

Islamic Finance in the UK



British Embassy
Bishkek



I'm very happy to present this booklet on the UK's offer for Islamic Finance to the Kyrgyz Republic.

The United Kingdom has, for over thirty years, been a leading voice in the development of Islamic Finance. We are determined to continue to support the global Islamic Finance industry.

Many people ask us why the UK has shown this commitment, for so long, especially given that we are not a predominantly Muslim country.

It's because we are committed to two important principles.

Firstly, we believe that financial inclusion is really important to help economies grow, and to bring prosperity to individuals. Financial inclusion means providing bank account and basic services to individuals. It also includes offering opportunities for investors to put their money to good use.

The second principle is that we believe that people shouldn't have to compromise their values when they do business.

As Islamic Finance has developed in modern times, it has enabled large numbers of people to trade securely, to invest for growth, and to access finance – sometimes for the first time. And it has opened up large potential investment funds held by those who wish to follow Sharia principles when they invest.

Professionals in the UK have built up considerable expertise in structuring Sharia-compliant financial products that work. They bring a deep knowledge of both Islamic and conventional sectors. While they ensure that Islamic values are respected, they are focussed on developing products that provide yields that are competitive with conventional finance, and have appropriate risk management. Our experience is that these products are often so good that they are as attractive for non-Muslims, as they are for Muslims.

So we are delighted to support the development of the Islamic Finance industry in Kyrgyzstan.

Robin Ord-Smith, MVO

British Ambassador to Kyrgyzstan



While the principles underpinning Islamic Finance have existed for many hundreds of years, the modern industry started to develop in 1975 with the establishment of the Islamic Development Bank. It has grown rapidly – in 2014 alone, the global market (measured by assets) grew by 12% to \$2tn.

Islamic Finance is a term that includes a wide range of financial products and services. In many ways Islamic Finance products resemble conventional products. This is not surprising because their basic objectives are the same: to facilitate investment by someone who has money, used by someone who needs money.

Islamic Finance is often called Sharia-compliant finance. This highlights the main difference between conventional and Islamic finance: while both types of finance must obey the laws of the country in which they are offered, Islamic Finance is designed to also be compatible with the laws of Islam.

The most common principles that govern Islamic Finance are:

- Investment must not be in businesses related to alcohol, pork products, gambling, pornography, and weapons
- Investment cannot involve the payment of interest
- Investment cannot include speculation, or deals with extreme uncertainty
- Risk must be shared between at least two parties

Conventional debt-based products generally work on the basis of the investor making profit by means of receiving interest, and are therefore not allowed in Islamic Finance. Therefore, different forms are required if an investor wishes to make a non-equity investment.

The approach to risk in Islamic Finance products is quite different to conventional products. So while an Islamic Finance product may have the similar objective to a conventional finance product, it is likely to have a very different risk/reward profile. At times, this unconventional risk/reward profile is attractive to potential investors, even when they are not motivated by religious reasons.

While the basic principles of Islamic Finance are well-understood and generally accepted, there can be some variation in viewpoint between Islamic scholars on how these principles apply in certain situations. So it is possible that certain deals may be regarded as acceptable in some places, but not acceptable in others.

History of developments

Islamic Finance first came to the UK in the 1980s, with the introduction of Murabaha transactions. The first UK Islamic bank, Al Baraka International, launched in 1982. This was followed by the growth of bespoke Sharia-compliant products in trade finance, leasing and project finance.

In the early 2000s the UK Government started to take a serious interest in Islamic Finance, and developed a work programme to make the UK's financial services regulations compatible with the growth of Islamic Finance. Changing the tax treatment, to ensure that Islamic and conventional finance transactions with an equivalent purpose resulted in equivalent tax bills, was also an important step to allow the market to grow.

At the same time, there has been significant growth in the offer of retail Islamic Finance services, providing choice to more than 2.5

million Muslims resident in the UK. At the present, there are five fully Sharia-compliant banks in the UK, with twenty institutions offering Islamic Finance services.

To service this growing industry, a wide-scale programme of professional education and training in Islamic Finance developed. At present, four professional institutes and nearly 70 universities and business schools offer qualifications in Islamic Finance.

The Islamic Bond (Sukuk) market in the UK started in 2007, and has continued to grow. By 2015, 57 Sukuk had been listed on the London Stock Exchange, with a total value of \$51bn. In 2014, the United Kingdom Government became the first Western government to issue sovereign Sukuk, over 11 times oversubscribed.

