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FINANCIAL MARKETS SERIES

ISLAMIC FINANCE

MAY 2011

Gatehouse Bank

Gatehouse Bank is pleased to support TheCityUK Islamic Finance 2011 report. Gatehouse Bank is an active market participant in a growing community of financial institutions in the UK dedicated to the delivery of Shariah compliant solutions.

To maintain London and the UK's position as the leading western centre for the provision of Islamic financial services to the international market, industry stakeholders recognise the need for continual education, training and qualifications to enhance skills and learning for Islamic finance professionals, as well as broader education for other entrants seeking to increase their understanding on Islamic financial services. We therefore welcome the latest, credible research and data that supports these objectives, and raises awareness about the achievements made by the UK Islamic financial services industry.

With the creation of a more informed audience, and increased business activity as market participation grows, Islamic financial services will play an increasingly valuable role within the international financial system.

Gatehouse Bank is a Shariah compliant wholesale investment bank in London offering world class products and expertise.

Our business focus includes:

- Real Estate
- Asset Finance
- Capital Markets
- Treasury
- Shariah Advisory

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TheCityUK

partnering prosperity

TheCityUK is an independent membership body, established in June 2010, promoting the UK financial and related professional services industry.

TheCityUK's key areas of activity include:

- Promoting the UK-based industry as a world leader offering unrivalled service and expertise to partners around the world.
- Creating a partnership for a sustainable industry: demonstrating the industry's role in enabling growth and prosperity in the wider UK economy.
- Using research, evidence, insight, data and analysis to meet the needs of its members and to provide the evidence to support our promotional objectives.

ISLAMIC FINANCE

MAY 2011

Islamic finance is growing as a source of finance for Islamic and other investors around the world. This report summarises global trends in Islamic finance with particular reference to how the market is developing in the UK.

OVERVIEW

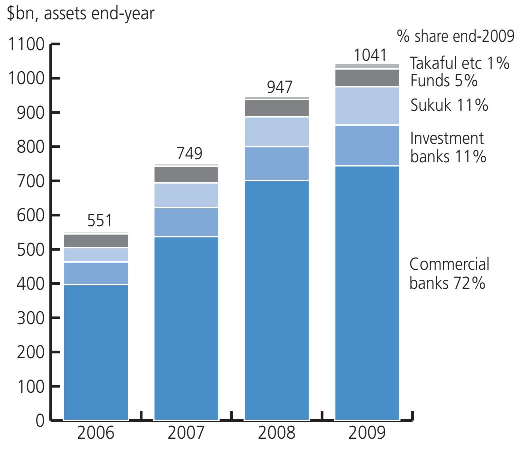
The global market for Islamic financial services, as measured by sharia compliant assets, is estimated by TheCityUK to have reached $1,041bn at end-2009, 10% up on $947bn in 2008. Growth in 2009 was a respectable outturn for the industry in the context of the financial crisis at the time (Chart 1). Islamic finance is benefiting from recovery in the global economy, particularly in emerging markets, and is likely to have experienced a further year of steady growth in 2010 estimated by TheCityUK at 10-15%. It has the potential to sustain this rate of growth over a number of years.

Islamic finance was less affected by the financial crisis and downturn than some parts of conventional finance, although some Islamic banks have been exposed to the volatile real estate markets and a number of sukuk issuers have defaulted on payments. Revenues of banks recovered during 2010, in contrast to 2008 and 2009 when revenue and profitability was under pressure. Commercial banks account for the bulk of the assets with investment banks, sukuk issues, funds and takaful making up the balance.

Key centres are concentrated in Malaysia and the Middle East including Iran, Saudi Arabia, Malaysia, Kuwait, UAE and Bahrain (Chart 2). These countries should provide fertile ground for future growth, although prospects for the Islamic finance in some Middle Eastern countries could be affected by the spread of political upheaval in the region. Islamic finance is also developing in Asian countries such as Bangladesh, Pakistan, India and Indonesia, as well as North African countries such as Sudan and Egypt.

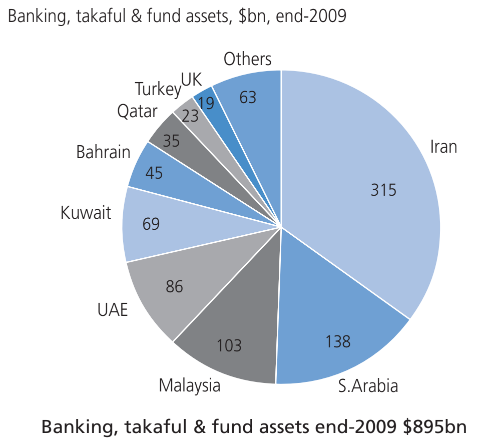
The UK, in 9th place, is the leading Western country and Europe's premier centre with $19bn of reported assets, largely based on HSBC Amanah. Islamic finance has the opportunity to build a broader presence in the UK particularly in the Moslim community of over 2m people. Assets in other Western countries are currently small but a number of countries, particularly France, are looking to develop a presence in Islamic finance. While scope for development exists elsewhere in Western Europe, an appropriate legal and regulatory structure first needs to be designed and implemented.

