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FINANCIAL MARKETS SERIES

ISLAMIC FINANCE

MARCH 2012

Gatehouse Bank

Gatehouse Bank is pleased to support UKIFS Islamic Finance 2012 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.

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- Asset Finance
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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 currently operates six practitioner-led market advisory workstreams that convene regularly to drive the development and delivery of strategic goals:

1. Islamic Financial Institutions
2. Retail Banking & Wealth Management
3. Commercial Real Estate
4. Legal
5. Accountancy, Tax & Regulation
6. 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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ISLAMIC FINANCE

MARCH 2012

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

Global market The global market for Islamic financial services, as measured by Sharia compliant assets, is estimated by the UK Islamic Finance Secretariat (UKIFS) to have reached $1,130bn at end-2010, 21% up on $933bn in 2009 (Chart 1). Assets are likely to have grown a further 14% in 2011 to reach $1,289bn, making a rise of about 150% from $509bn in five years since 2006. Islamic assets represent about 1% of the global financial market. The largest centres remain concentrated in Malaysia and the Middle East, including Iran, Saudi Arabia, UAE, Kuwait, Bahrain and Qatar (Chart 2).

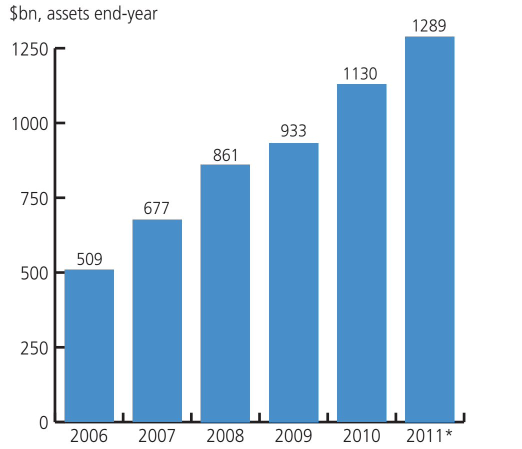
Islamic finance has shown resilience during the past two years at a time when global recovery has slowed and conventional banking in Western countries has remained under pressure. It is not unaffected by broader global macroeconomic problems with some Islamic banks exposed to the volatile real estate markets. In the Middle East, especially the Gulf, Islamic finance has benefitted from economic and financial stability in most countries, despite political unrest in a few.

The development of Islamic finance is being driven by Sharia compliant institutions taking the opportunity to expand products and services that can be accessed by Muslim customers and investors. This is leading to the expansion of retail and capital markets, helping, for example, to meet growing demand for infrastructure finance.

Banks account for the bulk of Islamic assets globally with funds and takaful making up the balance. Banks and funds are major investors in sukuk, which strengthened in 2011. Sukuk issuance was up 60% to a record $84bn: two thirds by Malaysian institutions.

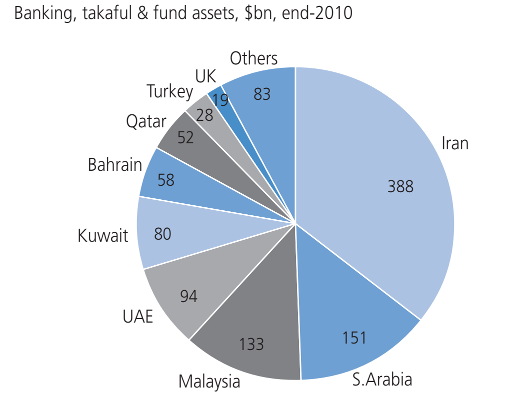
The market for Islamic funds worldwide rose by 8% to $58bn in 2010, estimated by Ernst & Young to have doubled in size from $29bn in 2004. Income has come under pressure with the average management fee falling from 1.5% in 2006 to 1.0% in 2010. Returns of -3% on Islamic funds in 2011 are likely to have curtailed further growth in Islamic assets, although the potential market for Islamic funds is estimated at over $500bn. Takaful also reached a new high in 2011 with premiums estimated by Ernst & Young to have reached $16bn.

