

LEGAL AND REGULATORY FRAMEWORK FOR THE  
INTRODUCTION OF ISLAMIC RETAIL-BANKING  
PRODUCTS IN CANADIAN BANKS

BY

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## **ABSTRACT**

Islamic finance has made its first steps in Canada; however, there is still a lack of Islamic financial products in the country. The Muslim community still struggles nowadays in finding retail-banking products that do not contravene their religion. In fact, there are some Islamic financial institutions in Canada; however, these face many challenges as to the legal and regulatory framework of the financial system. The literature has proven that for the success of Islamic finance it has to start from the Canadian banks that have full support from the government and a well established and powerful presence in the country; in the current legal and regulatory framework of the Canadian banking system represents an obstacle as to the offering of Islamic retail-banking products in Canadian banks. This research deeply delved in the study of the Canadian legal and regulatory framework and found that there are various issues and challenges faced by Islamic Financial Institutions in Canada as well as different issues and challenges that impede Canadian Banks from offering Islamic Retail-Banking Products. As a result, some amendments need to be made in this framework for the offering of Islamic retail-banking products in Canadian Banks, the most important ones being in the Bank Act as well as some other amendments. These amendments were analyzed in details in this research and it is recommended that Canadian authorities and policy-makers take them into consideration in order to satisfy the needs of the Canadian Muslim Community.

## ملخص البحث

شرعت المالية الإسلامية بخطواتها الأولى في كندا غير أنه يوجد نقص معتبر في المنتجات المالية الإسلامية، وبسبب ذلك تعاني الجالية المسلمة المتواجدة في كندا من عدم وجود طرق شرعية لتلبية حاجياتها المالية. ورغم تواجد بعض المؤسسات المالية الإسلامية في كندا إلا أنها تعاني من تحديات في الإطار القانوني والتنظيمي المالي. إضافة إلى ذلك، أظهرت الأبحاث أن أهم شرط لنجاح المالية الإسلامية في كندا يكمن في عرض الخدمات المصرفية الإسلامية للأفراد كخطوة أولى عبر البنوك الكندية التقليدية نظرا للدعم الذي تتحصل عليه من طرف الدولة ولقوة حضورها في البلد ومع ذلك فإن الإطار القانوني والتنظيمي الحالي للبنوك لا يسمح للبنوك الكندية بتقديم المنتجات الإسلامية لاحتوائه على قيود متعددة لا تتوافق مع مبادئ المالية الإسلامية. يقوم هذا البحث بالخوض بطريقة عميقة في الإطار القانوني والتنظيمي البنكي و ذلك لدراسة التعديلات اللازمة من أجل تقديم الخدمات المصرفية الإسلامية للأفراد في البنوك الكندية. أظهر البحث أن المؤسسات المالية الإسلامية في كندا تواجه عدة مشاكل تعرقل وظيفتها. كذلك كي تتمكن البنوك الكندية من تقديم المنتجات المالية الإسلامية يجب إجراء تعديلات في الإطار القانوني والتنظيمي الحالي للبنوك أهمها في قانون البنك وغيرها.

## **APPROVAL PAGE**

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*This thesis is dedicated to my late father who advised me to pursue this PhD right before he passed away, to my mother who bore with me while I was far from her, to my elder beloved sister who left this world too soon while I was still doing this PhD, to my two younger sisters who have always been there for me, and last but not least to the Muslim community in Canada, hoping that this thesis would benefit them one day soon.*

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## TABLE OF CONTENTS

Abstract .....	ii
Abstract in Arabic .....	iii
Approval Page.....	iv
Declaration .....	v
Copyright Page.....	vi
Dedication .....	vii
Acknowledgments.....	viii
List of Tables .....	xv
List of Figures .....	xvi
List of Cases.....	xvii
List of Statutes .....	xviii
List of Abbreviations .....	xix
<b>CHAPTER ONE: INTRODUCTION .....</b>	<b>1</b>
1.1 Background of the Study.....	1
1.2 Research Questions .....	2
1.3 Research Objectives .....	3
1.4 Problem Statement .....	3
1.5 Literature Review.....	5
1.5.1 Islamic Finance in the West .....	5
1.5.2 Islamic Finance in Canada .....	7
1.5.3 Muslims in Canada.....	9
1.5.4. Canada's Interest in Ethical Principles .....	11
1.5.5 Legal and Regulatory Framework of the Canadian Financial System .....	11
1.5.6 Taxation.....	13
1.5.7 Requirements for the Establishment of Islamic Finance in Canada .....	14
1.6 Scope and Limitations of the Study .....	17
1.7 Methodology .....	18
1.8 Significance of the Study .....	19
1.9 Chapterization .....	19
1.10 Chapter Summary.....	20
<b>CHAPTER TWO: ISLAMIC FINANCE IN CANADA .....</b>	<b>21</b>
2.1 Introduction .....	21
2.2 Overview of Islamic Finance in Canada .....	21
2.3 Financial Institutions Offering Islamic Financial Products in Canada .....	22
2.3.1 Canadian Islamic Financial Institutions .....	23
2.3.1.1 Ansar and Islamic Cooperative Housing Corporation.....	23
2.3.1.2 Manzil.....	24
2.3.1.3 AlBassam House Inc .....	24
2.3.1.4 An-Nur Cooperative Corporation .....	25
2.3.1.5 Qurtuba Housing Cooperative .....	25
2.3.1.6 Al-Ittihad Investments .....	26

