



Islamic Finance in the UK

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Global Islamic Finance Industry



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About the IFC

“Broader than banking, wider than the Middle East”

- 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

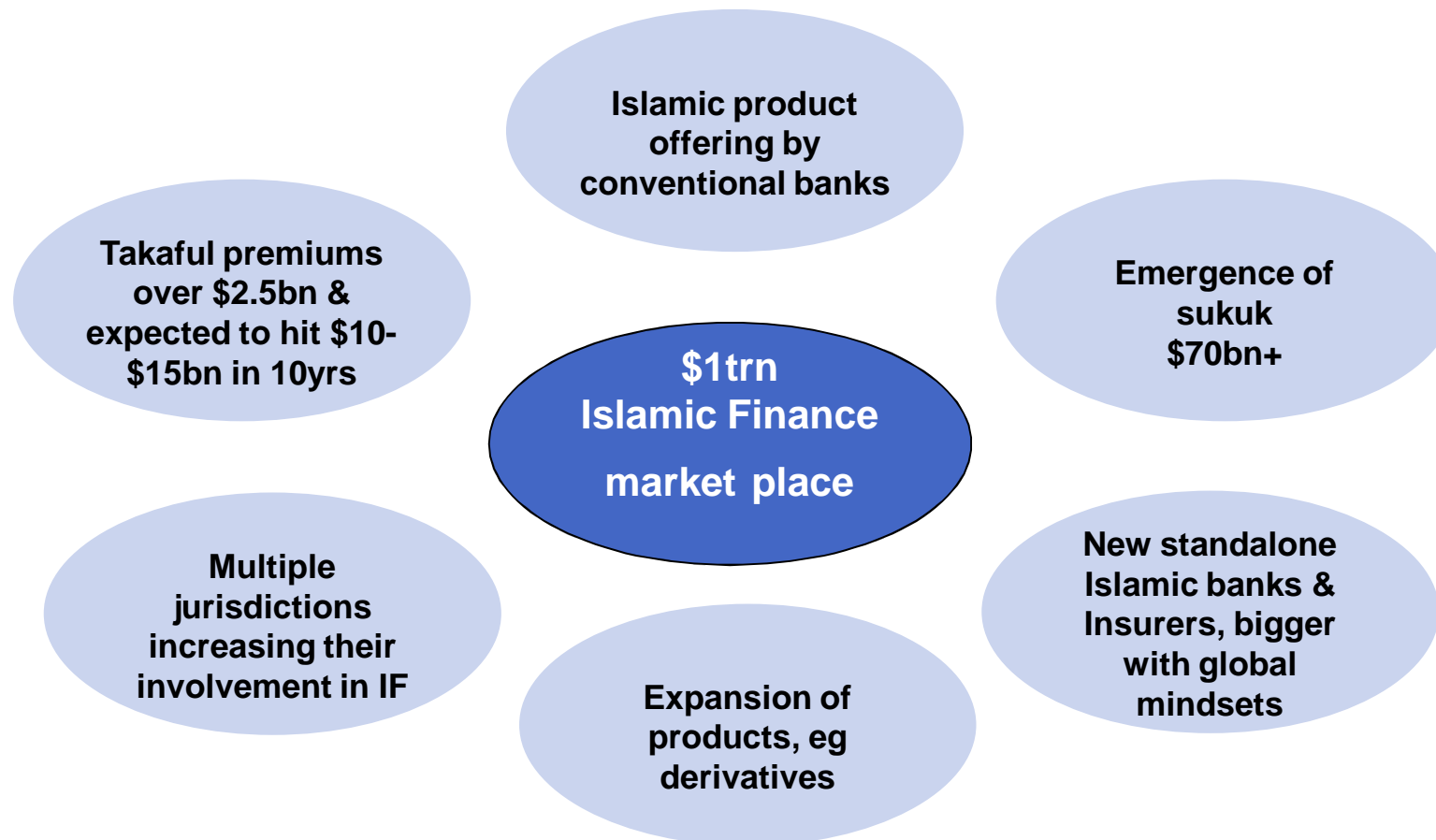
The Islamic Financial Services Market

“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)
- The German state of Saxony-Anhalt has already issued an AAA-rated five-year sukuk, along with Singapore and other predominately non-Muslim states
- Fundamental structural differences in Islamic banking products with inherent additional challenge of Sharia compliance

Key industry achievements

“Transitioning from a niche into mainstream”



Market analysis – UK Market

- Strong support from Government
 - > 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”
- 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. CASS, CIMA, etc.

