided into two parts.

Part 1 focuses on the business-based approach through three paragraphs. While Section 2 draws a comparison between the concept of banking business and banking activities between conventional banking in Italy and Islamic banking, Section 3 looks into any legal and regulatory obstacles raised by the authorisation process and, finally, Section 4 pays close attention to institutional issues, namely, the transparency duties of Italian banks and the participation of a deposit guarantee scheme.

Later on, Part 2 deals with the cultural-based approach (Section 5). Here, the most controversial point will be to ascertain whether Islamic finance may be legally enforceable in the Italian legal framework as a "cultural" phenomenon both in the enterprise-State and in the customer-service provider relationships.

To conclude (Section 6), the paper will remark how no formal obstacle is raised by Italian law to the accommodation of Islamic banking in the domestic framework. Indeed, as Italian banking business adheres to a teleological approach (that is to say, the community-based approach establishing the meaning of European norms in the light of their fundamental purposes[2] Fennelly, 1996): this may allow to overcome some formal differences between Islamic and conventional financial business and to address the domestic legal institutions more consistently with the peculiarities of Islamic finance.

As far as the main legal sources of this study are concerned, these are the Italian Banking Law (IBL)[3], the Italian Financial Law (hereafter, IFL)[4] and the Italian Civil Code[5]; no remarkable case law on Islamic banking in Italy is available at the moment. Consistently with its core subject, the study is mainly based on the Italian legal doctrine in compliance with the Court of Justice case law. Indeed, from a business-based approach, the European banking directives on the authorisation process have applied a minimum harmonisation approach, and this has left a certain degree of discretion to national lawmakers in the process of legislative transposition. Moreover, in terms of cultural-based approach, the enforceability of non-State based rules (at least in the meaning of "law of country" on which Rome I Regulation is based) still remains a domestic legal issue in the European Union, on which domestic legal doctrines can play an active role in the accommodation process (Romano, 1962; Libertini, 2011; Velluzzi, 2010). Both approaches perform a systemic interpretation of

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European and Italian banking rules and regulations, paying attention to the economic substance of businesses as well as to the historic roots of the Italian legal framework, firmly based in the Roman legal tradition.

2. Part 1 – the business-based approach

2.1 The banking business

The banking business is founded upon a two-tier model (Porzio, 2007): it consists of taking deposits and other repayable funds from the public to extend credit, and this definition has been laid down in IBL. Moreover, complying with the European banking directives, the Italian framework establishes the banking business as a regulated activity: the pursuit of banking business may only be carried out by financial institutions with the proper authorisation, namely, banks. With regard to the authorisation process, there is no distinction between corporate and retail banks.

However, thanks to the choice of the 1993 IBL in favour of a general process of de-specialisation, banks may be allowed to carry out not only banking business but also any other financial activities that have not been reserved to financial intermediaries others than banks by law. Some of these economic activities are included in the list of so-called "passported activities"[6].

The statutory list of passported activities has basically been transposed by the Second Banking Directive and updated from time to time. They may be provided throughout the European Union according to the principles of mutual recognition of the banking licence and home country control. According to the principle of mutual recognition any bank authorised in a Member State is entitled to:

- operate throughout the European Union establishing a branch or providing services from abroad (this is not true for the establishment of subsidiaries); and
- comply with the regulation of its "Home State" (the Member State which released the banking license) under the supervision of the Home supervision authority: this is the Home country control principle.

When banking activities are not covered by the European passport, an institution authorised as a bank by the Bank of Italy may provide them within the Italian Republic, but any trans-border activities of this nature must be specifically authorised by the control authority of the host country[7].

Additionally, the banks may operate investment services too, once provided with a licence distinct from banking one, under the supervision of the Bank of Italy and Commissione Nazionale per la Società e la Borsa (CONSOB). Looking at *Shari'a*-compliant investment deposits through the lenses of the functional approach, some authors have argued that it would be advisable that the *Shari'a*-compliant banking institutions operating in Italy to be licensed as investment companies or funds[8] or, once they had been authorised as banks, they should concentrate their business on the financial market providing services including the negotiation of financial instruments and portfolio management on an individual basis[9], provided the similarities between such activities and restricted and unrestricted profit-and-loss sharing (PLS) operations (Abbadessa, 2010)[10].

Given that the financial disintermediation process has made the above-mentioned definition barely workable, IBL added that the core banking business covers the "raising of sight funds and any form of fund-raising related to the issue or administration of generally spendable means of payment" (article 11 IBL) (Porzio, 2003; Motti, 2003;

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Parrella, 2010). It means that the "banking business" definition is centred around the performance of the monetary function. This is worthy of mention because a *Shari'a*-compliant bank provides savings and demand deposits too. They are made for safekeeping under guarantee and establish a creditor-debtor relationship.

Shari'a-compliant demand deposits are comparable to conventional demand deposits because both of them are repayable on demand at par value (Piccinelli, 2010; Errico and Farahbaksh, 1998; IADI, 2006). Indeed, when the demand or savings deposits are provided in a two-window system[11], there are two windows on the bank liability side, one for demand deposits/savings and the other for investment deposits. The funds placed as demand deposits (the choice is left to the depositors) still belong to their holders and, for this reason, they are not considered as investable funds, and they benefit from a mandatory 100 per cent reserve requirement. However, when the demand and savings deposits are included in a full integrated asset-liability side (i.e. a two-tier *mudaraba* system), the depositors transfer the bank title onto the placed funds and, as a consequence, the bank is empowered to invest such funds at its discretion in PLS-operations with no mandatory reserve requirements. Apart from being investable funds or not, and apart from being covered by mandatory reserve requirements or not, *Shari'a*-compliant and conventional demand deposits make their holders riskless creditors at least while the banks are solvent and both of them essentially perform a monetary function (Errico and Farahbaksh, 1998).

However, there are important differences between the Italian and Islamic banking business approach with reference to at least three aspects:

(1) the PLS model;
(2) mark-up based operations; and
(3) the *riba* prohibition.

So, the question is: can this gap be convincingly narrowed?

2.2 Profit-and-loss sharing operations

The Islamic banking paradigm is based upon a partnership relationship according to a PLS model. It mainly takes two forms: *mudaraba*- and *musharaka*-based operations.

2.2.1 Mudaraba-*based operations.* While in IBL, the definition of deposit and reimbursable funds, and the legal concept of credit extension[12] establish the banking business into a creditor-debtor relationship, the *mudaraba* approach provides for a capital provider ("silent partner") and an entrepreneur ("active partner") contributing either their own capital or their time and work to the venture. Therefore, both of them are entitled to a pro-rata basis return. Conversely, all losses fall solely on the capital provider, while in the case of returns lower than expected or no returns at all, the entrepreneur has already lost his time and efforts.