With strong Islamic insurance, fund management and banking sectors, the UK has also developed expertise in the

ISLAMIC FINANCIAL TERMINOLOGY

Common Sharia-compliant financial contracts include:

- **Consumer loan (Murabaha):** Asset purchased by the bank and sold on to the customer with an agreed mark-up;
 - **Leasing agreement (Ijara):** Asset purchased by the bank and leased to the customer over a specified period;
 - **Joint Venture Agreement (Musharaka):** Investment partnership in which profit sharing terms are agreed in advance and losses are attributable to the sum invested.
 - **Equity financing (Mudaraba):** Partnership financing contract under which one party provides the labour whilst the other provides the capital;
 - **Advance payment (Salam):** A contract in which advance payment is made for specific goods to be delivered later.
 - **Gradual financing (Istisna):** A kind of Manufacturing Finance where payments are made in stages to facilitate gradual progress in manufacturing, processing or construction.
 - **Agency Agreement (Wakalah):** A contract where a person authorizes another to do a certain well-defined legal action on his behalf.
- Other commonly practised financial products:
- **Bond (Sukuk):** Islamic type of bond representing the ownership by the Sukuk holders in the underlying asset;
 - **Insurance (Takaful):** Mutual insurance. Takaful is a risk sharing entity that allows for the transparent sharing of risk by pooling individual contributors for the benefit of all subscribers.

supporting professions, with business advisory and legal forms building up bespoke Islamic Finance practices.

In 2015, the UK did a world-first: our export credit guarantee department provided guarantees for a \$913m Sukuk to finance the purchase by Emirates Airlines of 4 Airbus A380 aircraft.

How has the UK benefitted?

We have a strong network of professionals who are skilled at creating innovative deals that are Sharia-compliant. The UK Government also plays a significant role in facilitating delivery of these deals. This has signalled to the world that if investors want to make Sharia-compliant investments, and benefit from the highest product standards, then the UK is the place to come. London is the largest Islamic Finance centre outside of the Muslim world.

It isn't just our finance professionals that have benefitted. Confidence in the UK's Islamic Finance offer has attracted investment in prestige infrastructure and regeneration programmes, including iconic buildings such as the Olympic Park, the Shard and Battersea redevelopment. Recently, Gatehouse Bank, a Sharia-compliant bank based in Kuwait, committed to develop a programme of social housing offered for rent. The recent Airbus deal shows how a strong Islamic Finance offering can lead to significant export wins.

What are we doing now?

We continue to examine the UK's Islamic Finance landscape, looking at ways to make it work even better. An example of this is work the UK's Central Bank is undertaking to provide Sharia-compliant liquidity facilities, to ensure that Islamic Banks operating in the UK can work on a solid footing.

How does the UK approach fit with others?

A feature of Islamic Finance around the world is the variety of approaches taken in different countries. The UK Government is often asked which of the approaches it favours.

The UK has built a framework for Islamic Finance that allows all schools of thought to thrive. Our approach is to be make sure that any Islamic Finance product is financially sound. We want those who are involved in deals to decide whether any particular product or service fits their values. Because of this, our professionals and regulators are able to work with all of the different approaches to Islamic Finance.

ISLAMIC BANKS IN THE UK

Fully Sharia-compliant

Abu Dhabi Islamic Bank
Al Rayan Bank
Bank of London and The Middle East
Gatehouse Bank
QIB UK

Conventional banks offering Islamic financial services

ABC International Bank
Ahli United Bank
Bank of Ireland
Barclays
BNP Paribas
Bristol & West
Citi Group
Deutsche Bank
IBJ International London
J Aron & Co
Lloyd's Banking Group
Royal Bank of Scotland
Standard Chartered
UBS
United National Bank

Source: TheCityUK

The Kyrgyz Republic was the first CIS country to incorporate principles of Islamic Finance into the economy.

The start of Islamic Finance development in the Kyrgyz Republic originated in 2006, when under Islamic Development Bank assistance; Eco Islamic Bank launched the pilot project. Later in 2009, a concept of Islamic Banking was included in laws on “Banks and banking in the Kyrgyz Republic” and “National Bank of the Kyrgyz Republic”.

Islamic Finance services in Kyrgyzstan are still a developing sector with one bank and three microfinance institutions fully operated under principles of Islamic Finance. There is also a non-profit organisation called “Association of Islamic Economics, Finances, and Industry Development” which has the role of supporting new market players, consulting conventional finance institutions and holding Islamic Finance training sessions.

Over the last 5 years the Kyrgyz finance system, with assistance from the State Service for Regulation and Supervision of Financial Market, has made positive steps towards adoption of Islamic Finance products as Islamic bonds (Sukuk) and insurance (Takaful).

Finance Inclusion and Principles of Islamic Finance

World Bank analysis of financial inclusion in the Kyrgyz Republic published in 2014 indicates that, 18% of adults have bank accounts, 14% have formal borrowings, and 5% have banking savings. Islamic Finance opens the opportunity for more people to engage with trusted institutions to manage their savings and borrowings, without compromising their beliefs.



**Potential financing
amount for Kyrgyz
MSMEs reaches
\$342.2 – 456.mil.¹**

*Islamic Finance and the Government's
Strategy of Sustainable Development*

The National Sustainable Development Strategy for the Kyrgyz Republic provides an important framework for policy making. Islamic Finance offers the possibility of supporting some of that strategy's key targets:

- The increasing availability of Islamic Finance products, instruments, and services will foster market competition among financial institutions, which could lead to greater availability of less expensive long term capital, a wider variety of financial products, and more opportunities for attracting FDI into the country.
- Increasing use of Islamic Finance could help facilitate foreign investment in the country's major infrastructure and Public Private Partnership projects.