2.3.1.7 Zero Mortgage Canada .....	26
2.3.1.8 Salam Financial .....	26
2.3.1.9 Amana Canada Holdings .....	27
2.3.2 Canadian Non-Islamic Institutions.....	27
2.3.2.1 Assiniboine Credit Union .....	27
2.3.2.2 Wealth Simple Investment Portfolio .....	28
2.3.3 Non-Canadian Institutions offering Islamic Financial Products in Canada .....	28
2.3.3.1 Ijara Community Development Corporation (IjaraCDC)....	28
2.4 Islamic Financial Products Available in Canada.....	29
2.5 Islamic Financial Products to Incorporate in Canadian Banks .....	31
2.5.1 Deposits.....	33
2.5.1.1 Mudarabah Deposit Account .....	33
2.5.1.2 Islamic Current Account.....	34
2.5.1.3 Qard Hasan Deposit.....	34
2.5.2 Financing.....	35
2.5.2.1 Home Financing .....	35
2.5.2.2 Auto-Financing.....	36
2.5.2.3 Leasing.....	36
2.5.2.4 Credit Cards.....	36
2.5.2.5 Short-Term Financing.....	37
2.5.2.6 Personal Consumption Financing .....	37
2.5.2.7 Medium to Long-Term Financing .....	37
2.5.2.8 Agricultural Financing.....	38
2.5.3 Loans .....	38
2.5.3.1 Qard Hasan .....	39
2.6 Chapter Summary.....	40

**CHAPTER THREE: THE CANADIAN BANKING SYSTEM..... 41**

3.1 Introduction .....	41
3.2 Overview of the Canadian Banking System .....	41
3.3 Overview of the Canadian Law.....	42
3.3.1 Common Law versus Civil Law .....	43
3.3.2 Federal Law versus Provincial Law .....	43
3.4 The Canadian Legal Framework for the Banking System .....	44
3.4.1 The Bank Act 1871 .....	44
3.4.2 Bank of Canada Act 1934 .....	47
3.4.3 The Office of the Superintendant of Financial Institutions Act 1985 .....	47
3.4.4 The Financial Consumer Agency of Canada Act 2001.....	50
3.4.5 The Canada Deposit Insurance Corporation Act 1967 .....	51
3.4.6 Financial Administration Act 1985.....	51
3.4.7 Trust and Loan Companies Act 1991 .....	52
3.4.8 Competition Act 1985 .....	52
3.4.9 National Housing Act 1934.....	53
3.5 The Canadian Regulatory Framework Of The Banking System .....	55
3.5.1 Overview of the Canadian Banking Regulatory Framework.....	55
3.5.2 Regulatory and Supervisory Authorities Governing the Canadian Banking System.....	57

