

Why (Islamic) Banks Lend Instead of Invest: The Economics They Don't Want You to See
Safdar Alam

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Over 40 years we have been told Islamic banking is “ethical, asset-backed, and different.”

I’ve spent 25 years inside the system. The truth is far worse — and far simpler.

Islamic banks don’t invest in assets. They manufacture debt.

I’ve broken the entire hidden architecture into a 4-part series.

Part 1 drops tomorrow.

Here’s the core problem in laid out in four images

PART 1/4

My criticism of banking, and, by extension, Islamic banking is well documented. A common response to this is along the lines of the following:

- It might be not perfect, but these are steps in the right direction
- Islamic banking is a young industry, and we need more time to develop
- Islamic banks are just trying to be commercial in a competitive industry
- Let’s support all the work that has been done, and let’s continue to build on it and support improvements

Any my response to these points has, unwaveringly, been as follows:

- Banks (including Islamic banks) are built on debt - debt is their DNA, they cannot change
- Banks must lend or they will die
- Of all the models we could have chosen to build on, the selection of a banking platform is immensely damaging to Muslims, and could only have been a decision encouraged by the enemies of Muslims
- Waiting for a bank to move from debt and lending, to real investment, real profit sharing, and beneficial direction of capital, is like waiting for the sun to rise in the west

For those familiar with my stance, you will notice that I have watered down the wording

of my positions, so that I do not exclude those who might be supportive of Islamic banks. I would say that the supporting of Islamic banks can only be a position based on ignorance, or the will to harm Muslims, but I will not say that here. Yet.

In the early days of my Islamic finance career, before Blackberries were the newest thing, when we still sent faxes to execute deals, I was not aware of many of the structural imperatives that decided for banks what they must do. What I did see, were the consequences of these imperatives.

I observed deal being executed that started off as regular sales transactions, or what appeared to be investments in real assets, but then were combined, or structured in such a manner (often by myself) such that the end result bore no resemblance to what was initially presented.

I created products on Murabaha, Musharakah, Wakala, Mudarabah – and all of them, invariably – were tweaked, amended, deconstructed - and turned into debt.

This structuring process was at the heart of my role as Global Head of Islamic Structuring at JP Morgan, and my roles in setting up the Islamic banking teams at UBS and Credit Agricole investment banks. It was something I actually enjoyed, and it was very challenging.

My main aim was to make money for my bank, and if I failed in that, I would have been fired. And quickly. In order to make these large amounts of profit, I had to understand what the markets wanted, and my clients were all Islamic banks. I had to gain an expert knowledge of what they wanted, what tools we had available to us, and how to use those tools to deliver what was required. The conventional banks I worked for never presumed to have a position on what is good or bad in Islamic finance. Their stance was:

- We are here to make money
- We need to do what our clients want
- We don't care if Islamic finance / banking is good, bad, ethical or downright Satanic
- Tell us your rules, your requirements, what you want, and we will deliver it or Safdar will lose his job

What I did notice was that, if I wanted to keep my job, I had to deliver debt to the Islamic market. And, virtually, all the time.

There were exceptions. We created some funds, which were fun, and actually invested in real things and made profit for investors. But in terms of size, these funds probably totally \$500mn and the debt I delivered was at least \$20bn, and more. And I was not

even the debt specialist in my teams, and they did more.

I also delivered many solutions that were needed because of the size and complexity of the debt that was created. We found that Islamic banks, once they started to accumulate debt instruments and liabilities on their balance sheets, had a need to manage this interest rate risk. So I personally constructed the first Profit Rate Swaps in the sector, which have some of the most involved and complex characteristics of any products I developed.

We also delivered currency and treasury risk management solutions to Islamic banks. These were lots of fun too, to develop.

But all of these were needs of the market that arose because of their entrenchment in debt. Manage interest rate risk because they were giving so many loans of differing tenors and risk profiles to clients. Manage currency risk because they were busy in giving loans in different currencies.

Before I get lost in the nostalgia of the “good” old days, let’s bring this back to the topic at hand.

While I was structuring all these weird and wonderful products, I noticed that everything led back, in an indirect and roundabout sort of fashion, to debt.

