

## BANKING &amp; FINANCE

## London's Islamic finance market

BY RICHARD SUMMERFIELD

The global market for Islamic finance has grown steadily of late, in 2014 climbing 12 percent to \$2 trillion. Indeed, the size of the market has more than tripled since the onset of the financial crisis in 2007 and shows little sign of slowing.

According to a recent report from TheCityUK, 'The UK: Leading Western Centre for Islamic Finance', the Islamic financial services sector could be worth as much as \$3 trillion by 2018 and \$4 trillion in the 2020s. Though this figure is comparatively small compared to the vast size of the overall global financial services market, the growth seen in the Islamic space indicates a burgeoning interest.

**London calling**

Much of the growth in the Islamic financial services market, particularly in the West, is focused on the UK, London specifically. There are a number of factors behind this growth.

In October 2013, the UK's prime minister David Cameron announced that going forward London would assume a position of significance in the Islamic finance market. Mr Cameron said he wanted "London to stand alongside Dubai as one of the great capitals of Islamic finance anywhere in the world".

Arguably, Mr Cameron has seen his wish realised. The city has cemented its place at the epicentre of Islamic finance in the Western world. The number of institutions across the country offering Islamic finance is double the number of similar institutions located in the US, and far outstrips other Western countries. There are 20 Islamic banks, five of which are fully Sharia compliant, licensed to operate in the UK.

As the TheCityUK report notes, the London Stock Exchange is also a key global venue for the issuance of Sukuk bonds. The UK's issuance of its first Sukuk in 2014 was a big step in helping to cement London's position in the Islamic finance space, with the UK the first non-Islamic country to

issue a sovereign Sukuk. "With the government leading the way, with the Sukuk issuance to diversify the UK's investor base by attracting liquidity from different sources, and in order to stimulate the financial market, the hope is that the sovereign issuance will encourage further private sector issuances of Sukuk in the UK and cement the UK as an Islamic finance hub," says Tarek El-Assra, a partner at Morgan Lewis.

However, the UK's role as the pre-eminent centre of Islamic financial services is not simply restricted to the number of financial institutions within the country. There are, according to the report, 70 educational institutions in the UK providing Islamic finance courses and degrees, the most of any Western nation. "As the leading Western centre for Islamic finance, the UK has been at the forefront of key developments for the industry in Europe and is well positioned to capture a growing share of Islamic finance business in the coming years," says Chris Cummings, chief executive of TheCityUK. "We are already a Western leader in the supporting infrastructure and environment for Islamic finance, with services offered by financial intermediaries, asset managers, insurance providers, and over 30 international law, accountancy and consultancy firms. The UK is also a world leader in developing skills in Islamic finance, with around 70 educational institutions offering Islamic finance courses at both undergraduate and postgraduate level," he adds.

So what has helped to facilitate this considerable growth in the value of the Islamic financial services sector? For Zamir Iqbal, head of the World Bank Global Islamic Finance Development Centre, increased demand for financial products which are in keeping with Islamic principles has had a major impact. "Islamic financial services are an emerging market which is experiencing rapid growth, and in some countries the growth rate is exceeding the growth in conventional

financial services," says Mr Iqbal. "Key drivers are increased demand for financial products and services complying with Islamic principles, increased liquidity in Islamic assets seeking investable opportunities, and global thinking to move towards asset-based and equity finance."

In many respects, London's recognition that Islamic finance represents an area of significant growth has made it attractive to firms in the space. "With the UK's desire to maintain its position as a leading global finance hub, it has positioned itself as an Islamic finance hub with the aim of earning a reputation as an Islamic finance centre of excellence," says Mr El-Assra. "The demands of certain investors looking for Sharia-compliant financial products such as loans, mortgages and insurance have also fuelled the industry, especially in the Middle East and Asia where there are large pockets of the local population looking for Sharia-compliant solutions. The growth in recent years has also been supplemented by lenders and investors wishing to diversify their portfolios and seeking alternative methods of investments such as Islamic finance, especially in light of the capital holding requirements imposed following the most recent global financial crisis," he adds.