Chart 1
Global assets of Islamic finance



*UKIFS estimate
Source: The Banker, Ernst & Young

Chart 2
Islamic Finance by country



Banking, takaful & fund assets end-2010 $1,086bn

Source: The Banker

Considerable potential exists for expansion of Islamic finance with The Banker estimating that only 12% of Muslims worldwide use Islamic financial products. Extent of the industry's penetration varies substantially. In Bangladesh, for example, Islamic banking accounts for 65% of total banking assets but only 4% to 5% in Turkey, Egypt and Indonesia.

Indonesia has the largest Muslim population in the world at an estimated 205m and Bangladesh the fourth largest at 149m; India and Pakistan make up the other two countries with the largest Muslim population each with around 177m. These four countries account for 44% of the worldwide Muslim population of 1.6bn (Table 2).

More countries are looking to expand the Sharia offering. New Sharia compliant institutions have been reported by The Banker in, for example, Australia, Azerbaijan, Nigeria, Oman, Pakistan, Qatar and Russia. Oman is the last of the Gulf Co-operation Council (GCC) states to open the door to Islamic banks. Leading countries for Islamic finance should provide fertile ground for future growth, although the long-term impact of political unrest on development of Islamic finance in some Middle Eastern countries, such as Egypt, remains to be seen.

Islamic finance in the UK The UK, in ninth place worldwide, is the leading Western country and Europe's premier centre with $19bn of reported assets, largely based on HSBC Amanah. London's profile as the leading Western centre for Islamic finance has grown in recent years, although institutions in the UK have been providing Islamic financial services for 30 years. 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. Islamic finance also has a role to play in facilitating the supply of finance to ethnic minorities, with the opportunity to build a broader presence in the Muslim community of over 2m people.

Key features of the UK Islamic finance industry:

- 22 banks, of which five are fully Sharia compliant, more than in any other Western country.
- 37 sukuk issues raising $20bn currently listed on the London Stock Exchange, including 10 in 2011. Seven exchange trade funds and two exchange trade products are also quoted on the London Stock Exchange.
- Around 25 law firms supplying services in Islamic finance.
- Use of Islamic finance for major infrastructure projects in London such as the Shard of Glass and redevelopment of Chelsea Barracks.
- Advisory services provided by the largest four professional service firms.
- Qualifications in Islamic finance offered by four professional institutes and at least 10 universities and business schools.
- Off-exchange trading in commodity-based agreements linked to LME contracts.

Many firms operating in Islamic finance in the UK are members of UK Islamic Finance Secretariat (UKIFS), which is part of TheCityUK.

Table 1
Global Islamic finance assets by sector

Sharia compliant assets, $bn

	2008	2009	2010	2011*
Banks	800	863	1048	1200
Funds	51	54	58	60
Takaful	8	13	21	25
Other	1	3	3	4
Total	861	933	1130	1289

*UKIFS estimate
Source: The Banker, Ernst & Young

Table 2
Muslim population by country

2010 estimate	Millions	*% share of country's population*
Indonesia	205	*88*
Pakistan	178	*96*
India	177	*15*
Bangladesh	149	*90*
Egypt	80	*95*
Nigeria	76	*48*
Iran	75	*100*
Turkey	75	*99*
Algeria	35	*98*
Morocco	32	*100*
Iraq	31	*99*
Sudan	31	*71*
Afghanistan	29	*100*
Ethiopia	29	*34*
Uzbekistan	27	*97*
Saudi Arabia	25	*97*
Yemen	24	*99*
China	23	*2*
Syria	21	*93*
Malaysia	17	*61*
Russia	16	*12*
Niger	16	*98*
Tanzania	13	*30*
Senegal	12	*96*
Mali	12	*92*
Tunisia	10	*100*
Other countries	200	---
World total	1619	*23**

*% share of world population
Source: Pew Research Center

GLOBAL MARKET FOR ISLAMIC FINANCE

As mentioned in the overview, UKIFS estimates that the global market for Islamic financial services, as measured by Sharia compliant assets, reached $1,130bn at end-2010, 21% up from $933bn in 2009. It is likely to have grown a further 14% in 2011 to reach $1,289bn, making a rise of about 150% from $509bn in five years since 2006 (Chart 1).

