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### **UK leads in sowing seeds for a sector**

Shyamantha Asokan says the City has stolen a march on many of its global rivals

One Friday night in 2006, London's financial traders shunned the flashy wine bars for a room furnished with white cloths and devoid of alcohol.

The City was hosting a ceremony to break the Muslim fast of Ramadan. Part of Mansion House, usually used for meetings with finance ministers, had been converted to a prayer room for the night.

The event was widely interpreted as a sign of London's eagerness to establish itself as a hub of Islamic finance. This aim had been explicitly stated by the then chancellor, Gordon Brown, who had that year spoken of his ambition to make the UK "the global centre" for the sector.

Almost two years on from that speech, the City is well on the way to becoming a thriving centre for Islamic finance. There are four licensed wholesale Islamic banks - the only ones in the EU - and 21 conventional banks offering Islamic services. London's newest Islamic bank, Gatehouse, received its licence in late April. Principle Insurance, the first independent company fully compliant with Islamic law in the UK, launched at the start of May.

The London Stock Exchange has admitted 16 sukuk, or sharia-compliant bonds, to its markets, raising £5.5bn. The UAE company Tabreed issued the first LSE-listed sukuk, for £109m, in July 2006. The Kingdom of Bahrain registered the first sovereign sukuk in London, for £176m, this March.

"If you want to talk to anyone about Islamic finance, and you're not in the Middle East or Far East, you come to London," says Humphrey Percy, head of Bank of London and the Middle East, which was licensed last year.

"It has the right timezone for dealing with Asia and the Middle East, a huge talent pool, and a concentration of diverse markets - the stock exchange, futures, metal, oil. Also, the government and the Bank of England have supported Islamic finance."

The UK government has been introducing legislation to nurture Islamic finance since 2003. Sharia, or Islamic law, forbids interest on the grounds that money should measure rather than create value. An Islamic investment thus often uses several purchases and sales to create a comparable increase.

During the past five years, finance acts have contained laws that try to ensure that Sharia-compliant transactions are not exposed to multiple stamp duty or ineligible for the tax breaks granted to certain kinds of interest in the UK.

The government gives two reasons for its zeal: to aid the integration of Britain's 2m Muslims, and to maintain London's position as a global business centre.

"This isn't just an altruistic gesture [for Muslim investors]," says Richard Thomas, who chairs the government's advisory board on Islamic finance. "This is a way of keeping the City at the forefront,

"This area is growing rapidly and these new banks draw activity to the UK. That money could go to Bahrain, but we would like it to come to London."

Islamic banking assets have been growing at a rate of just under 20 per cent, according to Moody's, the rating agency. The sector still accounts for just 1 per cent of global banking assets.

London has so far had little competition to become the west's centre for Islamic finance. New York, the only possible contender, struggles with its timezone and remains ambivalent about the sector after the September 2001 terrorist attacks.

"US politicians still confuse Islamic finance with terrorist finance," says Mohammed Amin, who oversees Islamic finance projects at PwC.

Meanwhile, in Asia, countries such as Japan, Hong Kong and Indonesia have started to show an interest in the sector.

But the UK still has work to do. Some sharia-compliant transactions are more heavily stung by value-added tax than conventional equivalents, but this area of legislation is EU-wide and difficult to modify.

City executives are also calling for the UK to issue sovereign sukuk as an alternative to government bonds - it is thought this step will be announced in next year's finance act.

The UK cannot yet boast an Islamic finance sector as sophisticated as that of Malaysia or Bahrain, often considered leaders in the field. But it has made impressive progress in a few years.

As David Testa, head of Gatehouse, said when the bank received its British licence: "What with the problems of Northern Rock and the crackdown on non-doms [non-domiciled foreigners], this really is one area where the City got it right."