Chart 1
Global assets of Islamic finance



Source: TheCityUK estimates based on The Banker, Ernst & Young & Zawya

Chart 2
Islamic Finance by country



Source: The Banker

Issuance in the sukuk market rose further in 2010 to reach a record $50bn. This demonstrated that quality issuers of sukuk continue to attract demand from investors. Despite some defaults, the impact on the broader market has therefore not been as extensive as was feared a year ago. There are considerable opportunities for sukuk in the Gulf, North Africa and east Africa in financing investment in infrastructure.

While less affected by the financial crisis and global economic downturn, Islamic finance faces ongoing operational challenges:

- Management of liquidity is constrained by a lack of products, despite initiatives to automate murabaha transactions and to bring forward new instruments that are sharia compliant.
- In addition to the ongoing challenge of ensuring sharia compliance for all products, the cost of finance may be inflated by compliance risk: the risk that some assets could be judged non-compliant.
- Diversification of assets would help to spread risk and reduce exposure to real estate which has contributed to falling asset values. Real estate has attracted a large share of bank finance and sukuk issuance due to its sharia compliance.

Separate to operational challenges, there are also opportunities to improve governance and reporting:

- Multiple representation of some sharia scholars on company boards could be addressed by development of internationally agreed code on representation. The skills base from which new scholars could be drawn is broadening.
- There is scope for improvement in reporting as less than half of companies submitted accounts for The Banker's annual survey of The Top 500 Financial Institutions.

While London has been providing Islamic financial services for 30 years, it is only in recent years that this service has begun to receive greater profile. An important feature of the development of London and the UK as the key Western centre for Islamic finance has been supportive government policies intended to broaden the market for Islamic products. Key aspects of Islamic finance in the UK include:

- 22 banks, of which five are fully sharia compliant, more than in any other Western country.
- 31 Sukuk issues raising $19bn listed on London Stock Exchange.
- 34 Islamic funds managed from the UK: total investments $0.3bn.
- Over 20 law firms supplying services in Islamic finance.
- Advisory services provided by Big Four professional service firms.
- Institutions offering qualifications and training in Islamic finance.
- Off-exchange trading in commodity-based agreements linked to LME contracts.

global Islamic finance assets
up 10% in 2009 to $1,041bn

GLOBAL MARKET FOR ISLAMIC FINANCE

As mentioned in the overview, TheCityUK estimates that the global market for Islamic financial services, as measured by sharia compliant assets, reached $1,041bn at end-2009, 10% up from $947bn in 2008 (Chart 1). Assets have grown from about $150bn in the mid-1990s. Islamic commercial banks accounted for 72% of the assets, investment banks 11%, sukuk issues also 11%, funds 5% and takaful & other assets 1%. Banks in aggregate therefore account for 83% of assets.

Assets that can be allocated to individual countries from The Banker's survey of 500 organisations reveal that the leading countries for sharia compliant assets are Iran with $315bn, Saudi Arabia $138bn and Malaysia $103bn (Table 1). These are followed by other Gulf states including UAE, Kuwait, Bahrain and Qatar, and then Turkey. The UK, in ninth place, is the leading Western country with $19bn of reported assets, largely based on HSBC Amanah. Countries with most of the 348 firms reporting to The Banker's survey include Malaysia with 39, Kuwait 37 and Bahrain 34. Indonesia, Saudi Arabia, Pakistan, Iran, UAE and the UK each have between 20 and 26 firms supplying Islamic finance (Table 1).

Broadening geographical customer base for Islamic services The market is currently most developed in Malaysia, Iran and the majority of countries that form the Gulf Co-operation Council (GCC). These countries remain fertile ground for future growth, although prospects for the Islamic finance in some Middle Eastern countries could be affected by the spread of political upheaval in the region. Islamic finance is moving beyond its historic boundaries into new territories. Markets where Islamic finance is developing include:

- Other countries in the Middle East and North Africa such as Turkey, Sudan, Egypt, Jordan and Syria.
- Other Asian countries such as Indonesia, which has the largest indigenous Muslim population in the world, as well as Hong Kong, Singapore, Bangladesh, Pakistan, China and India.
- Western countries in Europe and North America. Countries such as the US, France, Germany and the UK each have indigenous Muslim populations of between one and five million, although Russia has much the largest in Europe with 30m. The customer base in Western countries is not necessarily restricted to Moslims: other customers may be attracted by the ethical and environmental basis of Islamic finance.