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 $388bn, Saudi Arabia $151bn and Malaysia $133bn (Chart 2, Table 3). 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 345 firms reporting to The Banker's survey include Kuwait and Malaysia, each with 39 firms, and Bahrain with 33 firms. A group of countries including Indonesia, Iran, Saudi Arabia, Pakistan, UAE and the UK each have between 20 and 27 firms supplying Islamic finance (Table 3).

Broadening geographical customer base for Islamic services The market is currently most developed in Malaysia, Iran and the majority of countries that form the GCC. These countries remain fertile ground for future growth, although prospects for the Islamic finance in some Middle Eastern countries could be negatively affected by any further spread of political unrest 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 Africa such as Turkey, Sudan, Egypt, Jordan, Syria and Nigeria.
- 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 such as Luxembourg, Switzerland and Australia are developing as centres for Islamic finance. The US, France, Germany and the UK each have indigenous Muslim populations of up to 5m, although Russia has much the largest in Europe with 16m.

While scope for development exists in Western countries an appropriate legal and regulatory structure first needs to be designed and implemented. The customer base in Western countries is not necessarily restricted to Muslims: other customers may be attracted by the ethical basis of Islamic finance.

London is seeking to consolidate its position as the gateway to Islamic finance in Western Europe. Providers of Islamic finance in London are likely to focus on services that complement those available elsewhere. Government strategy for the development of Islamic finance in the UK is summarised on page 9.

Table 3
Islamic finance by country

Banking, takaful, fund & other assets, $bn, 2010

		--------------of which-------------				*Number*
	Total	Banks	Takaful	Funds	Others	*of firms**
Iran	**388.0**	383.5	4.2	0.3	---	*27*
S.Arabia	**151.0**	147.8	3.2	---	0.0	*26*
Malaysia	**133.4**	120.4	9.9	---	3.2	*39*
UAE	**94.1**	92.5	1.5	0.0	0.1	*21*
Kuwait	**79.7**	68.9	0.1	10.6	0.0	*39*
Bahrain	**57.9**	56.2	0.4	1.3	---	*33*
Qatar	**52.3**	50.0	0.5	1.8	0.1	*19*
Turkey	**28.0**	28.0	---	---	---	*4*
UK	**19.0**	19.0	---	---	---	*6*
Sudan	**12.1**	12.1	---	---	---	*13*
Bangladesh	**11.7**	11.4	0.3	0.1	---	*16*
Indonesia	**10.5**	10.0	0.5	---	---	*26*
Syria	**8.7**	8.7	---	---	---	*3*
Egypt	**7.9**	7.9	---	---	---	*2*
Switzerland	**6.6**	6.6	---	---	---	*2*
Jordan	**5.9**	5.7	0.1	0.1	---	*10*
Pakistan	**5.7**	5.6	---	---	0.1	*23*
Brunei	**3.8**	3.8	---	---	---	*1*
Other countries	**10.3**	9.8	0.4	0.1	0.0	*35*
Total	**1086.5**	1047.7	20.9	14.3	3.5	*345*

*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 represent the forms of Islamic finance that are most well established, with takaful (insurance) and funds also developing. Products that may be the subject of innovation include private equity and private wealth management.

Banking In The Banker's survey, balance sheet assets of Sharia compliant banks rose by 22% from $863bn in 2009 to $1,048bn in 2010. Commercial banks account for the majority of assets, with investment banks making up most of the remainder. Ernst & Young has indicated that profitability of banks in the Middle East and North Africa stabilised in 2009 and 2010 having suffered in previous years due to higher provisions and operating costs.