3.5.2.1	Department of Finance .....	57
3.5.2.2	Bank of Canada (BoC) .....	58
3.5.2.3	The Office of the Superintendent of Financial Institutions (OSFI) .....	58
3.5.2.4	Canadian Bankers Association (CBA) .....	59
3.5.3	Customer Protection Agencies .....	60
3.5.3.1	The Financial Consumer Agency of Canada (FCAC).....	60
3.5.3.2	The Office of the Privacy Commissioner of Canada (OPC).....	61
3.5.3.3	Canada Deposit Insurance Corporation (CDIC).....	61
3.5.3.4	The Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) .....	62
3.5.4	Dispute Resolution: The Ombudsman for Banking Services and Investments (OBSI) .....	62
3.5.5	Technical Organization: Payments Canada .....	63
3.5.6	The Financial Institutes Supervisory Committee (FISC).....	63
3.6	Banks in Canada.....	65
3.6.1	Classification of Banks in Canada .....	65
3.6.2	The Most Important Banks in Canada .....	66
3.6.2.1	Royal Bank of Canada (RBC) .....	67
3.6.2.2	Toronto-Dominion Bank (TD) .....	67
3.6.2.3	Bank of Nova Scotia (Scotiabank) .....	67
3.6.2.4	Bank of Montreal (BMO) .....	68
3.6.2.5	Canadian Imperial Bank of Commerce (CIBC) .....	68
3.6.2.6	The National Bank of Canada .....	68
3.7	Retail Banking Products Generally Offered by Canadian Banks .....	69
3.8	Chapter Summary.....	72

**CHAPTER FOUR: RESEARCH METHODOLOGY ..... 73**

4.1	Introduction .....	73
4.2	Research Philosophy .....	73
4.3	Research Paradigm.....	74
4.4	Research Design.....	74
4.4.1	Research Strategy.....	75
4.4.2	Research Choice.....	78
4.4.3	Time Horizon .....	79
4.5	Research Approach .....	80
4.6	Research Purpose .....	81
4.7	Data Collection Techniques .....	82
4.7.1	Doctrinal Legal Research and Reform-Oriented Research.....	82
4.7.2	Semi-Structured Interviews.....	84
4.8	Data Collection Procedures.....	86
4.8.1	Procedures of Semi-Structured Interviews.....	86
4.8.1.1	Steps of the Semi-Structured Interviews .....	86
4.8.1.2	Limitations and Weaknesses of Interviews .....	86
4.8.1.3	Ethics in Interviews .....	87
4.9	Sampling Techniques .....	87
4.10	Pilot Study.....	88
4.11	Data Analysis .....	88

4.12 Credibility of Research Findings .....	91
4.13 Research Framework.....	92
4.14 Chapter Summary.....	93
<b>CHAPTER FIVE: RESULTS AND FINDINGS.....</b>	<b>95</b>
5.1 Introduction.....	95
5.2 Participants' Profile.....	95
5.3 Findings and Analysis .....	97
5.3.1 Issues and Challenges Faced by Islamic Financial Institutions in Canada .....	97
5.3.1.1 Theme 1: Strict Legal and Regulatory Framework .....	97
5.3.1.2 Theme 2: Structuring Products according to Three Different Laws .....	98
5.3.1.3 Theme 3: Restrictions for different types of Islamic Financial Institutions.....	99
5.3.1.4 Theme 4: Absence of a Legal Enforcement Body.....	101
5.3.1.5 Theme 5: Quasi-impossibility to open an Islamic Bank....	102
5.3.1.6 Theme 6: Taxation Issues .....	103
5.3.1.7 Theme 7: Other Issues .....	104
5.3.2 Issues and Challenges in the Canadian Legal and Regulatory Framework Impeding Big Banks from Offering Islamic Retail- Banking Products.....	104
5.3.2.1 Theme 1: Business of Banking Challenge.....	105
5.3.2.1.1 Interest Versus Profit .....	106
5.3.2.1.2 Dealing in Goods and Wares .....	107
5.3.2.1.3 Ownership.....	107
5.3.2.2 Theme 2: Liability Issues .....	108
5.3.2.2.1 Leasing.....	108
5.3.2.2.2 Partnership .....	109
5.3.2.2.3 Risk Exposure .....	110
5.3.2.3 Theme 3: Disclosure Requirement Issues .....	111
5.3.2.3.1 Consumer Protection.....	111
5.3.2.3.2 Interest .....	112
5.3.2.3.3 Deposits .....	113
5.3.2.4 Theme 4: Liquidity Issues .....	114
5.3.2.4.1 Segregation of Funds .....	114
5.3.2.4.2 Absence of an Islamic Market .....	115
5.3.2.5 Theme 5: Taxation Issues .....	115
5.3.2.5.1 Provincial Land Transfer Tax .....	116
5.3.2.5.2 GST/HST and commodity taxes .....	116
5.3.2.5.3 Income Tax .....	117
5.3.2.6 Theme 6: Equity Investment.....	117
5.3.2.7 Theme 7: Risk of Discrimination .....	118
5.3.2.8 Theme 8: Home Financing .....	118
5.3.2.9 Theme 9: Car Financing .....	119
5.3.3 Provisions and Sections that Need Amendment for the Possibility of Implementing Islamic Retail-Banking Products in the Canadian Big Banks .....	120
5.3.3.1 Financial Consumer Agency of Canada (FCAC) Act .....	121