Following the lead set by the UK, other Western countries, such as Japan and France, are looking to make the appropriate regulatory and legal reforms that would facilitate provision of Islamic financial products. London is seeking to consolidate its position as the gateway to Islamic finance in Western Europe. Providers in London are likely to focus on services that complement those available in other centres. Government strategy for the development of Islamic finance in the UK is summarised on page 9.

Table 1
*Islamic Finance by country**

Banking, takaful, fund & other assets, $bn, 2009

		--------------of which	-------------			*Number*
	Total	Banks	Takaful	Funds	Others	*of firms**
Iran	**314.9**	310.9	3.7	0.3	---	*22*
S.Arabia	**138.2**	138.2	2.2	---	0.0	*25*
Malaysia	**102.6**	100.5	3.8	---	2.2	*39*
UAE	**85.6**	85.6	1.4	0.0	0.0	*22*
Kuwait	**69.1**	56.3	0.1	12.6	---	*37*
Bahrain	**44.9**	42.7	0.4	1.7	---	*34*
Qatar	**34.7**	32.8	0.4	1.9	0.0	*18*
Turkey	**22.6**	22.6	---	---	---	*4*
UK	**19.0**	19.0	---	---	---	*6*
Bangladesh	**9.4**	9.1	0.2	0.1	---	*16*
Sudan	**9.3**	9.3	0.2	---	---	*---*
Egypt	**7.2**	7.2	0.0	---	---	*3*
Indonesia	**7.2**	6.8	0.4	---	---	*26*
Pakistan	**6.2**	6.2	---	---	---	*23*
Syria	**5.5**	5.5	---	---	---	*3*
Jordan	**5.0**	4.8	0.1	0.2	---	*10*
Brunei	**3.3**	3.3	---	---	---	*6*
Other countries	**10.3**	2.4	0.5	-0.8	0.3	*38*
Total	**895.0**	862.3	13.3	16.0	2.5	*348*

**includes only those firms submitting data to the Banker's survey*
Source: The Banker

UK is leading western country with $19bn in reported assets

Sharia compliant financial services

Banking and sukuk - the issue of Islamic notes - represent the forms of Islamic finance that are most well established, although takaful (insurance) and funds are also evolving. Products that may be the subject of innovation include private equity and private wealth management.

Banking Islamic banks are looking to develop as economic growth becomes firmly established, particularly in core markets in the Middle East and Asia.Islamic banks compete not only with each other but also with all other banks offering conventional finance, particularly those that have established Islamic 'windows'. In the Banker's survey, balance sheet assets of sharia compliant banks rose 8% from $800bn in 2008 to $862bn in 2009, of which $744bn were in commercial banks and $119bn in investment banks. This represented a slowdown from the rapid rates of growth reaching 36% and 26% in 2007 and 2008 but a respectable outcome in a challenging economic and financial environment.

Revenues recovered during 2010, in contrast to 2008 and 2009 when revenue and profitability of Islamic banks suffered from higher rate of non-performing loans than conventional banks, mainly due to their exposure to falling real estate markets. Competition is continuing to put pressure on profitability and liquidity is a significant restraint for some banks.

In addition to the challenge of ensuring sharia compliance for all products, Islamic finance institutions face the possibility of compliance risk: the risk that a particular product and therefore some assets could be judged to be non-compliant. This follows a decision by The Investment Dar Company, in a debt restructuring process, that $10.7bn owed to Blom Developments Bank under an Islamic financing facility was not sharia compliant and therefore not a transaction that Investment Dar was permitted by its Articles of Association to enter into. The English High Court has decided that Investment Dar be allowed to run this argument at trial.

In its World Islamic Banking Competitiveness Report 2010/11 McKinsey & Company noted that retail banking would be a key driver of revenue growth in the Middle East but Islamic banks would face stiff competition from conventional banks offering Islamic products, particularly in capturing business from more wealthy clients. The report noted the significant opportunity for Islamic banks in the market for Small and Medium sized enterprises (SMEs) and the mid-corporate market, which account for about a quarter of loan volumes, but are growing faster than average.

Qatar took the radical step in February 2011 of preventing conventional banks from offering sharia compliant products through Islamic windows. While some commentators have taken the view that this will encourage product innovation and and enhance the distinctiveness of Islamic finance, others are concerned that some sharia compliant firms need more time to mature and develop, before full separation is established.