And, clearly, I noticed the structuring elements that converted the purchase of commodity, or the apparent investment into property, or oil fields, that converted these transactions into debt products. I noticed this because I was the one who did it.

I knew Islamic banks liked debt, and had debt everywhere in their business, but did not understand how deep this need was, and why it arose. Perhaps I thought it was because they just saw it as easier to manage and everyone wants loans, so it’s an easy way to make money.

It took me some years to delve deeper into this, and to gain some understanding of the underlying conditions that resulted in these actions. And the more I discovered, the more depressed I became.

In this paper, I want to provide a mechanical, practical and realistic example of why Islamic banks love debt. And why it is insanity to expect Islamic banks to somehow develop, or improve, and move away from debt.

As I sit here at a café while writing this, watching the world pass by, I think it is more likely that the whole street is lifted into the air, and turned over, and deposited back

upside down onto the ground, than seeing Islamic banks move away from debt.

the details of the beast inside that force Islamic banks to embrace debt and Riba

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Why (Islamic) Banks Lend Instead of Invest: The Economics They Don't Want You to See

PART 2/4

So, let's talk about Islamic Banks and Debt

Let's imagine an Islamic bank, that is quietly going about its day, and is presented with an investment opportunity. This opportunity is to invest in property, perhaps a development, and take risk on the outcome, and hope to profit from this venture. It can partner with an experienced developer to reduce risk.

And also let's imagine the same Islamic bank has received multiple mortgage requests to provide financing to customers to purchase property. Let's see, in real terms, how an Islamic bank will approach these two differing opportunities for deployment of capital.

The bank has around £1mn to invest and must choose between these two directions. Let's see how they make their decision.

Basel III

Of course, I had heard of Basel III in my career, but it was one of those things that did not directly impact my work, so I ignored it. I knew it is important for all banks, but things like risk and regulatory requirements was dealt with by different teams. My role was to make money for my bank, and we left these kinds of things alone, to be dealt with by those whose job that was.

Basel III is a global regulatory framework for banks, developed by the Basel Committee on Banking Supervision (BCBS) after the 2008 financial crisis, to strengthen banking sector resilience through higher capital, liquidity, and leverage standards, ensuring banks can better absorb economic shocks and continue financing activity.

This is all fine, but what does it mean in reality, and how does this impact our discussion here today?

In fact, understanding this regulatory framework will be absolutely critical in our drive to

understand what banks do, and why they do it. And it will explain why I felt that everything I was doing in Islamic finance was debt.

These regulatory requirements are in place so that banks don't become insolvent. A bank becoming insolvent is a very different matter to a regular commercial entity becoming insolvent, because people hold their deposits at banks, and people trust banks. And because governments protect deposits held at these banks.

If a bank becomes insolvent, as we have seen since the 2008 crisis, and since, it can spread panic amongst the financial markets and amongst people. The process of a bank run is a very interesting one, along with the mental and emotional reactions from people who hold deposits at any bank, but that is for another day.

These rules are in place so that banks can demonstrate that they can survive adverse market conditions. They should ensure that banks are "resilient" and they can weather negative events.

So, back to our situation, when the Islamic bank assesses the two financing opportunities, their decision will be firmly rooted in understanding the regulatory capital impact of potential financial transactions they undertake.

Let's consider the direct investment into property of £1mn. This property will become an asset of the bank, and Basel III states that each asset will have a Risk Weighting, that indicates, as the term implies, how risky that asset is for that bank. This means the asset can go down in value, it can become hard to sell that asset (liquidity), or other events could occur that mean the bank can lose some or all of its investment into that asset.

These factors are assessed for any kind of asset on the bank's balance sheet, with property as one key category. Basel regulations assign a range of risk weights to property investments, typically from 70% to 150% depending on the type (lower for secured loans, higher for direct holdings). Many direct property investments fall in the 100%-150% range. For our illustration of buying a property—the most common form here—I'll use 115% as a reasonable midpoint within that band.

So we can calculate the risk weighting of this investment as 115% of £1mn, being £1.15mn. Now, Basel III states that banks must maintain a minimum amount of Regulatory Capital of 8% of Risk Weighted Assets (RWA). There is also a requirement to maintain a Capital Conservation Buffer of 2.5% of these RWA, which adds up to 10.5%.