Historical links between the Islamic financial services space and London have also proved important in helping the sector develop in the UK. With Sharia compliant transactions carried out in the city as far back as the 1980s, London already had a head start on many of its rival hubs of financial activity. "Recent discussions at various G20 platforms to promote alternative asset-based finance could prove a stimuli for the promotion of Islamic finance in the Western financial services space. In this case, the UK definitely has an edge over other financial centres due to its experience with financial engineering and developed markets, as well as its well developed legal and regulatory environment," says Mr Iqbal. The UK is ►

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ranked above other important centres on its overall Islamic finance offering, according to the latest ICD Thomson Reuters Islamic Finance Development Report. It has an index value of 16.2, well above the global average of 10.3, and the highest ranking of any non-Muslim-majority country.

The UK's considerable Muslim population has played a major role in helping to establish London as the focal point of Islamic financial services in the West. With 4.5 percent of the UK's population Muslim, according to the 2011 census, the potential for further advancements in the Islamic financial market is certainly there. Over 1 million of the 2.8 million Muslims living in the UK reside in London.

According to TheCityUK's report there are currently around 100,000 Islamic finance retail customers in the UK. Products such as Sharia compliant individual savings accounts, home purchase plans (which serve as an alternative to a mortgage but are consistent with the principles of Islamic finance), a Sharia compliant pension scheme and business start-up financing have all played a major role in establishing London as a hotbed of Islamic financial activity.

In addition, the UK's legal framework is a historic and deeply trusted one which has been exported around the globe. This has undoubtedly been to the UK's – and London's – advantage. The UK's legal framework and its significant number of precedents have formed the bedrock of many Islamic financial transactions over the years. Many of the legal contracts drawn up for Islamic financial transactions are written in English.

For some time, London has enjoyed the leading share of trading in many international financial markets, including foreign exchange and OTC derivatives trading, international bank lending and international insurance. Furthermore, it is the focal point of sovereign wealth funds, hedge funds and private wealth management in Europe. With these factors in mind,

it seems inevitable that Islamic finance professionals would choose to invest in the city. "The UK's financial markets have a long history of intermediating financial services for Islamic financial institutions," points out Mr Iqbal. "The well-developed legal, regulatory and supervisory environment conducive for asset-based finance and securitisation is the key advantage which the UK offers, and attracts Islamic finance."

With liquidity in the Middle East reaching record levels in recent years, it is of little surprise that London has emerged as the preferred financial hub among Islamic investors. Groups looking to diversify their holdings have made London a natural choice. The pre-eminence of English as the *lingua franca* in the financial services market, as well as the city's relative locality to investors in the Middle East, has allowed London to profit from an influx of Islamic finance.

#### Infrastructure development

It is important to note, however, that Islamic finance has not just benefitted from London's extensive and well developed legal, financial and regulatory environment; it is also making a very positive impact on the UK as a whole. In recent years, Islamic finance has begun to play an integral role in the development of infrastructure projects in the UK. More than 6500 homes in the North-West of England and the Midlands are currently being financed by a £700m investment by Gatehouse Bank, a fully Sharia compliant bank.

Yet London is where the impact has been felt most. Financing has been made available for heavyweight new developments including the Shard, the regeneration of the Battersea Power Station district, London Gateway, the Olympic Village and the major redevelopment of Chelsea Barracks. Though the spread of Islamic finance into the UK has been one of natural progression, the UK government has instituted several supportive policies over the course

of the last decade which have created a fiscal and regulatory framework intended to broaden the market for Islamic products.

"Major developments such as the UK sovereign Sukuk – the first outside the Islamic world – and other UK government initiatives to create a level playing field for Islamic institutions and their clients have been enormously important," says Mr Cummings. "It is part of what makes the UK the leading international financial centre. There is so much opportunity to develop this market and we look forward to continuing our work with the UK government to encourage inward investment through Islamic finance and help create a political environment where innovation is encouraged."

#### Moving forward

The prognosis for the Islamic financial services market is healthy, with many analysts predicting continued growth of both the Islamic financial services sector as well as the industry's focus on London as the dominant Western Islamic financial services space. "The expectation is that the industry will continue to grow," confirms Mr El-Assra. "For this trend to continue, greater conformity in the structures will equip the industry to tackle one of the longstanding barriers to entry. This should be supplemented with new innovative structures and products to develop the Islamic markets, such as Sharia compliant pension schemes, for example. A greater number of scholars, lawyers, accountants and bankers, who are experienced in Islamic finance transactions and understand the structures, will take the Islamic sector to the next level."

While over time it is likely that other locations may challenge London's pre-eminence in the industry, it seems unlikely that that challenge will come from Europe. New York may provide some competition, given the city's standing as a global centre of finance, but the threat to London is unlikely to materialise for some time. ■

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