In the UK, the five fully sharia compliant banks, listed in Table 2, were established between 2004 and 2008 and put the UK in the lead in

22 Islamic banks in UK
more than any other Western country

Western Europe. While there has as yet been no further addition to these five banks, there are also an estimated 17 conventional banks that have set up windows in the UK to provide Islamic financial services (Table 3). HSBC Amanah is the only conventional bank with an Islamic window to report to The Banker's survey: its assets of $16.7bn account for 88% of the UK's identified assets, with a further 5% from BLME and 3% from the HSBC parent bank. The 22 Islamic banks in the UK substantially exceeds that in any other western country or offshore centre (Table 4).

The Islamic Bank of Britain (IBB) is a retail bank, the only Islamic bank with a high street presence having eight branches and around 50,000 customers. IBB's founding shareholder Qatar International Islamic Bank injected £20m in 2010 through a placing of shares, which followed a share issue of £7.5bn in early 2009. In the first six months of 2010 IBB saw customer financing increase by 19% to £55m, while deposits rose by 3% to £193m.

The Bank of London and The Middle East (BLME) is an independent wholesale sharia compliant UK bank based in the City of London.In November 2010 BLME launched a sharia compliant web-based foreign exchange trade platform to provide clients with direct access to multiple currencies. Currency trading in a sharia compliant environment is used to support cross-border transactions.

European Finance House was rebranded QIB UK in 2010 to reinforce its identity within QIB's global network. QIB UK offers a range of sharia compliant financing and investment products for both Islamic and non-Islamic clients alike. European Islamic Investment Bank (EIIB) provides sharia compliant investment banking services including trade finance, private equity and asset management.

Gatehouse Bank is a sharia compliant wholesale investment bank operating in capital markets, real estate, asset finance, Treasury business and sharia advisory services. In 2010, Gatehouse Bank completed more than £160million in Sharia compliant real estate acquisitions.

Liquidity management Treasury murabaha is a key component of banks' liquidity management. These are usually commodity based contracts of the London Metal Exchange, traded off exchange. SWIFT, the society for world interbank payments, has developed an automated messaging standard to support murabaha transactions which is replacing a manual paper process. SWIFT noted in November 2010 that the standard has been certified compliant with the International Islamic

Table 3
Assets of Islamic banks in UK

Shariah compliant assets, $m

	Year-end	2007-08	2008-09	2009-10	*% change 2009-10*
HSBC Amanah Finance	Sep-10	15194	16537	16699	*1*
Bank of London and the Middle East	Jun-10	1196	1119	1041	*-7*
HSBC	Sep-10	570	698	524	*-25*
European Islamic Investment Bank	Dec-09	648	555	271	*-51*
Islamic Bank of Britain	Dec-09	337	394	336	*-15*
QIB UK	---	94	---	---	---
Gatehouse Bank	Dec-09	15	108	79	*-27*
Total		18055	19411	18949	*-2*

Source: The Banker

Table 2
Islamic banks in UK

Fully sharia compliant
Bank of London and The Middle East
European Islamic Investment Bank
Gatehouse Bank
Islamic Bank of Britain
QIB UK

Islamic windows
ABC International Bank
Ahli United Bank
Bank of Ireland
Barclays
BNP Paribas
Bristol & West
Citi Group
Deutsche Bank
Europe Arab Bank
HSBC Amanah
IBJ International London
J Aron & Co.
Lloyds Banking Group
Royal Bank of Scotland
Standard Chartered
UBS
United National Bank

Table 4
Islamic banks in western countries & offshore centres

Number located in each country	
UK*	22
US	10
Australia	4
Switzerland	4
France	3
Canada	1
Cayman Islands	1
Germany	1
Ireland	1
Luxembourg	1
Russia	1

**TheCityUK estimate for UK*
Source: The Banker

finance standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI).

Despite this initiative, sharia compliant products to support liquidity remain in short supply. Consequently, eleven central banks that are members of the Islamic Financial Services Board agreed in October 2010 to establish the International Islamic Liquidity Management Corp (IILM) to help Islamic financial institutions work towards an Islamic money market and improve cash management.

Other products to have been proposed as candidates for new liquidity management tools include asset-backed structured commercial paper; sukuk repo alternative; and leased asset-backed instrument with strong market makers.