In reality, there seems to be no room for investment deposits – whether restricted or unrestricted *mudaraba* – in the Italian banking business model.

On the liability side, the conventional depositor or, generally speaking, the conventional financier is a *riskless* creditor: indeed, the funds placed in the bank are repayable either on demand or at the expired date. Instead, in the *mudaraba*-based approach, the depositor acts as silent partner who gives a bank title to a sum of money to be invested but takes on the risk of financial losses. Therefore, he/she will gain a pro rata-return if, and only if, there are real returns on the total investments made (Piccinelli, 2010).

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Turning to the asset side, the conventional borrower is a debtor and, most of the time, he/she has to reimburse the capital according to a predetermined interest rate either in instalments or on the spot, whatever the actual returns may be. Indeed, generally speaking, the provision of funds covers any temporary accrual of assets in favour of a borrower against a duty of reimbursement, for example, a loan, a signature loan as well as the underwriting of bonds and other financial instruments. By contrast, in the PLS model, the *mudaraba*-based relationship makes the borrower an active partner who alone makes his own investment decisions, shares the total returns with the bank according to a profit sharing ratio and bears the financial losses *investing* his time and his work without a remuneration (Vogel, 2010).

Additionally, with regard to the bank's role in both banking business models, in the process of taking funds from the public, both conventional banks in Italy and *Shari'a*-compliant institutions take title to the placed funds and invest them at their discretion (unrestricted *mudaraba*). However, while the conventional banks are obliged to reimburse the capital "borrowed", paying also a fixed interest rate on the capital (wherever an interest rate was agreed upon) either on demand or on the expiry dates, *Shari'a*-compliant banks acting as entrepreneurs share the returns with the PLS deposit holders (if any profits are yielded) on a pro-rata basis.

In the provision of funds, both conventional banks in Italy and *Shari'a*-compliant banks use the funds collected from the public either as deposits (or other repayable funds), or as PLS deposits to extend credit. However, conventional banks accept projects for funding primarily on the basis of the creditworthiness or solvency of the borrower, while in the *Shari'a*-compliant model, the projects for funding are expected to be selected mainly on the basis of their probable profitability. It depends on the fact that conventional banks acting as lenders take on the liquidity as well as the credit risks. On the other hand, PLS assets are (or rather, should be)[13] uncollateralised equity financing, where the banks take on not only the credit and liquidity risks but also the investment risks with or without the possibility of pre-agreed arrangement for monitoring and managerial formula for capital provider.

Turning to the extension of credit, in the Italian legal framework, there is no statutory definition of what it covers. However, it is worth noting a difference between the extension of credit and lending activities. The former covers any transfer of funds against the transfer of the same or higher amount of funds and the funds may be paid back by either the borrower or by a third party; the bank does not take upon itself the risk associated with the use of the funds, but only the risk of the borrower's default. The latter covers any other lending activities, for example equity participation or the finance project, where the bank as provider of funds shares to a certain extent the risks associated with the use of the funds and with the activities to be performed. The risks associated with credit extension and any other lending activities are different and the Bank of Italy accordingly sets out different prudential supervision standards. This means that *mudaraba*-based asset-side activities may not be subsumed under the concept of extension of credit but might be compared to lending activities other than the extension of credit. This sounds much more interesting as the extension of credit in itself represents the second prong (aspect?) of the Italian banking business definition, and, as a consequence, a banking licence may be granted as far as the application envisages the provision of the banking business.

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In conclusion, if *mudaraba*-based activity cannot be subsumed under the paradigm of the Italian banking business, it does not mean that it is not comparable to one or more suitable banking activities other than banking business. The point is to build up a persuasive argument. Indeed, there are some Italian legal instruments resembling the participatory paradigm of Islamic banking, but a perfect match may be difficult to be found.

For example, some authors have argued that the Italian *contratto di associazione in partecipazione*[14] (the association-in-participation contract) resembles *mudaraba*-based investment deposits. According to the Italian civil code, the entrepreneur-associator confers on a third party-associate a stake in the future gains of the economic activity according to a predetermined ratio against a contribution. As regards the losses, the third party will take them on according to a predetermined ratio but no more than the value of his stake. The entrepreneur-associator manages the economic activity because he is the holder, and acts as the only one responsible in the enterprise-creditors relationship. Provided that banks in Italy can enter into this type of contract acting as the associator (Bank of Italy, 2003), would this really match the role of the active partner in the *mudaraba*-based operations? According to the PLS model, for example, the active partner should not bear the financial losses of the economic activity except in the case of mismanagement.

2.2.2 Musharaka-*based operations.* PLS-operations are also carried out through *musharaka* mechanisms (Mirakhor and Zaidi, 2007). Here, the Islamic bank invests the funds collected from the public through limited or unlimited *mudaraba* contracts to fund one or more *musharaka* projects. *Musharaka* has the appearance of a partnership in ventures where the bank and other partners contribute capital or work to the venture together with their client: all of them participate in the business management as well as in the profits and losses according to a predetermined ratio proportionate to their stakes[15] (Vogel and Hayes, 1998).

As for the assets side, equity participation gives very little certainty in terms of the reimbursement of capital; a *musharaka* operation is not the equivalent of an extension of credit in the Italian system but is one of the lending activities. Moreover, widespread recourse to *musharaka* may end up being extremely *expensive* for Islamic banks. In fact, IBL establishes a precise link between the amount of a bank holding in non-financial enterprises and the level of bank capitalisation. Therefore, Islamic banks in Italy might be required to increase their own funds to take out qualified holdings in non-financial enterprises. Provided a "qualifying holding" is defined as a direct or indirect holding in an undertaking which represents 10 per cent or more of the capital or of the voting rights, or that makes it possible to exercise a significant influence over the management of that undertaking, it is established that a "qualifying holding" in a non-financial enterprise is expected not to exceed 15 per cent of the bank's own funds and, additionally, the total amount of non-financial holdings of the same bank are excepted not to exceed 60 per cent of the bank's own funds (Benocci, 2010).

Dealing with the liability side, no room is left for *musharaka*-based activities in the area of taking-up activities, as the Italian banking business model is centred on the duty of reimbursement[16].

2.3 Non-profit-and-loss sharing operations

In general, the Islamic banking paradigm is centred around PLS models. However, it also caters for non-PLS operations establishing creditor – debtor relationships between a bank and its clients on the both the asset and liability sides.

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On the asset side, Islamic banks can also provide non-PLS funding. Indeed, the provision of funding on a mark-up basis establishes a creditor-debtor relationship between the bank and the "borrower".