Considerable potential for expansion exists with The Banker estimating that only 12% of Muslims use Islamic products, although scope is more limited in countries where Muslims represent a minority. Extent of the industry's penetration varies substantially. In Bangladesh, Islamic banking accounts for 65% of total banking assets; in Bahrain 46% and Saudi Arabia 35%. However penetration in other countries is limited with Islamic banking accounting for only 4% to 5% of total banking assets in Turkey, Egypt and Indonesia (Chart 3).

Islamic banks, including those with Islamic 'windows', are now looking to enhance their position in faster growing core regions of Middle East, Asia and Africa. Offering products that are competitive on price and service could help to generate business not only from Muslims with a preference for Sharia compliant services, but also from Muslims and other customers that currently use conventional banking services.

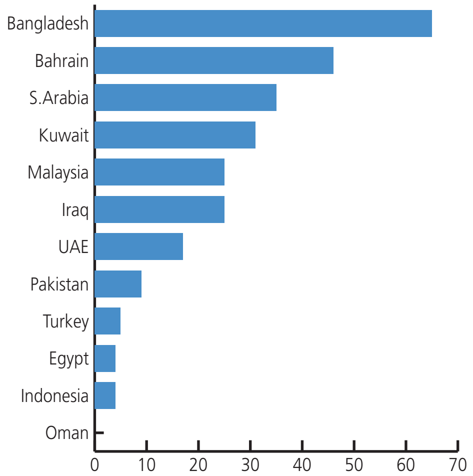
Significant international developments in the past year have included:

- Launch in November 2011 by Thomson Reuters of the world's first Islamic interbank rate, which is designed to provide an indicator for the average expected return on Sharia compliant short term interbank funding.
- Oman's decision in May 2011 to permit the establishment of Islamic banks in the country the last of the six GCC states to do so. The aim is to tap into regional demand for Sharia compliant banking services and other products currently being met elsewhere in the region and therefore to curtail the current outflow of investment from Oman.
- Qatar's move in February 2011 of preventing conventional banks from offering Sharia compliant products through Islamic windows. The boundary is expected to provide opportunities for Islamic banks to gain market share.

In the UK, the five fully Sharia compliant banks were established between 2004 and 2008 and put the UK in the lead in Western Europe (Table 4). There are also an estimated 17 conventional banks that have set up windows in the UK to provide Islamic financial services. 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

Chart 3
Islamic finance penetration in selected countries

% share of Islamic banking in total banking assets in each country



Source: The Banker, Maris Strategies

Table 4
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 5
Assets of Islamic banks in UK

Sharia 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	Dec-10	1196	1119	1115	0
HSBC	Sep-10	570	698	524	-25
European Islamic Investment Bank	Dec-10	648	555	284	-49
Islamic Bank of Britain	Dec-10	337	394	342	-13
QIB UK	---	94	---	---	---
Gatehouse Bank	Dec-09	15	108	79	-27
Total		18055	19411	19042	-2

Source: The Banker

UK's identified assets, with a further 6% from BLME and 3% from the HSBC parent bank (Table 5). The 22 Islamic banks in the UK substantially exceed that in any other Western country or offshore centre (Table 6).

The Islamic Bank of Britain (IBB) is a retail bank and the only Islamic bank with a high street presence having five branches and around 50,000 customers. IBB's founding shareholder Qatar International Islamic Bank took full control of the bank in 2011. IBB's admission to the AIM market was cancelled in April 2011.

The Bank of London and The Middle East (BLME) is an independent wholesale Sharia compliant UK bank based in the London. BLME's offering spans corporate banking, treasury and wealth management that comprises private banking and asset management. BLME aims to strengthen its services and market penetration in the GCC.