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**



UK Treasury and FSA

Legislation has subsequently been introduced to create a level playing field

No specific mention of Islamic finance or Arabic terms in the legislation

•2003

Legislation changed to remove possible double Stamp Duty on Shariah compliant home purchase facilities. Subsequently the UK Islamic mortgage market has grown to £0.5 billion, increasing 50% between 2006 and 2007

•2005 - 2006

Changes to taxation created level playing field for savings products utilising Mudaraba and Wakala structures; asset finance through Murabaha; stamp duty incurred through Ijara and Child Trust Funds structures

•2007

The Budget 2007 introduced new measures enabling Sukuk to be held and traded in the same way as corporate bonds

•2008 - 2009

Discussion and consultation about application of Stamp Duty Land Tax to Sukuk issuance

Introduce legislation in Finance Bill 2009 to provide relief from stamp duty land tax (SDLT) for alternative finance investment bonds, following a formal consultation.

Amend legislation to classify alternative finance investment bonds as loan capital for the purposes of stamp duty and stamp duty reserve tax (SDRT).

Introduction of legislation to allow existing corporation tax and income tax rules on alternative finance arrangements to be amended by regulation if and when required.

Current state of the UK Islamic finance market

- First mover advantage – most advanced Western jurisdiction
- Retail market is challenging
 - limited development and uptake (surprisingly few savings products)
 - awareness and education challenge
- Impact of global financial crisis
 - Reduction in activity
 - Gulf IFI's hit by overly exposed to RE
 - Impact on capital markets (sukuk)
- Strong potential, ongoing require clarification around certain tax (inc VAT) treatments and regulatory view
- Challenges from European Governments

Innovation in Islamic Finance



Saftar Sarwar

IFC Executive Board Member

The market size for Islamic finance – engaging customers

“Inclusive proposition with a captive value group”



RESULT OF...

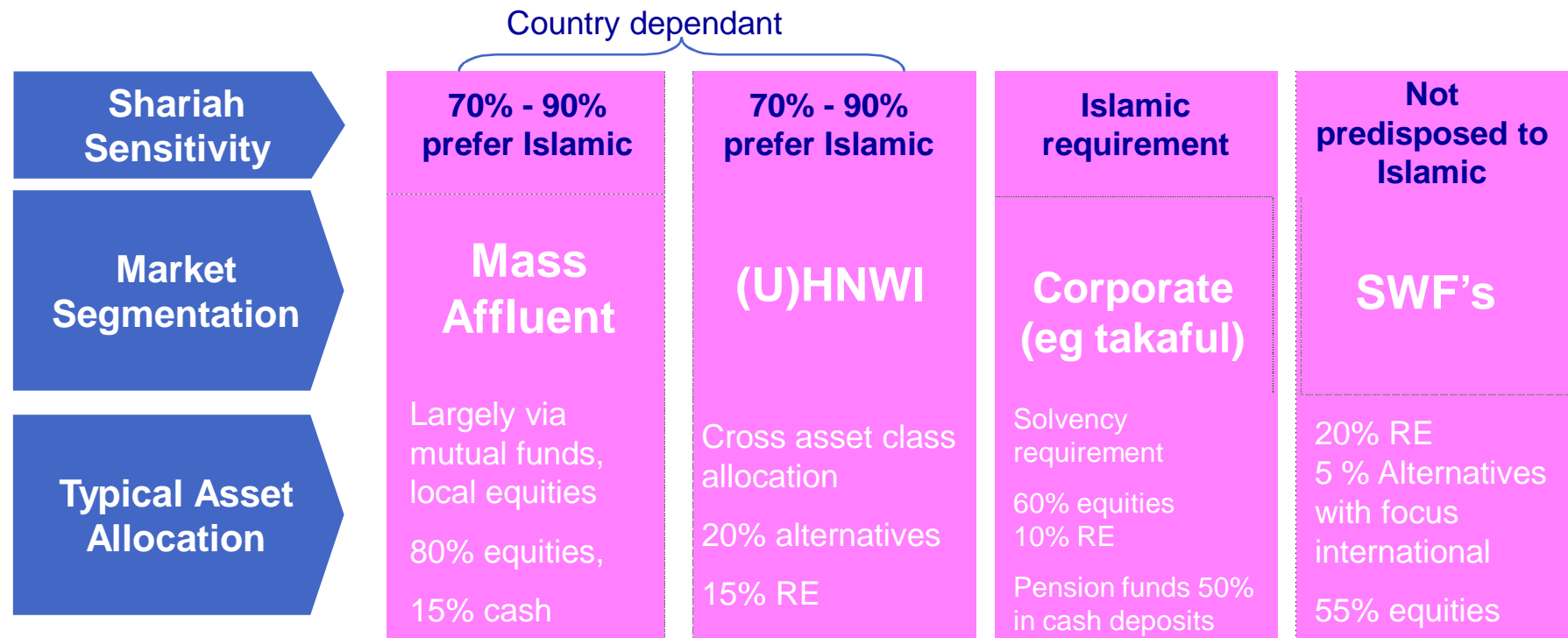
- Increased awareness
- Western players offering Islamic finance products & services
- Increased number of enablers
- More Islamic banks present
- More innovative products
- Competitive pricing