One of the most common non-PLS financing modes is *murabaha*. In *murabaha*-based transactions, banks and customers enter into sale-based transactions. The bank finances the purchase of an asset by buying the item on behalf of the client and then resells it to the client adding a mark-up. It is a cost-plus profit contract: the mark-up is the service price[17]. Moreover, the bank provides funds entering into an *Ijara* financing: this resembles either an operating lease or a financing lease. In the *ijara*-operating lease, the bank-lessor transfers the usufruct of the item to the customer, while the lessee is entitled to use it on payment of specified rentals over a certain period; otherwise, in the *ijara*-financing lease, the bank-lessor buys the asset and leases it to the borrower-lessor. If the latter opts to buy it, the monthly payments will cover both the rentals for their use and the instalments towards the purchase price.

Some non-PLS transactions – the *ijara* especially – show some functional-based similarities in relation to passported activities, i.e. financial activities other than banking business subject to the principle of mutual recognition and listed under article 1, para. 2, letter *f*. The statutory list of passported activities includes:

- taking-up activities: deposit-taking and other forms of borrowing;
- lending activities such as consumer credit, mortgage lending factors, invoice discounting and trade finance, factoring, forfaiting, financial leasing, guarantees and commitments;
- the provision of payment services;
- the issue and administration of means of payment;
- money transmission services; and
- trading on one's own account or the account of the customers in money market instruments, foreign exchange, financial futures and options, exchange and interest rate instruments or securities.

The above-mentioned list does not include all the economic activities set out under art. 1, para. 2, let. f) IBL but only the ones which may be relevant to our investigation.

Generally speaking, this is a closed list and it is updatable in parallel with the Community-based rules and regulations (dir. 646/1989/EEC and the updatings). The passported activities are economic activities other than banking business which, in the opinion of the EU Commission, represent the core of banking activities and operations. However, they are neither exclusive to banks nor perform an intermediary credit function. A bank performing one or more passported activities enjoys the principle of mutual recognition and is subject to Home country control.

This means that any institution authorised as a bank in a Member State is allowed to perform one or more passported activities in another Member State when the following cumulative conditions are met:

- the Home banking licence covers the activity to be performed; and
- the activity to be performed was one of the passported activities according to the Annex of the Second Banking directive.

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It is worthy of mention that, in the process of transposition of the Second Banking directive, the Member States were free to decide which banking activities listed in the Annex a Home-based credit institution is allowed to perform. Therefore, it may happen that "credit institutions from other Member States may provide services in a Host Member State that credit institutions licensed by that Host Member State are not permitted to provide" (Gruson and Nikowitz, 1988).

Moreover, the community-based framework for banks does not regulate non-PLS activities in themselves: the legal framework for the contracting relationship most of the times refers to national civil laws.

2.4 The Riba *prohibition*

In addition to the creditor–debtor relationship, the comparison between the Italian and the Islamic banking models points to a *riba* prohibition, which refers to any illegitimate increase lacking in a proper counter-balance. Provided that money represents a "monetized claim of its owner to property rights" (Iqbal and Mirakhor, 1987) created by assets obtained through either the combination of creative labour and natural resources or an exchange, Islamic banking allows the rate of return in PLS-operations and a service charge in non-PLS operations. Both of them put the capital provider – the bank – at risk from the point of view of investment. As I have already said, in PLS-operations, the bank-capital provider is entitled to a share of the profits based on a predetermined ratio, and earns a profit if, and only if, there are any profits. Conversely, in non-PLS operations, the bank-capital provider is remunerated by means of a charge fixed on the resale price or the leasing price, but this charge is based upon the risks the bank takes on over a period. This explains how in *murabaha* operations, the bank must take title of the asset until the borrower-acquirer pays back the resale price, but it also explains how, in the case of default or delinquency by the borrower, nothing changes in the resale price, whereas in conventional lending, the interest will continue to compound until all principal and interest is paid[18] (Vogel, 2010).

However, I am not really convinced that the *riba* prohibition represents such a tough obstacle as to prevent *Shari'a*-compliant financial institutions from entering the Italian market. While on the asset side, one way of side-stepping the *riba* prohibition refers to non-PLS operations and so-called pass-ported activities, on the liability side, in demand deposits, the provision of an interest rate is a *natural* factor and does not raise a regulatory obstacle *per se*. Indeed, according to the European framework, no Italian law is entitled to prohibit the paying out of an interest rate on demand accounts[19], but the bank and the customer may agree to do so[20]. In addition, regarding the security-based collection of reimbursable funds from the public, it is worth noting that Italian banking regulations allow the banks to issue debt instruments where *an* and *quantum* reimbursement of the holder are based upon the results of the investments to be performed. Such a choice may turn out to be a viable path for Islamic banking in Italy. In the end, *riba* prohibition seems to make *Shari'a*-compliant banks less competitive in comparison with domestic or non-EU banks only (Rotondo, 2010).

3. The authorisation process

In the Italian regulatory framework, a bank is an undertaking authorised to carry out banking business (article 1, § 1, lett. b, IBL). This means that a legal entity is a bank as long as it has the proper authorisation.

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Generally speaking, authorisation is an administrative act issued by a supervisory authority to allow a natural or legal person to provide a number of economic services. According to IBL, the Bank of Italy is in charge of authorising banks and ascertaining a set of objective conditions (article 14 IBL).

The authorisation process as such does not make access to the Italian banking market difficult. Metaphorically speaking, one could imagine the Italian legal system as a building with three front doors and a back door.

3.1 The back door

The back door enables Islamic financial intermediaries to operate in the Italian legal system keeping either the control or a qualifying holding in Italy-based banks, where a holding is *qualifying* when it amounts to 10 per cent or more of the capital or voting rights[21].

It looks like a fairly straightforward solution because, although such an operation requires the authorisation of the Bank of Italy as the Home supervisory authority, the Bank of Italy is not entitled to refuse authorisation unless the holding of the qualified participation is likely to pose a risk for bank stability, i.e. to impede the operation of banking business and the proper exercise of prudential supervision (article 19 IBL). However, holding a qualified participation in an Italian bank would let the Islamic financial intermediaries influence or control the undertaking, but the banking business would be carried out within the framework of the original licence, namely a conventional model. In such a case, through the qualified holdings, financial institutions could allow their Italian bank to provide a series of products for Muslim clients as a new line of business, but it is hardly credible that the provision of one or more Islamic-like banking services makes a banking business *Shari'a*-compliant. Indeed, Islamic banking is one approach to economic activity and deals with the way of funding, allocating risks or having recourse to financial leverage[22].

