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**The World Islamic Banking Conference  
European Summit**

**The Park Lane Sheraton Hotel, London**

**Session 2: The Landscape of Opportunity: Defining the Driving  
Forces of Growth for Islamic Finance in Europe**

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DDCAP Limited**

# Defining the Driving Forces of Growth for Islamic Finance in Europe

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## Introduction

During this presentation we will briefly consider and evaluate:

- **The Islamic financial marketplace and EU focus**
- **The emergence and growth of Islamic financial services in Europe**
- **Present status and assess growth drivers moving forward**
- **Summary and concluding remarks**



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## Islamic Financial Marketplace

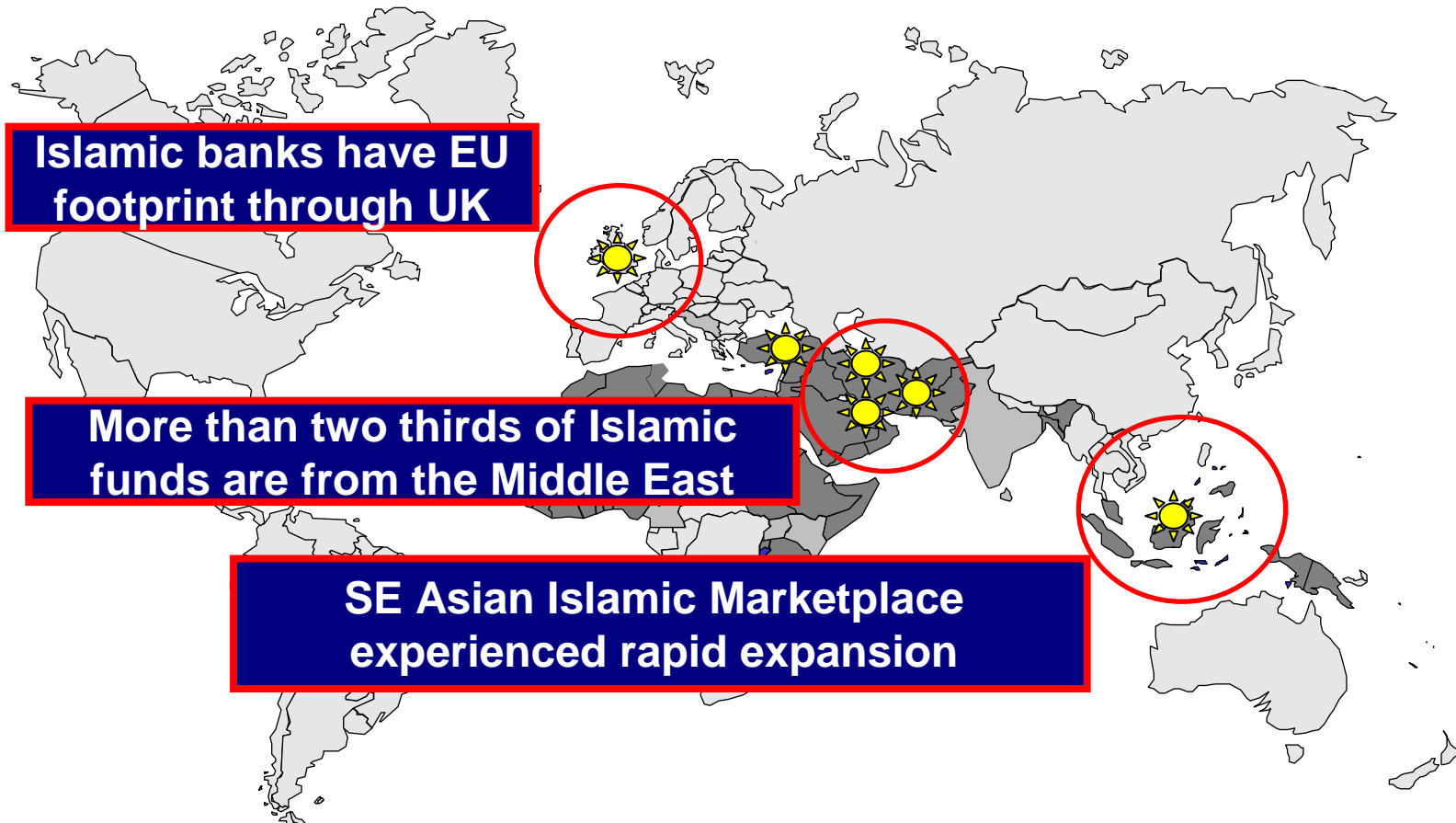
- **The contemporary Islamic financial sector was pioneered by several, super high net-worth individuals in the early 1970s**
- **Today there are more than 350 established Islamic banks and financial institutions and many conventional banks with Islamic “windows”, divisions, or subsidiaries**
- **In October 2006 S&P estimated market potential of US\$4 trillion (\*1) with market size at 10% of potential**
- **Financial assets within the sector are estimated at US\$ 500bn \*2**