5.3.3.2 Amendments Pertaining to Interest Rate Disclosure .....	122
5.3.3.2.1 In the Deposit Side:.....	122
5.3.3.2.1.1 Subection1(b) Canada Deposit Insurance Corporation (CDIC) Act-Schedule .....	122
5.3.3.2.1.2 Section 441 (1) of the Bank Act: .....	123
5.3.3.2.1.3 Section 413 of the Bank Act.....	123
5.3.3.2.1.4 Sections 3 and 4 of the Disclosure of Interest (Banks) Regulations.....	124
5.3.3.2.2 In the Financing Side .....	125
5.3.3.2.2.1 Sections 449 to 451 of the Cost of Borrowing Regulations .....	126
5.3.3.2.3 Provincial Securities Legislations.....	127
5.3.3.3 Amendments to be done to the Bank Act .....	127
5.3.3.3.1 Section 409 of the Bank Act: Business of Banking.....	127
5.3.3.3.2 Section 410 (2) of the Bank Act .....	128
5.3.3.3.3 Section 417 of the Financial Leasing Regulations .....	128
5.3.3.3.4 Section 421 of the Bank Act.....	129
5.3.3.3.5 Amendments Pertaining to Investments .....	129
5.3.3.3.5.1 Section 464 sub (1) of the Bank Act	129
5.3.3.3.5.2 Section 466 Sub (4) of the Bank Act .....	130
5.3.3.4 Amendments to Taxation Acts .....	131
5.3.3.4.1 Excise Tax Act.....	131
5.3.3.4.1.1 Subsection 123 (1)of the Excise Tax Act.....	131
5.3.3.4.1.2 Section 149 of the Excise Tax Act ...	132
5.3.3.4.2 Subsection 2(1) of the Income Tax Act .....	133
5.3.3.5 Section 94 of the Winding Up and Restructuring Act.....	134
5.3.3.6 Other Amendments.....	134
5.4 Chapter Summary.....	135
<b>CHAPTER SIX: DISCUSSION ON FINDINGS .....</b>	<b>136</b>
6.1 Introduction .....	136
6.2 Research Objective 1.....	136
6.3 Research Objective 2.....	139
6.4 Research Objective 3.....	142
6.5 Other Findings.....	146
6.6 Chapter Summary.....	147
<b>CHAPTER SEVEN: CONCLUSION .....</b>	<b>148</b>
7.1 Conclusion.....	148
7.2 Limitations .....	151
7.3 Contribution to Knowledge.....	151
7.3.1 Contribution to Academia.....	152
7.3.2 Contribution to Research Methodology .....	152
7.3.3 Contribution to the Industry .....	152

7.4 Recommendations .....	152
7.4.1 Recommendations for Regulators and Policy-makers .....	152
7.4.2 Recommendations for Islamic Financial Institutions.....	153
7.4.3 Recommendations for the Canadian Government .....	153
7.4.4 Recommendations for the Muslim Community .....	153
7.5 Suggestions for Future Research.....	154
<b>REFERENCES.....</b>	<b>155</b>
<b>APPENDIX A: INFORMED CONSENT FORM.....</b>	<b>164</b>
<b>APPENDIX B: INTERVIEW QUESTIONS.....</b>	<b>166</b>
<b>WEBSITES OF DIFFERENT CANADIAN ORGANIZATIONS .....</b>	<b>168</b>
<b>GLOSSARY.....</b>	<b>169</b>

## LIST OF TABLES

Table 2.1	Financial Institutions Offering Islamic Financial Products in Canada	22
Table 2.2	Islamic Financial Products Available in Canada	30
Table 2.3	Islamic Retail-Banking Products to Incorporate in Canadian Banks	39
Table 3.1	Acts Applicable to Banks in Canada	54
Table 3.2	Governmental Organizations and Bodies Governing Canadian Banks	64
Table 3.3	Retail-Banking Products Offered by Canadian Banks	71
Table 5.1	Participant's Profile: ID, Position, Work Experience and Company	96
Table 6.1	Amendments Required in the Current Canadian Legal and Regulatory	145

## **LIST OF FIGURES**

Figure 4.1	The Research Framework of the Study	92
Figure 4.2	The Research Summary of the Study	94