3.2 The front doors

As for the front doors, an Islamic bank can enter the relevant Italian market as:

- a European credit institution;
- a non-EU Country bank; or
- a domestic bank.

3.2.1 Being authorised as a European credit institution. Situation (1) is based upon the existing legal framework at Community law level. An EU bank is a credit institution authorised by a competent authority in a Member State outside Italy according to the Consolidated Banking directive (dir. EU/2006/48). The banking licence amounts to a European banking passport enabling the credit institutions with their registered and head office in a Member State to operate the banking business and pass-ported activities for which the authorisation had been released throughout the European Community according to the Home Country regime and under the supervision of the Home State authority (Dalhuisen, 2002). No further authorisation may be required in the host countries.

Metaphorically speaking, this is the biggest door into the Italian jurisdiction. European banking directives are based on a minimum harmonisation approach and, as a consequence, every Islamic bank licensed as an EU credit institution may easily take advantage of regulatory competition among Member States. However, regulatory competition can raise doubts and legal uncertainties. In fact, the European law-maker refrained from regulating the object and the parties' duties of most of the pass-ported

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activities. Some of them have been harmonised in other directives and regulations (for example, the provision of payment services or the issuance of payment instruments), but a large number of them follow domestic laws.

Moreover, Islamic banks should deal with the sole Home regulator. Thanks to the mutual recognition principle of the licence and supervision regimes, the Home regulator is responsible for micro-prudential supervision upon access and, later on, in the pursuit, of the banking activity. In fact, it is the Home regulator who must assess whether a bank, already provided with the European passport, really does have structural organisation and the financial resources to be allowed to set up branches or provide services in Italy. This was the case for the European Islamic Investment Bank, the Bank of London and the Middle East and the European Financial House, all *Shari'a*-compliant banks authorised in the United Kingdom as EU credit institutions are allowed to provide trans-border services and set up establishments throughout the European Union.

3.2.2 Being authorised as a non-EU bank. Situation (2) deals with a non-EU bank, namely, a branch of a financial institution set up in a third country. It is authorised to operate as a bank by the Bank of Italy (Costi, 2012).

This looks like the narrowest door for entry into the Italian banking system. Indeed, the authorisation process is much more cost-expensive. Non-EU financial institutions need the non-opposing opinion of the Italian Ministry of Foreign Affairs and the authorisation of the Bank of Italy to create the first branch and any further branch, or provide services from abroad. Furthermore, the Bank of Italy not only ascertains whether the *Shari'a*-compliant institution meets three objective threshold requirements – capital adequacy, an approved business plan and good reputation, knowledge and experience of the directors of the branch – but also assesses the soundness of the parent institution and the proper functioning of the Home supervision banking system[23]. In this situation, the political and social conditions or, generally speaking, contextual factors can influence the outcome of the Islamic banking authorisation process. For example, it is questionable whether Sudan, Pakistan or Iran, or the Countries of the so-called Arab Spring can ensure a proper flow of information from the Home regulator to the Bank of Italy nor whether they can ensure an appropriately functioning system guaranteeing stability and anti-laundering controls.

3.2.3 Being authorised as a domestic bank. Situation (3) addresses the case of an Islamic bank authorised as an Italian bank. This is the middle door.

Thanks to the universal banking model, any Italy-based bank is entitled to provide retail or corporate services once the (same) banking authorisation is granted. No functional specialisation is made in the legislative framework.

A banking licence is issued when the following requirements have been met:

- registered office and "mind and management" in Italy;
- a specific legal status;
- paid up capital never below the amount required by the supervisory authorities;
- a good reputation, knowledge and experience of the directors and the persons who control the undertaking;
- suitability of persons holding directly or indirectly qualifying holdings;
- an approved business plan; and

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- non-existence of close links being obstacles to the supervisory activity (article 14 IBL).

Thanks to the choice of the 1993 ILB in favour of a general process of de-specialisation, banks may be allowed to carry out not only banking business but also other financial activities that have not been reserved to financial intermediaries others than banks by law. This means, among other things, that in the process of examining any banking licence applications, the Bank of Italy ascertains also whether the applicant intends to set up an organisation suited to providing banking services, even though it will *de facto* provide mainly, or even exclusively, other financial services[24] (Donato and Freni, 2010). Indeed, it is worthy of attention that the competent authorities are entitled to withdraw the authorisation when the institution does not make use if the authorisation within twelve months (article 17, 2006/48/EC directive): the authorisation covers not only the provision of the banking business but also the provision of one or more passported activities.

Looking at the authorisation requirements, neither of them seems to be an obstacle for the access of Islamic banking to the Italian banking system. Indeed, as pointed out (Errico and Farahbaksh, 1998), in Islamic banking "[…], as in conventional banking, an appropriate regulatory framework for an Islamic system should aim at reinforcing banks' operating environment, internal governance, and market discipline".

The Bank of Italy is entitled not to issue a banking licence if the applicant does not fit the "sound and prudent management" rule (article 14.2 IBL). It suggests that authorisation is not the sum of factors but implies a certain degree of discretionary power, i.e. a *technical* discretionary power. In fact, the Bank of Italy is empowered to ascertain qualitatively and quantitatively whether the structural features of the applicant, the services to be provided and the qualities of shareholders are likely to obstacle the sound and proper pursuit of the business. This is relevant to the authorisation process because, according to qualified economics studies, Islamic banking is highly likely to challenge the sound and prudent management rule at least because of its increased investment risk[25], while the Basel principles and prudential supervision rules for conventional banks are not suitable as such for the Islamic banking paradigm and its heterogeneous applications. However, the active role of the Bank of Italy in the authorisation process is conducive to achieving a workable solution based upon a case-by-case approach. Indeed, the process of setting up a bank requires prior authorisation from the Bank of Italy. This means that, among other things, the Bank of Italy can ask for some changes whenever there are reasons to believe that, for example, the organisation, proposed plan or the financial resources do not fit the sound and prudent management rule.

4. Institutional aspects

Whatever the type of authorisation is, when an entity, provided with the proper authorisation, operates the banking business or other financial services in Italy must comply with the business conduct rules in the service provider – customer contracting relationships (articles 115 – 120 IBL) about information disclosure, and the banking operator has to join a deposit-guarantee scheme.

