CHAPTER 12

Operating an RF Bank in the United States

A bank—also known as a government chartered (licensed) depository institution—is allowed by government authorities to solicit and accept deposits from the public and institutions for safekeeping and to manage these deposits. Legally, the bank's relationship with its customer is defined by the type of account the customer chooses to open with the bank. As will be discussed later, if the customer uses the bank as a place to keep money safe and to withdraw from it using a checkbook or the Internet, the bank is looked upon legally and according to Shari'aa and the Judeo-Christian-Islamic values as a trustee of these funds. This type of account is called a *demand deposit account* (DDA) in conventional riba-based banking. In RF banking it can be called a *deposit in trust account* (DIT Account, or *Amana*, which means trust). That means that the bank has accepted a legal responsibility and promised the depositor before God and the laws of the land to safeguard his or her funds, in order to make them available on demand. For this service the bank can charge a fee.

On the other hand, the bank is also entrusted by U.S. bank regulations and laws to manage a pool of funds for those customers who choose to invest their money in an investment account, such as, for example, a *time certificate of deposit* (TCD). In this capacity, the contrast between the role of the riba-based conventional banker and the RF banker becomes clearer. In riba-based conventional banking, the objective is to maximize the spread between the interest charged to customers who use the money to finance their needs and the cost of these funds, which is mainly the interest paid on the money deposited (invested) in the bank—mainly TCD. The riba-based banker is trained to make that spread as high as possible within a well-designed portfolio with a risk profile that is approved by the bank treasury, the loan department, and the board of directors of the bank. The riba-based banker who is involved in lending is trained to "sell" loans that will employ the deposited funds in financing different projects. As the funds available to the banker grow—as in the case of the mega-banks—the loan officer of the bank is given a quota that must be met, and in most cases, without proper training on social responsibility, experience shows us that money motivates many such "loan sales people" to sell more loans. This is especially true for loan officers who receive a percentage of the loans booked as a commission. They use their sales training to entice and encourage the consumer and businesses to borrow more money than they need and to create more consumption. This may lead to more loans for the bank and more consumption for the economy, but in many cases it leads to very little real economic production and a deeper hole of debt for the consumer and the business. In addition, the riba-based banker who works in the treasury of the bank can also choose between a number of short-term and long-term investment instruments to squeeze as much interest as possible out of that cash. Because the funds are insured by the FDIC, the riba-based conventional bank management would also use the DDA deposits, which are deposited as a trust and conceptually for safekeeping, to generate more interest income.

In contrast, the RF banker is trained to look at the money deposited in the bank in a quite different way. First and most important is the DIT (*deposit in trust* or *Amana* deposit). This DIT money cannot be invested in any instrument except the Fed Funds, which are, in fact, government instruments that reflect the government's monetary policy in a *fiat* (paper) money regime, as discussed in Chapter 5. The interest given by the government—the Fed Funds rate—is not the same as the interest prohibited by the Judeo-Christian-Islamic value system and by the Law (Shari'aa). In this case, the RF banker becomes the safekeeping holder of this money in trust. The other role of the RF banker is to act as a money manager (*mudharib*) entrusted with the prudent investment of the funds earmarked for that purpose to create real economic production, job opportunities, and prosperity. This is done by investing the money in projects and services that will make a difference in peoples' lives. The RF banker is trained to:

- Encourage people to live riba-free by helping them devise a plan to pay off their debts (especially the riba-based ones like personal loans and credit card debt) as soon as possible in a methodical process and to help them achieve their dreams without overburdening themselves with excessive borrowing
- Help them in restructuring and reducing their obligations and debts
- Encourage them to consume less by living within their means

That is why the RF banker in charge of financing/investing operations (lending in riba-based banks) is not trained to "sell" loans to customers in order to maximize the size of the loan portfolio. The RF banker is trained to think of the process of financing (lending in a riba-based bank) as a process of investing prudently with the customer. The RF bank employees, management, board of directors and shareholders believe in the values of voluntarism and real service to all people in the community. They are willing to forgo some of the short-term higher profits, higher salaries, and "perks" to ensure the success of this new brand of banking. The RF bank staff members are required by bank management to approach their responsibilities not as businesspeople who are interested in squeezing their customers for more cash—by charging fees and other expenses to achieve higher profits. They are trained to be dedicated and believing leaders in their communities for the purpose of developing the community, touching peoples' vision, hearts, minds, and future. The dream of these RF bankers is to apply and bring to life a working RF banking system, on a community level, as one of the pillars of a worldwide RF banking system—pioneered in the United States—which operates according to Judeo-Christian-Islamic values and principles. In this context, the real profits of the RF bank will not only be measured in dollars and cents but also in the number of households served and the extent of that service as it changes peoples' lives and fortunes for the better. The real profits will be the contributions of the bank to a better society and a happier community by opening job opportunities through financing the community's members and businesses. The net result would be more economic activity, healthy economic growth, and an affluent community.

INVESTING IN AND OPERATING A RIBA-FREE BANK IN THE UNITED STATES

Riba-free (Islamic) banking in North America (the United States and Canada) was introduced in 1987 by LARIBA in the United States. So far, it has focused mainly on providing the money needed by the community to invest in home mortgages, commercial buildings, businesses, and automobile purchases. We are privileged at LARIBA to have started this grassroots, purely American movement in 1987 by offering, in a humble way, financing services for the needs of the community in order to strengthen it financially, get its members to live a full and active life in the United States as Americans living by the Judeo-Christian-Islamic value system according to Shari'aa, and to produce a new generation of community members who are qualified bankers and who believe in RF banking.[1]

It is believed that riba-free and gharar-free (*gharar* is deceptive misrepresentation and use of misleading representations) faith-based financing in the United States and Canada (in particular, in the United States, with which I am more familiar) will present the financial capital markets at large with one of the better banking and financing products and services available in the world. The reason is that these products and services comply with the most sophisticated and best designed regulatory standards available in the world—the U.S. banking regulations and the Securities and Exchange Commission (SEC) regulations—to provide the investor with fairness, safety, soundness, full disclosure, and compliance. In addition, corporate governance in RF banking institutions is not only supervised by the U.S. government, but also by a higher authority (i.e., God). It is interesting here to remember the very popular Hebrew National advertisement for kosher hot dogs in the 1960s, which stated, "We Answer to a Higher Authority."

As RF banking expands in the United States and creates demand for more capital from the general global markets (outside the traditional Gulf petro-dollars), it will need to attract new investors who subscribe to its concepts and approaches to invest in its products and services and eventually in its capital. The RF banking industry will have to devise the strategies needed to meet this challenge.

It is important to remember that the foundation of the whole concept of RF banking (riba-free and gharar-free) is to attract community deposits and savings and redeploy these deposits and savings into the community as investments to generate economic prosperity, job opportunities, and a better future for all. This is not much different from the well-known and important U.S. banking regulation called the Community Reinvestment Act (CRA). This act makes certain that the accumulation of wealth from a certain community is largely invested back in the community without discrimination. Investing community assets outside that community has been and still is something that is chronic in most countries, especially the developing ones.

To shape the architecture of the RF banking industry and its capital needs, it must meet the most stringent measures of full disclosure and transparency, and a strict sense of corporate governance not only based on the banking and financial laws and regulations of the land but also on the basic moral and ethical values in Shari'aa and the tenets of the Judeo-Christian-Islamic value system. That means not only relying on supervisory examinations by the regulatory authorities of the U.S. Treasury Department (the Office of the Comptroller of the Currency, or OCC, for national banks; the state finance authorities for state-chartered banks) and the SEC, but also by dedicated organizations that make sure that the foundations of Shari'aa, including moral and ethical values of the day-to-day dealings of all the RF bank's staff, management, board of directors and customers are upheld in all operations.

To recap what has been covered in the book thus far, the following section discusses important aspects needed to strengthen investors' confidence in RF banking and finance and its projected capital market needs.

THE ADDED VALUE OF RF BANKING

New RF banking institutions need to let the market know—through practice, experience, and track record—the answer to a very important question: *What is the added value of investing in RF products and services?*

Here is a brief list of the significant sources of added value that RF bankers need to articulate to the newcomers to the emerging RF banking industry and put into effect in the day-to-day operations of the RF financial institution. These added values are taken seriously by the RF institution's management and staff, who are trained and instructed to be serious and sincere about implementing the following code of ethics and mode of operations in their RF banking practice:

- The ethics of *halal* (divinely allowed) and *haram* (divinely prohibited).
- The discipline of the *know-your-customer* rule in banking and finance, because RF banks serve all people in the community of faith-based congregations, including members of temples, synagogues, churches, and masajid (mosques).
- The deep-seated belief that RF financial services are available to all community members of all faiths and backgrounds without discrimination of any sort, because discrimination is one of the worst offenses against the higher authority we all subscribe to in the Judeo-Christian-Islamic value system (i.e., God).
- The policy of full transparency, proved by full disclosure and full documentation of contracts and all related parties.
- RF banking is:
  - Asset/services-based financing
  - A socially responsible system
  - A system based on the *mark-to-the-market* and *commodity indexation* rules as capital market tools to ascertain prudence in investing and financing
  - Based on the belief that credit is one of the important basic human rights
  - Superior, because it offers lower risk and better return on investment

WHAT IS RF BANKING AND FINANCE?

As was discussed earlier in the book, RF finance is not only about the mechanics of financing. It is a new banking brand, designed for people of all faiths. The Judeo-Christian-Islamic value system prohibits the culture of renting money at a rate called interest rate and the abuse of the power of money. The foundation of the RF banking and finance system (riba-free and gharar-free) is based on the moral and ethical values and behavior of its bankers and employees. It is a system based on:

- Riba-free financing and banking procedures, which means not renting money, but establishing the prudence of investing money in the clients' assets and services and that the rental of those assets/services produces attractive returns on investment
- Gharar-free, which means that it is free from deception and/or misrepresentation of facts and the use of "tricks" or ruses (*heelah*) to circumvent the spirit and substance of Shari'aa and the spirit of Judeo-Christian-Islamic values
- Delivering services that are focused on the substance of the transaction, and not only on its form and its mechanics
- Compliance with the tenets of Shari'aa while not violating the laws of the land

U.S. Banking Regulations and Bank Regulators

The U.S. banking regulations represent the most sophisticated and up-to-date documentation of rules and regulations defining the relationship between the financial institution and the customer. These regulations represent the integration of all accumulated human efforts designed over time to prevent, to the best of our abilities, the illegal, fraudulent, and unfair practices some people attempted to use to enrich themselves over the years by misleading and defrauding the average consumer, investor, and depositor. These regulations are the latest efforts of humanity to ascertain that financial institutions are fair, transparent, and truthful to the unsophisticated and less financially educated customers and communities. In studying these regulations, it can be testified that they are the best tools developed, and they are still being developed. Many of these regulations were discussed in Chapter 7.