QIB UK took on its new branding 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. It 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 £160m 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. The challenges faced by Islamic banks with regard to liquidity management have been summarised by Mohammed Amin in New Horizon:

- There may be no lender of last resort: in the UK, for example, the Bank of England does not offer Sharia compliant facilities.
- Liquidity requires assets to be structured so that they are resaleable, but Islamic bank assets, for compliance reasons, in practice cannot be resold at face value but only at a discount.
- There is a shortage of Sharia compliant highly rated, liquid, short-term assets that are available to hold for liquidity purposes.

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.

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.

Table 6
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

*UKIFS estimate for UK
Source: The Banker

Sukuk global issuance reached **new high of $84bn in 2011**

Sukuk are issues of Islamic notes that represent an alternative to conventional bonds. Sukuk issues have expanded strongly in the past three years, with Zawya Sukuk Monitor reporting a 62% increase in sukuk issuance to $84bn in 2011 from $52bn in 2010 (Chart 4). This follows a recovery from a low point of $20bn in 2008 to $33bn in 2009. Sukuk made a strong start to 2012 with $20bn of issuance in January.

Sustained growth in the sukuk market demonstrates appetite for quality issuers of sukuk from both Islamic and non-Islamic investors. Agreement in 2011 on a debt restructuring for Dubai World has improved sentiment towards sukuk in general.

The earlier drop in 2008 was consistent with a broad-based slowdown in global capital market activity. There was also a temporary break in issuance in 2008 as a result of a ruling from the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOFI) that questioned the Sharia compliance of some sukuk structures. Prior to 2008 sukuk had increased rapidly during the decade.

Zawya indicates that Malaysia is the dominant country in the global market, with issuance totalling $58bn, two thirds of 2011 issues (Chart 5). There were also sukuk issues of $9bn from Qatar, and $4bn each from UAE and Indonesia. Other issues came from Bahrain, Pakistan, Brunei and Kuwait. Some 89% of sukuk were for domestic markets although the 14 international sukuk totalling $8.6bn in 2011 was up from 11 sukuk worth $5bn in 2010. Government institutions accounted for 66% of issuance worth $56bn. The financial sector's 17% share totalling $15bn was significantly up on the 10% share worth $5bn in 2010. Notable developments in 2011 included the first sukuk by Yemen; the first short-term sukuk out of Pakistan; and the first sukuk in Jordan.

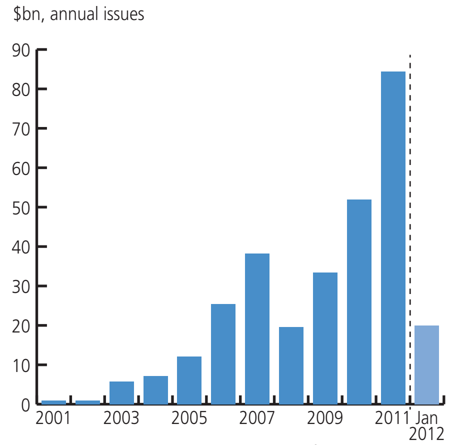
There were 10 sukuk listings on the London Stock Exchange worth $5.1bn in 2011 and two in early 2012 bringing total current sukuk listings on the LSE to 37 and a value of $20bn (Chart 6). A further six sukuk, previously admitted for trading, have reached maturity and been delisted. Taking account of these, a total of 43 sukuk have been listed on LSE with a total value of $24bn.

Key milestones for the LSE have included the GE Capital sukuk in 2009, the first listed sukuk by a US corporate, and the Kuveyt Turk sukuk, the first by a European bank. The first UK corporate sukuk was issued in 2010 by International Innovative Technologies (IIT).

Elsewhere, Nasdaq Dubai has 15 listings with a value of $11bn, the most recent admission being in December 2009. Luxembourg is also an important centre with 16 sukuk listings worth $7bn at end-2009.