Sukuk are issues of Islamic notes that represent an alternative to conventional bonds. Zawya Sukuk Monitor reports that issuance of sukuk has staged a recovery in the past two years, rising by 54% to a new high of $50bn in 2010 from $33bn in 2009, which was itself 70% up on $20bn in 2008 (Chart 3). The drop in 2008 was consistent with a broad-based slowdown in global capital market activity. The recent recovery demonstrates appetite for quality issuers of sukuk from both Islamic and non-Islamic investors, despite defaults by Dubai World and other sukuk issuers. Dubai World received a $10bn loan from Abu Dhabi in 2010 and has subsequently signed a final accord with lenders in March 2011. A further 20 sukuk defaults are estimated to have involved issues to the value of around $2bn. Concerns persist about settlement of sukuk defaults, but have not stood in the way of recovery in issuance.

Previously, Issuance of sukuk increased rapidly from $1bn a year in 2002 to $34bn in 2007. Issuance fell away during 2008 as a result of a decline in asset valuation, a lack of liquidity and a lack of market confidence. The ruling from the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOFI) that questioned the sharia compliance of some sukuk structures also acted as a break on issuance in 2008.

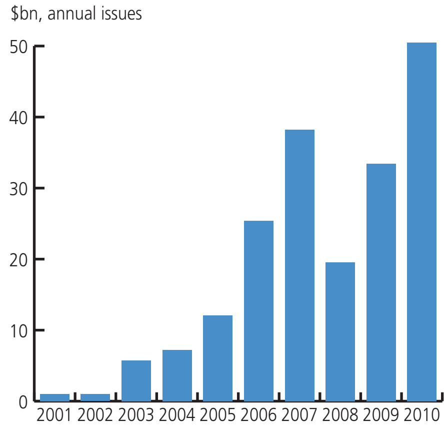
Zawya indicates that most issuers in 2010 continued to be government or quasi government organisations, accounting for 71% of issuance while the financial sector contributed 10%. Malaysia is the dominant country in the global market, with issuance totalling $33bn, two thirds of 2010 issues. There were also sukuk issues of $3bn from Indonesia and Saudi Arabia, and $2bn from Qatar, while Pakistan and UAE each had issues of around $900m in the final quarter.

The UK has a strong interest in the development of the sukuk market. The London Stock Exchange have proven to be an attractive draw for sukuk issuance. In 2010 there were 5 new listings worth $1.7bn on the LSE's markets, with a single sukuk in early 2011 worth $0.5bn. This has brought total sukuk listings to 31 and a value of $19bn (Chart 4). Key milestones for the LSE have included the GE Capital sukuk in 2009, the first listed sukuk by a US corporate, and in 2010 the Kuveyt Turk sukuk, the first by a European bank.

Elsewhere, Nasdaq Dubai has 16 listings with a value of $11bn, a total

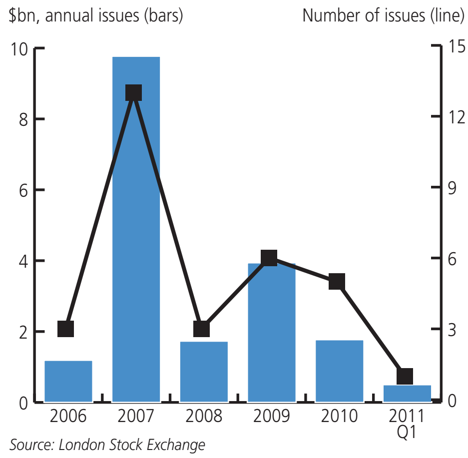
Sukuk global issuance reached **new high of $50bn in 2010**

Chart 3
Sukuk global issues



Source: Zawya Sukuk Monitor, Islamic Financial Information Service

Chart 4
Sukuk listings at London Stock Exchange



Source: London Stock Exchange

London Stock Exchange 31 sukuk listings **total $19bn** that has fallen as a result of delistings including three Nakheel issues worth over $5bn. Luxembourg is also an important centre with 16 sukuk listings worth $7bn in 2009.

A significant development in the UK in 2010 was the first corporate sukuk issued in 2010 by International Innovative Technologies (IIT). The company is a new technology development company specialising in design, precision engineering and manufacture of innovative products. The £10m sukuk will be used by the company as growth capital.

The Islamic finance industry in the UK is still keen to see a UK sovereign sukuk. While there is strong cross-party consensus in the UK on the need to develop Islamic finance, the UK government in January 2011 reiterated the position of the previous government: that the issue of a sovereign sukuk is not judged to provide value for money at the present time (also see section on UK government strategy on page 9).

Long term prospects for development of sukuk globally are positive, with three factors having a role in fostering growth in demand when market conditions improve:

- There is a commitment to a substantial programme of infrastructure investment in the GCC totalling up to $1,000bn over the next ten years, some of which will be financed through Sukuk.