## LIST OF CASES

*Central 1 Credit Union v. UM Financial* [2011] ONSC 5612

*R v. Kalair* [2015] ONSC 6784

*R v. Kalair* [2019] ONSC 3471

## **LIST OF STATUTES**

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Bank of Canada Act 1934  
Canada Deposit Insurance Corporation Act 1967  
Competition Act 1985  
Constitution Act 1867  
Cost of Borrowing (Banks) Regulations (SOR/2001-101)  
Excise Tax Act 1985  
Financial Administration Act 1985  
Financial Consumer Agency of Canada Act 2001  
Financial Leasing Regulations (SOR/2001-389)  
Financial System Review Act 2012  
Income Tax Act 1985  
Internet Disclosure (Banks) Regulations (SOR/92-321)  
National Housing Act 1934  
Office of the Superintendent of Financial Institutions Act 1985  
Trust and Loan Companies Act 1991  
Winding Up and Restructuring Act 1985

## LIST OF ABBREVIATIONS

BMO	Bank of Montreal
BoC	Bank of Canada
CBA	Canadian Bankers Association
CDIC	Canada Deposit Insurance Corporation
CIBC	Canadian Imperial Bank of Commerce
FCAC	Financial Consumer Agency of Canada
FITRAC	Financial Transactions and Reports Analysis Centre of Canada
FISC	Financial Institutes Supervisory Committee
HPP	Home Purchase Plan
IFI	Islamic Financial Institution
IRBP	Islamic Retail-Banking Products
MSCI	Morgan Stanley Capital International
OBSI	Ombudsman for Banking Services and Investments
OPC	Office of Privacy Commissioner of Canada
OSFI	Office of the Superintendent of Financial Institutions
RBC	Royal Bank of Canada
RESP	Registered Education Savings Plan
RRSP	Registered Retirement Savings Plan
TD	Toronto-Dominion Bank
TFSA	Tax Free Savings Plan

# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1 BACKGROUND OF THE STUDY**

Canada welcomes immigrants from all over the world and Muslim immigrants are not left apart in this immigration process. The Muslim community in Canada is increasing at a fast pace to the point that Islam makes the second largest religion in the country just after Christianity (Edward, 2011). The main reason why Canada is a safe, secure and homelike country of immigration is because it respects and accommodates the needs and backgrounds of its immigrants in terms of culture and religion. However, Muslims are finding hardship when it comes to financing their major needs such as homes and vehicles because they can rarely find an institution that deals in transactions that can be considered Shariah-compliant (El Hammaoui, 2012; Tahmina, 2013).

Canada is the second largest country in the World. The number of Muslims in Canada amounts to more than 1,400,000 in 2017 making Islam the second largest religion in the provinces of Ontario, Quebec and in Canada itself (Tahmina, 2013). Furthermore, according to statistics, the Muslim population in Canada doubles every ten years. With a population of 8% of Muslims in the city of Toronto and 6% of Muslims in the city of Montreal which are respectively the biggest and most important cities in the provinces of Ontario and Quebec respectively, the need for Islamic retail-banking products is on the rise in order to satisfy the needs for this population according to the requirements of their religion (Edward, 2011). There were some attempts in the past to offer Shariah-compliant retail-banking products; however these companies faced several difficulties because of the existing legal, regulatory and

taxation frameworks. Some institutions decided to offer home financing but the restrictions present impediments to its implementation (El Hammaoui, 2012). These institutions are mainly based in Toronto. In Montreal, only one Islamic institution under the name of Qurtuba offers Shariah-compliant home financing; however, its limited capital inhibits its ability from satisfying the big demand of its customers (Qurtuba, 2020). When approaching policy-makers, they are either reticent because they do not believe in religious financial practices or they ignore the elements of implementing Islamic finance due to potential policy impediments (Edward, 2011).

This thesis first looks into the Islamic financial products that are currently available in the Canadian market. It then looks into the issues that are faced by the current financial institutions offering Islamic retail-banking products. Finally, the research investigates the gap present in the Canadian law that is impeding banks from offering Islamic retail-banking products, the requirements of the introduction of the Islamic retail-banking products in the Canadian market, as well as the amendments needed to be made in the regulatory and legal frameworks for this purpose.

## **1.2 RESEARCH QUESTIONS**

1. What are the issues and challenges faced by institutions offering Islamic retail-banking products in the Canadian legal and regulatory framework?
2. What is the gap in the Canadian legal and regulatory framework impeding Canadian banks from offering Islamic retail-banking products?
3. What are the amendments required in the current legal and regulatory framework for the offering Islamic retail-banking products in Canadian banks?