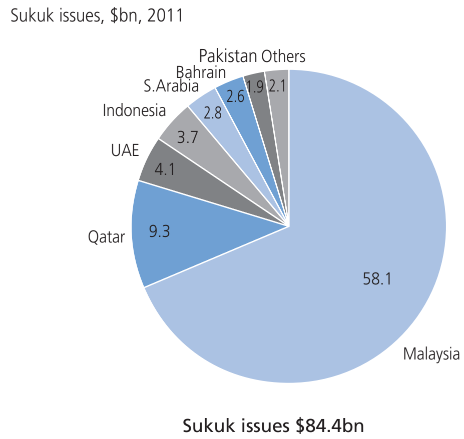
The Islamic finance industry in the UK is still keen to see a UK sovereign sukuk. While there is strong cross-party consensus in the UK on the need to develop Islamic finance, the UK government in January 2011 reiterated the position of the previous government: that the issue of a sovereign sukuk is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

Chart 4
Sukuk global issues



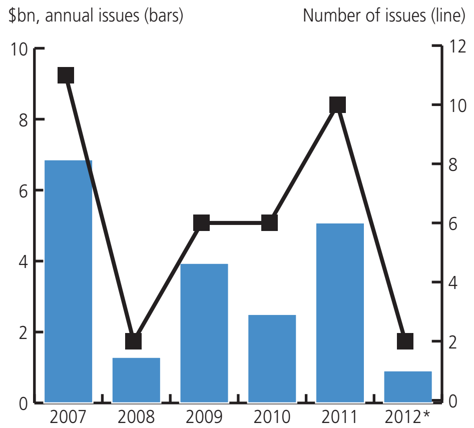
Source: Zawya Sukuk Monitor, Islamic Financial Information Service

Chart 5
Sukuk issues by country



Source: Zawya Sukuk Monitor

Chart 6
Sukuk listings at London Stock Exchange



*January & February 2012
Source: London Stock Exchange

London Stock Exchange's 37 sukuk listings **total $20bn**

Long term prospects for development of sukuk globally are positive, with sukuk having a key role for both government and the private sector as a domestic source of finance. More widely the commitment to a substantial infrastructure programme, particularly in the GCC, should be matched by strong demand from both Islamic and non-Islamic investors.

Islamic funds The market for Islamic funds worldwide rose by 8% to $58bn in 2010 from $54bn in 2009, having doubled in size from $29bn in 2004 (Chart 7). Ernst & Young noted that this reflected money inflows as well as strength in fixed income, commodities and alternative investments. Weaker returns in 2011, combined with negative sentiment due to the sovereign debt crisis may have curtailed growth in assets 2011. There are around 800 funds worldwide, up more than threefold from 250 in 2004. Ernst & Young estimate that the available pool for Islamic funds is over $500bn and growing rapidly, so Islamic funds under management currently represent only around 10% of the potential Islamic market.

Saudi Arabia, UAE, Malaysia and Kuwait are the main centres for management of funds. Major domiciles for funds are Saudi Arabia, Malaysia, Cayman Islands and Bahrain, but also some European centres such as Luxembourg and Ireland.

Equity funds account for the largest segment: 39% of funds, followed by commodities 15%, other investments including alternative investments and feeder funds 13%, fixed income 12%, money market 9% and balanced 2% (Chart 8). Ernst & Young's analysis indicates 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. Fees have fallen from 1.5% in 2006 to 1.0% in Q1 2011, as a result of competitive pressures (Chart 9).

Eurekahedge estimates that the average return on Islamic equity funds fell from 9% in 2010 to -3% in 2011, although returns over the past decade have averaged 4%a year, higher than global equities which have averaged 2% a year but less than bonds 6% a year (Chart 10).