In May 2014, International law firm Simmons & Simmons and the Kyrgyz Republic has signed a ground breaking agreement to provide consultancy services for the development of laws and regulations, supporting the introduction of Takaful (insurance) and Sukuk (securities) in the Kyrgyz Republic. The consultancy services to be provided by Simmons & Simmons are to be funded under a technical assistance grant provided by the Islamic Development Bank.

Stated by Media Office of Simmons & Simmons

¹Islamic Banking report, opportunities from Micro, Small and Medium Enterprises in the Kyrgyz Republic. International Finance Corporation (IFC), World Bank Group. Bishkek, February 2016.

The UK is the leading Western centre for Islamic finance. Institutions in London and other cities in the UK have been providing Islamic financial and related professional services for nearly 40 years.

Insight from TheCityUK

The UK is ranked above other important centres on its overall Islamic finance offering. The latest ICD Thomson Reuters Islamic Finance Development Report gives the UK an index value of 16.2, above the global average of 10.3 and the highest ranking of any non-Muslim-majority country.

There are currently five fully Sharia-compliant banks licensed in the UK which puts it in the lead amongst Western countries. Assets of these banks totalled \$3.6 billion at the end of 2014. There are also a number of conventional banks that provide Islamic financial services from a UK base. In total, over 20 banks in the UK offer Islamic finance services. This substantially exceeds the number in any other Western country or offshore centre and is nearly double the number in the US. Assets of UK-based institutions that offer Islamic finance services totalled some \$4.5bn at the end of 2014.

The Islamic finance retail market has developed in recent years with the launch of a series of Sharia-compliant products

including individual savings accounts, home purchase plans, a Sharia-compliant pension scheme and business start-up financing. The Government is also developing Islamic student financing. There are now over 100,000 Islamic finance retail customers in the UK.

The London Stock Exchange (LSE) is a key global venue for the issuance of Sukuk. To date a total of 57 Sukuk have been listed on London Stock Exchange with a total value of \$51bn. Net assets of Islamic funds in the UK amount to around \$600 million. A total of four Sharia-compliant exchange traded funds (ETFs) and two Sharia-compliant exchange trade products (ETPs) are listed on the LSE.

Banks, Sukuk issuance and exchange traded products are complemented by world leading professional services support for Islamic finance deals and transactions. Services in the UK are offered by financial intermediaries, asset managers, insurance providers and over 30 international law, accountancy, and consultancy firms.

There is a growing global demand for skills as Islamic finance expands. UK institutions are at the forefront of providing academic and professional qualifications for the global industry. The UK is the leading centre of Islamic finance education and training with four professional institutions and nearly 70 universities and business schools offering Islamic finance courses and degrees.

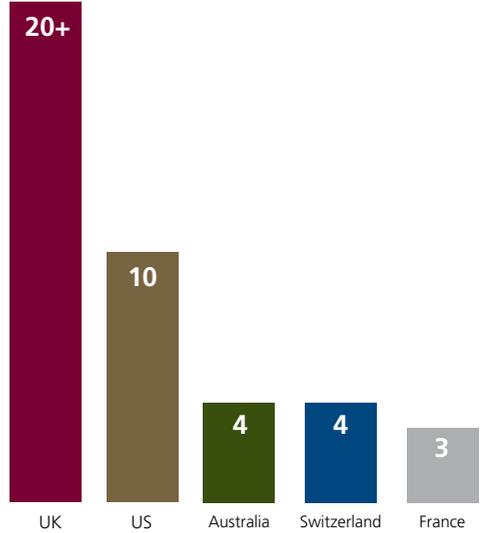
Islamic finance plays a significant role in infrastructure development in the UK. This includes development finance for The Shard, Battersea Power Station regeneration, London Gateway, the Olympic Village and the redevelopment of Chelsea Barracks. Over 6,500 homes in the North West and the Midlands are currently being financed by a £700 million investment by Gatehouse Bank, a fully Sharia-compliant bank. Current trends suggest that the role of Islamic finance in funding infrastructure development will continue to grow in the years ahead.

An important feature of the development of the UK as a centre for Islamic finance has been a range of supportive Government policies over the last decade which have created a fiscal and regulatory framework intended to broaden the market for Islamic finance products. The Islamic finance sector in the UK operates under legislation that applies to all sectors – hence, there is a level playing field for both Islamic and conventional financial products.

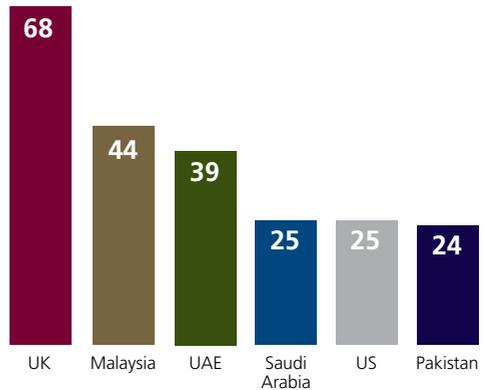
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ISLAMIC BANKS IN WESTERN COUNTRIES



NUMBER OF EDUCATIONAL INSTITUTIONS BY COUNTRY



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