U.S. Securities Laws and Regulations

The U.S. securities laws, in general, prohibit the solicitation of funds for investment purposes and/or the sale of securities to the public without full disclosure and proper registration with the SEC. In some cases, funds can be solicited without registration with the SEC, as in the case of a *private offering*. These are allowed to be offered exclusively to *accredited investors*, who are wealthy and sophisticated enough—as defined clearly by SEC rules—to be able to understand the risks involved.

The Spirit of the Riba-Free and Gharar-Free (Islamic) Banking and Finance System

Money is a manmade measuring device, created to help people transact business activities (buying and selling) and to measure the accumulated wealth and the success or failure of a venture. It cannot be rented. Renting money (through the use of the interest rate) is riba and is prohibited by Shari'aa. Assets are considered to be the properties of God, and they are placed in trust by God—according to His infinite wisdom—in different forms and quantities in the custody of each one of us. It is our duty to honor that trust, and when we invest or use these assets, we should do so properly and prudently. Assets and savings of each community must be largely reinvested in the community to create economic growth, prosperity, and job opportunities. The system redistributes wealth through the mechanics of "trickle-down economics" through the system of inheritance and almsgiving.

STRATEGIES USED TO BUILD A VIABLE RF BANKING SYSTEM IN THE UNITED STATES

The following is the set of strategies we used when we started RF banking services in the United States, first in the form of a finance company—LARIBA—in 1987, and then as a full-service national bank in 2003.

- RF banking and finance proponents' ultimate goal is to offer an alternative banking and finance service, not to discredit and/or dismantle the existing riba-based conventional banking system.
- The RF bankers' attitude is not to grow as quickly as possible by using capital or sources of money from outside the community. RF bankers believe in putting their money where their mouth is. We state that it is wiser and more prudent to grow methodically with our own money and the community's money to develop community ownership. Our commitment is simply to develop trust between our community members, and to start with what is possible to achieve what may be impossible, as we learn from the Sunnah of our beloved prophets Abraham, Isaac, Ishmael, Moses, Jesus, and Muhammad (pp.). It is not shameful to say today that we are small because, God willing (*inshaa Allah*), we aspire to be bigger by the blessings of God.
- The RF bankers' goal is not to change the laws of the land. The goal is to adhere and uphold these laws without violating Judeo-Christian-Islamic values and the tenets of Shari'aa (the Law). RF bankers need

to remember that the most overriding goal of Shari'aa is to bring what is beneficial and useful to the community and to drive away any harm.

- RF bankers are out to popularize our RF financing and investing to all people of all faiths and backgrounds. The goal is to present what we believe through the quality, style, and dedication of the financial services our dedicated RF banking pioneers provide.
- The RF banking motto is: *We Do Not Rent Money—We Invest in Our Customers*. The RF bankers' philosophy and disciplined training programs, as well as RF banking operating policies, should reflect the belief that an RF banker's primary job, as the customers' preferred banker and advisor, is not to dig a deeper hole of debt in the customer's life but rather to find ways and means to optimize that debt, to establish to the best of their abilities that it is used for financing rewarding and prudent investments and businesses, and to help customers get out of it as soon as possible. RF bankers are trained to look at customers as true members of their families. In times of need and difficulty, the RF banker is trained to practice the concept of merciful caring, helping, and assisting (known as *tarahum* in Islam).
- RF bankers' operating challenge is not to take existing riba-based products and services and dress them to make them look riba-free (and gharar-free). In fact, doing so may bring unforgiving harm to all of those involved in the RF banking industry, as well as the community, and will destroy the work that many dedicated servants of the community have spent their lives to develop. The approach used in Shari'aa-based RF banking and finance is to do the exact opposite, by conducting the RF banking business according to the Law (Shari'aa), then dressing it up to fit the laws of the land. And yes, one word of great caution for all those who are focused on marketing in the name of God and faith: Violation of and noncompliance with, as well as toying with, the financial laws of the land may take time to uncover, but when it is discovered, these offenses bring immediate, swift, irreversible, terminal, and global punishment to the perpetrators.
- The RF bankers' job is not to try to use non-English words to brand products to make them appear foreign to the English-speaking public. The real challenge is to choose names that make it easier for the English speakers (or, for that matter, speakers of whatever the local language is, anywhere in the world) to understand what these products are and what their function is. For example, instead of only using *murabaha*, the RF banker can use cost-plus; for *musharaka* one can use joint venture, and so on. RF bankers need to remember that the goal is to benefit people by helping them understand and use RF banking. We need to

popularize the RF banking services to people of all faiths and make it easy to compare RF banking to the existing riba-based conventional banking products.
- The RF banker does not live lavishly, because the money he or she manages is in fact the trust of our customers—a trust hanging from our necks before God. RF bankers refuse to travel first class, stay in expensive hotels, or live a luxurious lifestyle, squandering their customers' and shareholders' money on expensive advertising campaigns. RF bankers believe that money respects those who respect it.
- RF banking grows by word-of-mouth referral from satisfied customers.

The net outcome of all these values and modes of operation for this new RF banking service is superior service, solid products, lower risk, and higher returns because of lower default rates and lower overhead. Naturally, more customers will come to the RF bank to be served, and many more investors will keep coming.

Key Internal Controls at the Bank

The following committees were created to establish the key internal controls that ensure compliance. Committee proceedings are reported to the bank's board of directors:

- The *Bank Secrecy Act (BSA) Committee* meets on a regular basis to discuss Currency Transaction Reports, Suspicious Activity Reports, Wire Transfers (domestic/international), Office of Foreign Assets Control (OFAC), Financial Crimes Enforcement Network reports/findings, and other BSA matters. Minutes of the meeting are maintained.
- The *Credit (Loan) Department Committee* meets on a regular basis to discuss issues pertaining to credit approval and related matters. This includes the current loan portfolio, loans in progress, and the status of credit memos. In addition, the performance of each loan is evaluated to assess the level of risk. Minutes of the meeting are maintained.
- The *Information Technology/Security (IT/IS) Committee* meets on a regular basis to discuss all matters pertaining to the computer and information technology (IT) systems' viability and security. The committee reviews, on a regular basis, any attempts to penetrate the computer system, data security, network server, computers, software, security cameras, telephones, online banking, and disaster recovery.
- The *Daily Operations Committee* meets on a daily basis to discuss issues pertaining to operational activities. This includes non-sufficient fund activities, non-posted transactions and items, stop payment

orders, wire transfers, and basic management of daily reports and transactions.

In addition, the following are samples of the bank policies developed by management and approved by the board of directors:

- Employees are restricted from entering other departments' areas, the vault, and the Fed wire and computer room.
- Faxes sent and received must be checked by the CFO, CEO, or a qualified officer. All faxes must be approved before sending.
- Opening/closing bank doors may only be done by designated bank officers who have a set of keys to open the bank. The officer who is opening and/or closing the bank must follow a specific procedure for searching/clearing the facilities and sign a logbook located next to the vault. A log for keys handed out to employees, as well as other keys, is also kept.
- The vault is opened by two officers; each officer has half of the combination. Both officers must sign the Opening/Closing Vault log next to the vault. Vault access is limited by time clock as well as by authorized personnel.
- The ATM/Night Drop needs to be opened every day by two employees, one of whom must be an officer. The night drop is opened twice a day, once in the morning and afternoon. The ATM is opened daily in the afternoon.
- All information for an outgoing wire transfer needs to be approved by CEO, CFO, or Vice President. All wire transfers are entered and verified under dual control and registered in a special log.
- Employees are required not to use work e-mail for personal use, and all incoming and outgoing e-mail is monitored, read, and reviewed by the chief security (executive) officer.
- All mail sent and received by the bank is checked by an officer, and all shipments received through special delivery (UPS, FedEx, Messenger, etc.) are logged into the book and opened by two persons, one of whom is an officer.

Creating True RF Private Bankers and RF Credit Analysts

The conventional riba-based approach to developing a loan portfolio has been to attract an employee from another bank who can bring with him the customers who borrowed money from his current bank to grow his new bank's loan portfolio. In addition, these banks train their bankers to bring in loans to the bank, prompting the banker to be a "salesman" of loans and to encourage prospects to rent money at a "lower" interest rate. In fact, in many cases the salesman mentality prompts many bankers to practice what is known in the banking business as "bait and switch," in which the loan officer quotes a very low interest rate but intentionally does not talk about details such as fees, administration costs, loan origination fees, and other expenses. The customer thinks that he/she has gotten a low rate, only to discover at the time of signing the loan documents that the implied interest rate of the loan is much higher than promised. This is because Regulation Z requires that all loan costs and fees be added to that interest rate. That is why we always ask our community members and clients to insist that they get these offers in writing, so that they can read all the fine print in these loan proposals.

Many of these loan officers carry expensive brief cases, wear designer suits and expensive watches, and drive expensive cars; they carry inflated banking titles with no meaning, like "Senior Vice President—Loans," "Senior Vice President—Business Development," or "Senior Vice President—Loan Adviser." They use these "attractive" interest rates as sales and bargaining tools to meet the weekly target production expected by management. In their pursuit to meet the bank's targets, many families end up in a deeper hole of debt which they cannot serve. The subprime mortgage loan crisis in America is a case in point! While some banks de-emphasize the value of providing highly trained account officers who are supposed to serve and guide honest and hard-working families and business owners, RF bankers choose a different course of action. In addition, while many banks replaced their "loan" officers with computerized credit scoring, Internet-based operations officers, and a retail (mass production) approach to corporate banking, RF bankers chose an opposite course of action.