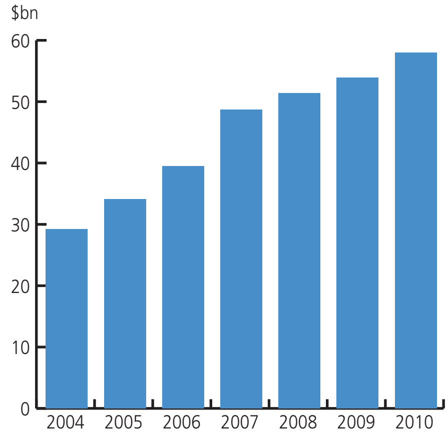
In the UK, BLME launched a real estate fund in 2011. A total of seven Sharia compliant exchange traded funds (ETFs) and two Sharia compliant exchange trade products (ETPs) are listed on the London Stock Exchange.

Previously, new offerings in 2009 included a money market fund by BLME and a sukuk fund by QIB UK. 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 to have reached $16.5bn in 2011. This includes an estimated $4.5bn generated in Iran where takaful is the compulsory form of insurance, and Ernst & Young's estimate of $12.0bn for the rest of the world (Chart 11).

Islamic funds
worldwide total $58bn

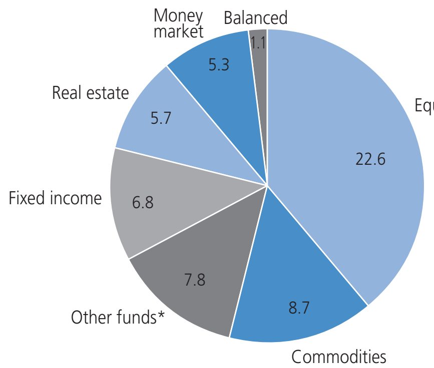
Chart 7
Islamic funds worldwide



Source: Ernst & Young

Chart 8
Assets managed by Islamic funds

Assets under management worldwide, $bn, end-2010

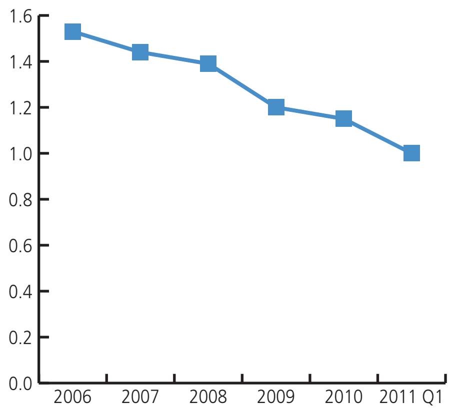


Islamic funds under management end-2010: $58bn

*Includes alternative investments and feeder funds
Source: Ernst & Young based on Zawya & Eurekahedge

Chart 9
Management fee of Islamic funds

Average management fee, % of fund value



Source: Ernst & Young based on Zawya and Eurekahedge

Takaful assets, reported in The Banker's survey, were $20bn in 2010, up from $13bn in 2009. A further rise to $25bn is likely for 2011.

Malaysia and Iran were the largest markets in 2010 with assets of $9.9bn and $4.2bn respectively. Along with Saudi Arabia $3.2bn and UAE $1.5bn, these four countries account for 90% of the global takaful market. Other smaller markets for takaful with assets between $100m and $500m include Bahrain, Qatar, Indonesia, Bangladesh, Jordan and Kuwait. Penetration of takaful is nevertheless low in these and other countries with Islamic majorities. Takaful therefore represents a strong growth opportunity. HSBC Amanah's home insurance offering is thought to be the main takaful offering in the UK.

Law firms The UK is a major global provider of the specialist legal expertise required for Islamic finance, with around 25 major law firms providing legal services in Islamic finance (Table 7).