(sources: – \*1 S&P Report – ‘The Islamic Financial Industry comes of age’ / \*2 World Bank 2007)



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## Islamic Financial Marketplace – Sources of Funds and EU Focus



- **1.3 billion Muslims (20% of population)**
- **Fastest growing and one of the most active religions**

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## Emergence of Islamic financial services in Europe

- **Conventional banks in UK and Europe have been working with Islamic Financial Institutions (IFIs) since the late 1970s**
- **In the 1980s arrangement and facilitation of core, wholesale banking structures such as Morabaha, were superseded by establishment of Islamic “windows” in major international banks**
- **Europe's first IFIs were also established in Europe in 1980s**
  - **Albaraka International Bank in London**
  - **Islamic Bank International in Copenhagen**
- **During the 1990s Sharia’a compliant products and services evolved from a European platform; wholesale focus migrated to retail and the first Sharia’a compliant home purchase products were innovated**



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## Emergence of Islamic financial services in UK

- **The UK, specifically London, has long been perceived as a hub for Islamic finance**
- **Market perception has been supported by the UK's established financial infrastructure and the skills and services available**
  - **London's financial markets offered early support to the emerging IFIs in the Middle East**
  - **British and international banks arranged and executed wholesale, Sharia'a compliant banking products from London offices**
  - **UK's extensive global trade links originated investment opportunity**
  - **Commodity markets provided sustainable, tangible asset support for Sharia'a compliant transactions e.g. London Metal Exchange warranted material**
- **Historically, wholesale Islamic financial services have been a UK export**
- **Two factors have negatively impacted the emergence of Islamic finance in the UK – taxation and regulation**



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## Islamic Financial Services in the UK - Taxation

- **Most Islamic financial products and services were not available when the relevant tax law was drafted**
- **Legislation has subsequently been introduced to create a level playing field**
- **2003**
  - **legislation changed to remove possible double Stamp Duty on Sharia'a 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**



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## Islamic Financial Services in the UK - Regulation

- **The Financial Services and Markets Act 2000 is a single piece of legislation applying to all UK financial services**
- **Whilst stating its own desire to promote a level playing field between conventional and Islamic providers, the UK Financial Services Authority (“FSA”) always emphasised “no special favours”**
- **Work that started at the Bank of England in the late 1990s was taken up by the FSA and key issues (for example the legal definition of a deposit) were resolved through consultation with industry and government**



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## Growth of the Islamic Financial Sector in the UK

- The collaborative relationship between Government, financial sector authorities and industry culminated in the authorisation, again, of Islamic banks and financial institutions in the UK:

- **Islamic Bank of Britain plc**,  ISLAMIC BANK OF BRITAIN®  
البنك الإسلامي البريطاني **in August 2004**
  - the first Islamic bank to operate in the retail space in Europe
- **European Islamic Investment Bank**  **in March 2006**
- **Bank of London and the Middle East**  **in July 2007**
- **European Finance House**  **in February 2008**
- **Gatehouse Bank plc**  **in April 2008**
- **Principle Insurance** **in May 2008**



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## Government support for the UK and European proposition