10.5% of the RWA here (which is £1.15mn) is around £121,000. Does this mean the Islamic bank must now hold this amount of cash? The answer is no, as Basel III specified in form this regulatory capital can take. It can either be Tier 1 Capital (which is

the equity of the bank, ie the ordinary shares it has issued, plus some forms of preference shares and also retained earnings from previous years)) or Tier 2 Capital (which is mainly bonds/Sukuk, and other forms of debt assets held by the Islamic bank).

We should note that cash does not count as regulatory capital here, so the bank cannot say that it holds this £121,000 in cash as the required regulatory capital for this asset. It can, however, use that cash to purchase the necessary debt instruments that do qualify.

Or the Islamic bank can point to existing Tier 1 and Tier 2 capital that has not already been allocated as regulatory capital for other assets on its balance sheet. In any case, the Islamic bank must now ensure regulatory capital to the value of £121,000 is allocated specifically to this property investment.

So, in total, the bank has paid £1mn for the property, and allocated £121,000 of regulatory capital to support this investment.

Now let's look at how the bank will approach providing home loans instead of buying property.

Risk Weighting for Debts as opposed to Investments

Let's assume the bank wants to provide financing to a customer who wants to purchase the same property of value £1mn. Let's also assume the bank just provides the whole amount as a loan, ignoring the fact that in reality, a deposit would be required.

When the bank provides this loan, something important takes place. It is Credit Creation. The bank does not need to go and find £1mn in cash to make this loan – it simply creates this £1mn out of thin air and places it into the account of the customer (in reality, it will not do that, but send this £1mn straight to the seller).

So we see one major difference already compared to actually buying property, which is that in order to buy the property, the bank must deliver £1mn in cash to the seller, but to provide a loan, the Islamic bank simply creates this credit out of thin air and says, "Voila, here is the £1mn".

This credit creation is, after all, why banks exist, and why they work so hard to obtain a banking license in the first place. The history behind how banks obtained this power, and how governments contracted out the practice of creating money to banks, is something that I recommend every reader to study.

There is possibly no more disturbing and damaging event in our financial history than these events.

Let's carry on – so the bank magically creates this £1mn, and now the bank has, an asset on its balance sheet, a loan of £1mn that is repayable by that customer. This is an asset for which we must calculate the risk weighting as before. Because this is a loan, and not a direct asset like a property, it attracts a much lower risk weighting than the previous asset. These range from 20% to around 40%, and we can use 35% for our purposes here. So the risk weighting attached to this financing is $35\% \times £1\text{mn}$ which is £350,000. We apply the same regulatory capital requirement as above of 10.5%, which comes out to around £37,000. We note this is quite a lot lower than the equivalent requirement for £121,000 for the property investment. This is expected, because such a loan has lower risk volatility associated with it than the investment.

The property can fall in value, or rise, and it can fail to deliver returns (lease income or rental income) or it can be destroyed (insurance will be in place) and it also needs to be maintained – tax and duty payments, upkeep, repairs, and all the general headaches associated with actually owning property.

With a loan however, all the bank needs to do is to make sure it is repaid. They will have conducted risk assessments on the customer, and also conducted a valuation on the property itself, and the property will act as collateral in case the customer defaults on this loan. The risks associated with this are regular business for any bank.

So, to purchase a property for investment purposes, the Islamic bank needs to allocate £121,000 of regulatory capital, and deal with the real risks of ownership. And to provide a loan of the same amount, the bank needs to allocate £37,000 of regulatory capital, and face only credit risk supported by collateral (the property).

So can we say the Islamic bank can provide loans for around 3 properties compare to buying one property as investment? This would work out to the same ratio of the risk weightings (115% vs 35%).

Well, the answer is no – the answer is not that simple.

Remember, for the investment, the bank had to use real cash of £1mn, but for the loan, it created this £1mn out of thin air, because it is a loan. This is the key distinction that sends out analysis into the stratosphere.

Let me demonstrate.