At the RF-operated Bank of Whittier, N.A., we took the basic approach: we determined what our customer base wanted, and we simply gave it to them in an RF format. We promoted and delivered concepts such as the idea that "we do not rent money—we invest in our customers," honesty, caring, service, family feeling, family values, the comfort of talking with a sincere and concerned advisor, local decision-making authority, tailor-made business banking services, and professionalism. It was thought that separating the lending/underwriting decision from the banking services and advisory responsibility would be a more efficient, credible, and prudent way of delivering true RF banking. This separation helps isolate the emotional attachment of the loan officer to the customer, an attachment that may lead to reaching the wrong credit decision. That is why we have introduced two new important but complementary activities at the RF bank. These are the *RF private banker* and the *RF credit analyst*.

The RF Private Banker The *RF private banker* function was designed to provide each customer with a well-trained and seasoned community banker who is well-educated, responsible, and reputable in the community to become the point of contact between the client and the RF bank. The RF private banker is responsible for maintaining continual contact with bank customers to understand who they are, and to get to know their families, their businesses, and their detailed financial situation including any changes that might come up in the future. The RF private banker is trained to become the "financial doctor" of the family, responsible for the articulation of the family's current financial situation and their goals and aspirations. He/she is responsible for guiding the family towards its financial goals, be it their retirement, the children's education, or financial independence and business growth. The RF private banker aspires to add new family members to the bank's expanding family. The RF private banker makes sure that he/she is available to serve our customers 24 hours a day, 7 days a week.

The person best suited to being an RF private banker is a professional in his/her mid-career who has decided to change his/her career or has lost his/her job. These staff members are handpicked from the community, were extremely successful in what they did before they joined us, are active in the community, are responsible, with high moral and ethical values, and have wisdom and life experience. The ideal RF private banker is a person who is real, sincere, and who is believable and trustworthy.

The RF private banker is trained to read financial statements, financial newspapers, and publications like: *The Wall Street Journal*, and *The Financial Times* (London). Naturally, the RF private banker will not be the expert who recommends how to finance things, but he or she will be the trusted guide who holds the clients' hands and presents the client to qualified bank experts in the needed fields.

The RF Credit Analyst The role of the *RF credit analyst* is to conduct a thorough analysis of the credit application, using the most sophisticated tools in financial analysis and applying RF financing models that use marking-to-market techniques. The RF credit analysts draw on their business, analytical, and banking expertise to reach the most educated and well-thought-out recommendation on whether to approve or decline the credit application.

It is also important to note that the objective of the analysis is to make sure that the customer will be able to service the debt and that the investment the customer wants to embark on makes—in our best judgment—prudent investment sense. The most important factor in the credit analysis step is to make sure that we do not "help" the client dig a deeper hole of debt for him- or herself. We want the client to succeed, and the bank will be an important factor in that success story. In fact, we at the RF bank believe that the success of the customer will lead to our success through new referrals.

To ensure that the RF credit analyst has all the information needed to recommend a course of action, the RF private banker helps the customer understand the purpose of the application process and the usefulness of properly completing forms and promptly supplying all needed documents so that the RF credit analyst can carry out a fair and thorough credit analysis. The RF private banker also acts as an advocate for the client. The RF credit analyst, on the other hand, takes the role of the "hard-nosed" analyst and makes sure that serious questions are asked and issues are raised during client conferences. These conferences are attended by both the RF private banker and the RF credit analyst, and are moderated by the chief credit officer and/or his/her deputy.

In the credit department, we train our associates to believe in the following:

- We are not in the money "renting" business. When we evaluate a credit application, we look at the customer's total situation, including their families, their businesses, and their goals and aspirations, and we provide true total financial advice. The RF bankers pride themselves on investing their time in prudent analysis before they invest the bank's money.
- The best credit is that which is cultivated and developed by the RF private banker.
- The walk-in credit applications are to be reviewed very thoroughly to ensure that the RF bank is not one of the many banks tried by a walk-in customer after he/she has been rejected by other banks.
- We do not accept brokered loans and/or deposits.
- We are not in business to look for participation loans in which to invest the RF bank's money. We are in business to cultivate, develop, analyze, and originate credit transactions, with the purpose of participating in the success, prosperity, and growth of the community.
- We give priority to the community. We gather our deposits from the community, and it is our social, moral, ethical, and regulatory responsibility to reinvest those deposits in the community.
- The best source of customers is our depository clients and their families and friends.

The RF credit analyst function is enhanced by employing some of the better educated people in the field of financial analysis, some of whom have MBA degrees; the department senior advisors and management hold business school degrees from some of the better business schools in the United

States. The goal of the RF credit analyst is to conduct a thorough analysis of the financing application at hand and to develop a number of scenarios and recommendations as to whether or not to finance the proposed project. The RF credit analysis staff is trained not only to protect bank interests, but also and primarily to make sure that the investment is in fact in the best interests of our customers. The RF bank staff must be trained to understand that the RF bank is not in the business of renting money; it is in the business of investing in and with the clients in order to cultivate an ever-larger family of successful and satisfied customers who have chosen to live riba/ribit-free, according to the values of the Judeo-Christian-Islamic system.

Recruiting and Interviewing RF Bankers

An important tradition that I learned during my career while interviewing candidates for Atlantic Richfield Oil Company (now owned by British Petroleum) at the University of Wisconsin and Massachusetts Institute of Technology (MIT) was the process of the interview. I wanted to make interviewing the candidate a real experience of adding a new member to our family and at the same time a memorable and useful experience for the candidate even if it was decided not to employ him/her. The process resembles the interview you hold when your son or your daughter brings home a candidate for a future serious relationship (i.e., marriage).

Candidate interviews are done in a unique way. The candidate is requested to be at the bank at 8:00 a.m. to see if he/she is an early morning person and if he/she will be on time that early in the morning. I start the interview by offering the candidate something to drink, to make him/her feel at ease, and I personally prepare and serve that drink.

I start by introducing the candidate to the interview process. I share with him/her my story, in order to structure his/her story in the same way. I also share with the candidate the goals of the organization and our dreams. I check whether the candidate did his/her homework on our organization by visiting the Web site and other sources on the Internet. The candidate is asked to tell us about his or her experiences in high school and what courses he/she liked and disliked, as manifested by the grades he/she achieved. We then proceed to the college years at length. In the course of the interview, I evaluate the candidate's character and the depth of his/her parent's efforts to bring him/her up with values and discipline, in order to gauge their character. I then proceed to tell the candidate that we at the bank commit to making him/her a very successful banker in two years, and that he/she does not have to have prior banking experience. I share with him/her that we can hire a well-dressed chimpanzee and teach it how to print charts and impressive reports. However, there are two traits that we cannot teach a chimpanzee: speaking the truth and not betraying the trust vested in him/her. This segment takes approximately 90 minute to two hours.

Then the candidate interviews most of the staff members for 20 to 30 minutes each. This approach helps intensify the family feeling among the staff members and makes them feel that they are participating in the employment decision. It also enables the candidate to take a closer look at the family that he/she will join. After each of the interviews with the staff, I ask the staff member his or her opinion. At the end, I invite the candidate to come back to my office to debrief him/her and to listen to his/her feedback. A decision is then made, and the candidate is made an offer or declined.

When the candidate accepts the offer he/she is asked to complete an employment application, and the human resources department conducts a confidential background check to make sure that there are no prior derogatory or criminal records. The candidate is given two very important books. The first is the employee handbook, which details the policies, rights, and responsibilities of the employee. The other is a recording book. The candidate is requested to take clear and detailed notes during his/her training, communications, meetings and work. This book is one of the most important aspects of the employment.

Community Participation, Networking, and Customer Service

One of the challenges we faced was how to integrate with a new city and a new community. There are some who say that the easiest way is to call the Muslim community and try to solicit business from the masajid (mosques). That was a very easy task for me because of the credibility I have accumulated through serving the North American Muslim community in most cities in North America since 1968. However, I did not want to take the easy way out of a great challenge. Our goal was to sincerely offer the RF banking services we believe in to people of all faiths in our immediate neighborhood of a 50-mile radius. The other standard approach was to join the Chamber of Commerce organizations of the different cities. We found that such organizations are very difficult to integrate with because of the many old friendships and alliances developed over the years, which include other competing banks.

Two months before the new management took over the bank, we started an independent survey of the city of Whittier market. We identified businesses, colleges, and responsible officials in city government. We contacted Whittier College, California State Fullerton University, and California State Long Beach University so that we might get to know their professors and administrators, hoping to attract good candidates and interns from their business programs. These efforts yielded wonderful results. Our bank was introduced to the leaders of thought and the producers of talent in the immediate community. We understand that many of the professors spoke very highly of our team at the bank, and they also recommended their top students to interview with us. I was also honored to be invited to preside as the keynote speaker at commencement exercises at some of the colleges. A typical event is attended by at least 250 graduates and their families, totaling at least 1,500 guests. This presented a great opportunity and free advertising for the bank.

We decided to develop a strategy that helped us introduce what we do. The first step was to do business with the surrounding community. If we needed to print something, to replace the carpet, to make signs, to order food, or to fix the plumbing, we went to local providers, in order to give back to the community. In addition, the team decided to capitalize on my long-term experience in the interfaith movement. We looked for and located the interfaith groups in the city and started to participate first as individuals, then as a team from the bank. We participated in Christmas, Thanksgiving, Jewish festivities, Chinese New Year festivities, and Muslim festivities that the community sponsored,

This step proved to be one of the most important and significant contributors to bringing credibility to what we do and to sharing the Judeo-Christian-Islamic values of our new RF banking movement. I was asked to author a newspaper article on the economic meltdown of 2008, in which I discussed many of the Judeo-Christian-Islamic ideas of RF banking. The article was very well received in the community. I felt extremely fulfilled when one of the bank customers asked me, "Dr. Rahman, are you a Christian?" I asked him why he was asking. He said because of what you all do at the bank. I responded by saying that we are subscribers and believers in the Judeo-Christian-Islamic value system, and his feelings proved it. The bank has gained the accounts of most churches in town and many of their flocks. We also finance churches, schools, and places of worship for people of all faiths. We established contacts and met with the city manager and political and administrative leaders at city hall in order to introduce the new RF format of the bank and to share with them our vision and plans to make the bank an important institution in the city.