4.1 Information disclosure

The information framework in the Italian legal system attempts to redress the information asymmetries between the service provider and the customer. Indeed, according to

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transparency rules, every banking institution operating its own business in the Italian jurisdiction – credit institutions based in Italy or providing cross-border services – must disclose to the general public the information on the interest rate as well as any contract conditions economically relevant, and where no information is disclosed or published either in the branch office or on the website, nothing is owed to the service provider. Additionally, any service contract is to comply with the information disclosed and any clauses not complying with the information disclosed are null and automatically substituted by the ones issued. Finally, no reference to trade customs is admitted and, whenever it is made, it is automatically replaced by the interest rate of the treasury bonds issued in the year before (Porzio, 2002). Therefore, the information legal framework is based on:

- the duty to provide general advice for potential customers in the banks' premise or website;
- the duty to provide preliminary information in the process of making a banking contract, handing over a copy of the contract conditions; and
- the duty to provide periodical information during the contracting relationship.

It is worth mentioning that the legal framework on information in the bank-customer relationship does not belong to the Community-based framework. This has been peculiar to IBL since the 1990s, and no banking directive ever laid down Community-based rules on information disclosure in the contracting relationship between the bank and the customer when the bank performs banking business or any banking activities other than banking business (the so-called passported activities).

Generally speaking, there is a general agreement among *Shari'a* scholars on the need for information disclosure not only between the banking institutions and the supervision authorities but also in bank/customer relationships. Indeed, in unrestricted *mudaraba* relationships, information disclosure helps to reduce information asymmetries and give proper incentives for keeping moral hazard under control (Errico and Farahbaksh, 1998). However, while the standardisation process of the economic conditions is far from placing juridical obstacles according to *Shari'a* rules, the information disclosure of non-economic contracting conditions may clash with the Islamic hermeneutical approach and *Shari'a* sources of law[26] where Islam lacks a hierarchical structure and "each scholar's opinion is equally valid" (Khan and Aly Crowne-Mohammed, 2009).

This is the reason why independent international organisations like the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) carrying on a process of standardisation and harmonisation of Islamic finance practices are performing a pivotal role on the international stage. The AAOIFI is, for example, a not-for-profit organisation, and its members (Islamic financial institutions as well as central banks) voluntarily comply with the accounting or corporate standards legitimately adopted according to the Articles of Association. What might be the role of organisations like AAOIFI in the Italian jurisdiction? And what effect can AAOIFI-like standards have in the Italian banking framework?

AAOIFI standards are based on the agreement of the organisation's members, and, therefore, they may be compared either to the Basel standards or to banking association agreements. However, while the former imply the formal filter of a legislative act (either community or domestic), the latter are more easily enforceable even though it is arguable that the Italian Antitrust Authority might take action against them as cartels.

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In both the situations, their implementation may be advantageous in the light of information disclosure for Italian operators.

4.2 The deposit insurance system

Italian banks, EU credit institutions or non-EU banks in Italy must join a deposit insurance system (Mecatti, 2010; Maccarone, 2010).

This is a private-based organisation committed to reimbursing depositors in the event of a bank's insolvency. Joining a certified deposit-guarantee scheme is deemed to be a condition for operating the banking business. Indeed, the Bank of Italy is entitled to revoke the banking licence where the bank either does not adhere to, or is excluded from, a deposit insurance system. On the question of whether a *Shari'a*-compliant bank established in Italy may join a deposit insurance system, it is worth mentioning that both conventional and Islamic finance agree that joining a deposit-guarantee scheme can maintain reliable financial stability provided that the supervisory authorities control the moral hazard[27] (Md Khairuddin Hj Arshad, 2011; IADI, 2010; BIS, 2009).

With regard to the eligible products, both Islamic and conventional financial systems agree on the protection of savings and current deposits. In fact, they are reimbursable on demand at par value both in the two-windows and in the two-tier *mudaraba* systems (Errico and Farahbaksh, 1998; IADI, 2006). But are the investment deposits, i.e. PLS deposits, eligible for deposit-guarantee schemes?[28] (IADI, 2010).

Having regard to Islamic background, there are three doctrines at issue. On one side, those scholars belonging to the classical *Shari'a* doctrine argue that PSIAs holders should not enjoy a guarantee because it would contradict the very nature of *mudaraba* contracts. On the opposing side, it is argued that PLS operations allow a deposit-guarantee scheme to operate as a third party as happens in Malaysia where the guarantor protects the current value of PSIA and not its principal in the case of Islamic financial institutions' insolvency. Finally, a distinction is drawn between restricted and unrestricted investment deposits [namely, profit sharing investment accounts (PSIA) deposits], contending that while in the former PSIA account holders entrust the Islamic service providers to invest their funds under certain conditions (how, where and for what purposes), in the latter, PSIA holders entrust the Islamic financial institutions to use their funds without imposing restrictions and, for this reason, are comparable to the role of the Islamic financial institutions in savings and demand deposits and should be regarded as insurable financial products (Md Khairuddin Hj Arshad, 2011; IADI, 2010).

Coming to the IBL, in general it is established a distinction between what constitutes "banking business" and what is covered by the deposit-guarantee scheme. Namely, pointing to the taking-up activity like the first prong of the banking business, whatever its legal form is (securitised or not), the holder of reimbursable funds has title to reimbursement. Now, only the holders of non-securitised reimbursable-fund products will be covered by the deposit-guarantee scheme; while the bonds' or financial instruments' holders are protected indirectly through the prudential supervision activity of the supervision authority[29].

Speaking specifically, the investment deposits are not eligible for deposit-guarantee scheme because they seem to fall outside the definition of banking business, according to the Italian banking model. This is because, apart from its legal form, every taking-up activity in the Italian banking business model is featured by the duty of reimbursement that does not belong, for their own nature, to the investment deposits. Therefore, the

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holders of *Shari'a*-compliant investment deposits will be treated in the same way as the holders of conventional bonds and other financial instruments.

5. Part 2 – the cultural-based approach

5.1 Islamic banking and the Muslim community

As remarked in the introduction of this article (Section 1), the full adherence to the rationales of Islamic banking for Muslim believers suggests that *mudaraba*, *musharaka*, *ijara* and *murabaha* operations should not be reduced to mere means of business, but conceived as *operative instruments of a community culture*.

Indeed, Islamic economics is treated as a science helping human beings to perform their obligations to Allah and society to prevent injustice in the management of natural resources and the pursuit of prosperity and welfare[30] (Abul A'la Maududi, 1947).

The framework is based upon the idea of Man as a social being who needs the cooperation of others to get what he is lacking for. But, according to Muslim tradition, man is also very likely to be greedy and tends to hoard (Abul A'la Maududi, 1947). Therefore, to keep man's basic instincts under control, *Shari'a* was granted through the instrument of His Prophet Muhammad covering every aspect of social life from worship duties to the family and commerce (Uthman, 1998).