Part 3/4

The Real Difference in Lending vs Investing

If we look in terms of pure capital outlay, the loan is costing the bank £37,000 (this

amount of regulatory capital needs to be allocated to that loan), and for the investment the bank is incurring a regulatory capital cost of £121,000 PLUS the real cash investment of £1mn.

This means the bank has to allocate real cash plus regulatory capital of £1,121,000 for the investment and only £37,000 for the loan.

So now, the bank can repeat this same loan of £1mn several times, and each time they need a full cash PLUS capital outlay of £37,000.

This means they can repeat the loan process over THIRTY times until they reach the same cash plus capital outlay (£1,121,000) as the single property investment.

This is quite mind boggling, isn't it?

So we can see that the bank has a choice of giving loans for 30 properties or actually buying a single property, and this would result in the same outlay (cash plus regulatory capital).

Now let's look at profitability.

We have to make some assumptions here.

In the UK, current 2-year fixed mortgages are in the range of 4.5%-5.0%. We can use 4.5%, so we can estimate the bank will make an interest profit of 4.5% on £1mn in the first year of the mortgage. The actual amount will not be this, due to the following:

- Islamic banks tend to charge higher interest rates on mortgages than conventional banks, because they are just more inefficient and also charge a premium on piety
- Real interest rates will depend on Loan to Value, borrower credit quality, fixed vs variable rates
- Outstanding balance is normally amortised
- The Islamic bank's cost of capital, availability of regulatory capital, liquidity costs, and other costs impact returns

Even with these conditions, we can provide this estimate as being reasonable for our higher level purposes here. And if these estimates materially overestimate the profit earned by a bank on this loan, then please feel free to correct me, and calculate the impact on my calculations below.

For a property investment, gross rental yield of 5%-6% is considered good. We can use 6% here. Other relevant costs include (estimates only):

- Stamp Duty – for this value property, the standard rate plus additional property surcharge in the UK works out at around 10%, and we can amortise this over an

assumed tenor of ownership of 25 years, which is the standard mortgage tenor in the UK, so the annualised cost here is £4,000

- Property management and letting fees are around 10% of rent in the UK, so this works out around £5,000 per year
- Repairs and maintenance – assume 1% of property value per year, being £10,000 annually
- Insurance, landlord services, legal and tenant vetting, we can assume £2,000 per year
- Void periods – assume 5%
- Council tax and other property taxes - £3,000 per year

Putting all these together, this provides an annual income of around £60,000 - £28,000 = £32,000.

Thus the Islamic bank will make an estimate net income of around £32,000 from this property investment. I acknowledge the above estimates may seem prudent, but why should we give Islamic banks the benefit of any doubt?

So, on the 30 Islamic mortgages, the bank will make an annual estimated income of £45,000 x 30 = £1,350,000, and on the property investment it will make an annual estimate net income of around £32,000.

Hence – the Islamic bank earns 42 times more profit by issuing mortgages instead of buying a single property.

Let us remember this fact when we next look at an Islamic mortgage and are considering whether the bank is actually investing in a property, or partnering with us, or is the bank simply making loans at interest?

Why an Islamic bank will NEVER buy property and will always prefer loans

- Loans require no cash and investments require 100% cash
 - o Mortgages are created from nothing (Credit Creation) and actual property investments drain liquidity rapidly
- Loans consume very small amounts of regulatory capital
 - o Mortgages 35% risk weight vs investment 115% risk weight
- Loans produce steady, predictable income
 - o Property produces uncertain income with void periods, repairs, legal costs
- Islamic Banks are not allowed (by design) to be property investors
 - o Their business model, regulatory structure, and funding models all reward lending, not ownership
- Loans scale infinitely, Assets do not
 - o An Islamic bank can issue 30 mortgages using the same resources that buying one single property consumes
- Banks are built to maximise Return on Investment. (ROI)

- o Mortgages generate enormous returns on tiny slivers of capital
- o Property investment destroys ROE

The CORE Truth

Islamic Banks are NOT property investors, they are credit manufacturing machines.

Their entire regulatory and economic structure makes lending exponentially more profitable than buying real assets.

This is why Islamic banks will always push YOU to buy the property via a loan, and NEVER buy it themselves.

An Islamic bank, as a lender, earns 122% per annum on the same amount of capital it can invest into property where it will earn net 3% per annum.