The new management team has made it a standard operating procedure to greet every customer who walks into the bank. I personally come out to introduce myself, learn their names and their businesses, introduce them to everyone in our family of employees, with a brief comment on their background, and invite them to my office. All of the tellers are trained to introduce themselves and share with customers the fact that they are aspiring bankers who will be graduating after so many semesters, and that they are here for hands-on training. The tellers are also trained to learn the name of the customer, how many children the customer has, and other details about the customer's business and family. We have trained the tellers and the operations personnel to be polite, courteous, and helpful when they receive a request on the phone; thanks to the use of the most up-to-date computer systems, the answers are usually readily available within a few seconds.

The operations staff checks every morning for NSF (non-sufficient fund) checks, and personally calls every NSF customer, asking them to come to the bank as soon as possible to cover their positions, so that we may avoid returning the check and creating unnecessary embarrassment for the customer. This practice is not done any more by most of the other banks, and it is highly appreciated by our customers. If the NSF behavior becomes chronic, we have a private meeting with the account owner and counsel him/her to either abide by the rules or leave the bank.

TRAINING PROGRAM AT THE BANK OF WHITTIER OPEN UNIVERSITY

One of the challenges we faced when we moved to run the Bank of Whittier as a successful RF bank was to find qualified staff. One option was to advertise for experienced bankers who had experience and a successful track record in the community banking business. We have attempted this option since 1998, without tangible success. Most of the experienced bankers we met and worked with are used to a standard operating procedure that made us wonder about their commitment to community service. The first thing they would ask for is a very high salary package. The package not only included a very high salary compared to the profit capability of the bank, it also included other perks—an expensive car allowance, a country club membership, or a generous expense account.

When we started planning the management changeover in July 2003, we decided to start with a core group of bankers from the community, consisting of a president, a chief financial officer, and a chief credit officer. They all accepted a very humble salary and benefits package, because they were committed to this new brand of banking. We also started interviewing fresh business school graduates. We were lucky, because the bank was located within a short driving distance from a number of high-quality business schools. We believe that if we employed superior graduates who had achieved a very high grade point average (3.75 out of 4 or higher), that would present us with serious hardworking young men and women who were fresh, smart, eager to learn, and excited about becoming the new RF bankers of the future. We also concluded that a well-designed training program should be designed and implemented to enhance the goal of producing a new generation of successful RF community bankers.

We pioneered the *Bank of Whittier RF Open University*. The university is convened twice a year. Each session lasts 45 days, meeting every weekday from 8:00 A.M. to 9:30 A.M. A rigorous curriculum was prepared, and the faculty consisted of upper management, invited guests, and experts in banking. The training program is enhanced by videos and hands-on training. In addition, we use outside auditors in all fields of banking operations to train our staff. The auditors were asked to engage the staff members in order to conduct their audits and to train the employees at the same time. This approach proved to be very successful. In a matter of 12 months, the employees started to operate efficiently and to be in full compliance with the auditors' findings. We also instructed the staff to consider the auditors their coaches, and not to argue or justify the errors they committed but rather listen and learn. In addition, management met with the auditors at least once each day to discuss any noncompliance issues and get the staff to fix them immediately. This policy has won us wonderful reviews from the outside auditors and the regulators.

In addition, we also recruited students at the business schools who aspired to become bankers to serve as tellers. This job gave them a chance to learn, to evaluate the bank staff "family," while at the same time enabling us to get to know them and to recruit from amongst them for future staff at the RF bank. It is important to note that management very closely reviewed the grades the candidates achieved in every course to identify where they would best fit. For example, if the candidate received an A or a minimum grade of B and mostly A's in the accounting courses, it would qualify the candidate to start in the treasury department. If the candidate received top grades in mathematics and financial analysis and had good verbal skills, she or he would qualify for the credit analysis department. In addition, superior staff members who provide outstanding performance in two years are sponsored by the bank to study in a three-year part-time banking MBA program in one of the superior-rated business schools that specialize in banking and finance. The program is held for two weeks every year; in the interim period, the candidate remains in touch with the faculty and is given assignments via the Internet. These reports and the results of the tests are reviewed by upper management.

The purpose of the Bank of Whittier RF Open University training program is to graduate qualified and high-caliber RF bankers within two years by familiarizing the employees with an overview of all U.S. banking regulations and other banking operating codes, as well as different U.S. banking acts. All new employees who join the bank are required to receive the same training within three months of their employment.

The following is a summary of the Open University curriculum. It is not exhaustive, but gives a quick review and highlights of the important segments of the training program.

Reading Discipline

The staff members are trained to read with their fingers. Each staff member is asked to touch every letter, in order to read carefully any document they are asked to review. Management watches the new candidate to make sure that finger reading is practiced as a unique and universal characteristic of the bank staff. If the new employee does not use this technique, she/he is considered to be not qualified to continue as a member of our family.

RF Banking Values and Social Responsibility

RF banking values are detailed, and our motto, *We Do Not Rent Money—We Invest in Our Customers*, is discussed and made clear. Contrasts between conventional riba-based banking and RF banking outlook and approach are made clear and discussed.

Social responsibility, as manifested by dedicated and humble service to the community, is drilled in all our presentations and training. In addition, we review the very popular movie *It's a Wonderful Life*. The movie depicts a savings and loan banker with his wife who have spent their savings and life developing the community by helping community members move from rundown apartments to beautiful homes financed by the savings and loan bank, which used its deposits to build homes, finance autos for taxi drivers, and meet other community needs. In fact, we tell the staff that the first RF banker in America was George Bailey (acted by Jimmy Stewart, the star of the movie).

Introduction to Banking

The training program also includes an introduction to banking, the creation of money, the Federal Reserve System, and interest rates. A brief review of economics and monetary theory are also discussed. The contents of this book are essentially summarized to the staff in the Open University. In addition, important banking concepts like the multiplier effect, the creation of credit, bank capital adequacy, and liquidity requirements are discussed. Finally, a brief review of important bank policies is introduced and discussed with the staff.

Character Building: Honesty and Integrity[2]

This part of the program focuses on character and discipline of RF bank employees as the trusted custodians and safekeepers of our customers' money and private information. We play out different scenarios in which that trust is compromised before the class, in order to make them aware of the severe punishment that awaits embezzlers and bank workers who steal.

Management stresses beyond any doubt or mercy that it will be uncompromising and very brutal should the slightest indication of such behavior be discovered.

Know Your Customers, Privacy, Customer Identification Policies, and Fraud Prevention

New Accounts Opening After the crime of September 11, 2001 and the increased abuse of bank services in the United States by con artists, money launderers, and terrorists, strict regulations and security laws have been passed, making it difficult to open a new bank account for a new customer. This part of the program trains bank staff on the Customer Identification Program (CIP) at the bank and the required steps that must be taken to safely open a new account.

Staff is also made aware of and trained to follow the requirements and the guidelines of the USA PATRIOT Act.[3] This training program teaches the methods of *enhanced due diligence* and explains where to find documentation to assist in the verification of information.

Safeguarding Customer Information and Protecting Customer Privacy The staff is trained to recognize the methods and techniques used by con artists, impersonators, and identity theft experts to achieve their goal of getting as much information about bank customers as possible. Privacy regulations are discussed as well. The program also uses a video that dramatizes the mistakes innocently made by bank employees that can compromise customer data safety.

The responsibility of keeping depositors' information confidential is one basic and required responsibility of banking and, in particular, RF banking. A video training program was developed in compliance with regulatory requirements and is designed in such a way that the staff will fully understand the responsibilities with which they are entrusted.

Discovering and Identifying Check Fraud Bank staff—especially operations personnel, tellers, and the staff in bank treasury—are taught and trained on what to look for when a check is presented for processing, and procedures that should be followed to determine if the check is genuine or counterfeit.

Identifying and Preventing Fraud against the Elderly Many elderly members of the community use banks to deposit their savings and to receive their Social Security monthly payments and pension monthly payments. Elderly citizens are frequently the victims of choice of con artists. We show and discuss a videotape that illustrates procedures that may allow bank employees to detect and ultimately prevent frauds committed against elderly customers of banks.

Bank Security The staff is trained in ways to enhance security at the bank, from bank opening and closing discipline to daily bank operating procedures, as well as the bank's program to defend against bank robbers.

Understanding Banking Regulations

All bank regulations are discussed in great detail, and a summary of each regulation is handed out to staff. In addition, the Open University program focuses on a number of important regulations that must be understood clearly and followed religiously by staff members to conduct a safe and reputable banking operation.

Prevention of Money Laundering and Complying with the Bank Secrecy Act

Bank Secrecy Act (BSA) and USA PATRIOT Act[4] Banks may be the most important starting point in identifying irregular and suspicious activities. Bank tellers, private bankers, and management are responsible for keeping the public trust by always staying alert to any abuse of that trust by people who try to circumvent the system and abuse it. This training program is designed to be hands-on training for the staff, teaching them to comply with the Bank Secrecy Act (BSA) requirements and the customer privacy acts such as the Gramm-Leach-Bliley Act (GLBA). The training includes information on programs used by the bank to open accounts and identify customers who deal with the bank, like the Customer Identification Program (CIP) and others. The staff is also made aware of the repercussions and the stiff penalties for violating the Act.

Additionally, the staff is trained on executing regulations issued by FinCEN,[5] which requires that special reports be filed with the government about those customers who try to, for example, structure deposits so that they might circumvent the laws. The staff is also trained on the details of checking information on customers using the data available from the Office of Foreign Assets Control (OFAC). Staff is made aware of the stiff penalties applied to institutions that do not comply with the OFAC requirements.