Shari'a legal order is centred around the pivotal role of the community. It is said that *Shari'a* or the Divine Law sets limits on property rights and on one's freedom of trade because everything belongs to God and *Shari'a* allocates the right portion of the common bulk of resources owed to everyone. Indeed, it is argued that:

> […] while in the Western tradition property rights are basically conceived as jural inter-personal relations aimed at an *equal division* in social and economic justice, in the Islamic universe, in contrast, they belong to a social reality shaped around an *equal sharing* of economic resources (Cattelan, 2013).

Therefore, the prohibitions of *riba* and *gharar* as well as profit-and-sharing or sale-based models are the means of fulfilling a system of social and economic values and is supposed to be applied consistently. Indeed, *Shari'a* provides that any contracts or operations not complying with *riba* or *gharar* prohibitions – just to take some examples – are not legally enforceable.

Additionally, the Muslim community plays an essential role in the construction of *Shari'a* precepts and sources of law. According to the sacred texts, it is said that, in the beginning, the message of God-Allah was spread through the Prophet Muhammad's words and testimony with the help of the Gabriel Angel. Once the Prophet was dead no heir was indicated but for the community as a whole entrusted with *fiqh*. The "community" at issue is made up of a selected group of people, precisely *Shari'a* scholars, while *fiqh* has been compared to the *iurisprudentia* of the Roman tradition. Quoting Ulpianus, Santillana referred to *fiqh* as *divinarum atque humanarum rerum notitia, iusti atque iniusti scientia*, arguing that *fiqh* is, for Muslims, the knowledge of duties and rights through which man can live his life in everyday happenings in preparation for the future life, as Hanefiti contends (Santillana, 1926).

This sounds like a very interesting parallelism to shed light on the role of the community of scholars. In fact, in the Roman tradition *iuris dictio* – "the power of prescribing the legal principles for determining legal disputes" (Mousourakis, 2014) – was initially performed by *pontifices* and assessed as a distinguished declaration of *ius* (instead of a religious practice). In turn, *pontifices* were recognised as having the

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experience needed to draw a distinction between *fas* and *nefas* in social practice. Later on, until the *ius publice respondendi* of Augustus' reign, *iuris prudentes* were entrusted with issuing juridical opinions (*responsa*), and each opinion prevailed over the others in and out of private litigation thanks to the prestige of its author (Guarino, 1990).

The same holds for *Shari'a* scholars and schools, and no hierarchical structure is entrusted with officially validating *Shari'a* constructions. *Shari'a* scholars and schools provide historical support because they form *igma* or general, distinguished, approval. *Igma* became much more important when the Prophet, His companions and anyone who had been a direct or indirect eyewitness disappeared: in fact, this is the way that the Holy Books are linked to the development of times and situations and it represents the third source of law[31] (Santillana, 1926).

Considering all this, it can be said that Islamic banking and finance goes beyond the business product and certainly involves the socio-cultural life of Muslim people. Therefore, any accommodation process of Islamic finance in the Italian jurisdiction should deal with:

(1) a precise approach to property rights (*sharing* instead of *dividing*); and

(2) a construction of rules according to *igma*.

This means, among other things, that any shareholder, investor or contracting party approaching a financial entity claiming to be *Shari'a*-compliant legitimately expects that the entity will operate consistently with (1) and (2) above-mentioned.

Can this expectation become legally relevant in the Italian law?

Generally speaking, all economic activities performed in Italy have to comply with the general principle of fair trading not only in the contracting relationship with actual and prospective customers but also in the market relationship with actual and prospective competitors (i.e. the relation between conventional and Islamic banks). Indeed, Italian business law establishes the principle of correctness and fair trading upon which any entrepreneur may operate as long as no market distortion is brought about. In fact, a financial institution claiming to be *Shari'a*-compliant and *de facto* operating like a conventional bank ends up following misleading and deceptive practices and taking unfair competitive advantages against its competitors.

Considering all this, the point is to which extent whether *Shari'a* rules can become legally binding and, as such, enforceable in the Italian legal system, in the light of the adherence to Islamic principles according to a cultural approach able to recognise the specificities of the Islamic financial market.

5.1.1 A closed way: Shari'a *rules as law of a country.* To this aim, one might argue that there is the Rome I regulation on the governing of contractual obligations. Indeed, this regulation establishes that the parties to a contract must choose the governing law and when the law chosen is that of a country other than that most closely to the contract, the provisions of the latter law must be respected. The point is that *Shari'a* does not represent the law of a country (at least in the meaning of the term "law of a country" on which the Rome I regulation is based): in fact, as remarked above, *Shari'a* is basically the law of a Muslim community, wherever it is based.

5.1.2 Shari'a *rules as socio-legal precepts.* Assuming that *Shari'a* precepts, on the contrary, are social in nature, there seem to be three ways ahead to promote the accommodation of Islamic finance in Italy according to a cultural approach:

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(1) the enforcement of *Shari'a* according to the incorporation principle;
(2) the enforcement of *Shari'a* rules as a special legal system according to a pluralistic perspective; and
(3) the enforcement of *Shari'a* rules as social rules in the form of "clausole generali".

5.1.2.1 The incorporation principle. First, all *Shari'a* rules pertaining to relevant operations can be fully incorporated in the contract, whether it is a company contract or investment contract. This approach is fascinating. Indeed, the contract for the provision of financial services is, in Italian law, a master contract whereby a financial service provider is entrusted with performing a series of investment operations on behalf of a client. Master agreements in themselves provide a general legal framework for the operations and establish a long-standing relationship. However, the contracting parties must reach an agreement on each investment operation. Therefore, historic-based concepts, like *riba* or *gharar* for example, might be updated in line with the evolution of a community's sensibilities. However, such an approach starts from the questionable premiss that the financial intermediary and the client have the same contracting power to bargain the interpretation of *Shari'a* rules. Moreover, it does not clarify how the weak party, i.e. the client, may revise the construction or the application of the contract whenever he/she assumes that it is contrary to the good faith principle (with regard to *Shari'a fiqh*). In the end, this interpretative approach ends up increasing the informative asymmetries between the service provider and the client.

5.1.2.2 Santi Romano's pluralistic approach and the idea of community. Second, assuming a pluralistic approach, *Shari'a* may be considered at least to some extent as a special legal system. The scholarly references in Italian academic literature are essentially based on Santi Romano's studies. Santi Romano (1875-1947) was one of the leading experts of public and administrative law in Italy, and one of the fathers of institutionalism in Italy. He is still addressed as the main source on the concept of special legal systems in Italian jurisprudence.