Part 4/4 to drop soon, where I explore real blueprints for moving Muslims away from Riba while growing the real economy and uplifting Muslims, stay tuned!

Part 4/4 Islamic banking is not a compromise with Riba. It IS Riba — industrialised, licensed, and Shariah-approved

Series - Why Islamic banks Lend instead of invest - The Economics They Don't Want You to See. - From an Insider who built this machine

BEGINNING

In the previous parts we have observed the following:

Islamic banks are subject to stringent regulatory requirements, such as Basel 3, which requires banks manage the risks that they enter into by taking certain measures. A key measure is that the bank must allocate sufficient regulatory capital to meet the risk of adverse events, such as their customers (borrowers) failing to repay loans, and other assets of theirs falling in value (or being illiquid such that they cannot effectively be utilised in emergency scenarios)

The consequences of these regulations mean that lending is far more efficient than actually buying an asset or making an investment. The latter two attract much higher risk weightings, meaning they are less efficient for the Islamic bank.

With the addition of credit creation, this inefficiency is now longer just impractical, it is downright impossible. Credit creation can be utilised for lending and not for investing or

buying assets. As such, the Islamic banks can deliver 30x more loans than a single investment of the same size, and when it comes to residential property, it can make over 40x more profit with the same capital outlay (cash and regulatory capital) than buying a property outright,

Islamic banks obtain a banking license that permits them to lend whilst putting the deposits at risk. It is this activity that requires a banking license (as defined by the Bank of England) and the following activities do NOT require a banking license:

- The taking of deposits
- The provision of loans (look at the proliferation of non bank credit providers in the market).
- The buying of assets, such as property, commodity, Palm Oil, or milk cartons
- The holding, and selling of such assets
- Investments into any financial assets

So, if an entity goes through the process of obtaining a (Islamic) banking license, then it will be intending to lend money whilst putting deposits at risk.

And the process of obtaining a banking license is not something you wake up and decide. It is a long onerous and expensive process.

For example, in the UK, Revolut obtained its banking license in 2024, and it took their application 3 years to be accepted, and at the time they had 9 million customers in the UK and group revenue of over £2bn.

As noted in FinTech Weekly:

“A full UK banking licence would grant Revolut access to the domestic lending market, enabling it to deploy customer deposits for loans and other credit products. Such a move could introduce new competition to established high-street banks, particularly in digital consumer finance.

However, without the licence, Revolut’s capacity to operate as a traditional bank remains limited. The company continues to function as a hybrid platform that combines payments, foreign exchange, and investment services under its existing permissions.”

So, we have an Islamic bank that has undertaken the serious, lengthy and expensive process of obtaining a banking license, the primary benefit of which is it can now lend money.

There is also another benefit of a banking license, which is that it can engage in credit creation, a right that is given to private banks and to no other entity on the planet. (This is, in fact a monstrous right that they have, and is the source of much of the financial slavery we experience today).

Islamic banks also have this right to effect lending via credit creation. And that is WHY they obtained a banking license in the first place.

The result is that for an Islamic bank to buy a real asset, instead of lending, it must accept making 1/40th of the profit it can make via lending. This decision is suicide. If they did not have a banking license, and instead actually purchased property, and made investments, such as is the activity of a huge portion of the global investment market, then they would not be subject to such comparisons, They would utilise real capital, make real investments and be forced to deliver efficiencies to ensure their investments are profitable. All of these are good things, and especially so in Islamic Finance.

So, we must conclude, that the fact that Islamic banks have decided to obtain a banking license means they have already worked all of this out and decided that lending is the way to go.

Now, of course, lending money and making profit on it is Riba. So they cannot do that.

But they must utilise credit creation to benefit from this 40x profit leverage, so what do they do? What they do is very simple.

They utilise simple Shariah contracts such as buying and selling to instead replicate this lending, This provides the required façade to enable some scholars to provide Shariah approval and thus the activity of the bank is now Shariah compliant.

My position is that the robust and intellectually honest application of Shariah to these trading activities of an Islamic bank would result in this Shariah compliance being removed.