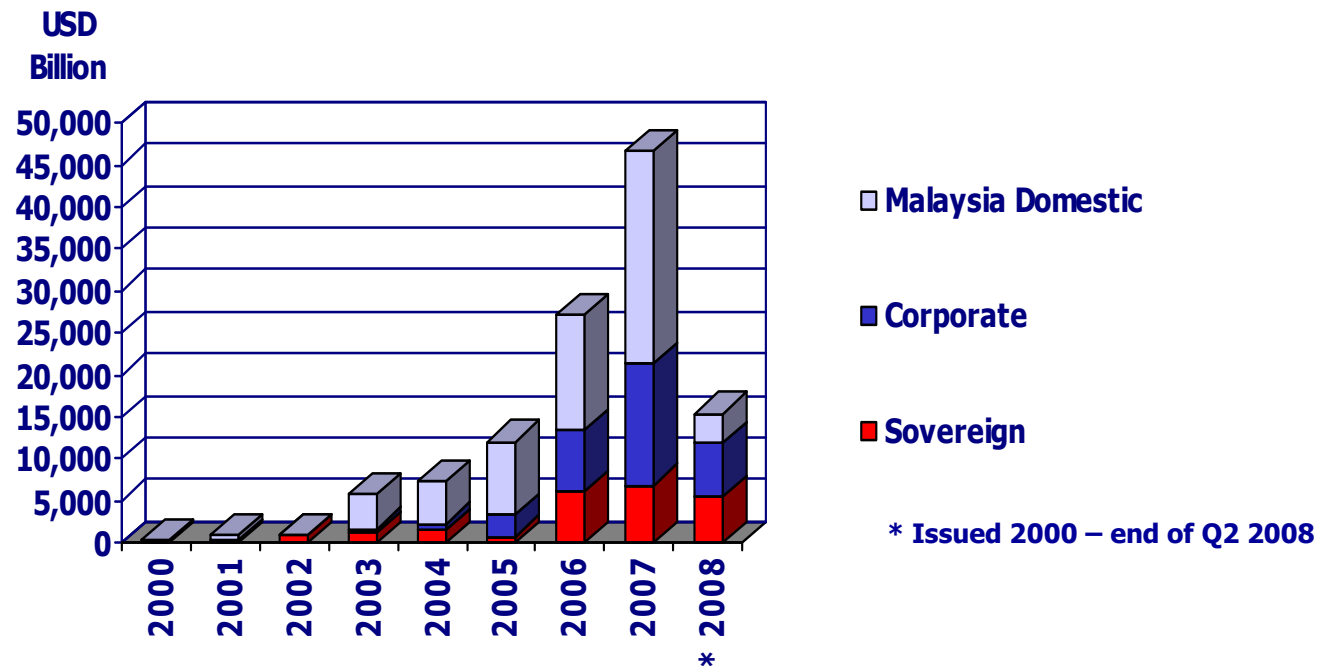
- **April 2007 – HM Treasury established the Islamic Finance Experts Group to act as an industry sounding board for the Government and FSA**
- **Consultation since Autumn 2007 has supported UK Government's proposal to issue a Sterling denominated Sovereign Sukuk**
- **Expectation is that further IFIs will be authorised by the FSA and other European markets will be explored**
- **In May 2008 the French Finance Minister announced France's desire to compete in the Islamic financial market**



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## What are the Forces driving Islamic Market Growth in Europe today?

- The Islamic capital market - an industry segment that has possibly prompted more media coverage than any other in the past few years
- Issuance of Sukuk since 2000 aggregated c. US\$ 110 billion at end June 2008



(\*source – IFIS)

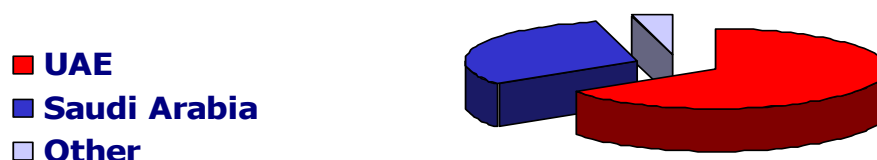


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## The Growth of the Islamic Capital Market

- Sukuk now account for a major and increasing percentage of total debt issuance in the GCC
- Corporate Sukuk issuance in the region hit record levels in 2007. Investors came from Asia and Europe as well as GCC
  - Total GCC bond issuance 2007 reached US\$ 47.7bn
  - Total GCC corporate bond issuance for 2007 totalled US\$23.7bn (up US\$11.7bn on 2006), approx. 50% were Sukuk \*
  - UAE (particularly Dubai) accounted for 65% of total, Saudi Arabia 30%