Risk Assessment for Noncompliance A major part of every financial institution examination by responsible government and state authorities is a close look at risk assessment and risk management. Financial institutions are used to doing in-depth evaluations in lending, data processing, and information technology (IT) areas, where a breach could cause serious damage. However, risk must also be addressed from every vulnerable location, whether in operations, administration, the back office, or in the branch.

This segment of the program focuses on training staff to identify and communicate the many types of risks that most often occur in the bank branch(es) and to handle those incidents in a safe and sure manner.

Special Courses for Credit Department Personnel

Fair Lending Act Fair lending is an important RF banking requirement as well as an important government regulation. It must be taken seriously by all, and it must be recognized and practiced by bank management and staff. The bank's staff members are trained that the principle of fair lending, dealing with all people graciously and respectfully regardless of their skin color, affluence, religion, national origin, gender, or language, is not only good service but demonstrates compliance with the laws of the land and with Shari'aa, which makes discrimination one of the most serious offenses against our Creator.

Staff is trained to understand that it is not enough to perform sophisticated credit analysis and generate glossy and detailed financial analysis reports. The credit analysis staff is trained to gauge the character of the customer, his/her background and training as depicted by their personal history (a resume of the applicant is required by the bank credit department as part of a credit application package), the nature of the business, how the business is managed, and the detailed background of the managers in charge. Another important aspect of the training sheds light on the importance of visiting the customer's place of business and facilities—including the questions they should ask and the clues they should look for. Officers of the credit department and staff are trained to identify credit risks in such important business activities as marketing, business planning, environmental protection, governmental regulatory compliance, competitive analysis, operations management, inventory controls, safety practices, employee relations, and sales management.

Predatory and Subprime Lending RF banking is a brand of banking that does not even consider being involved in the business of predatory[6] or subprime lending,[7] because these businesses are against the Judeo-Christian-Islamic moral and ethical values of the RF bank. The staff is trained that they are not in business to make money on commissions from selling loans to borrowers or to meet "loan production" quotas, particularly when it comes to customers who could not afford to pay the loans back. The fact that some loans may be, for example, guaranteed by the U.S. government's Small Business Administration (SBA) or that the mortgage will be assumed by one of the government-sponsored entities (GSEs, like Freddie Mac or Fannie Mae) does not justify being "flexible" in applying the strict requirements of RF financing. The staff is trained to understand that we—as a dedicated RF bank—are in business to help people succeed and to meet their commitments and obligations. We also teach staff that digging a deeper hole of debt for our trusted customers by giving them loans that they cannot service is not only improper or illegal, but against the values by which we, as RF bankers, exist.

THE BALANCE SHEET OF THE RF BANK

Before explaining how to run an RF bank in general, it is useful to familiarize the reader with some of the accounting concepts used in banking. Any company, and for that matter any bank, has to balance what it owns—its assets—with what it owes—its liabilities. The difference between the assets and liabilities is equal to the shareholders' equity. The following is a detailed description of the balance sheet of an RF bank, compared to that of a riba-based conventional bank. It is important to note here that an RF banker looks differently at various liabilities and deposit accounts and the classification of the types of liquidity available to him/her. For example, the shareholders' capital is looked upon by the RF banker as the highest risk capital, which should be—implicitly—used first in its financing operations. On the other extreme, an RF banker views the demand deposit accounts (DDAs) as those that must not be exposed to any risk, because they are considered a trust (*Amana*) to be kept as though it were in a safe deposit box.

General Concepts

Liabilities When a customer deposits money in the bank, this deposit is called a *liability*, because the bank owes the money to the depositor when he/she demands it. When a customer comes to a bank to invest in a time certificate of deposit (TCD), that means that the bank owes that customer this money and the profit (interest or the rent of money, in the case of riba-operated conventional banks, and rent income derived from the rent of facilities in the case of RF banks) distributed by the bank.

Assets The bank is expected to invest the money that its depositors have entrusted it with by, for example, financing the credit needs of customers who want to finance the purchase of a car, a home, a commercial building, or a business. The promise of these customers to pay back is formalized in an agreement between the bank and the customer and is called a promissory note. It is considered as one of the bank's assets. If the riba-based bank has excess cash waiting to be invested in financing facilities (loans), it prefers to invest this cash liquidity in short-term investment instruments to produce more income, in the form of interest income. The most secure investment is with the Federal Reserve (the central bank of the United States), and the bank receives the Federal Funds interest rate. The cash could also be invested in TCDs in other banks, in government-issued bonds, in mortgage-backed securities (MBSs), or in other short- and medium-term debt securities that pay an interest income. These are all called assets. In the case of RF banks, the investment activity is categorized in relation to the type of liability on the RF bank's book. Here is a detailed classification of these deposits:

- *Demand deposit accounts (DDAs).* As stated earlier, DDAs can only be invested in Fed Funds and receive Fed Funds interest, which, as was explained in Chapter 7, is different from the prohibited riba in the Judeo-Christian-Islamic value system.
- *Shareholders' equity and time certificate of deposits (TCDs).* These funds can be invested in the RF financing portfolio, based on the *mark-to-market* principle. The income is distributed to the TCD holders. To comply with the government banking regulations, TCDs must declare a specific rate when they are advertised. The first solution is to limit the maturity to one, three, six, or twelve months. The advertised rate is a portion of the rent return on the RF portfolio assembled by the RF bank in a finance portfolio/TCD maturity matching program. As the RF bank is established and is accepted by the public and the regulators, a variable TCD rate can be offered.

The Balance Sheet and the Shareholders' Equity The responsibility of any accountant or bank chief financial officer (CFO) is to balance the assets with the liabilities and produce a balance sheet, which balances assets with liabilities. The balance (the difference between the assets and the liabilities) is the shareholder's equity. If the bank earns profit and, for example, its board of directors decides not to pay dividends to the shareholders, but to invest the profits back in the bank, the shareholders' equity increases. If the bank makes a loss, that loss has to be subtracted from the shareholders' equity, reducing it by the amount of that loss.

Comparison Between the Balance Sheet of an RF Bank and a Riba-Based Bank Operating an RF bank in the United States requires using standard language and accounting principles and abiding by all U.S. accounting regulations, principles, and standards. However, that does not prevent the RF banker from thinking and constructing an (internal) RF bank balance sheet, based on the RF principles detailed in this book, without violating the Financial Accounting Standards Board (FASB) rules and regulations. RF banking and financing is about style, philosophy, mode of operation, character, and mindset. This prompts the RF management to look at different parts of the balance sheet with an RF perspective, upholding the laws of the land while also upholding Shari'aa. Exhibit 12.1 contains a table that attempts to contrast the RF bank's balance sheet with the conventional riba-based bank balance sheet.

EXHIBIT 12.1 RF bank balance sheet versus conventional riba-based bank balance sheet.

Riba-Based Conventional Bank	RF Bank
Assets	**Assets**
Investments:	**Investments:**
Federal funds sold	Federal funds sold
Interest-Bearing Deposits	Short-Term RF Credits
Loans	**Asset/Service-Based Credits/Investments**
Commercial	Commercial
Real Estate	Real Estate
Consumer	Consumer
Liabilities	**Liabilities**
Interest-Bearing Deposits:	**Matched Rent/Income-Generating Deposits:**
NOW, Money Market, Savings	RF NOW, RF Money Market, RF Savings
Time Certificates of Deposit	RF Certificates of Deposit
Shareholders' Equity	**Shareholders' Equity**

Please note that the income and expenses of the bank are handled in another financial statement, which accounts for all the income sources of the bank and its expenses.

Income Ideally, the main income source of the riba-based conventional bank should come from the interest income earned on loans, because the interest rate charged is higher than all other sources of income, such as interest on TCDs with other banks, MBSs, or government bonds. In an RF bank, there is no interest income on loans, but there is rent income generated by the RF LARIBA model of financing.

There are other sources of income, such as the fees charged by a typical riba-based bank for its services. Example of these fees include *loan origination fees*, which cover the cost of time spent by bank employees (credit department and other administrative functions); *nonsufficient funds fees*, which penalizes those who write checks without having enough money in their accounts to cover the amount; *late payment fees*, which penalize those who are late in making the monthly payment on a loan; and *wire transfer fees*, which cover the expenses of wiring money from the bank or to the bank. Perhaps the largest of all fees and the highest of all interest income sources and fees is from the credit card business.

In an RF bank's case, all income generated from penalties charged for unjustified customer behavior is deposited in a special fund we call the M-Fund. (M is the first letter of the word *miskeen*, which means the needy. These are persons—in some cases employees with special circumstances, customers, or other individuals—who cannot make ends meet by relying only on their insufficient salary.) In addition, any unavoidable interest earned by the RF bank goes first to the M-fund and, if there are excess funds, then to registered and certified charities in the local communities, including faith-based organizations of all faiths.

Expenses Regular bank expenses include salaries and benefits of the bank employees and the interest expenses paid to investors in TCDs or other money market instruments, in the form of interest paid on interest-bearing deposits of different types in the case of an RF bank and income generated from the RF portfolio in the case of an RF bank. Other expenses are the usual expenses necessary to keep a business going, such as rental of premises, depreciation of equipment and other facilities, computer data and item processing (e.g., handling and processing checks), and the computer accounting system itself, which is provided by an outside service company that services all bank check sorting and processing needs as well as banks' computer and accounting services needs. In the case of the RF bank, these expenses are the same, except for the fact that the RF bank does not pay interest, as in the case of interest-bearing deposits; instead, the RF bank holds rent-generating deposits and the depositors are paid a portion of the rent income of the bank's RF investment portfolio.

Another expense that the bank management always must estimate carefully and take into consideration is to allow for any loan (credit) losses. This expense is called the allowance for loan and lease losses (ALLL). The ALLL is planned for by allocating an expense to allow for these potential losses. This expense is like an emergency fund that can be tapped in case there is a nonperforming loan. The money charged to the profit of the bank is considered as an asset. If a loan fails and is considered a loss, that will produce a very serious expense item that can be detrimental to the bank. The first step is for management to try to pay for the loss from ALLL. However, if ALLL is not enough, then the amount is charged to the expenses, and if there is a loss, this loss is charged to reduce the bank's capital.

