

# London – the European hub for Islamic finance

by Gillian Walmsley, London Stock Exchange

**As the profile of Islamic finance continues to grow and with current market conditions highlighting the resilience of some features of the Islamic market model, several financial centres are becoming alive to the possibilities for fostering Islamic finance and attracting new investors to their markets.**

London is well established as the gateway for Islamic finance in Europe and this pre-eminent position has developed due to a unique combination of factors: the depth and breadth of the London capital markets, the extensive pool of expertise offered by one of the largest concentrations of specialist legal and advisory expertise in the world, a regulatory framework which facilitates innovation and the commitment of the UK Government to developing the market with a series of tax and regulatory changes to offer a “level-playing field” between conventional and Islamic products. These key elements, combined with London’s culture of financial innovation and a truly international outlook, have allowed London to meet the needs of a growing market for Islamic financial products outside the traditional centres of the GCC countries and Malaysia.

As other European centres seek to replicate the London model with the early stages of legislative and tax reform, the UK continues to forge ahead by working closely with market practitioners to build on the substantial financial and regulatory foundation already in place with a view to establishing the most advanced and comprehensive offering for facilitating Islamic finance.

## A continued commitment to development

London has been at the forefront of all the key developments of Islamic finance in Europe and has led the way with a number of significant milestones. In August 2004, the UK’s Financial Services Authority (FSA) authorised the Islamic Bank of Britain, the first stand-alone Islamic bank in a non-Muslim majority country. This first in the field of retail banking was followed in March 2006 by the authorisation of European Islamic Investment Bank, the first Shariah-compliant bank in a Western country to offer Islamic financial services for the wholesale markets.

Since these pioneering steps, the FSA has authorised three further Shariah-compliant banks: The Bank of London and the Middle East, European Finance House and Gatehouse Bank. In addition, a

Shariah-compliant hedge fund manager and a dedicated Takaful provider have gained FSA authorisation and there are over 20 conventional banks providing Islamic financial services – more than in any other Western country.

London continues to offer the most open, flexible and attractive tax and regulatory structure for facilitating Islamic finance transactions of any European or US centre and this has been achieved by tailoring the tax and regulatory regime to reduce barriers to Islamic financing structures. A number of important changes have been made to ensure a “level playing field”. In 2003 tax legislation in the area of stamp duty land tax (SDLT) was enacted to cater for alternative property financing arrangements and to remove the burden of a double charge of SDLT incurred in the structuring of Islamic mortgages.

Subsequent legislative changes in 2005 and 2006 saw the introduction of new types of borrowing concepts to cater for murabaha and diminishing musharaka financing arrangements. And the Finance Acts of 2007 and 2008 contained important measures to facilitate sukuk issuance in the UK by addressing differences in the tax treatment of conventional debt securities and alternative finance investment bonds, as sukuk are classified.

HM Treasury and the FSA most recently conducted a detailed consultation on specific points relating to the issuance of sukuk with a view to removing legal uncertainties in the distinction between conventional debt securities and their Islamic equivalents. The consultation paper demonstrated the considered and detailed approach that the UK Government has taken in supporting sukuk issuance and the proposals seek to facilitate the listing process by reducing the burden of approvals on a case-by-case basis. All of these measures highlight the UK Government’s continued and substantial commitment to facilitating Islamic finance in the UK and to offering an open and flexible environment in which Islamic financial institutions can operate.

## Sukuk issuance on the London Stock Exchange – key highlights

- £1.3bn raised by Aldar Funding Limited via Sukuk al-Mudarabah structure (March 2007).
- £1bn raised by JAFZ Sukuk Limited structured as Sukuk al-Musharaka (November 2007).
- Central Bank of Bahrain, first sovereign sukuk listed in London (March 2008).

## Islamic finance at the London Stock Exchange

The London Stock Exchange has played a pivotal role in London's development as a global centre for Islamic finance and continues to offer a diverse range of products and services to provide Islamic financial institutions and investors with the tools they need to do business. The Exchange's AIM market offers growing companies all the benefits of being traded on a world-class public market within a regulatory environment that has been designed to meet their specific needs. The flexible approach to regulation and the streamlined admission process have made it an attractive market for smaller institutions, including growing Islamic companies, to develop their business. The company shares of four Shariah-compliant institutions are quoted on AIM: Islamic Bank of Britain plc, European Islamic Investment Bank plc, The Family Shariah Fund Ltd. and Shariah Capital Inc.

The London Stock Exchange is also a global centre for the issuance of sukuk. To date over £6.5bn has been raised through 18 issues of these alternative finance investment bonds on the London Stock Exchange. The Exchange offers the choice of two routes to market – the Main Market or the Professional Securities Market.

The Main Market is the Exchange's flagship international market for established companies and offers access to deep pools of capital and the benefit of a high profile launch to market. The Main Market is an EU Regulated Market and listings can subsequently be passported to other European markets.

The Professional Securities Market, which is Exchange-regulated, offers the benefits of listing with more flexible regulatory requirements. Since the market is tailored towards the needs of the wholesale investment market, the PSM allows the admission of debt securities and sukuk using listing particulars rather than mandating a full EU standard prospectus and issuers can meet disclosure requirements by reporting in their local domestic GAAP rather than IFRS.

In addition to the prestige of admitting securities to trading on a truly international and globally respected exchange, allowing companies to raise their profile with investors worldwide and access a deep pool of capital, London offers the benefit of competitive

admission and listing costs as London is the only major listing venue which does not charge an annual fee to issuers of debt securities and their Shariah-compliant alternatives.