According to Santi Romano's theory (1962), a legal system ("diritto" or "ordinamento giuridico") or institution or legal order (Fontanelli, 2011) is made up not only of rules of conduct, but first and foremost, also of rules of organisation. He began by contending that a legal system amounted to a sum of norms, and consequently, objectivity and enforceability through sanctions – which were commonly thought of as characteristics of norms – were to be considered as the distinguishing features of the legal system as whole. Therefore, the enforceability of rules of conduct should be justified not by the sanctions mentioned in some rules of conduct – it goes without saying that not every norm has its own sanction – but by a general mechanism of enforcement. It is clear that at the heart of Santi Romano's theory, there is the *community*, and it is assessed as an organisation embodying a social order. It means that where there is a group of persons, with or without legal personality, displaying a vague or a complex organisation, there is a legal system and, as consequence, there is an institution. Therefore, the concept of legal system departs from any religious, ethical or political purposes pursued and becomes a matter of *form*: it needs organisational rules, namely, rules addressing the authority entrusted with legislative power, the procedures to lay down and enforce the rule of conduct and, finally, the conditions of membership of social organisation. Romano argued that:

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> […] every organised social force qualifies as a legal order. This maxim implies that there can be multiple legal orders, each corresponding to a different social force (variously embodied in, and represented by, an ideal, a common purpose or aspiration). Their full dignity and autonomy as legal orders do not postulate their isolation; however, the way in which orders relate to each other is defined internally: rules of interaction can be found in each legal order, governing its relationship with external ones […] (Fontanelli, 2011).

The concept of legal system or legal order as institution may turn out to be a powerful means of (cultural) accommodation of *Shari'a* financial law: they have in common the idea of community. However, one may question whether *Shari'a* financial laws reach "enough" level of organisation like the Catholic Church or the football league do, for example, and which are considered as institutions from Santi Romano's point of view.

5.1.2.3 Shari'a and the role of general clauses. Lastly, *Shari'a* may be applied as social rules in the form of *clausole generali* or, in an imprecise way, general clauses and standards.

Indeed, "clausole generali" refer to any juridical prescriptions – such as good faith, fair trading, the precautionary principle, artistic value – to be applied through reference either to other legal precepts or to notions falling outside the general normative framework. For example, it allows us to refer to social rules as well as, in technical contexts, to drive the juridical interpretation to one result or another[32]. The enforcement of *clausole generali* can be judicially reviewed both by trial judges with regard to the substance of a decision and by *corti di legittimità* on the consistency of the *ratio decidendi*[33].

There are good arguments in favour of treating *Shari'a* like a system of *clausole generali*, but two questions come to mind. First, in the case of disagreement, Italian judges are entrusted with identifying the most popular or widespread opinion of *Shari'a* scholars (or *Shari'a* schools), but they are not entitled to examine the truth or validity of such opinions. This, however, is much more important in so far as the provision of financial services represents an ongoing economic activity able to put new products on the market and raise new critical issues.

Second, it does not give certainty about the consistency of application of such a rule for the whole length of the contracting relationship or the financial life of the company. Therefore, it can encourage entrepreneurs' opportunist behaviour, in contrast with the fair trading principle.

6. Conclusions

This study has shown to what extent *Shari'a*-compliant financial institutions can be accommodated as banks in Italy; at the same time non-PLS activities are subsumable under one or more passported activities.

Indeed, the comparison between the Italian legal framework and *Shari'a*-compliant financial or banking business models highlights that there is no juridical obstacle to accommodating Islamic financial institutions as banks in the Italian legal system (Donato and Freni, 2010) despite some doubts in terms of stability (Montanaro, 2010). However, the accommodation process turns out to be a costly operation. It is likely that Islamic banks will be required to apply higher capital ratios even though they are not able to benefit from all the possibilities the universal banking model allows the conventional banks to perform. Therefore, from the outset, Islamic credit institutions might suffer a competitive disadvantage.

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In the light of the accommodation process, the business-based approach (Part 1) seems to be a persuasive method to the extent to which it points to Islamic banking simply as a trade system. But, looking at Islamic banking as an essential aspect of the life of Muslim people, the cultural-based approach (Part 2) becomes much more consistent with *Shari'a* and the rationales of Islamic economics, both in the light of the community and the general principles of correctness and fair trading.

In this regard, the business- and the cultural-based approach can be intended as complementary one another. In fact, the "clausola generale" tools (Section 5.2.3) can offer significant help to meet the socio-legal expectations of Muslim customers and investors in the Italian legal framework in terms of *Shari'a* compliance, while, at the same time, the enforcement of transparency and information rules in the customer-provider (as well as in investor-issuer) relationships (Section 4.1) can let the general principle of correctness and fair trading fully operate according to a business-based approach, thus fostering the sound growth of the Islamic market from a twofold perspective.

Notes

1. Biancone and Radwan wrote: "Moreover the positive impact on the immigrant's integration policies through providing them with a Sharia compliant financial system on one hand and benefitting from their funding liquidity on the other hand".
2. Indeed, Italian banking and financial laws are essentially the transposition in the domestic jurisdiction of rules harmonised at the Community law level. With regard to teleological approach see: Judgment of the European Court of Justice, 14 October 1999, c-223/98, § 24).
3. Legislative Decree n. 385/1993, published in OJ, n. 230 of 30th September 1993 (and updates).
4. Legislative Decree n. 58/1998, published in OJ, n. 71 of 26th March 1998 (and updates).
5. Decree 16 th March 1942, n. 262, published in OJ n. 79, 4th April 1942 (and updates).
6. According to the 2006/48/EC directive the list of "passported activities" covers: 1. Acceptance of deposits and other repayable funds 2. Lending including, inter alia: consumer credit, mortgage credit, factoring, with or without recourse, financing of commercial transactions (including forfeiting) 3. Financial leasing 4. Money transmission services 5. Issuing and administering means of payment (e.g. credit cards, travellers' cheques and bankers' drafts) 6. Guarantees and commitments 7. Trading for own account or for account of customers in: (a) money market instruments (cheques, bills, certificates of deposit, etc.); (b) foreign exchange; (c) financial futures and options; (d) exchange and interest-rate instruments; or (e) transferable securities. 8. Participation in securities issues and the provision of services related to such issues 9. Advice to undertakings on capital structure, industrial strategy and related questions and advice as well as services relating to mergers and the purchase of undertakings 10. Money broking 11. Portfolio management and advice 12. Safekeeping and administration of securities 13. Credit reference service 14. Safe custody service.
7. More details on passported activities in Section n. 2.2.
8. The collective management in the form of – for example – a "fixed capital investment company" (SICAF) means a "closed-ended UCI constituted in the form of a joint stock company with fixed capital with registered office and general management in Italy with the exclusive purpose of the collective investment of the assets obtained by the offer of its own shares and other financial instruments of equity held by the same" (art. 1, para. 1, lett. i bis IFL).