As an example, consider a situation in which the bank assets are $100 million, and out of these assets was a loan portfolio of $85 million. One of the loans, say in the amount of $5 million, does not perform as agreed, which means that the customer, for one reason or another, has not made payments, cannot honor the loan commitment anymore, and is bankrupt. The bank decides to expense this loan as a nonperforming loan. Suppose the ALLL was $2 million. The bank management may try to allocate it to ALLL and according to the rules they only can allocate $500,000. This reduces ALLL to $1.5 million. Assets would be reduced by $5 million—$500,000 from ALLL and $4.5 million is allocated to reduction in income. If net income was $4.5 million and the bank capital was $10 million, then the new reduced bank capital would be $5.5 million. This may result in a bank with inadequate capital ratios as required by the regulators. The bank is required by the regulators to raise more capital in order to continue its operations.

Another unfortunate situation may happen. If the economy goes bad, or if the loan department was sloppy and not careful about its credit analysis and financing discipline, the bank might have four loans (say, $5 million each) that are considered a loss. That would mean a loss of $20 million. The net result would be that the bank capital is wiped out. Of course, bank management can hide these losses in many ways. One of these ways is to keep renewing these loans and not recognizing the facts, but in the end such losses will have to be recognized. That is essentially what happened in 2008.

THE NEED FOR A GOOD DETAIL-ORIENTED MANAGEMENT TEAM AT THE RF BANK

The success of any bank depends mostly on its management. Some bankers may want you to believe that banking is a very sophisticated business. It really is not. It is a simple business, but it requires intensive and expert attention to the minute details. That is why the centralized model, in which mega-banks acquire smaller banks and centralize different bank functions (especially the lending activity) at the bank headquarters, has proven to be ineffective, as was proven by the 2008 bank crisis and by subsequent tests performed by regulators in the first quarter of 2009. The large size of the system reduces the human dimension of this personal business called banking. Banking is a business that handles peoples' needs and trust; it cannot be done by reducing the customer to an account or loan number, sent to a central location to be processed and evaluated. This approach has transformed the bank branches of many of the mega-banks and the investment banking institutions in small communities into "asset gathering" outlets, without paying attention to the most important asset for a bank: the customer and the community.

For example, at the Bank of Whittier, every morning at 9:00 A.M. the bank president (branch manager) convenes a 15- to 20-minute meeting. Meeting participants include the CFO, the chief credit officer, the head of private banking and operations, the head of the credit (loan) department, and the operations manager. The group goes through the bank ledger line-by-line to make sure that not a single penny or data entry is missed or recognized, and to decide what to do regarding the checks that were returned to the bank because of insufficient funds. The chairman of the bank starts early in the morning—around 6:30–7:00 A.M.—and pores over the ledger and sends his questions to the 9:00 A.M. meeting; in some cases, he attends the meeting.

In addition to the 9:00 A.M. meeting, the operations of the bank must be scrutinized in great detail. This is done in the 11:00 A.M. meeting. This meeting is convened by the senior vice president in charge of operations and is attended by the CFO, the operations manager, and the treasury department supervisors to ensure that all of the bank's financial activities have been accounted for, that all nonsufficient funds accounts have been called by their RF private bankers, and that the customers with NSF warnings came to cover the deficit (or, if not, it is decided that the NSF check must be returned).

RESTRUCTURING A RIBA-BASED BANK TO OPERATE AS AN RF BANK

As has been stressed throughout the book, RF banking is not about form; it is about substance and operations that fulfill the requirements of Shari'aa, which reflect the fundamental values of the Judeo-Christian-Islamic system. This makes the transformation of the bank to an RF operating bank much easier, without even the need for a regulatory change or transformation of the current laws of the land in the United States. We believe that RF banking and finance is all about training the management and staff and how they all handle the most important of all God's gifts—the trust given to us by our customers when they entrust us with their hard-earned money, savings, and retirement planning funds and their private personal information. It is also about how management looks at the balance sheet of the bank, how the RF credit (loan) portfolio is developed, and how the RF bank liquidity is invested.

The first step the new management took when it arrived at the bank with the new RF banking team was to assess what was going on at the bank, in order to progressively transform the bank into an RF operating bank. Here is what we did.

Evaluation and Review of Existing Services

Review Existing Loans and Add New Credit to the Portfolio Using the RF Finance Principle of Mark-to-Market We were lucky to have a bank with a very small riba-based conventional loan portfolio that equaled about 20 percent of total deposits. That gave us a wonderful opportunity to start building an RF finance portfolio using the principles of marking-to-market and the RF finance model based on Shari'aa. The first step we wanted to take was to invest the large amount of cash we had on hand at the bank in different projects, such as commercial buildings, home mortgages, schools, faith-based worship centers, fast food franchises, medical doctors' clinics, and automobiles. We were lucky because we had accumulated extensive RF financing experience since 1987, when we started LARIBA.

The building of an RF finance portfolio needed time, and the bank had a very large cash position. In situations like this, a typical bank management contacts loan brokers to buy loans through them. This option was not available to us, because according to Shari'aa buying and selling of debt (*dayn*) is prohibited. In fact, this stipulation has been one of the most important factors that helped many Islamic banks fare better than conventional riba-based banks during the 2008 financial meltdown. In RF banking, the practice of investing the bank's money in different finance facilities must be conducted by the bank credit department, and it should be done with those customers who are known in person to the bank so that the money will be invested with them in the projects they need to finance. On the other hand, RF bankers are not allowed to sell their loans or sell the servicing of these facilities (servicing a loan means taking care of billing clients, collecting monthly payments, escrowing the funds needed to pay taxes and insurance, and responding to customers' needs), because selling debt and/or servicing is also not allowed.

I usually use a striking metaphor to make the concept clearer: "You cannot get married and turn around and sell your children." The finance facilities originated by the RF bank must be kept in the portfolio and serviced by the RF bank that originated them. It is much easier for the customer—who is looked on as a partner—to call us for assistance at any time. If the loans and their servicing were sold to an outside organization, as some banks do, the customer would end up calling a general number and speaking to a representative who has never met him/her and does not know anything about RF banking. At any rate, we were patient and built the RF financing portfolio at the bank in a prudent and meticulous way.

Investing the Bank's Cash The RF bank management is trained to categorize the different types of cash that the bank has. It begins by investing the shareholders' capital, which is—by definition—supposed to be exposed to the highest risk in the risk profile defined and approved by the board of directors. Subsequently, the treasury, in its allocation of funds to RF financing, uses the investment deposits that are invested as time certificates of deposit (TCDs). The funds that are tagged as deposits in trust (DIT, or *Amana*), which are known as DDAs in riba-based banks, must not be invested because of the implied covenant made by the RF banker to the owners of these deposits to keep these funds safe. Because our DDAs, from experience, were approximately 20 to 25 percent of the total deposits, the ratio between finance facilities (loan) to deposits was kept by policy not to exceed that percent (75–80%). These funds can only be invested with the Fed.

Evaluating the Risk of Nonperforming Parts of the Financing Portfolio: Calculation of ALLL To minimize the possibility of any unexpected variation in the portfolio performance, the Bank of Whittier's management pioneered a new risk-based system to evaluate the risk of nonperformance of one or more of the components of the financing portfolio. The following is a four-step summary of the procedure and methodology we developed.

1. The credit analysis team meets frequently to assess its credit facility portfolio in light of any significant changes in the economic, demographic, social, and political factors that have occurred in the quarter or are expected to occur in the short-term in the following quarter. These meetings are attended by the CEO, chief credit officer, credit analysts, treasury department, loan servicing manager, and private bankers. During the meeting, every credit facility on the bank's books is discussed by the credit analyst, the servicing department manager, and

the private banker in charge, as well as the rest of the participants including the servicing department manager. Based on the discussion, a vote is taken regarding the risk rating assigned to each credit facility and the need to keep it as-is, reduce it, or increase it.

2. The bank's CEO, chief credit officer, and deputy chief credit officer scan important financial, economic, monetary, and political news, analysis, research, and reports published by *The Wall Street Journal*, *The Financial Times* (London), *The Economist* (London), the Heritage Foundation, the University of Southern California (USC), the University of California at Los Angeles (UCLA), and various agencies of the federal, state (California), and local (southern California) governments. An integrated report on the state of the economy is published and distributed to the Strategic Credit Assessment Group (SCAG) to assist its members in formulating their opinions on risk factors affecting the allowance for loan and lease losses (ALLL) reserves.
3. Members of SCAG independently identify a matrix of the risk factors affecting ALLL reserves for the operating quarter to come. Based on this review, a probability-based qualitative/quantitative analysis is conducted by identifying in the matrix of variables the different economic, demographic, political, monetary, policy, labor and international factors. Each member of SCAG assigns factors to each of the variables, to include an estimate of how much each parameter will impact the different category the bank is active in financing. The result of the analysis produces a set of aggregated percent allocations for each credit facility that must be reserved in ALLL. This analysis is done independently by each member of SCAG.
4. The weighted average of the SCAG committee (usually six to seven members, with weights assigned based the member's experience and responsibility) is then applied, along with the historical credit facility loss factors, to calculate the required ALLL reserve.

Can the RF Bank Offer Unsecured Loans? What About Lines of Credit? Unsecured loans are loans granted by riba-based banks to individuals and institutions based only on the historic and projected cash flow. The riba-based bank does not take any asset as collateral for the loan. Because of the RF banking rules discussed in the book, unsecured loans are prohibited in an RF banking regime. As was detailed earlier, RF banking uses asset/service-based loans only, and the asset/service must be marked to the market.