## Shariah-compliant Exchange Traded Funds

But London is not only a venue for listing the equity shares of Shariah-compliant companies or for raising capital through sukuk instruments. Through the London markets, Islamic investors are able to take full advantage of product innovations in other areas of the industry. The London Stock Exchange has a vibrant market in Exchange Traded Funds (ETFs), one of the few areas of the market to show sustained growth in 2008. In Europe, ETF assets under management grew 11.2% to over US\$142bn.<sup>1</sup> On the London Stock Exchange, the total number of ETFs listed expanded to 182, including seven Shariah-compliant ETFs. Total ETF value traded for the year was £35bn, an increase of 67% on 2007. During difficult market conditions, the benefits of transparency, on-exchange security and simplicity which ETFs provide were further highlighted as more investors sought to access the markets using these flexible and innovative instruments.

ETFs are open-ended index tracking funds listed and traded on exchanges like shares. They allow investors to gain exposure to a diverse range of assets and offer simple and efficient access to developed and emerging markets, broad and sector indices. By trading a single share, users can effectively gain access to an entire index without the burden of investing in each of the constituent stocks making ETFs a highly efficient and cost effective investment tool. ETFs are supported by dedicated market makers who quote tradeable prices throughout the trading day and because they are backed by the central counterparty, ETFs offer the security of an exchange-traded product at a time when default risk is of key concern to investors.

## A centre of excellence and specialist expertise

In addition to the government's efforts to offer Islamic financial products a level playing field, the UK's success in developing an Islamic financial market lies in the expertise and reputation of the City's key institutions and participants.

## ETFs on Islamic indices

Two of Europe's key ETF providers offer Shariah-compliant ETFs on the London Stock Exchange. iShares offers ETFs based on the MSCI World Islamic, MSCI USA Islamic and MSCI Emerging Markets Islamic indices and, in 2008, these ETFs saw turnover of £75.5m by value. db x-trackers Islamic ETFs are based on the S&P Japan 500 Shariah, S&P 500 Shariah, S&P Europe 350 Shariah and DJ Islamic Market Titans indices and saw a combined 2008 turnover value of £5.9m. The indices underlying these ETFs are constructed by screening constituents for compliance with Shariah-compliant investment principles. Screening criteria include restrictions on financial leverage and prohibited business activities.

The listing process in London is highly efficient and the UK Listing Authority (UKLA), the division of the FSA responsible for reviewing the necessary prospectus documentation and admitting securities to the Official List, has an international reputation as a fair, effective and responsive regulator. By complying with the UKLA's disclosure and regulation standards, issuers of conventional debt securities and sukuk alike can enhance their standing within the global investment community and be confident of the robust regulatory environment in which they are listing. The UKLA offers a personalised service from a UKLA Specialist throughout the listing process and issuers and advisors can contact the UKLA directly to discuss proposed transaction timetables or technical matters without the need for an intermediary as there is no requirement for a listing agent or sponsor to manage relationship between UKLA and issuer.

London also has an extensive advisor base with over 200 international law firms – in fact the top three law firms in the world are London-based international law firms and Chambers & Partners cites 18 major London law firms with specialist Islamic finance expertise and experience. Indeed, London-based international law firms have been at the centre of many landmark Islamic finance deals and have advised both governments and corporates on a wide range of ground-breaking and award-winning structures.

The UK is committed to developing this knowledge pool. There are now more educational institutions offering specialist Islamic finance qualifications in the UK than in any other country in the world. The Islamic Finance Qualification was the first international benchmark qualification in Islamic finance and was launched in 2006 by the UK Securities and Investment Institute as a joint initiative with Lebanon's *Ecole Supérieure des Affaires*. The Chartered Institute of Management Accountants offers the CIMA Certificate in Islamic Finance, the first global qualification offered by a professional chartered accountancy body. And, with a view to promoting deeper and broader understanding of the role of Islamic finance within the context of established international financial markets,

the Islamic Finance Council UK has pioneered a worldwide Scholar Professional Development Programme which provides education in the mechanics of conventional financial products to the global community of Shariah scholars.

## Looking to the future

The advantages of London's position as a leading international centre of conventional finance, the deep liquidity of its capital markets and the wealth of specialist expertise well established in London, have fostered and cemented London's pre-eminence as the Western centre for Islamic finance. This, allied with the strides the UK Government has already made in building an open and flexible tax and regulatory environment to facilitate innovative financial structures and the detailed and considered approach with which HM Treasury and the FSA continue to review and enhance the legislative framework will no doubt ensure that London continues to remain at the forefront of Islamic financial development in Europe and internationally. The London Stock Exchange's product offering, spanning the traditional equity and debt securities markets and also extending to a host of new and innovative exchange traded products, including the fast-growing ETF segment, offers a truly global market where the world of Islamic finance can come to do business.

### Note:

<sup>1</sup> Barclays Global Investors "ETF Landscape" - Industry Review, year-end 2008.

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# The world's capital market



**With a long history in Islamic banking, deep and broad capital markets and a regulatory framework which facilitates innovation, London is well established as the gateway for Islamic finance in Europe.**

The London Stock Exchange offers a suite of four markets, tailored to provide something different to issuers of Sukuk, Exchange Traded Funds and other Shari'ah compliant security types.

In total, more than £6.5 billion has been raised through sukuk issues on our markets, and our Main Market lists seven Shari'ah compliant Exchange Traded Funds which have assets under management exceeding £25 million. In addition, four Islamic institutions have chosen AIM as the best place to grow their businesses.

## **Isn't it time you joined the world's capital market?**

To find out more about the opportunities available to you on the London Stock Exchange's markets, please contact our team on +44 (0)20 7797 3679.

[www.londonstockexchange.com](http://www.londonstockexchange.com)