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9. The portfolio management service covers "the management, on a discretional and individual basis, of portfolio investments which include one or more financial instruments and according to mandate conferred by customers" (art. 1, 5 *quinquies*, IFL).
10. This argument sounds fascinating but the above-mentioned options do not seem to fully cope with the restricted and unrestricted *mudaraba* paradigm. Indeed, it is true that, in the Italian banking framework, the service provider – be it a bank, an investment company or an asset management company – is under no obligation to reimburse the capital to the provider, and the customer as investor takes on the financial risks of the investment operations to be carried out, but the service provider – the bank, in this case – is far from being fully comparable to the active partner in the *mudaraba*-based paradigm. Speaking specifically of the portfolio management service, for example, the service provider, in charge of the investment choices on the account of the customer, is entitled to remuneration as long as he makes his investment choices in compliance with the customer's instructions as well as meeting a set of business conduct rules laid down in the secondary regulations, and same is true of the suitability and the adequacy rules (Articles 24 IFL; Consob Regulation n. 16190, art. 38 ff.). There is no statutory connection between the bank-service provider's remuneration and the lower, higher or no return accrued on the investments.
11. Islamic banking may operate either as a two-windows system or as a two-tier *mudaraba*-based system. In the latter, assets and liabilities are fully integrated. Therefore, both demand deposits and investment deposits represent investable funds. This means that demand deposits are repayable at par on demand, but the bank as active partner may use these funds to make PLS investments.
12. There is no legal definition of "credit extension either at the Italian framework or the Community level".
13. As Errico and Farahbaksh (1998) wrote: "[…] Islamic banks are allowed to use a degree of discretion in deciding if collateral is needed before granting their facilities, including the PLS modes of financing".
14. Article 2549 civil code.
15. The 'diminishing' *musharaka* is becoming very common. This means that both the bank and the borrower have joint ownership of a property: the client-borrower will progressively purchase the equity belonging to the bank. Specifically, once joint ownership has been established, the bank leases its share in the asset to the client charging rent to him. Ownership remains undivided, but the bank's share is mathematically divided into a number of units to be bought over time by the client.
16. See, Section 2.1.1.
17. Another non-PLS provision of funds is *bai'salam* or prepaid purchase of goods. Here, the bank pays the price immediately, precisely when the contract is made and receives the commodity later. This kind of transaction is usually made to finance agricultural commodities, but it is applicable to manufactures as well.
18. In Islamic leasing, the bank-lessor bears the risk of the leased asset and any attempt to shift the risk of loss to the lessee (as is commonly done in modern operating leasing) is void. This is on account of the maxim "profit accompanies liability for loss". If the lessor does not bear the risk, he cannot enjoy the profit.
19. With demand deposits, the provision of an interest rate represents a natural feature. In the Caixa Bank case law (CaixaBank France v Ministère de l'Économie, des Finances et de

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l'Industrie. C-244/04 of October 5th 2004), the European Court of Justice stated that the European Court of Justice held that the prohibition by law of the remuneration of sight accounts would have damaged the proper functioning of the internal market, causing new legal barriers to the access of the subsidiaries of third countries' banks because the rate of remuneration paid on demand accounts amounts to "one of the most effective methods" for the subsidiaries of third countries' banks to compete with the incumbents.

20. *De facto* there is no *riba* at issue provided that, most of the times, the demand deposits in the Italian system are not remunerated any longer.
21. The Bank of Italy authorisation is also required when the holder is going to increase is participation so that the proportion of the voting rights or of the capital reached or exceeds 20, 30, 50 per cent or so that the credit institution would become his subsidiary (article 19 CBL).
22. It goes without saying that the establishment of the so-called Islamic windows would better serve the accommodating objective.
23. According to the Bank of Italy regulations, the banking regulations for Italian banks are also applied to non-EU banks.
24. As Donato and Freni (2010) wrote: "The concrete notion of 'bank' on which supervisory activity rests thus refers to a universal intermediary free to choose its particular entrepreneurial vocation. There is no banking supervisory rule setting a minimum amount of deposit-taking or lending in order to be a 'bank'. In any case, any such threshold limits would require prior classification of all transactions on the asset and liability side in order to define them as 'banking' or not, the sort of archaic regulatory approach that has long since been abandoned. [...] Even if it could appear paradox, often for these banks there is not a perfect consistency between the scope of the authorisation (banking business) and the activities actually carried out (financial services)".
25. In fact, Islamic banks are entitled neither to monitor their 'investments' participating in the management of the investment project nor to require collaterals or other guarantees. Moreover, stability regulations should also address the ability of Islamic banks to reduce the capital value of investment deposits in case of loss: this possibility introduces strong incentives for moral hazard that could result in systemic risks.
26. It is worthy of mention that *Shari'a* rules usually fall outside a State-based, positive legal system.
27. Instead, it is a matter of debate how to establish the relationship between the single financial institution and a *Shari'a*-compliant deposit guarantee scheme without incurring in the *riba* or *gharar* prohibitions. Therefore, a *Shari'a*-compliant deposit guarantee scheme is hopefully based upon a donation from the Islamic banking institution to the deposit-guarantee scheme. However, a hybrid form has recently been proposed, namely, a donation contract with some features of mutual cooperation whereby every Islamic banking institution joining a deposit-guarantee scheme agrees to make voluntary contributions to protect depositors of any other member becoming insolvent.
28. In Islamic-based deposit-guarantee schemes, a distinction is made between the one and the other depositors' claim according to the underlying contract of deposit. More precisely, non-profit sharing has priority over PLS ones. See: IADI (2010, p. 16).

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29. This is because, according to the legal doctrine, the first group of reimbursable funds are peculiar to the banking business, while the second is border line between the banking and the financial market.
30. Therefore, the so-called *economic problem* deals with stimulating the advancement of "human civilisation", the progress of society and allowing every man in the community to develop his own personality and fulfil his capacities and aptitudes at best. Abul A'la Maududi (1947), one of the founding fathers of Islamic economics, argued that "So the main reason for the difficulty encountered in understating and correctly solving the economic problem of man is that some people look at this problem from the point of view of economics alone".
31. This conclusion is much more important in so far as *Shari'a* is essentially an orally based system.
32. In the 1960s of the last century, some distinguished authors argued for the crucial role of "clausole generali" because they allowed the Italian legal system to develop according to its own social values in a pluralistic approach.
33. It would make it possible to comply with the principles of unity and certainty – pivotal principles in the Italian legal system.

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