- Issuance of corporate bonds by the GCC has potential of US\$50 billion for 2008 \* (sources – \* Moody's Investor Service Q4 2007)
- 2008 issuance was slower in Q1, recovering somewhat in Q2 and issuance in GCC currency has been a strong trend

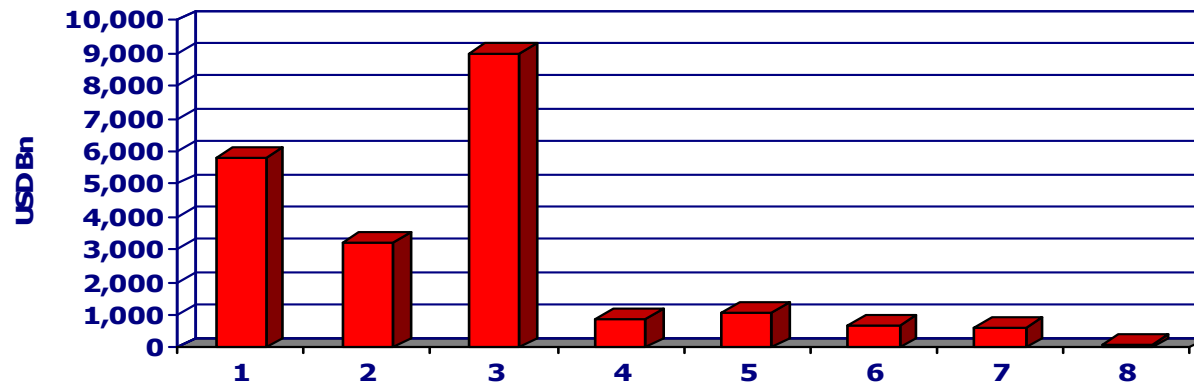


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## European participation in the Growth of the Islamic Capital Market

- **Islamic Capital market issuance was initially concentrated in Malaysia and the Middle East**
- **European involvement began in 2004 when the German state of Saxony-Anhalt issued its inaugural Sukuk**
  - **Issue size: €100mn**
  - **Structure: Sukuk Al Ijara**
  - **Pricing: Against Euribor flat**
  - **Rating: AA- (Fitch S&P)**
- **It established precedents and remains a landmark in Europe**

**Total Sovereign Issues (+IDB) by country  
- to June 2008**



### Sovereign Issues

- 1) Malaysia International
- 2) Bahrain
- 3) UAE
- 4) IDB
- 5) Pakistan
- 6) Qatar
- 7) Brunei
- 8) Germany

(sources – i) Bloomberg – 2007 issues ii) IFIS – International issues iii) Securities Commission – Malaysia issues)



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## UK participation in the Growth of the Islamic Capital market

- **A leading financial centre, London also offers deep liquidity resources and hosts more institutional investors than anywhere else in Europe**
- **It has an established capital market infrastructure including a primary market for listing Sukuk:-**
  - **Since mid 2006 Sukuk have been listed on the London Stock Exchange (20 issues (2 programmatic))**
  - **Aggregate value of issues to date is c. US\$ 20bn**
- **Benchmark issues (Aldar, DIB, ADIB) have had dual listing in London and on local exchanges**
  - **Issuers access new sources of funds, world class financial services structuring, advisory, intermediary, legal systems and practice**
- **There are established links to other, international markets**



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## What Next? Summary and Concluding Comments

- **Concentration in core Islamic marketplace resulting in refocus on geographical diversification**
  - **Islamic investors are keen for investment and risk diversification**
  - **UK's authoritative regulation and proven legal infrastructure generates confidence within an emerging marketplace**
  - **Authorisation of IFIs demonstrates a more favourable operating environment**
- **However, the growth of Islamic finance in Europe is also being driven by other, economic and market related factors**
  - **Return of US\$ issuance (eventually) and increase in Sterling and Euro issues**
- **Growing market awareness of Islamic financial products in global markets**
  - **International counterparties are keen for new investment and funding diversification**
- **UK's own Islamic banks are offering a bridge between markets**
  - **A complete offering for Sharia'a compliant investors seeking a gateway to international markets or for global participants seeking Islamic finance**