- Recent years have shown that there is an appetite and demand for investment in Sukuk that goes well beyond Islamic investors amongst those investors that wish to gain exposure to diverse but high quality assets.

- Governments and regulators in a variety of countries have recognised the important role that Sukuk can play in capital markets and have been giving priority to developing their countries as Sukuk centres. In addition to Dubai and the UK, these include Bahrain, Hong Kong, Malaysia, Japan, Pakistan, Singapore and South Korea.

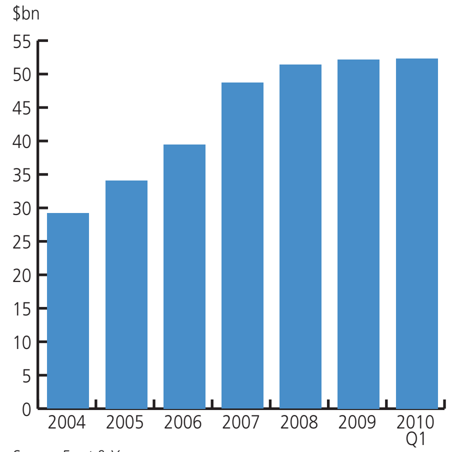
Islamic funds Growth in the market for Islamic funds has eased with Ernst & Young estimating that assets edged up to $52.3bn in Q1 2010 from $51.4bn at end-2008 (Chart 5). This is reflected in a slowdown in the number of new funds launched from 173 in 2007 to 78 in 2008 and 29 in 2009. New launches in 2009 only just exceeded the 27 liquidations. The total number of funds has edged up to around 760, having risen more than threefold from around 250 in 2004.

Equity funds account for the largest segment: 35% of funds, with alternative investments and feeder funds 16%, fixed income 14%, money market 14% and commodities 12% (Chart 6).

Ernst & Young's analysis indicated that the bulk of Islamic funds are small scale with 69% of fund managers - 139 out of 201 - having less than $100m under management, including a third that have less than $25m. Only 22 fund managers, 11% of the total have more than $500m assets under management. Fees have fallen from 1.53% in 2006 to 1.15% in Q1 2010, as a result of competitive pressures.

Islamic funds
global total $52bn

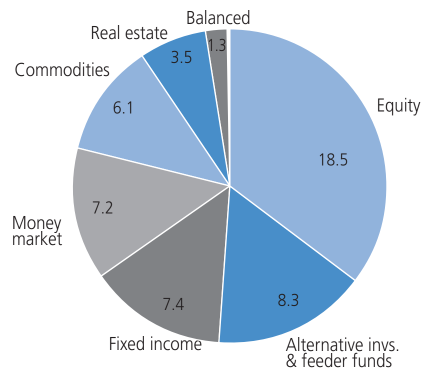
Chart 5
Islamic funds worldwide



Source: Ernst & Young

Chart 6
Assets managed by Islamic funds

Assets under management worldwide, $bn, end-2009



Islamic funds under management end-2009: $52bn

Source: Ernst & Young

Table 5
Islamic funds distribution by country

Funds based on home country of asset manager

	Value $bn	Number of funds
Saudi Arabia	22.8	181
UAE	6.1	82
Malaysia	5.1	177
Kuwait	4.0	100
US	2.7	8
Bahrain	1.2	24
UK	0.3	34
Other countries	10.1	188
Total	**52.3**	**760**

Source: Ernst & Young

The domicile of funds is heavily concentrated with over 70% of funds, based on number and value, managed in four jurisdictions: Saudi Arabia, UAE, Malaysia and Kuwait (Table 5). Other significant jurisdictions include the US, from where funds to the value of $2.7bn are managed and the UK from where 34 funds are managed.

Eurekahedge estimates that the average return on Islamic equity funds was nearly 10% in 2010, less than the 22% return in 2009, and less than the 15% return on the global equity index (Chart 7). In the UK new offerings in 2009 included a money market fund by BLME and a sukuk fund by QIB UK. This followed a more active year in 2008 when four exchange traded funds (ETFs) were listed on the London Stock Exchange. Other offerings in 2008 included a fund of equity funds, the first of its type globally by SEI; the first sharia compliant retail capital-protected equity fund in the UK by Alburaq; and the launch by FTSE Group of the FTSE Bursa Malaysia Hijrah Sharia Index, in association with Bursa Malaysia.

Takaful, similar to mutual insurance, is a risk sharing entity that allows for the transparent sharing of risk by pooling individual contributions for the benefit of all subscribers. The global market remains at an early stage of development with premiums estimated by Ernst & Young to have reached $14bn in 2010, of which $5bn were generated in Iran, where takaful is the compulsory form of insurance (Chart 8).

