Development of Islamic Finance in the UK & Europe

Aston Business School, El Shaarani Centre for Islamic Finance & Business

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Islamic Finance Council

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IFC Executive Board Member

About the IFC

"…most proactive entity country" Arab News 2009

- Not for profit established to promote the Islamic finance industry both locally and globally
- Lead by committed group of professionals with relevant sector experience
- Engaged in various activities including:
  - Community education and awareness – round tables, awareness events, imam training
  - Governments - strategy advisory (UKTI, SG, JFL)
  - Shariah scholars - international CPD programme (delivering in Malaysia)
- Encourage and facilitate an environment where every believer in ethical finance has the option to undertake their financial transactions in line with their belief
- Unique body, showcased in UK City and Treasury brochures
- Proud roots, based in Scotland a country with a strong heritage in ethical finance

The Islamic Financial Services Market

"Broader than banking, wider than the Middle East"

- Islamic finance is a new industry in its infancy which has only come to the fore over the past five to seven years
- Industry worth circa $1trillion (McKinsey) and growing between 15% – 20% pa (S&P)
- Islamic finance is a horizontal niche affecting a number of areas
- Driven by increasing demand and petro$ liquidity a number of new Islamic banks and insurance companies are being established
- Traditional hubs are Malaysia and Bahrain with increasing involvement by other jurisdictions (Dubai, London, Pakistan, Brunei, etc)
- Fundamental structural differences in Islamic banking products with inherent additional challenge of Sharia compliance
- How Islamic financed faired in the current crisis?
    - Performance of funds,
    - Shielded from sub-prime
- Can inherent features of Islamic finance create a less volatile paradigm?
    - Gharaar – certainty, restriction of short selling, additional governance via SSB, asset backed nature enhances link to real economy, riba/interest ban

Key industry achievements

"Transitioning from a niche into mainstream"

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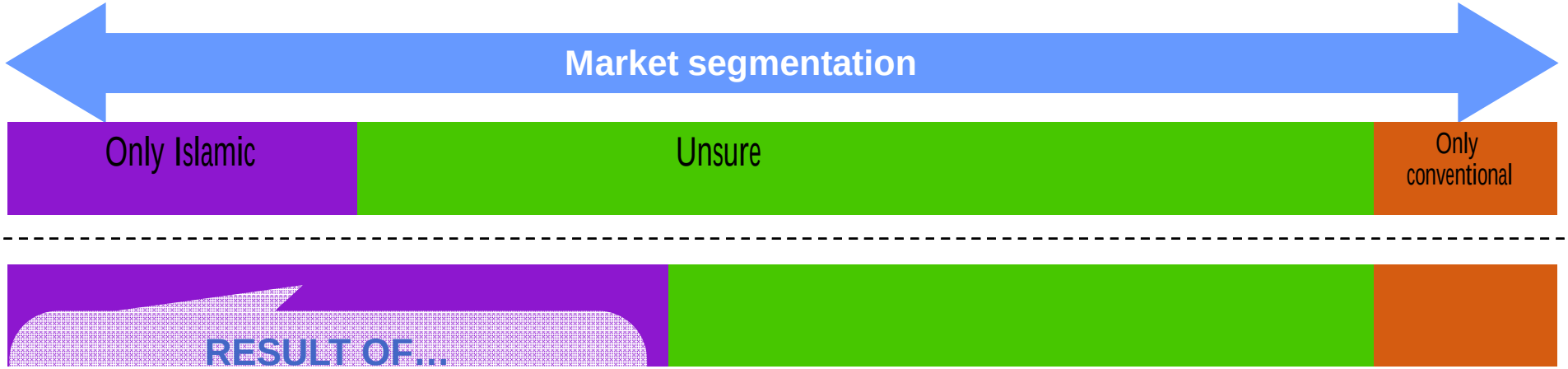
$1trn Islamic Finance market place

- Islamic product offering by conventional banks
- Takaful premiums over $2.5bn & expected to hit $10-$15bn in 10yrs
- Emergence of sukuk $70bn+
- Multiple jurisdictions increasing their involvement in IF
- New standalone Islamic banks & Insurers, bigger with global mindsets
- Expansion of products, eg derivatives

Understanding the Islamic market size dynamic

"Inclusive proposition open to all with a captive value group"



- **Increased number of product providers and competitive pricing**
- **Increased awareness and education**
- **More innovative products**

Potential target for Financial Institutions offering Islamic Financial Services

Market analysis – UK Market

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- Strong Government engagement (UKTI, Treasury & FSA)
  > Gordon Brown, PM "*UK a global gateway for Islamic finance*"
  - > Amendments to Finance Act – to create a level playing field
  - ➢ FSA encouraging the sector with existing regulatory framework being robust enough to adequately regulate IFI's – "no special favours"
  - ➢ UKTI promotional activities UK roundtables, international pavilions (WIBC)
- Continuing trend of new Islamic Financial Institutions (IFI) setting up in London.
- UK market now has 6 stand alone Islamic financial institutions authorised
  - **4 wholesale focused**
  - **2 retail focused (one bank and one insurance)**
  - **continues to be primarily funded by Gulf liquidity**
- Conventional banks in process of establish windows
- Government issued response to the Sukuk consultation paper. Committed to their plans to issues a sovereign Sukuk, but not sure when!
- Increasing number of academic institutions entering into Islamic finance arena eg. ABS, CASS, Durham, Reading (qualifications from CISI, CIMA) etc.

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Stand alone IFI's in the UK

- **Islamic Bank of Britain plc - August 2004**
  (first Islamic bank to operate in the retail space in Europe)
- **European Islamic Investment Bank - March 2006**
- **Bank of London and the Middle East - July 2007**
- **European Finance House - February 2008**
- **Gatehouse Bank plc - April 2008**
- **Principle Insurance - May 2008 (Oct09 into run-off)**

ISLAMIC BANK OF BRITAIN
البنك الإسلامي البريطاني

EIIB

BLME BANK OF LONDON AND THE MIDDLE EAST

EUROPEAN FINANCE HOUSE

Gatehouse Bank

Principle
Insurance Company Limited

Current state of the UK Islamic finance market

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- First mover advantage – most advanced Western jurisdiction
- Retail market is challenging
  - limited development and uptake (surprisingly few savings products)
  - awareness and education challenge
  - Credibility challenge – "…this looks the same to me…is this really Islamic?" – building community trust
  - Selling Islamic finance to appeal to religious and moral dimensions results in customers looking for social element to the product
  - Arabic terminology creating confusion
  - Successful market penetration – top down/outside in view OR inside out
  - Educating key gatekeepers – ulema/imam training
  - Fundamental characteristics of minority ethnic community is different – eg average family size varies thus impact on actuarial assumptions for insurance models
  - Shariah consistency
- Impact of global financial crisis
  - Reduction in activity
  - Gulf IFI's overly exposed to RE
  - Impact on capital markets (sukuk)
- Strong potential, ongoing require clarification around certain tax (inc VAT) treatments and regulatory view
- Lack of sovereign sukuk

Islamic finance in Europe

- Opportunity to capture large funds flow from Gulf countries
- UK first mover advantage (?)
- Muslim minority demographics with larger communities:
  - c5m in France
  - 3m Germany (3.6% of population)
  - 1m Netherlands (5.8% of population)
- The German state of Saxony-Anhalt has already issued an AAA-rated five-year sukuk
- French Government – amending legislation and larger Muslim population
- Luxembourg – Islamic funds hub
- Switzerland – Islamic private bank

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Thank you

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