### **1.3 RESEARCH OBJECTIVES**

1. To explore the issues and challenges faced by institutions offering Islamic retail-banking products in Canada in terms of legal and regulatory framework.
2. To analyze the gap in the Canadian legal and regulatory framework impeding Canadian banks from offering Islamic retail-banking products.
3. To suggest amendments required in the legal and regulatory framework for offering Islamic retail-banking products in Canadian Banks.

### **1.4 PROBLEM STATEMENT**

Presently, Islamic retail-banking products are offered in Canada by non-bank financial institutions such as cooperative societies and private companies (Edward, 2011). Despite the good will and efforts put in opening Islamic financial institutions in order to offer such products, these institutions often face difficulties not only because of the restrictions in the Canadian financial laws, regulations and policies but also because of the lack of capital and the competition they have to face next to the big and successful Canadian banks (Chaudhry, 2011). These difficulties make these institutions much less attractive to Muslims who live in Canada and who are in dire need of Shariah-compliant retail-banking products. These Muslims face hardship when they plan to buy a house or a car or even when they open accounts in conventional banks. Most of them do not own these necessary assets because of their religious requirements, and those who possess them often have the guilt feeling of breaking the divine laws due to their dealing with interest in acquiring the assets (El Hammaoui, 2012).

On the other hand, Canadian banks are currently not allowed to offer Islamic retail-banking products because of the difference in requirements between the

conventional and Islamic retail-banking products in terms of laws and regulations (Goud, 2009; Edward, 2011). The main difference is that the principal source of income from the conventional products is the interest whereas the one from Islamic products is profit. Similarly, the conventional products are offered through the principle of loan whereas the Islamic products are offered through the principle of business (Alharbi, 2015). All these requirements are treated differently in the Canadian law; and in the current legal and regulatory framework of the banking system, Islamic retail-banking products have no place (Tahmina, 2013).

Dean & Schwindt (2014) mention that for any entrant be it a bank or a product to make an entry to a country like Canada, it has to face two challenges: the legislation barrier and the product differentiation barrier. They explain that the legislation barrier is represented by the difficult and lengthy procedures and regulations to follow. For instance, a bank can wait several years before getting a charter to open in Canada; two applications for Islamic banks have already been submitted next to the Office of the Superintendent of Financial Institutions in 2007 but they still did not receive any reply (Goud, 2009) and this is still the case in 2019. As per the differentiation barrier, a new bank or a new product in a near-bank will have to confront the already well-established banks that have the privileges of convenience and safety (Dean & Schwindt, 2014). The privilege of convenience can be seen in the presence of the major banks and their branches in every corner of the Canadian big cities, while the privilege of safety can be seen in the trust that Canadians put in the big and large banks because of their good reputation and success.

Dean and Schwindt (2014) mention that some types of institutions such as the big banks are granted unique benefits which are difficult to challenge. Thus, they conclude that instead of offering a new product in a new financial institution, it would

be more realistic to encourage the dominating banks to offer that new product and to empower them to strive for the public interest.

The literature strongly suggests that the best way to introduce an Islamic retail-banking product in Canada is through the big banks where there is in fact a legislation barrier, that is tackled in this thesis, but where the product differentiation barrier is absent (Dean & Schwindt, 2014). For all the reasons mentioned above, this study investigates the potential of introducing Islamic retail-banking products in Canadian banks by assessing the amendments that need to be made in different Canadian laws and regulations in order to make this introduction possible.

## **1.5 LITERATURE REVIEW**

The Literature Review of this thesis contains seven parts: Islamic Finance in the West, Islamic Finance in Canada, Muslims in Canada, Canada's Interest in Ethical Principles, Legal and Regulatory Frameworks of the Canadian Banking System, Taxation and the Requirements for the Establishment of Islamic Finance in Canada.

### ***1.5.1 Islamic Finance in the West***

Islamic Finance is a growing industry all over the world; be it in Muslim countries or non-Muslim countries (Casper & Ait Allali, 2017). Even though the market is relatively small compared to its conventional counterpart, Lalani et al. (2015), Chaudhry (2011), Alexakis and Tsikouras (2009) and Lynn (2009) acknowledge that Islamic Finance is growing in a better and faster way than the conventional one. The growth rate of Islamic Finance is evaluated at 15% per year, as on 2015, which is double the conventional growth rate (Lalani et al, 2015). Furthermore, the Islamic economic bloc became the fourth after the United States, China and the European