Takaful assets, reported to the Banker's survey were $13bn in 2010, up from $11bn in 2009. Malaysia and Iran were the largest markets with assets of $3.8bn and $3.7bn respectively. Along with Saudi Arabia $2.2bn and UAE $1.4bn, these four countries account for over 80% of the global market. Other smaller markets for takaful with assets between $100m and $400m include Bahrain, Qatar, Indonesia, Bangladesh, Sudan and Kuwait. Penetration of takaful is nevertheless low in these and other countries with Islamic majorities. Takaful represents a strong growth opportunity, particularly with regard to life insurance, as sharia compliant products are developed.

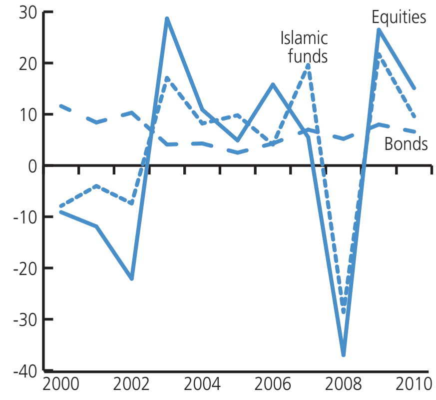
The takaful market in the UK remains at an early stage of development. Principle Insurance, authorised by the FSA in 2008, was the first sharia compliant independent takaful company in the UK, but it stopped taking new business in 2009. The remaining takaful available in the UK is restricted to HSBC Amanah's home insurance offering.

Other financial products The range of products generated by Islamic finance has broadened steadily. In the UK in 2007 Merrill Lynch structured the first sharia compliant credit default swap for a UK power company involving GCC investors. In 2008, Barclays Capital and Sharia Capital Inc. of the US launched the first Islamic fund of hedge funds. Sharia compliant public private partnerships (PPP) are also under consideration. In 2008 ETF Securities launched a sharia compliant precious metal exchange trade commodity platform, based on platinum, palladium silver, gold and a basket of other metals.

Law firms The UK is a major global provider of the specialist legal expertise required for Islamic finance, with over 20 major law firms

Chart 7
Rate of return on assets

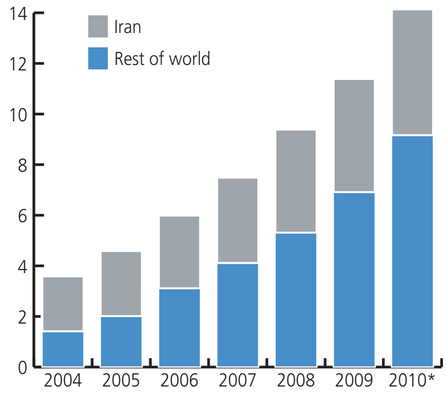
Annual % rate of return on assets worldwide



Source: Eurekahedge, S&P, Greenwich Alternative Investments

Chart 8
Takaful global premiums

$bn



**Estimate*
Source: Ernst & Young

Table 6
UK law firms offering legal services in Islamic finance

Allen & Overy LLP
Ashurst
Baker & McKenzie LLP
Berwin Leighton Paisner LLP
Clifford Chance LLP
DLA Piper
Eversheds LLP
Freshfields Bruchaus Deringer
Herbert Smith LLP
Hogan Lovells International LLP
Ince & Co.
King & Spalding International LLP
Linklaters
Milbank, Tweed, Hadley, & McCloy LLP
Norton Rose LLP
Pinsent Masons
Simmons & Simmons LLP
SJ Berwin LLP
SNR Denton
Stephenson Harwood
Taylor Wessing LLP
Trowers & Hamlins LLP
Wragge & Co.

Source: Chambers & Partners, Legal 500, TheCityUK providing legal services in Islamic finance (Table 6).

Professional service firms The Big Four professional services firms - PricewaterhouseCoopers, KPMG, Ernst & Young and Deloitte - have each established an Islamic finance team in London providing specialist services including advice on tax, listings, transactions, regulatory compliance, management, operations and IT systems.

Education and skills There is a growing global demand for skills as Islamic finance expands and UK institutions are at the forefront of providing qualifications for the global industry. Courses in Islamic finance are offered by the Chartered Institute for Securities and Investment (CISI), Chartered Institute of Management Accountants, Association of International Accountants, Cass Business School, Reading University and the Institute of Islamic Banking and Insurance. Aston Business School launched an Islamic Finance and Business Centre in 2010.