If a customer is applying for an RF line of credit, the situation must be handled on a case-by-case basis. For example, if a medical doctor wants to finance the construction of his new home, an RF bank cannot simply offer a line of credit in the traditional riba-based conventional banking way. First of all, land is not accepted as an asset in most commercial banking regimes, because it is illiquid and nonproductive. The solution the RF bank management uses to serve situations like this is to evaluate the fair market value of the medical doctor's business, based on its financial statements and operating history. We then devise an implied joint venture between the bank and the doctor in which the medical doctor conceptually sells to the bank a share in his business in lieu of the cash that would be made available to him in a line-of-credit form. As discussed in Chapter 10, a lien is taken by the bank on the business. When the doctor withdraws money, the bank becomes an implied share owner of a percentage of the business, and participates in its profit in the percentage indicated. When the doctor pays the money back, the bank automatically (conceptually) sells the shares of the business back. This process is structured as a dynamic process using the LARIBA model and the mark-to-market principles discussed in Chapter 10.

Buying and Selling Loans When the new management team took over the bank, we needed to aggressively add new loans to the bank's loan portfolio to increase income (as is done traditionally in riba-based conventional banks). Some of our management team recommended that we call loan brokers to buy loans from other banks and financial institutions. According to the Judeo-Christian-Islamic value system and Shari'aa, buying and selling paper debt and trading these "paper" instruments are not allowed for a number of reasons, as discussed in Chapter 10. The most important of these reasons is the fact that these loans were not constructed according to RF financing requirements. The idea was discarded. The other practical reason for management's decision not to buy loans from brokers is that the broker who will bring those loans (paper debt) will eventually try to "churn" them (offering them within a period of approximately two years to another bank), creating a speculative chain that does not create any benefit to the customer (whom the bank never meets, because it is a brokered loan) nor to the bank itself. The bank pays a commission to the broker who brings these loans and ends up losing that money within two years, along with the loans.

Our credit policy spelled out very clearly the condition of not buying debt, because of the RF bank's implicit function as an investor—in a riba-free way—with the customer, who should be known to the banker. Finally, it must be stated that the bank bought RF MBSs that were "manufactured" by LARIBA according to the Fannie Mae standards (RF MBSs). This was, in fact, not a purchase of debt but a practical and legal way, according to the laws of the United States and Shari'aa to invest, as the mortgages that constituted the RF-MBSs were produced by us at LARIBA, and every credit is known to us in full detail. The payment experience of each of the RF home mortgages in the RF/MBS was known to us in great detail because we were the ones who financed the underlying mortgages in an RF way. More details on RF MBSs will be included in the next chapter, which is devoted to RF financing case studies.

Selling the Servicing of the Finance Facility to Generate a Fee Income After the financing facility has been booked by any bank, it must be serviced. This means that the servicing department must issue the monthly billing statements and mail them to the customers, receive payments, keep track of the accounting, keep track of the insurance validity on the property and whether insurance is current, and make sure that the customer is paying local, state, and federal taxes on time. In the United States, there are companies that are willing to "buy" the servicing of the loans and pay a generous fee to the bank or the finance company. As discussed in Chapter 10, it was decided not to follow this practice, because we felt that it did not fit with Shari'aa and Judeo-Christian-Islamic values. It would be unacceptable to invest in a customer and then sell the relationship so that when the customer calls, he/she is connected to a representative whom he/she has never met, who may not be familiar with the community and with RF banking and finance values.

Screening of the Existing Deposit and Investment Accounts All of the existing accounts and the owners of these accounts were closely reviewed on a case-by-case basis and most of them were contacted and/or interviewed. We discovered that the bank had accounts for liquor stores, night clubs, bars, and check cashing companies. We proceeded to close the accounts of the liquor stores and the bars, for obvious reasons. We also concluded that the check-cashing companies were taking advantage of low-income citizens who did not have a bank account, and that the interest rates charged to these people were excessive. We decided to close those accounts, as well. It is important to indicate to the reader that while making the decision to close an account, we never gave weight to the size of the account. We focused on the requirements of the RF moral and ethical values, which manifest the values of Shari'aa and the Judeo-Christian-Islamic system.

Deciding on Types of Accounts Offered to Individuals, Families, and Businesses

Most banks in the United States offer a highly diversified array of services and types of accounts. One day, I asked myself about the motivation behind the different account types, names, and the conditions that have to be met, for example, for the customer to obtain a free business account service or low fees on income-generating accounts. It was clear that these many types of accounts were marketing techniques used by the new accounts departments of different banks to entice customers to open accounts and maintain their existing banking relationships.

In response, we convened a meeting of the concerned departments and after an in-depth discussion we agreed that the bank would offer simple and clearly defined account types and conditions, and that we would earn our income at the bank, mainly through reinvesting the funds in our customers by financing their needs. This practice brings our motto to life: *We Do Not Rent Money—We Invest in Our Customers*. The following is the list of account types that we decided to offer our clients. All these are offered at no fees.

Deposit-In-Trust Accounts (DIT)—Correspond to Demand Deposit Accounts (DDA) in Riba-Based Conventional Banks These accounts comply with the U.S. federal banking Regulation Q, because they are looked on literally as money given by the customer for safekeeping at the bank. A DDA is a type of cash account that makes customer deposits available upon demand. Regulation Q disallows the payment of interest/profit on these deposits because they are not allowed to be invested or given as a loan—this money must be available any time the customer asks for it by writing a check or by ordering it to be transferred by any banking mechanism.

This type of account is exactly what is called in RF banking the *Amana* account, meaning a deposit-in-trust (DIT) account. In RF banking, the chief operating officer (COO) must pay close attention, with his CFO and the rest of the treasury supervisors, to make sure that the Amana/DIT accounts are not used for financing activities (lending) because that does not comply with our implied agreement with the clients who wanted to use the bank as a safe place to keep their money. DIT deposits can only be invested overnight in the Fed Funds to alleviate some of the fees charged by the bank. The RF bank may be allowed by Shari'aa to charge a service fee that pays for the cost of safekeeping and servicing these types of accounts, in case the income from the Fed Funds is not sufficient. As discussed in Chapter 5, the Fed Funds rate is the rate that reflects monetary policy regarding the printing of paper money (fiat money); it is different from the interest prohibited by Judeo-Christian-Islamic Law (Shari'aa).

Income-Generating Accounts for Individuals and Businesses: Regulation D Deposits Investment banking firms (e.g., Merrill Lynch, Morgan Stanley, and Goldman Sachs) offer money market funds, denominated at $1 a share, which give a variable interest rate on the deposits. These money market funds are mutual funds that invest in short-term fixed-income interest-paying securities. In response, the federal banking regulators established

Regulation D, which allows the bank to open accounts as Negotiable Order of Withdrawal, or NOW, accounts for individuals, to allow depositors to earn income on their deposits. Later, businesses were allowed to open Money Market Accounts that also abide by Regulation D. One very important difference between the investment bankers' mutual funds' money market accounts and the depository institutions' bank money market funds is that the bank funds are FDIC-insured.

To limit sudden withdrawals of invested funds by the customers and to allow financial managers and bank treasuries to project their cash needs without compromising bank liquidity position, federal Regulation D places a monthly limit on the number of transfers the customer may make from his/her NOW or business Money Market Accounts (MMAs). Transfers affected by this regulation include:

- Automatic teller machine (ATM) transactions
- Transactions done in person at a branch
- Transactions sent in by mail, express drop, or night drop with an original signature
- Transfers made using the Internet
- Transfers made using the automatic telephone transfer system
- Overdraft transfers (made automatically to cover insufficient funds in other accounts)
- Transfers made by a bank service representative on customers' behalf
- Pre-authorized, automatic, scheduled, or recurring transfers

Regulation D allows customers six such transfers per month, per account, but only three of those may be made by check (a check counts against the month in which it clears, not the month in which it was written).

In an RF bank, the sources of income for these accounts are generated from the income the bank makes from the portion of the monthly rental payment that represents the bank's profit (return on capital invested, or RonC, as was described in Chapter 10). The money can be considered as a gift (*hebah*) to the depositors from the bank, in order to keep their short-term investments. In deciding on the level of hebah, it is obvious that the RF bank management takes into consideration what the competing Riba-based conventional banks are offering and tries to make the bank's hebah higher, to attract new customers and not lose existing customers to other banks.

Investment Accounts in Time Certificates of Deposit (TCDs) TCDs are the most important types of accounts for any bank. TCD money is invested in the portfolios constructed by the RF bank's credit department. This represents a very important challenge for the RF banker, because the RF bank management has to match the maturities of the TCD portfolio with the RF bank investment portfolio's (loan portfolio in riba-based banks) maturities. It is also important to know that the RF bank management, represented by the chief operating officer COO, the chief financial officer CFO, the bank treasurer, the chief credit officer, and the credit department, evaluates the expected return on a TCD investment that is matched to the credit (loan) portfolio in light of the bank's operating expenses, allowance for loan losses (ALLL), the average return on investment of the portfolio, the duration of the portfolio, and maturities, in addition to the rates offered by the competition.

This particular investment product is also very challenging because of two important limits and compliance requirements, which need to be met by any bank in the United States. These are the full disclosure of the (implied) interest paid to the TCD investor with different maturities and the penalty charged for early withdrawals.

The solution to this challenge depends on both sides of the financial ledger. On the assets side, the RF credit portfolio is constructed such that the implied interest rate (based on the actual market rental rate of the property or service, using the LARIBA RF Shari'aa-based model described earlier) is indexed to the rate by which the government declares the Fed Funds rate. That way, every time the Federal Reserve changes the rate, it reflects—in most cases, every quarter—the implied interest rate on the TCD is changed. On the RF TCD side, we offer our customers maturities that range from three to twelve months, and we discourage longer maturities so that we may comply with Shari'aa, which prohibits fixing returns in advance for a long time. In this case, the rates of return (the implied interest rate on the financing facilities) and the profit paid to the RF TCD holder (interest on CD in riba-based banks) are adjusted in sequence to avoid any violation of Shari'aa or of the strict U.S. banking regulations. As the RF banking industry matures and is accepted by both the regulators and the customers, a variable income TCD can be offered.

The rate of return on investment for RF TCD is calculated using two important guidelines:

1. *Competing rates offered in the market by all competing riba-based conventional banks:* The objective here is to make sure that the returns on investment/profit sharing given to the RF investor for investing in an RF TCD are at least the same return as (and hopefully more than) the riba-based returns paid by conventional banks.
2. *The profit distribution from the portfolio:* We ensure that the distribution is fair as disclosed to the customers.