So, we now have a clear presentation of the battlefield:

- An Islamic bank has a banking license and thus must lend to benefit from this 40x profit leverage
- An Islamic bank cannot be seen to be lending money as this results in Riba
- Islamic banks thus engage in buying and selling to replicate the effect of lending (thus gaining access to this 40x profit leverage) whilst demonstrating that their activities are simply buying and selling and thus Shariah compliant

If the above was true, we would see certain outcomes be clear:

- When an Islamic bank is engaging in trading, the outcome would be the same as a loan
- Any sales activities that result in the bank taking risks on the underlying assets must then be tweaked such that any asset risk is removed For example:
 - The bank will buy and then immediately sell an asset
 - The bank takes no risk on the delivery or performance of this asset
 - The bank will only buy the asset once the immediate sale of it is contractually certain
 - When the bank buys asset (cash out) it will pay immediately and when it sells an

asset (cash in) it will sell it on deferred repayments to replicate the required loan

- The sale to the customer (to effect the loan repayments) will be a function of the loan size, the repayment time, and the market interest rates (just like a regular loan)

In market practice we see every one of these outcomes, all the time, every time.

And this is all deemed as Shariah compliant because basic rules of sale contracts are followed. But the rules around combinations of sales contracts are ignored. It is this combination that results in the loan and Riba, not an isolated sales transaction in itself.

So the Islamic banks now apply themselves to present these sales transactions as standalone, isolated sales transactions, and not structured as a combination of 2, 3, or 4 circular sales transactions.

When we play games with Shariah, I have seen that something happens. It forces us to encounter anomalies and plain impossibilities. Because our Shariah is never intended to be used to justify lending and Riba, and when we force this, the reality then forces outcomes that are plain impossible. It is these outcomes that everyone must lie about, or plain hide from scholars. For example:

- When the banks conduct a Tawarruq transaction, which is a sequence of sales transactions, we end up having to claim that a commodity broker, with £5mn is buying and selling commodity worth £1bn in a single transaction

- We have a commodity / Tawarruq exchange in Malaysia that is selling \$25tn of commodity a year, when only \$2bn max of that commodity exists, and the Shariah requirement is that the commodity must be delivered to the buyer if requested

- We have billions of dollars of Islamic loans being effected by the buying and selling of commodities that nobody every wants, like platinum, timber, copper, palm oil and milk cartons

- Whenever an Islamic bank sells something it is replicating the repayment of a loan with interest, so that sales prices is deferred, repaid in the future, and benchmarked to interest rates, just like a loan demands

- When an Islamic bank sells something, it has to buy it first, but it will have cast iron guarantees, BEFORE it buys the item, that it will be onsold immediately to the customer

- The Sukuk market, which comprises 25% of the global \$4tn Islamic finance industry, is built on the apparent investment into assets, but all risk of asset ownership is systematically removed, piece by piece, so what is left is a bond which is Riba (I have written a whole book about this and made a 2 hour video about a single Sukuk issuance showing all this complex trickery works in practice)

- A Malaysian professor from INCIEF analysed 900 Sukuk issuances over 15 years and found precisely ZERO retain asset risk and performance, and all deliver bond performance, which is Riba

- We have a multi trillion business built on organised commodity sales to deliver Riba and supported, in a 250 page policy document, by a simple statement that sales transactions are permitted in Shariah, and quoting one verse from the Quran

- We have Islamic banks whose balance sheets are comprised between 95-99% (assets and liabilities) of interest rate instruments, not sales and investments

This is utter madness.

This is diabolical

We have systemically chosen Riba as our foundation (Islamic banking) and we have consistently, and relentlessly, delivered Riba via the guise of Shariah compliance, and we have built an army of scholars who fight to approve it and preserve it.

We are wholly lost.

We are wholly to blame.

In this part 4/4, I was meant to also address solutions, but our descent into madness prevents that. I will write a part 5/4 that looks at solutions and what the way forward must look like.

I have played a big role in building this monster, this abomination, and this is part of my public penance, my tawbah, and my duty to expose what I know. I have blame here, and do not seek to avoid it. I face it full on and ask for forgiveness.

My only aim is to lighten my scales on the Day and be a servant of Allah swt.

May Allah swt forgive us

Part 5/4 to follow - the way forward out of this diabolical mess