Potential target for Financial Institutions offering Islamic Financial Services

Islamic Funds and Investments Landscape

Source: EY WIFR Report



2009 EY Report key highlights:

- Islamic fund management sector has not been immune
 - All key Islamic asset classes (equity, fixed income, commodity, RE) have performed poorly in 2008, leading to a change in investor risk appetite
 - The industry remains fragmented and a shakeout appears to be taking place
 - Managers seeking to survive the downturn must manage their key business risks and adapt

What is the Value proposition in Islamic Banking

- **Makes Islamic sense**
 - You are catering for a growing affluent customer segment
 - Catering for all people, for all communities
 - Provide the Islamic option
 - Real innovation in the marketplace, a real ethical alternative

- **Makes business sense**
 - A more diversified and consistent revenue stream
 - A real focus on real assets, real work
 - Where is the affluence, follow the need
 - Innovation will further drive growth and profitability.

- **Keep focused**

Innovation in Islamic Banking

- Innovation to continue
 - Many Islamic finance propositions running parallel to conventional
 - Meeting a growing need
 - Demand led strategies
 - Commodity, real asset, led initiatives

- Examples:
 - Alpha and beta products
 - Structured Notes
 - ETFs
 - Absolute return products, strategies
 - Liability matching products

Asset class within the risk spectrum

DIVERSIFICATION

Key to successful investment strategy

Risk & Return Spectrum

High

Low



Equities

Real Estate, Sukuk

Commodity Murabaha

Limited
Universe

Sector
Overheat

Over Reliance &
Low Returns,

Opportunity !! – HIGH RETURNS 35%+

- > Natural next stage as the regional markets develop
- > Venture Capital the missing link in the ME region

Innovation in Islamic Banking

➤ **HNW**

- Bespoke solutions
- Absolute return strategies
- Structured Notes
- Private Equity

➤ **Retail**

- Simple investment products, scale, low volatility
- Cash and lending solutions – match the balance sheet

➤ **Unbanked**

- Micro lending strategies - US\$ bn ++ opportunity
- Community lending/savings

What matters

- Absolute return matters
- Competitive pricing
- Transparency of structure and profile
- Best in class

Potential for Islamic Banking in Nigeria

- Growing affluence base across demographics and within the Muslim population
- Opportunity to develop more infrastructure led initiatives
- High potential to internationalise Nigeria within Islamic and global capital markets - take the lead
- Opportunities at the governmental and state level to bolster this industry
- If not now, when?