Another important but challenging issue which needs a lot of future research is the ability of the investors in RF TCD to cash their deposits before maturity. In the United States, the regulation may require charging a stiff penalty. However, in case of an emergency such as a sudden illness, emergency funds needs, and the like, this penalty can be waived by bank management. Of course, clients cannot just unilaterally come to the bank to cash their investments before they mature, because they could cause a run on the bank that could have very negative repercussions on the bank's safety, soundness, and reputation. The difficulty here is in the ability of the RF bank to keep enough liquidity to pay the premature liquidation demands of the term depositors while most of the deposits are invested in medium- and long-term projects. In fact, if any bank fails to meet the demands of its depositors, the damage done will be serious and irreversible, and it could mean the closure of such bank. It is important for the RF bank management to take an active and very closely watched role in assessing liquidity needs based on experience, contact with the customers, and evaluation of the markets. In addition, it is recommended that the following steps should be taken in consideration:

1. Match the maturities of the RF TCD to the loan portfolio, and offer incentives to invest long term.
2. During the start-up of the RF bank (the first five years), consider financing projects with maturities ranging between three to twelve months in the first two years of operation, three months and three years in the following years, and then three months and five years in the following year. This way, cash will always be available for unexpected withdrawals and/or reinvestment.
3. The shareholders of the RF bank should stand ready to meet any run on the bank deposits by providing additional capital. The additional capital needs will be continually assessed by the RF bank's management and board of directors through continual contact with the shareholders to assess their ability, capacity, and willingness to meet additional capital needs. This in itself will make the shareholders, some of whom are also the managing directors and staff of the RF bank, careful about reviewing the assets/liabilities management and cash flow projections.
4. Commercial entities and individuals who seek financing from the RF bank should be required to bank with the RF bank and if possible to keep a balance on deposit as an investment with the RF bank.

The most important factor here is close and continual contact with every depositor, investor, and entrepreneur. If these contacts are developed to reach the level of a big family, then projections about the demands of the members of the family can be accurately assessed in advance, and liquidity can be planned without having to deal with any unpleasant surprises.

Credit Cards and Automatic Teller Machine (ATM) Debit Cards An RF bank offers two types of card services. The first is a regular credit card, which is administered and the credit approved by an outside credit card company, to avoid participating in riba and to minimize credit risk at the bank. This service is offered as a convenience to some, but not many, of our customers, so that the bank can offer all services needed in the market. It is important to note that the management at the Bank of Whittier trains the RF private bankers to give customers who apply for and use credit cards a very clear warning (which is also prominently displayed on the bank's Web site):

> *Credit cards are offered for shopping convenience; each customer should spend within his/her means and pay the card charges within the month to avoid paying interest. Credit cards are not meant for borrowing with interest.*

One day, a member of bank management received a call from a banking regulator, commending us for our very unusual invitation to people not to use their credit cards as a means of very expensive borrowing and our encouraging customers to pay the charges off as soon as possible (preferably no longer than a month). It is well known in the riba-based banking industry that credit card interest charges and fees have grown recently to represent a significant source of income for most of these riba-based banks.

In addition, the RF Bank of Whittier offers a Visa-linked debit card that allows the customer to debit his/her account directly anywhere in the world. We did not call it *Islamic*, as some have done, because our disciplined policy requires that we call it what it really is.

Risk Management for an RF Bank

It should be stressed that the credibility and performance of a new RF bank are not only the professional duties of the RF bankers but also their responsibility before God. It is important to design RF bank operations, policies, and systems in a fashion that minimizes the RF bank's risk of failure, which would result in the loss of people's money and trust. If that were to happen, the dream of popularizing this new brand of banking would die for the next three to four generations, because humans tend to remember failures over an average of three to four generations. RF bankers simply cannot and should not allow this to happen.

The Source of Shari'aa and Edicts (Fatwa) Used by the RF Bank This is perhaps one of the most serious concerns for an RF bank, because it directly impacts its reputation and credibility. When the board of directors at LARIBA and at the Bank of Whittier discussed which model to use and which scholars to follow, we were extremely careful and deliberate. Many issues came up. The first was where the scholar was from. As it is known, opinions on Shari'aa—and, for that matter, general legal *Shari'aa*-based interpretations and opinions—vary from one country to another. In addition, some have a personal preference for a certain scholar while others do not. These concerns were especially serious when dealing with the first-generation immigrant communities. To avoid any conflicts or disputes, we decided to:

1. Focus on the sophisticated and educated Americans who prefer to read carefully what they'll commit to and who are Internet- and computer-savvy. This way they can read and understand clearly the foundations of our models.
2. Publish all the models used by all the scholars on our Web site and include a disclaimer that states that displaying these edicts (*fatwa*) and models does not mean that we claim that we have a fatwa from a certain scholar about what we do. We have presented the fatwa because we believe that the customer should decide based on carefully reading the foundation upon which the LARIBA model was developed. It is also believed that the eminent scholars' names should not be used along with the faith as a marketing tool to "sell" more loans.
3. Make our Shari'aa scholar and supervisors, who are well-versed in the application of Shari'aa, available to directly answer any inquiries about the model, the details of applying it, and the ways in which other models differ from the model we pioneered. In fact, the supervisors spend an average of 3,000 minutes on the cellular phone every month communicating directly with prospects and clients.
4. Document many of the questions asked and the answers given by the Shari'aa supervisor on our Web site.
5. Closely supervise company operations, including responses to incoming calls and inquiries to the RF finance officers (who are salaried employees and are not paid a commission based on the volume of loans they originate), the company telephone operator, the servicing department, and everyone else involved, to ensure they abide by Shari'aa. To do so means they must always state the truth and be cordial and helpful; they must never use clever and misleading sales techniques that claim lower rates to lure new customers; misstate

facts; nor put down or criticize the competition in order to "sell." This practice is enhanced by the Shari'aa supervisor and his staff scanning all incoming and outgoing e-mails and communications to ascertain compliance with the Law (Shari'aa).

Risk Management by Applying the Proper RF Financing Model As indicated earlier in the book, cost-plus (murabaha) represents the least risky RF financing model. It is true that the profitability may be limited, and that the model itself is not accepted by many of the customers looking for RF financing because it is very close to and resembles conventional riba-based financing, but it offers a lowest-risk type of investment. The risk grows as we move from cost-plus (murabaha) to money management (mudaraba), joint ventures (musharaka), leasing (ijara), and RF financing of future production (ba'i ul salam).

It is recommended that for the first one to three years of operation, the RF bank should use the cost-plus (murabaha) approach, as we did in LARIBA for two years. Then you can slowly move into leasing and lease-to-own joint ventures using the RF LARIBA Shari'aa-based model as discussed in Chapter 10. To minimize risk during these first two to five years, the RF bank management should set aside sufficient reserves (ALLL) to allow it to meet any unexpected nonperformance of the financing activities in which it is participating.

Risk Management through Diversification of Clients The RF bank management should do its best to spread its financing activity throughout the community without concentrating the financing into a small number of already successful businesspersons. This strategy will also result in more clients on the investment side and a bigger pool of referrals. Additionally, the probability of failure is distributed over a larger number of clients.

Risk Management through Diversification of Sectors of the Economy It is advisable to recruit a viable board of directors for the RF bank. the members of which represent expertise in the business sectors to be financed by the bank. In addition, these directors must pledge not to finance their businesses with the bank to avoid the slightest concern of self-serving or violation of the U.S. banking Regulation O. It is also important that the RF bank, through its thorough analysis of economic activity as well as political, financial, and monetary developments, formulates an investment position on a quarterly basis, as discussed in assessing the level of ALLL. In this analysis, attractive sectors of the economy should be identified as well as unattractive sectors. In this way, the RF bank's credit policies committee devises an investment "pie" that allocates the investment of its funds in each sector. The allocation would be dynamic and would change as the economic projections change.

Risk Management through Diversification by Geographic Location Close attention should be exercised by the RF bank regarding the locations it is interested in serving. For example, if one is in the United States, risk factors should be assessed for different markets in different towns, cities, and states to determine how much of the bank's money should be allocated in each location, based on that risk factor, without any discrimination or violation of the tenets of the Community Reinvestment Act (CRA). It is important to ensure that hidden discrimination is not practiced by denying lower income communities the services offered by the RF bank; all communities must be served in a fair and balanced way.

NOTES

1. Yahia Abdul-Rahman, *Strengthening Investor Confidence in Islamic Finance, Attracting Investors to Invest in Islamic Financial Institutions and Instruments in the US & Canada*, speech delivered at Monash University 5th Annual Islamic Banking Conference, Mandarin Oriental Hotel, Kuala Lumpur, Malaysia, September 3–4, 2007.
2. Many of the video training programs cited in the Bank Open University training program are designed and produced by Bankers' Hotline, www.bankersonline.com/bin/bhhome.html.
3. The USA PATRIOT Act, commonly known as the Patriot Act, is a controversial Act of Congress signed into law by former President George W. Bush on October 26, 2001. The contrived acronym stands for "Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism." For more details please visit the official U.S. government Web site: www.fincen.gov/pa_main.html.
4. Ibid.
5. FinCEN is The Financial Crimes Enforcement Network, which is one of the U.S. Department of Treasury's lead agencies in the fight against money laundering. It serves as a link between the law enforcement, financial, and regulatory communities. Please visit the Web site at www.fincen.gov.
6. The name "predatory lending" originates from the word *predators*, which refers to hunting animals. The implication is that these lenders take advantage of those who are in great need of a loan by charging them very high origination fees and by asking them to sign contracts that sometimes allow the lender to confiscate and foreclose on the property the first time the customers are delinquent in making a payment.
7. Subprime lending was invented by lenders and heavily promoted by the U.S. Department of Housing and Urban Development, as well as many GSEs. It

began as a financing approach for those who have low credit scores, but evolved to cover a much wider spectrum and was relaxed to allow every applicant to take loans that, in many cases, they could not repay because they did not have the income. Subprime lending was the straw that broke the camel's back and exposed many of the excesses that led to the 2008 financial meltdown in America and the world.