The Islamic Finance Council UK has developed a Scholar Professional Development Programme' in conjunction with the CISI. The objective of the course is to teach conventional finance to Sharia scholars worldwide. Partners for this programme include the Central Bank of Bahrain and the International Sharia Research Academy for Islamic Finance (ISRA) that is backed by Malaysia's Central Bank.

Beyond Islamic finance, the UK education offering that majors in Islam spans the full range of qualifications starting from 16 year-old school level through vocational and career-based qualifications as well as undergraduate and postgraduate degrees.

The broadening of the global skills base in Islamic finance is intended to expand the number of qualified practitioners and also the number of sharia scholars available for sharia boards. Representation of sharia scholars is highly concentrated. A survey by Funds@Work found in July 2010 that the top 20 scholars accounted for over 619 board positions, over half of the 1,141 positions available. Representation amongst these 20 scholars ranged from four holding 14 board positions each to two scholars who each held 85 positions. AAOIFI are looking to draft rules that would regulate the number of supervisory boards that scholars can sit on. In Malaysia, since 2007, sharia advisers have to be registered and can sit on only one board in a specific market segment.

GOVERNMENT STRATEGY FOR DEVELOPMENT OF ISLAMIC FINANCE IN THE UK

London has been providing Islamic financial services for 30 years, although it is only in recent years that this service has begun to receive greater profile. An important feature of the development of London and the UK as the key Western centre for Islamic finance has been supportive government policies intended to broaden the market for Islamic products for both sharia compliant institutions and firms with 'Islamic windows'.

A key aspect of supportive government policy has been the establishment since 2003 of an enabling fiscal and regulatory framework in the UK for Islamic finance. There have been a number of initiatives which are intended to form part of a continuing process:

Islamic finance: principles & developments in the modern era

Principles

The underlying financial principles in Islamic finance have remained unchanged historically since their development over 1,400 years ago. Financial products must be certified as sharia compliant by an expert in Islamic law. Certification requires that the transaction adheres to a number of key principles that include:

- Backing by a tangible asset, usufruct or services, so as to avoid 'speculation' (gharar). Prohibition of interest payments (riba).
- Risk to be shared amongst participants. Limitations on sale of financial assets and their use as collateral.
- Prohibition of finance for activities deemed incompatible with sharia law (haram), such as alcohol, conventional financial services, gambling and tobacco.

Modern development

Modern Islamic finance emerged in the mid-1970s with the founding of the first large Islamic banks. Development initially occurred through marketing of a steadily expanding supply of sharia compliant financial instruments. This supply-driven model contributed to relatively slow growth until the mid-1990s, since when demand has increasingly driven the development of Islamic financial instruments. Rising awareness and demand for Islamic products, along with supportive government policies and growing sophistication of financial institutions, have together raised the rate of growth.

- The removal in 2003 of double tax on Islamic mortgages and the extension of tax relief on Islamic mortgages to companies, as well as individuals.

- Reform of arrangements for issues of bonds so that returns and income payments can be treated 'as if' interest. This makes London a more attractive location for issuing and trading Sukuk.

- Initiatives by the Financial Service Authority to ensure that regulatory treatment of Islamic finance is consistent with its statutory objectives and principles, most recently in reforming the regulation of alternative finance investment bonds (sukuk).

Regarding the latter the Government has in 2010 adopted an Order aimed ar removing barriers and uncertainty in the regulation of alternative finance investment bonds (sukuk). The Treasury has emphasised that this will reduce compliance and legal costs for these types of instrument and facilitate the issuance of corporate sukuk in the UK. The first such corporate sukuk was issued by IIT (see page 7).

The UK Government in January 2011 said that a sovereign sukuk would not offer value for money at the present time, reiterating the position of the previous government. Investors would welcome a UK Government sukuk as it would provide more liquidity in the secondary market and act as a benchmark for UK companies that might consider issuing sukuk

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ukifs ukislamic financesecretariat

The UK Islamic Finance Secretariat (UKIFS) brings together government and industry leaders to work in a joint and co-operative manner in the promotion of the UK as a global gateway for Islamic finance. The key aims and objectives of UKIFS are to co-ordinate and promote the development of Islamic finance in the UK and to act as the primary contact point for UK Government bodies including UK Trade & Investment, HM Treasury and the regulator.

In achieving these objectives, UKIFS operates five practitioner-led interest/working groups that convene regularly to drive the development and delivery of strategic goals.

1. Domestic Retail Banking
2. Islamic Financial Institutions
3. Legal
4. Accountancy
5. Education, Training & Qualifications (ETQ)

With over 2000 registered individuals and organisations, UKIFS is today the leading cross-sectoral body assisting the promotion and development of Islamic finance in the UK.

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