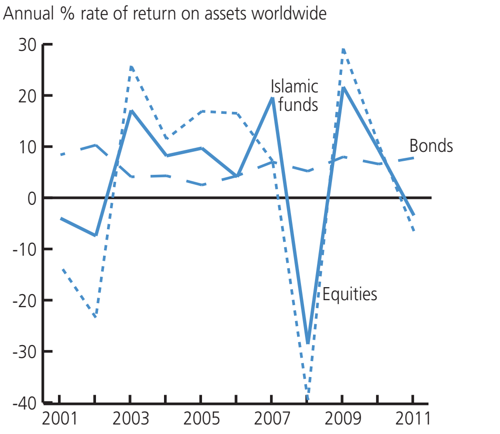
Professional service firms The largest four professional services firms - PricewaterhouseCoopers, KPMG, Ernst & Young and Deloitte - have each established an Islamic finance team in London providing specialist services including advice on tax, listings, transactions, regulatory compliance, management, 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, Chartered Institute of Management Accountants, Association of International Accountants and the Institute of Islamic Banking and Insurance. At least 10 universities and business schools offer an Islamic finance qualification including Aston, Cass, Durham and Reading (Table 8).

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.

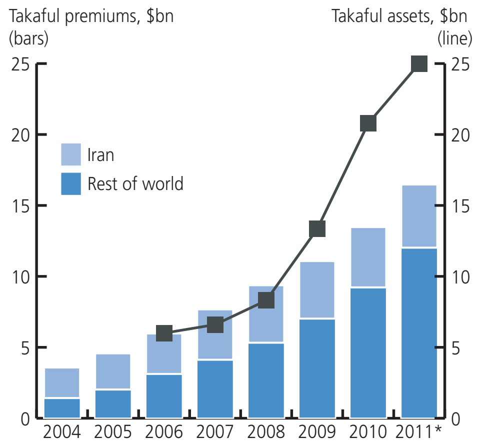
The broadening of the global skills base in Islamic finance is intended to expand the number of qualified practitioners and also the number of Sharia scholars available for Sharia boards. Representation of Sharia scholars on Sharia boards is highly concentrated. A survey by Funds@Work found in July 2010 that the top 20 scholars accounted for over 619 board positions, over half of the 1,141 positions available.

Chart 10
Rate of return on assets



Source: Eurekahedge, MSCI, Barclays

Chart 11
Takaful global market



*Estimates
Source: Ernst & Young

Table 7
UK law firms offering legal services in Islamic finance

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

Source: UKIFS

GOVERNMENT STRATEGY FOR DEVELOPMENT OF ISLAMIC FINANCE IN THE UK

London has been providing Islamic financial services for over 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'.

The development of Islamic finance has enjoyed cross party support over the past decade. There have been two key policy objectives: firstly, to establish and maintain London as Europe's gateway to international Islamic finance; and secondly, to ensure that nobody in the UK is denied access to competitively priced financial products on account of their faith.

The establishment since 2003 of an enabling fiscal and regulatory framework in the UK for Islamic finance has been key to facilitating these policy objectives. Initiatives have include:

- 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.

Investors would also 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. The position of the UK Government remains that a sovereign sukuk would not offer value for money at the present time.

Islamic finance: principles & developments

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.

Table 8
UK universities and business schools offering Islamic finance

Aston Business School
Bangor Business School
Cass Business School
Dundee University
Durham University and Business School
ICMA Centre Henley University of Reading
Glamorgan University
London School of Business and Finance
Newcastle Business School
Salford Business School

Source: UKIFS

OTHER SOURCES OF INFORMATION

Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI)
www.aaoifi.com

CPI Financial
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www.cpifinancial.net

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www.hm-treasury.gov.uk

Institute of Islamic Banking & Insurance
New Horizon (quarterly)
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www.securities.com/ifis

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Mushtak Parker Associates
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www.theislamicbanker.com

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Zawya Sukuk Monitor
Zawya Sukuk Quarterly Bulletin
www.zawya.com

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TheCityUK provides constructive advice and is the practitioner voice on trade policy and all aspects of taxation, regulation, and other legislative matters that affect the competitiveness of the sector. We conduct extensive research and run a national and international events programme to inform the debate. Our senior team regularly engages with regulators and policymakers at home and overseas, ensuring the sector's views are represented at the highest levels. We are tasked with creating a new vision for the financial services sector. We are focused on supporting policymakers and business to deliver the new policy ideas which will help deliver growth.

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