

The lie of the land



MOHAMMED AMIN TAKES A LOOK AT THE UK'S ISLAMIC FINANCE INDUSTRY TODAY AND CONSIDERS ITS PROSPECTS.

The UK ranks eighth in the world for shariah-compliant financial assets, according to the Islamic finance industry survey "Islamic Finance 2010", published by International Financial Services London. So with a Muslim population of just 2.4 million, the UK still outranks countries such as Indonesia, Pakistan and Bangladesh. The UK's Islamic financial services industry comprises both "window" operations and standalone companies.

WINDOWS. A window is an Islamic banking business embedded within a larger conventional bank. The advantage is its ability to use the infrastructure of a larger operation; the disadvantage is that potential customers may have a less positive perception compared with a standalone Islamic bank.

When it comes to branding, HSBC uses HSBC Amanah for its Islamic finance business in the UK and globally. Conversely, LloydsTSB offers Islamic banking through its branch structure but without a separate sub-brand. The UK Islamic retail offerings of other international players such as Citigroup and Standard Chartered are limited.

Most major investment banks in the UK will structure transactions for Islamic counterparties and many have some involvement in the Islamic capital markets.

STANDALONES. Standalone Islamic banks fall into four groupings:

■ **Islamic banks.** The Islamic Bank of Britain was the first Islamic bank in the UK and is the only one focused on the retail market. The UK retail market is relatively small and IBB has incurred losses since it started. Its relatively small equity base of £21.6m probably makes it relatively risk-averse when financing customers. However, the current yield curve results in its inter-bank assets producing relatively little income to support its operating overheads.

■ **Islamic investment banks.** There are four: the European Islamic Investment Bank, the Bank of London and the Middle East, European Finance House and Gatehouse Bank, listed here in the order of their establishment. Their balance sheet sizes vary but all are relatively small compared with conventional investment banks. Accordingly, as with traditional British merchant banks, their strategies would be expected to focus on deploying their intellectual skills and contacts rather than their balance sheets, with natural businesses including private banking, asset management and the origination of customer financings and securities, which are then syndicated or placed. Their published accounts show that these are indeed their strategies. The global financial crisis, combined with being in a startup mode, has meant that the most recent published accounts from the three banks that post accounts on their websites (I could not find any accounts on the European Finance House website) show losses.

■ **Islamic insurance providers.** Principle Insurance Holdings is the UK's first dedicated provider of takaful (Islamic insurance) under the brand name Salaam Halal Insurance. It commenced writing motor insurance policies in July 2008 but in November 2009 announced it was going into solvent run-off and ceasing to write new policies while it sought additional investment.

■ **Investment managers/corporate finance firms.** There are a number of these operating in London which are Shariah-compliant. Space constraints and the diversity of their businesses preclude coverage in this short article.

KEY ISSUES.

- **Liquidity.** In my opinion, the most pressing issue for the standalone Islamic banks is currently the Financial Services Authority's plan for changes to the liquidity management regime for all banks. In December 2008 the FSA issued consultation paper CP08/22 setting out its proposals for the quantity and quality of liquid assets that banks should hold. Paragraph 6.6 states: "The assets in the buffer should be the most liquid by virtue of the significant depth and resilience in stressed conditions of the established markets in which they are traded. We consider these to be: highly liquid, high-quality government debt



instruments as follows – gilts, plus bonds rated at least Aa3 issued by the countries of the European Economic Area (EEA), Canada, Japan, Switzerland and the United States; and reserves held with the Bank of England's reserve scheme and with the central banks of the US, the EEA, Switzerland, Canada and Japan."

Such a liquidity regime would make it impossible for Islamic banks to operate in the UK since none of the above assets are Shariah-compliant. Since the consultation paper was issued, discussions have been under way between the Islamic banks, the FSA and the Bank of England on how this circle can be squared.

The most straightforward solution would be for the UK government to issue Shariah-compliant securities economically equivalent to Treasury bills or gilts, which Islamic banks could hold to comply with the new liquidity requirements. However, the pre-Budget report on 24 November 2008 concluded that the issue of sovereign sukuk would not offer value. The government has consistently adhered to this position ever since.

The deadlock may be broken by the Islamic Development Bank. The AAA rated IDB is contemplating issuing a sterling-denominated sukuk that the FSA would be expected to accept as satisfying the quality requirements for liquid assets to be held by Islamic banks.

▪ **Political support.** The Islamic finance companies mentioned above were all established during a Labour government. Starting with changes to the stamp duty land tax legislation in the Finance Act 2003, we have seen a number of tax law changes intended to level the playing field between conventional finance and Islamic finance.

Opposition MPs contributed to the review of the legislation by parliament, but the Conservative Party did not make any policy pronouncements on Islamic finance. This silence led to disquiet in the industry that the present supportive government attitude might be reversed on a change of government.

The question started to crop up regularly at Islamic finance conferences until 20 January 2010 at the Norton Rose seminar "New Year: New Opportunities in Islamic Finance", when Mark Hoban, shadow financial secretary to the Treasury, gave a clear statement of Conservative support for Islamic finance. He emphasised that Islamic finance was not a party political issue, dispelling the growing concern that government support might disappear if the Conservatives came to power.

INDUSTRY PROSPECTS. No new Islamic bank has been established in the UK since Gatehouse Bank obtained its licence in April 2008. The simple reason is that the global financial crisis has caused a number of foreign institutions that were planning to set up an Islamic banking subsidiary in London to put their plans on hold.

As the economy improves, new Islamic banks can be expected to set up here. The logic for basing in London an investment bank operating internationally remains irrefutable. Conversely the UK retail market for Islamic finance remains small and it may be more attractive to operate any retail business on a pan-European basis.

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